Week

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Global Equities Outlook For 2019

By Jacob Mitchell, founder and chief investment officer for Antipodes Partners

With volatility rearing its head in October, the question remains as to whether this will normalise, or increase towards year end and into 2019.

In the US, against a backdrop of relatively subdued inflation, growth is soaring, with Trump's domestic policy analogous to burning all the furniture in the room. Whilst some indicators, such as the corporate profit cycle, industrial production, unemployment and consumer confidence suggest the economic cycle is maturing, residential/corporate investment and wage inflation is still at early or mid-cycle levels. The risk to the cycle is monetary policy, with an increasingly limited fiscal backstop.

Following the GFC, as policy rates neared zero, the Federal Reserve (Fed) actively targeted a flatter yield curve, rebalancing portfolios towards risk and duration, with the wealth effects of asset price inflation a key transmission mechanism to the real economy. The expansion of the Fed's balance sheet flooded the US banking system with reserves such that to maintain control over the target rate of interest, the Fed began paying interest on excess reserves.

The Fed's path to normalisation is as much about allowing the market forces to dictate the shape of the yield curve as it is about managing the target rate in-line with inflation. Allowing the balance sheet to shrink – Quantitative Tightening (QT) - is the strategy to achieve this, though the risk is that at some point we transition from a banking system with excess reserves, to one where reserves become scarce. As the balance sheet contracts and reserves are destroyed, the banking system will be required to compete for liquidity. The point at which this occurs, and the Fed reaction function is a matter of substantial debate.

The requirement for reserves in the US banking system is now structurally higher, meaning the Fed may not be able to safely reduce their balance sheet by much without provoking strains within the system, and with it, heightened volatility across all asset classes. Should this materialise sooner than expected, and the Fed struggles to navigate the liquidity driven turbulence that may arise as consequence, the ability of the Fed (and other central banks) to pursue QT to its end may be in doubt, and with it a return to the flatter yield curve targeting regime of the past decade. For equity investors, this environment favours the status quo - a stylistic preference for 'structural growth' or 'quality' at any price.

However, a successful (even if turbulent) implementation of QT, in conjunction with reduced bond buying by other central banks, is likely to steepen the US yield curve as the influence of central banks wane, the rate hike cycle matures and the Fed risks clamping down on growth. Whilst the market has typically imputed weaker growth as meaning further balance sheet expansion and yield curve compression, a sustained and gradual Fed run-off is likely to alter this dynamic, with the natural lever of the Fed to reduce policy rates before scaling back on QT at the risk of damaging its credibility. In this environment, a stylist preference for low multiple stocks could evolve.

Until the process of QT becomes more entrenched, the more immediate implication of the Fed enduring with its commitment to tightening is a flatter, potentially negative US yield curve, and without a rebound in European growth and/or a reversal of Chinese regulatory tightening, the risk of a Fed policy mistake is very real. This risk may be exacerbated by the inflationary nature of Trump's tax cuts and trade policy though somewhat offset by a stronger dollar, accelerating the need to tighten.

Given a capital market structure that has changed profoundly post GFC, with central banks and passive liquidity acting as shock absorbers to risk assets more broadly, the progression of QT is likely to trigger increasing volatility across all asset classes.

Longer term, we expect a successful implementation of QT to reverse the distortions of the low rate and flatter yield curve environment that has characterised the prior decade.

Socio-macroeconomic overview

Today's paradigm of free trade can be traced back to the early post-war period. Following harmful trade protectionism which saw global trade fall by ~65% during the Great Depression, the General Agreement on Tariffs and Trade, in operation since 1948 and superseded by the World Trade Organisation (WTO) in 1995, created the environment in which tariffs tumbled from an average of ~40% in 1947 to ~4% in 2016. The scaffolding of treaties, institutions and laws now supports an interconnected global economy – an underlying principle of economic development facilitating greater utility and welfare.

The mercantilist economics policies of US President Trump hope to “bring back American jobs” through a series of strategic trade policy decisions – withdrawal from the Trans-Pacific Partnership (TPP), renegotiation of the North American Free Trade Agreement (NAFTA) and the implementation of tariffs on foreign (particularly Chinese) goods. Framed in the context of increasing domestic jobs and repatriating profits from foreign firms to domestic competitors, these policies make sense – in theory.

Assuming no reciprocation, tariffs raise the price of foreign goods and services, shifting demand for imports to domestic producers, while exports remain untouched. This in turn increases domestic output, all else equal. The problem with this theory is the payoff accrues to one nation at the detriment of another – put another way, every nation is incentivised to retaliate.

Historical evidence suggests protectionist policies have a negative impact on the volume of world trade. While the protectionist mindset for all is more rational than a protectionist mindset for some, the outcome is sub-optimal in aggregate, with the role of the WTO to police the incentive for nations to deviate towards protectionism.

A reversal in globalisation would steer the global economy into uncharted territory, with the real risk of trade uncertainty sapping confidence and leading to a deferral in investment.

To date, the US has announced ~$250b of tariffs on Chinese exports to the US, roughly half of 2017 exports. China has responded measuredly, announcing ~$110b of tariffs on American exports to China, or ~85% of 2017 exports. Given China’s relatively greater reliance on US trade and limited manoeuvrability as tariffs escalate, the likely outcome is a more strategic response, such as increasing domestic subsidies while seeking stronger bonds with other nations.

China’s greatest strength in winning allies might be that its domestic demand remains relatively robust, allowing it to import more from other markets. Emerging markets, for example, have increased their goods exports to China from ~2% to ~15% since 2002, while exports to the US have declined from ~25% to ~15% over the same period.

Despite the People’s Bank of China (PBOC) lowering the reserve rate requirement for banks three times this year, unleashing tax reform and infrastructure stimulus, domestic policy remains tight as China remains committed to working off the excesses of the prior loose environment through a combination of macro-prudential property related policy and restrictive banking regulation. This may reverse should the trade war continue to escalate, to the benefit of domestic facing Chinese and European equities.

Opportunistically, China may pursue trade deals Trump walks away from. Following the ratification of the new TPP, Japan has been gazing eastward towards the Regional Comprehensive Economic Partnership (RCEP), whose members account for roughly half of the world’s population and more than a third of its GDP and global trade, almost twice that of the TPP. Despite the negative backlash to their outward investment profile, China will be well served to maintain high levels of foreign direct investment. In 2016, Chinese investment in the European Union (EU) jumped to nearly €36b from €2b in 2009, with Europe increasing its share of Chinese FDI from a fifth to a quarter. Somewhat cynically, one could assert that much of this state-backed investment speaks of China’s longer-term strategy to keep Europe from helping the US contain its rise.

As trade tensions continue to build, the probability of a miscalculation or provocation rises.

Sustained confrontation, for example, could result in a further weakening of the Yuan to offset tariffs or even damage to US commercial interests in China. US companies that are vulnerable to Chinese confrontation include those with China-dependent supply chains or that sell products in China with readily available substitutes such as Caterpillar, Apple and General Motors; though, as the US Department of Commerce’s now lifted ban on US companies selling goods to ZTE demonstrated, it too can inflict damage on national champions. Post November’s mid-term elections, sanity may prevail with Chinese authorities keen to de-escalate.

Looking ahead to 2019

October 2018 saw a sharp reversal in the outperformance of expensive ‘structural growth’ or ‘quality’ at any price, with extreme policy settings in developed markets leading to severe herding in these styles.

The key question for 2018 and beyond remains to what extent can the benign environment persist? Putting aside trade wars and policy missteps, whilst the US growth environment is unlikely to accelerate much from here, the combination of fiscal stimulus and the easiest US financial conditions since the Global Financial Crisis should sustain growth at current levels for longer. However, we believe the unusually favourable goldilocks combination of accelerating growth and tepid inflation experienced in 2017 will not repeat. Instead, normalisation of interest rate policy will likely upset the rhythm with more volatile and less forgiving markets.

Given the divergent risks of US monetary tightening, the Fed reaction function and the global growth outlook, investors should focus more than ever on uncovering sources of idiosyncratic alpha rather than relying on

momentum or passive beta. In this sense, we’re encouraged by the high level of valuation dispersion within and across markets as indicative of broad pragmatic value opportunities, both long and short.

In this sense, broadly both North American and Developed European equities look expensive. Given that these regions represent ~77% of the MSCI ACWI, investing in the global index is unlikely to lead to a great long-term return outcome. Comparatively, both Developed Asia (Japan, Korea and Taiwan) and EM stand out as regions with greater return potential.

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Antipodes Partners is a global asset manager offering a pragmatic value approach across long only and long-short strategies (~A$8billion AUM). Antipodes was founded in 2015 by Jacob Mitchell, formerly Deputy Chief Investment Officer of Platinum Asset Management, together with a number of former colleagues and like-minded value investors. We aspire to grow client wealth over the long-term by generating absolute returns in excess of the benchmark, at below market levels of risk. We seek to take advantage of the market’s tendency for irrational extrapolation, identify investments that offer a high margin of safety and build portfolios with a capital preservation focus.

Antipodes is majority owned by its seasoned investment team and its performance culture is underpinned by sensible incentives, a focused offering and the outsourcing of non-investment functions to minority partner Pinnacle Investment Management Limited.

For more information, please visit www.antipodespartners.com

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Is An Earnings Recovery Priced In To Orica?

After a soft FY18 result Orica expects ammonium nitrate volumes will improve. However, uncertainties over the Burrup plant weigh on the outlook.

-Has the market priced in the earnings recovery? -Growth still appears to be a challenge -Burrup not expected to run at full capacity until 2020

By Eva Brocklehurst

Orica ((ORI)) appears at a crossroads, emerging from several years of underperformance with the levers in place to expand. Yet there are reasons to be cautious, as brokers note the Burrup plant is not performing at an optimal level and this is weighing on profitability.

In the company's favour, there is a tightening supply/demand balance in the Australia-Pacific region that is being reflected in improving contract outcomes. The company has guided for ammonium nitrate volumes to increase 3% in FY19. No specific financial guidance was provided but Orica expects growth in revenue and operating earnings will be supported by increased demand and manufacturing improvements.

Expectations for earnings growth over FY19 and FY20 are underpinned by volume growth, stabilised pricing and business improvement initiatives, such as a full year's contribution from GroundProbe, and a recovery in Minova.

Morgans believes the market has largely priced in the earnings recovery and, having to contend with internal challenges and a re-setting of prices, the company's positive leverage to a recovery in volumes has been reduced. Still, the broker believes FY18 should be as bad as it gets.

Deutsche Bank points out the FY18 result was boosted by profit on asset sales of $17m while cash flow was enhanced by lower tax. Earnings did accelerate in the second half, with an improved contribution from margin/mix and a reduction in costs. However, margins contracted to 11.4% from 12.6% during the year.

The company reported underlying net profit of $327.2m and operating earnings (EBIT) fell 2.7%, reflecting the impact of unplanned maintenance at Yarwun and Kooragang Island, as well as continued challenges in the cyanide market and cost headwinds.

Regionally the outcome was mixed: Asia-Pacific led the way, while North America was in line and Latin America missed expectations. While Latin America was poor, Credit Suisse notes this was because of factors beyond the company's control and accentuated by adverse currency movements.

Uncertainties Prevail

Credit Suisse upgrades to Outperform from Neutral, although not entirely convinced in the upside case. Still, the company seems to be getting on top of operating issues and the tightening of supply should carry profits higher over the medium term. The reasons to be fearful, the broker acknowledges, include recent history and Burrup.

Morgan Stanley goes the other way and downgrades to Equal-weight from Overweight. There were no major surprises for the broker and the result was better than feared. The environment appears favourable and Morgan Stanley believes a premium to history is warranted at this point in the cycle, but being convinced about the growth profile for 1-2 years hence is a challenge.

Citi observes there was a relief rally in the wake of the result, as operating issues appear largely resolved and cash conversion is recovering. Nevertheless FY19 guidance implies sharp downgrades to consensus expectations and the broker continues to believe the stock is overvalued, maintaining a Sell rating.

Burrup

Utilisation rates at Burrup are likely to be just 20% and the company now expects the plant will not be running at full capacity until 2020. Brokers are still unsure regarding the outcome as Burrup is not running consistently, plagued by technical problems, which will mean higher cost alternative ammonium nitrate supply will be needed for Western Australian iron ore contracts.

Macquarie finds Burrup problematic and believes this is a risk to the downside. Orica has identified more problems at the absorption tower, in addition to the heat exchangers. The broker notes it is costing Orica $200/t to service

240,000t of Burrup contracts whilst the plant is off-line and there is risk of further costs in the event of delays.

FNArena's database shows one Buy rating (Credit Suisse), five Hold and one Sell (Citi). The consensus target is $17.56, suggesting -1.4% downside to the last share price. Targets range from $16.00 (Citi) to $19.08 (Credit Suisse).

See also, Work To Do At Orica on May 9, 2018.

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Subdued Outlook For Westpac

Another difficult year looms for Westpac and, while mortgage re-pricing should boost first half performance, slower wealth revenues and further customer remediation are likely to weigh.

-Reduction in proportion of interest-only loans but still ahead of peers -Cost guidance the main positive, but step change unlikely until FY20 -Capital position ahead of required benchmark, steady dividend expected

By Eva Brocklehurst

Remediation and funding costs dominated Westpac Banking Corp's ((WBC)) FY18 results and revenue growth was subdued, attributed to sacrificing margin as Australian home loans were re-priced.

The bank is adapting to an environment which features the end of the mortgage bull market, as well as scrutiny of conduct & competition and rising capital intensity in retail banking. Another difficult year looms, and brokers find little support in current trading multiples.

Overall asset quality was sound while non-interest income was softer, largely because of weaker markets income. Market non-interest income was down -17% in the second half. Slower wealth revenues and further customer refunds are expected to weigh on non-interest income. However, if Westpac can replicate its performance in FY19 first half revenue should increase on the prior half, Macquarie suggests.

Cash net profit was $8.04bn and the full-year dividend was steady at $1.88. Funding costs appear to have abated in recent weeks and the broker expects, if the trends persist, this will provide the scope for a positive surprise in FY19. Nevertheless, with potentially higher impairment charges, limited earnings growth is envisaged for FY19-20.

Morgans asserts the focus on productivity savings should still underscore cash earnings growth over the next three years. This feature of the FY18 result impressed the broker, as savings were $173m in the second half and more than offset the increase in business expenses. Westpac is targeting around $400m in productivity savings in FY19.

Mortgages

Mortgage re-pricing is expected to boost the bank's performance in the first half but the consumer sector is expected to be under pressure going forward because of the composition of the bank's mortgage book.

Net interest margins declined -26 basis points, or -20 basis points excluding customer remediation, but margin pressure is likely to remain in the medium term as Westpac has more exposure to interest-only loans.

This has been a factor weighing on the share price for some time, Morgans observes, although overall asset quality has kept pace with peers. Moreover, when the 30% cap on new interest-only loans was introduced, Westpac's exposure was 50%. The broker points out this has now reduced to 35%.

New interest-only facilities represented 23% of new mortgage limits in the second half and Westpac's share of interest-only loans remains 5-13% above peers. Competition appears to be affecting lending spreads across all loan markets, brokers note, particularly Australian home lending.

Costs

Cost guidance was a clear positive from the results, although Credit Suisse suspects a step change is unlikely until FY20 at the earliest. The bank also reported a decline in stressed exposures.

Morgan Stanley was hoping for more on costs but acknowledges it will take some time to realise the benefit of investment in technology and infrastructure. The broker forecasts around 3% growth in expenses in FY19, factoring in another $275m in remediation costs.

The capital position was strong and the CET1 ratio improved to 10.63%, which compares with the benchmark of 10.5% required by January 1, 2020. Morgan Stanley expects the CET1 ratio to settle around 10.9% without the need for additional dividend reinvestment plans. The broker forecasts the pay-out ratio will stay over 80% in FY19 and FY20, despite managements long-term pay-out ratio target of 70-75%.

Capital management could be on the agenda next year, although Macquarie suggests the scope is limited. Morgans anticipates the strong capital position and asset quality will support the current dividend.

FNArena's database shows three Buy ratings, four Hold and one Sell (UBS). The consensus target is $30.05, suggesting 11.9% upside to the last share price. The dividend yield on FY19 and FY20 forecasts is 7.0%.

Disclaimer: the writer has shares in Westpac.

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ResMed Expands Presence In Home Health

The price ResMed is paying for MatrixCare is rich, although brokers accept the deal will significantly expand its offering in home health data analytics.

-Diversifying revenue streams in home health -Provides scale opportunity in software design -Complements Brightree and HEALTHCAREfirst

By Eva Brocklehurst

ResMed ((RMD)) is building out its position as a provider of software-as-a-service to the US out-of-hospital market. To this end, MatrixCare is the number two operator in long-term post-acute software. ResMed will acquire MatrixCare for US$750m from the private equity division of OMERS, a Canadian pension plan.

Brokers are concerned the deal is rich, albeit it appears to complement the company's current offerings in home medical equipment and home health, delivered through Brightree and HEALTHCAREfirst. This should help lower risk and diversify revenue streams.

The price equates to 25x current year operating earnings (EBITDA) versus the 19x earnings paid for Brightree, excluding tax. For Ord Minnett, the success of Brightree underpins confidence that the company is ahead of the market with its strategy.

This latest acquisition should provide a large number of customers and patient records providing the scale that often leads to rapid market concentration. It establishes the company's cloud-based connected care that allows for the leverage of data analytics to improve the quality of care, Credit Suisse agrees.

MatrixCare services 15,000 providers across the skilled nursing, senior living and home care industries. It offers referral management, claims processing, payroll and nutrition management. The offering compliments Brightree, which is aimed at durable medical equipment providers, and HEALTHCAREfirst, aimed at hospices and home care.

ResMed estimates 2018 pro forma revenue and operating earnings to be US$122m and US$30m respectively. Citi estimates the transaction to be 2% accretive to earnings per share in FY19 and forecasts gearing to increase to 1.1x net debt/operating earnings.

ResMed will fund the transaction with existing debt and suspend its US share buyback. Ord Minnett calculates the acquisition to be earnings neutral in FY19 and around 1% accretive in FY20. UBS assumes that, under a well-resourced owner, investment in growth can be supported and translate to robust revenue and earnings for MatrixCare.

There is only modest crossing over with current offerings other than HEALTHCAREfirst and, in time, Ord Minnett expects operations to be integrated. Credit Suisse agrees the similarity of the MatrixCare and Brightree models provide economies of scale in the design of software solutions.

There is also a longer term opportunity to identify and refer patients who may suffer from obstructive sleep apnoea, chronic obstructive pulmonary disease or other respiratory illnesses.

Morgans believes the acquisition solidifies the company's connected care offering and, when coupled with stable pricing and moderating operating expenditure, supports a solid earnings trajectory. As a result, the broker increases sales assumptions by up to 4.6% and increases net profit by up to 1.8% for FY20 and FY21.

MatrixCare will be operated by existing management and retain its head office in Minnesota. This is the third large acquisition of a software business by ResMed. Given the current market dynamics, Citi now believes it possible ResMed can grow faster for longer. The company could take market share over the rest of FY19 while the mask re-supply program drives growth in the US.

FNArena's database shows four Buy ratings, three Hold and one Sell (Macquarie, yet to update on the transaction). The consensus target is $15.17, suggesting 5.3% upside to the last share price. Targets range from $13.50 (Macquarie) to $16.73 (Morgans).

See also ResMed Increases Market Dominance on Oct 29, 2018.

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Soft Retail Outlook Drags On UR Westfield

Unibail-Rodamco-Westfield has reiterated 2018 earnings guidance, with dilution from asset sales countering the accretion from the acquisition of Westfield.

-Sound premium from asset sales despite tough market -Could experience a negative structural re-pricing -De-leveraging could be achieved by retaining more development profits

By Eva Brocklehurst

Global retail property business Unibail-Rodamco-Westfield ((URW)) has signalled a tough outlook for shopping centres, noting conditions for retailers are getting harder, regardless of improving sales growth.

Earnings guidance has been reiterated for 2018 earnings in a range of EUR12.75-12.90 per share. This guidance was provided back in January, ex the integration of Westfield. Yet, the company has also indicated the acquisition of Westfield was accretive in 2018.

Dilution from asset sales completed during the year was greater than Unibail-Rodamco-Westfield expected, while there was a delay in project development and management revenue in London and California.

Macquarie suspects this has dragged on earnings and is the reason why there was no upgrade to guidance subsequent to the Westfield acquisition. Macquarie maintains an Outperform rating and $16.29 target on the ASX-listed stock.

Meanwhile, the challenging environment for retailers is causing longer leasing discussions and retailers are becoming more cautious about new store openings.

Unibail-Rodamco-Westfield has disposed of eight assets this year with net proceeds of EUR1.79bn. The sales represented a blended net initial yield of 4.5%, sold at a weighted average premium of 8.1% to book value as of June 30, 2018.

Citi believes the operating performance of the business is sound, despite pressures in the retail market and remains reassured by the premium from the sale of these assets. The broker has a Neutral rating with a target price of EUR204.

Morgan Stanley acknowledges the company has a long history of selling assets and selling well, having sold EUR11bn worth of assets at 11%, on average, above book value in the last decade.

For many years, the stock has been a core holding for specialist investors in the property sector but, the broker observes, this has now changed and the shares are underperforming the sector by around 30%.

De-leveraging

The shares are also pricing in a rise in property yields, the broker points out. Higher property yields and, conversely, lower property values, could lead to de-leveraging.

The company, along with many of its peers, has geared against lower property yields and Morgan Stanley believes this could become an issue if the market forces these businesses to unwind that gearing.

Yields on continental malls stand at 4.3%, at the lower end of the 4.3-6.1% range over the last decade. The broker's main worry is that the company's portfolio will experience a negative structural re-pricing because future rental growth is likely to be below past levels.

Yet de-leveraging could also be achieved by the company retaining more of its earnings through development profits, as well as through the positive impact of rental growth. However, most recurring earnings are paid out in dividends currently and, the broker points out, development profits are reduced when yields rise.

Morgan Stanley has an Equal-weight rating and EUR165 target. Assumptions incorporated into the broker's base view include a gradual increase in yields to 30-40 basis points above the current valuation. This should allow the company to sell sufficient assets but also assumes that investment markets remains sufficiently liquid.

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CBA Going Back To Being A Bank

Commonwealth Bank is moving back to being a retail and business bank and brokers welcome the potential for capital management down the track.

-Regulatory and compliance headwinds being dealt with -Outlook still challenging as housing market weakens -Scope for capital management by 2020

By Eva Brocklehurst

Brokers concur that Commonwealth Bank ((CBA)) has made good progress on addressing the concerns raised during the Hayne Royal Commission, simplifying its business and improving credit quality.

Cash net profit in the first quarter was $2.57bn, benefiting from lower impairment expenses. Revenue momentum appeared weak, with little or no growth in the quarter and, while costs were well managed, Ord Minnett notes there is a timing element because of lower investment spending. The broker was not surprised that net interest income was flat, given the revenue pressures flagged by other banks during reporting season.

Bell Potter observes the transition in the bank's business raises the issue of whether it has retained much of its original identity. Still the broker becomes positive in view of CBA mastering the myriad of changes that have been imposed in the last 12 months. Following the sale of CFS Global Asset Management, Commonwealth Bank should move back to being predominantly a retail and business bank.

The broker downgrades earnings estimates by around -4% from 2020, to exclude the CFSGAM earnings and maintains a $73 target, with the value offset arising from an expected post-tax gain on sale of around $1.5bn and the release of around $2.9bn in CET1 capital. The broker, not one of the eight monitored daily on the FNArena database, maintains a Buy rating as the bank continues its transformation.

Operating income, excluding one-off items, was 1% higher as higher other banking income more than offset flat net interest income. Overall, troublesome exposures remained stable in the quarter, although impaired assets were up, which Bell Potter attributes to "usual mortgage stresses - presumably in WA and Queensland".

Capital Management

Credit Suisse likes the falling operating expenses and considers CBA to be the emerging story of the sector, as many of the regulatory and compliance headwinds have been or are being dealt with. The focus now is on cost reductions and capital. A CET1 ratio of around 11.2% in a dividend-paying quarter indicates capital management could be on the cards and Credit Suisse upgrades to Outperform from Neutral.

Morgans agrees credit quality remains sound and forecasts a CET1 ratio of 11.3% by the end of FY20, agreeing there is scope for capital management, given APRA's unquestionably strong benchmark is 10.5%.

UBS is more cautious about extrapolating quarterly trends but accepts business momentum is continuing. Expenses, while well managed, were aided by the timing of investment expenditure and software impairments in the prior half-year, and the broker expects higher costs will continue in FY19.

Assuming the completion of divestments, the pro forma CET1 ratio will rise by 120 basis points, which the broker suggests will push the ratio towards 11.8% by the first half of 2020, allowing for a $5bn on-market buyback in its forecasts from late 2019. The outlook is still likely to be challenging, and potentially deteriorate as the housing market weakens.

Still, the core retail franchise is intact, although UBS retains a Neutral rating in the context of an overall cautious view on Australian banks.

Margin

The aspect of the quarterly update that most displeased Credit Suisse was the lower net interest margin, although re-pricing benefits are expected to take effect from the second quarter.

Morgans believes the bank is offering good value at the current share price and points to the net interest margin boost from the recent increase to all Australian variable home loan rates of 15 basis points. Household deposit growth was also strong in the quarter, at 8.9% annualised and the main driver was transaction deposits.

The broker also believes there are signs that front book home loan discounting in Australia has peaked and this is positive for the margin outlook. Deutsche Bank assesses the 3% growth required in the second quarter to meet its first half cash net profit forecasts is achievable, giving the upcoming benefit from mortgage re-pricing.

FNArena's database shows two Buy ratings, five Hold and one Sell (Morgan Stanley). The consensus target is $73.95, suggesting 5.9% upside to the last share price. The dividend yield on FY19 and FY20 forecasts is 6.2% and 6.3% respectively.

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Is Domino's Guidance Becoming Stretched?

Sales momentum at Domino's Pizza slowed over the first weeks of FY19 while the numbers of stores being opened appear significantly behind schedule.

-Shares are trading as if the company will beat FY19 guidance -Strong second half skew required for new store openings to reach target -Question of whether profitability in France, Germany can be lifted sufficiently

By Eva Brocklehurst

Sales momentum has slowed for Domino's Pizza Enterprises ((DMP)) recently, particularly in Australasia, although trends are expected to improve as the benefits of a new menu are savoured.

Same-store sales for the first 17 weeks of FY19 were up 2.91% compared with over 5% growth previously. Japan slowed sharply to growth of 5%, with 12% growth over the first five weeks implying just 2.1% in the last 12 weeks.

Morgans suspects the upper end of underlying operating earnings (EBIT) guidance of $227-247m is looking stretched. New menus may assist, particularly in Australasia, but the broker wants more clarity on top line momentum in order to be more confident regarding guidance. As the stock is trading over 10% above the target, Morgans downgrades to Reduce from Hold.

Citi, too, suggests the shares are trading as if the company will beat FY19 guidance and remains to be convinced. Macquarie continues to forecast significant earnings growth and believes the FY19 guidance range is conservative. The broker was pleased with the performance in Europe, given the parent company noted that region was negative in the three months to September as demand was affected by the hot summer.

Domino's Pizza can still grow its share of Australian takeaway, UBS asserts, forecasting market share of 5.9% by FY25 from 5.4% currently. This is despite the opportunities for aggregators, as these compete across only 10% of the takeaway market.

Morgan Stanley points out the company has signalled that higher food costs ensuing from the Australian drought will affect the business during the second half after benefits from lower cheese prices in the first half. Ord Minnett believes Domino's Pizza faces challenges given the slowing sales growth and the impact of Australia's drought on food costs.

Regional Divisions

In a departure from a trend of the last several years, no separate disclosure was provided for Australasia and Europe and Deutsche Bank wonders why the company was only providing more detail on the smallest division, Japan.

While Japan was singled out, Ord Minnett notes it was an undemanding comparable and there is a risk extrapolating trends, given infrequent pizza consumption in Japan versus other markets such as Australia.

UBS downgrades, to Neutral from Buy. The broker trims forecasts to reflect a greater skew to the second half. By division, the broker expects Japanese sales to be up 2%, Australasia to be flat and European sales down -3%. UBS continues to believe this is a good business with a strong earnings outlook but the latter is priced into the stock.

UBS also estimates European margins will not reach the target 25% by FY21, although the outlook is strong given the scale and industry consolidation potential. Germany and France will be key to hitting targets, as they are expected to drive around 80% of incremental store growth.

Store Targets

The company retains an expectation for rolling out 225-250 new stores in the current financial year. A strong second half skew is expected for new stores. Stores have increased by 36 so far, but management has noted that openings are more concentrated towards December and June.

Conversions of Hallo Pizza are ahead of expectations. Still, Citi believes the risks are building that new store roll-outs will be late in the fiscal year and make a smaller contribution to earnings.

Credit Suisse looks at the updates from the parent and other franchises that have indicated zero same-store sales growth in Europe. While European region has a volatile history, the broker is yet to find enough evidence that

profitability for franchisees in France and Germany can be lifted sufficiently to incentivise new store openings commensurate with targets.

As there are few competitor acquisitions available, targets need to be achieved almost entirely by organic means. The broker retains forecasts for new stores that are well below the company's target and points out, ultimately, it is store numbers the drive profitability.

Ord Minnett believes there is a higher risk is for negative same-store sales growth in France, a market where the potential may be significant but the execution difficult.

FNArena's database shows two Buy ratings, one Hold and five Sell for Domino's Pizza. The consensus target is $49.09, suggesting 0.3% upside to the last share price. Targets range from $36 (Deutsche Bank) to $65 (Morgan Stanley).

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Sell-Off In James Hardie Undeserved

North American earnings dented James Hardie's performance in the second quarter as cost pressures were elevated. Brokers believe the sell-off in the stock presents a buying opportunity.

-Cost pressures considered cyclical, not structural -Challenges from softer US housing activity making it hard to predict volumes -Stock seen as a compelling buying opportunity

By Eva Brocklehurst

The Asia-Pacific region delivered for James Hardie ((JHX)) in the second quarter and Europe was in line, but a substantial miss on US expectations drove the stock down sharply. North American earnings of US$99.5m were below most expectations. Production costs rose, driven by raw materials and freight, and this reduced gross profit margins by around 360 basis points.

FY19 net profit guidance has been lowered to US$280-320m, reduced by -6% at the mid point. Morgan Stanley considers the cost pressures cyclical rather than structural, but lowers FY19 forecast by -4% and ascertains the guidance range is conservative.

The broker considers the stock trading at an attractive multiple relative to both peers and to history. Cost pressures may be featuring now but should not be capitalised, and there is attractive earnings potential over the medium term. Credit Suisse expects margin pressure will peak, taking a 12-month view, while share momentum will build slowly.

Deutsche Bank found the outlook the most disappointing aspect of the report. Freight and input costs continue to pose challenges for the near term but the margin is expected to normalise as price growth is achieved. The broker rates the stock a Buy, as US housing growth is still likely to continue, albeit at a reduced pace. Primary demand growth is also expected to recover into FY20.

Yet UBS suspects price growth will not aid margins that much in coming quarters, and reduces margin forecasts to 22% for the second half of FY19, and 23.5% in FY20 from 24.8%.

The broker retains a Buy rating, based on long-term growth estimates, but concedes this will not be appreciated by the market in the near term. UBS believes James Hardie's ability to grow well in a softening market is now more difficult. Challenges from softer housing activity, as well as substitutes such as vinyl, are making it harder for the company to predict volume growth.

Progress continues to be made with Fermacell and the one-off costs for Europe are now at the lower end of prior guidance. Going forward, management expects the European business to have margins of over 10%.

Asia-Pacific results were also strong, as FX headwinds were overcome. Moreover, the impact of manufacturing initiatives are clearly evident, Macquarie asserts. Ord Minnett points to the Australian business recording AUD-denominated revenue growth of 16%.

North America

The North American performance was most disappointing, as input cost increases resulted in a compressed gross margin. These pressures appear likely to continue, in Macquarie's view, with part of the downgrade reflecting expectations that inflation will now persist, whereas previously James Hardie expected pulp and other input costs would ease.

Several aspects disrupted US housing market sentiment over the quarter including weather, the US elections and rising interest rates. While the company had targeted volume growth of 10-11% in the second quarter it fell short at 8%, which is still respectable in Citi's opinion.

The broker calculates primary demand growth accelerated to 3-4%, while James Hardie has retained an assumption for FY19 housing starts of between 1.2-1.3m. Still, given the weaker performance the company has trimmed earnings margin guidance to the "top half of the target 20-25% range" from "top end of the range". To Citi, this implies a stronger performance in the second half.

Macquarie believes investors over-reacted to the result, as the US market support is reasonable and market share growth is gradually accelerating. Volumes grew 5%, showing some acceleration in share gains in exteriors, which

grew 8%.

The main surprise for Morgan Stanley in North American volumes was the -6% decline in interiors, which management attributed to quarterly fluctuations. Management expects this segment to rebound to achieve a flat outcome in FY19.

James Hardie has a well-defined strategy to continue gaining share in exteriors but Ord Minnett decides on a more conservative stance, expecting primary demand growth of 2.5% in FY19 and 3.0% in FY20.

Buying Opportunity

Citi agrees the sell-off is overdone. US housing markets may have hit a soft patch but momentum is recovering and margins should be restored in the second half. The stock is trading at three-year lows and the broker believes it has become a compelling opportunity.

Ord Minnett expects upside for margins in the medium term as progress is made on manufacturing and operating improvements. The broker believes the sell-off in the shares is opportunity to invest in a high-quality business at a time when external factors are pushing on sentiment. Morgan Stanley agrees this is an opportunity to buy a quality business at an attractive multiple.

FNArena's database is unanimous, with seven Buy ratings for James Hardie. The consensus target is $21.37, suggesting 26.8% upside to the last share price. This compares with $24.08 ahead of the results. Targets range from $20.00 (Deutsche Bank) to $23.40 (Macquarie).

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Recovery Now Distant For Lend Lease

The market has slapped Lend Lease down, after a significant write-down for its engineering division, and confidence is expected to take a long time returning.

-Size of the provision a shock, no certainty this is the end of provisioning -Brokers ponder sale or spin-off of engineering division -Stock likely to be under pressure until problem contracts are completed

By Eva Brocklehurst

Lend Lease ((LLC)) has delivered a major blow to market confidence and will undertake a review of its Australian engineering & services business to reassess risk appetite as well as the bidding process for future transport infrastructure projects.

In announcing a further provision of $350m in its Australian engineering & services business for the first half, the CEO Steve McCann has suggested "nothing is off the table" and all alternatives are being evaluated. An update will be provided at the first half result in February and, in light of the underperforming division, Lend Lease has abandoned a bond issue worth $500m.

The provision and subsequent write-down are related to further deterioration in a small number of projects that were previously flagged by management. This includes NorthConnex, which has lower productivity in the post-tunnelling phases. Deterioration in other projects has been blamed on wet weather, access issues and remediation of defective designs.

The provision amounts to a write-down of around -$500m at the operating earnings (EBITDA) level, which is in addition to a -$280m loss reported in the prior first half. From this, Credit Suisse calculates a total operating earnings loss on problem projects of around -$700m versus project revenue of around $1.9bn.

Shaw and Partners struggles to find the levers that can be pulled to offset the the impairment in FY19. The company has indicated measures are being undertaken to mitigate anticipated losses, including alliances with third parties. The broker's earnings estimates and target price are now under review. Shaw and Partners, not one of the eight brokers monitored daily on the FNArena database, has a Buy rating.

The strategic review appears to Wilsons to be a belated response, given the pressures that have mounted for some time in the engineering business. The broker is shocked by the magnitude of the write-down and empathises with investors who have struck the share price down by around -18%.

Nevertheless, the broker considers this is an overreaction. From a group perspective the engineering division is the smallest contributor to earnings, at just 10% and represents around 5% of the broker's valuation. Meanwhile, the core business is in a strong position to win further major projects.

UBS suspects, given the abrupt nature of the announcement, the stock is likely to trade sideways until troublesome projects are completed, circa 2020. The broker estimates the current price implies no value for the Australian construction or the development business, and the market is expected to price the stock at a material discount until confidence returns.

Implications For Engineering

While current provisioning for problem projects is a best estimate, there is no certainty it will be sufficient. Citi suspects the worst may not be past and lowers FY19 estimates for earnings per share by -40% and FY20 by -14%. The broker calls the company's track record in engineering abysmal and questions how the division can get back on track as “it has not been on track in the first place”.

Yet, Morgan Stanley finds reasons to be cheerful, while also downgrading FY19 estimates for earnings per share by -40%. Even with a downwardly revised FY20 estimate the stock trades well below its 15-year average and the broker considers this compelling, given the ongoing momentum in the real asset business.

There is increased project momentum which diversifies development profits over a large number of projects and reduces risk and the company is also increasing its capture of development product via funds under management.

The broker acknowledges the quantum, timing and frequency of the engineering provisions could weigh on investor sentiment but maintains an Overweight rating. In contrast, Citi reiterates a view that engineering should be spun

off, if possible, and any path to recovery in the share price is dependent on a divestment, downgrading to Neutral from Buy.

Credit Suisse agrees the shares are oversold and the catalysts to restore the business are a long way off. The broker downgrades to Neutral from Outperform. The quickest solution to the engineering problem is likely to be a sale of the division but the broker concedes this may not maximise shareholder value. If the business is retained it will take a long time for a significant improvement in profitability and for investors to ascribe much value.

Margins of 3-4% are not considered sufficient and, in the broker's opinion, there are no synergies between the engineering business and the other attractive divisions. At the AGM on November 16, Credit Suisse suggests investors will be looking for the board to commit to significant change in order to address the challenges.

UBS points out integrated engineering expertise is a key differentiator for Lend Lease when bidding on future project and, given around $4bn of revenue backlog remains from existing projects amid a lack of disclosure, more impairments remain of concern.

Credit Review

The implications extend beyond FY19, in Ord Minnett's view, and include the likely sale of the engineering division and the dilution to earnings and dividends associated with an exit. This has put pressure on gearing and, potentially, one or more of the company's credit ratings may be revised down.

The broker suggests the business has limited capacity to absorb another major impairment without affecting available capital for development. As Lend Lease is trading below its valuation, the broker suggests the cost of capital to hold the stock is high, given the risks that remain.

Moody's Investor Service has placed the company's credit rating (Baa3) on negative outlook, albeit not negative watch. Hence, Macquarie reviews the company's debt position, noting gearing allows for around $1.5bn in headroom.

The company has spent around $140m on buybacks and, taking this into account, gearing moves to 9.2%, from 8.2% as of June 2018. Therefore, Macquarie assesses the balance sheet capacity as reasonable, absent further unexpected shocks. There is flexibility, if conditions were to deteriorate, as Lend Lease can discontinue to buy back stock or sell stakes in key assets.

FNArena's database shows five Hold ratings and one Buy (Morgan Stanley). The consensus target is $15.92, suggesting 22.3% upside to the last share price. This compares with $21.04 ahead of the announcement. The dividend yield on FY19 and FY20 forecasts is 3.8% and 5.7% respectively.

See also, Lend Lease A Winner In Global Development on August 8, 2018.

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Incitec Pivot Cleans The Slate For FY19

After being plagued by manufacturing issues in FY18 Incitec Pivot has a clean slate, with upside from higher fertiliser prices likely, although oversupply of AN will pressure explosives.

-Moranbah on track for production targets, contract re-negotiations -Phosphate Hill has largest potential for upside -Uncertainty continues for Gibson Island

By Eva Brocklehurst

Incitec Pivot ((IPL)) has set aside the manufacturing issues that plagued FY18 and provided an upbeat outlook for the new reporting year. Despite the challenges, earnings growth was supported by a full year for the WALA (Louisiana) facility and a higher realised diammonium phosphate price at Phosphate Hill, as well as solid growth from Dyno Nobel America explosives. Net profit of $347m was up 9% and operating earnings (EBIT) of $557m up 11%.

However, manufacturing problems at three plants and unfavourable weather, as well as other one-off costs, meant the company did not benefit from the earnings leverage that it typically enjoys from materially higher fertiliser prices. Morgans believes the stock is fairly valued although recognises that strong fertiliser prices and a falling Australian dollar as well as the share buyback are supporting the share price.

Citi agrees the stock is in "fair value" territory, with management committed to buying back the remaining $90m of its buyback program, beyond which the company is signalling a preference to reduce debt amid organic growth initiatives.

With few M&A opportunities readily visible, Citi believes the stock lacks re-rating catalysts outside of a stronger-than-expected cycle. Deutsche Bank, in marking to market spot fertiliser prices and FX, is more confident there is 20% upside to earnings and retains a Buy rating.

The share price has had a good run and the margin of error in forecasting FY19 is even higher than usual because of the imminent re-pricing of the Moranbah foundation contracts, CLSA contends. The broker, not one of the eight monitored daily on the FNArena database, has an Underperform rating with a target of $4.00.

No specific earnings guidance was provided for FY19, although the company expects moderate earnings growth in Dyno Nobel Americas, with Asia Pacific volumes broadly in line, and warns that domestic ammonium nitrate oversupply will keep pricing and margins under pressure.

Macquarie believes the Phosphate Hill plant has the largest potential upside in FY19, given its significant operating leverage. Fertiliser prices are also a watching brief for Morgan Stanley, amid higher spot prices. Still, the share price reaction since May's lows, having rallied 17%, means it sits within the broker's average valuation and an Equal-weight rating is maintained.

Explosives

Explosives volumes grew strongly, particularly in the quarry & construction sector where Dyno benefits much more than competitor Orica ((ORI)). Macquarie suspects Incitec Pivot is less confident than Orica on Australian ammonium nitrate pricing, attributed to its experience in Western Australia and the impending renegotiation of Moranbah contracts.

The company is considering the potential expansion of Moranbah in 2021, as the market returns to balance, and will update the market in May next year. Macquarie assumes the issue is price and, on that basis, ammonium nitrate prices are headed in the right direction.

Import threats have receded with recent anti-dumping action. However, Credit Suisse suggests a recent spike in Henry Hub gas costs versus spot ammonia pricing will need to be watched. While the anti-dumping duty should help raise import parity prices, management has indicated that competitive strain between domestic operators will be the factor that determines the price trajectory over the next year or so.

Morgans points out earnings will decline in FY20 as the WALA plant will shut for maintenance, which will reduce volumes, while Dyno Asia-Pacific and Moranbah will also be affected by lost or re-priced contracts. The broker believes restoring fertiliser earnings may eventually lead to a corporate transaction, as the explosives and less cyclical businesses appear to be the company's preference.

Fertilisers

Morgans suggests, if the company can fix its reliability issues, it should be able to take advantage of higher fertiliser prices and a lower Australian dollar. Turning around Phosphate Hill, St Helens and Cheyenne in FY18 should mean the company can recover $34m in costs plus a cost reduction of $25m from a new gas contract at Phosphate Hill.

Credit Suisse believes these improvements effectively offset an additional $50m in gas costs at Gibson Island and the impact of WA contract losses. Uncertainty at Gibson Island continues, Macquarie notes, as short-term gas arrangements expire in December 2019. If the company is unable to source economically viable gas the plant will close.

The impact of the drought in eastern Australia now factored in, Credit Suisse believes, although whether a recovery occurs in FY19 is another issue. The broker acknowledges it was caught out in its calculations regarding the extent of the drought impact, which reduced operating earnings by -$20m.

Credit Suisse encourages investors to focus on the fundamentals of expanding cotton production, and high-value fertiliser use, also noting that the company's position in that regard is dependent on continued production at Gibson Island.

FNArena's database shows four Buy ratings and three Hold. The consensus target is $4.25, suggesting 4.7% upside to the last share price. Targets range from $3.95 (Morgans) to $4.60 (Deutsche Bank).

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Elders Expects Growth Despite Dry Conditions

Elders expects to still deliver 5-10% growth in operating earnings in FY19 despite a reduced summer crop and continuing dry conditions on Australia's east coast.

-Further acquisition opportunities expected -Inventory remains high because of dry conditions -Stock trading at a material premium to peer group

By Eva Brocklehurst

Elders ((ELD)) has proven earnings can still grow despite the severe east coast drought and a declining cattle price. Retail products grew, and the company benefited from acquisitions and higher sheep and wool prices and volumes in FY18.

Management expects to deliver 5-10% growth in operating earnings (EBIT) out to FY20, through acquisitions and organic growth as well as cost controls. Guidance includes average winter cropping forecasts in the second half and implies FY19 EBIT of $78.3-82.1m.

The company expects livestock prices to be subdued although volumes higher, while real estate activity in the broad acre property market remains weak. Elders assumes a reduced summer crop and continued dry conditions will affect fertiliser and crop protection take up.

Net profit growth was greater than earnings growth in FY18 because of lower interest expenses and tax. The company was cycling record high cattle prices, which fell -16% and, in line with the poor winter cropping period, second half earnings dropped -2.0%.

The main negative, however, was operating cash outflows of -$12.1m. This was a lot worse than Morgans expected. The issues are related to timing and cash flow is expected to improve materially in FY19.

The company pointed to higher retail debtors because of a delay in receipts and public holidays at the year-end also affected the result. Around $30m in delayed debtors was received in the first week of October.

Major drivers of earnings and cash flow over 2019-21 are expected to include livestock turnover, with a shift in mix towards sheep, where the company generates a higher commission rate. Wilsons is slightly less positive about lamb/sheep prices, noting the supply/demand dynamic is structurally more favourable than cattle but spot prices are around 50% above the long-term average.

Bell Potter also notes the added benefit of the Kerr & Co acquisition. Further contributions are expected from acquisitions made during the year, including Titan Ag.

Dry Conditions Continue

Inventory remains high because of dry conditions. Initial forecasts are for the summer crop to be down -21%, and Bell Potter also suspects the heightened prospect of El Nino is more likely to result in a dry start to the next winter cropping period.

Given the extent of the east coast drought and the impact on peers, Morgans believes the FY18 results are a commendable outcome, which highlight the strength of the company's diversified business model. Still, the broker considers the stock fully valued and downgrades to Reduce from Hold. Target is $7.80.

Acquisition Potential

Wilsons also downgrades, to Sell from Hold, with a target of $7.25. Yet, the broker upgrades estimates by 6-7% and expects growth will be sustained as major corporate operators, such as Landmark, Elders and Ruralco ((RHL)), continue to consolidate their share of the rural services market.

This should complement, the broker assesses, modest organic growth driven by market share gains. Nevertheless, seasonal conditions and commodity prices will continue to add volatility to the company's earnings profile.

Management has identified around $10-15m in opportunities via acquisitions and Bell Potter lifts its targets for expenditure on acquisitions. The broker upgrades estimates for earnings per share by 15% for FY19 by 16% for FY20. This results in upgrade to the target to $7.45 from $6.65.

Bell Potter notes the stock is trading at a material 45-65% premium to its domestic agricultural peer group and, in this light, believes there are more reasonably priced assets in the sector with similar or perhaps greater operating leverage to a recovery in east coast crops. Hence, the broker downgrades to Sell from Hold.

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Pact Packages A Weak Earnings Outlook

Packaging provider Pact Group has disappointed brokers, reducing earnings guidance for FY19 on the back of higher costs.

-Earnings skewed to the second half, with full six-month benefit from acquisition -Resin cost pressures easing, providing potential for margin recovery -Is there a case for the chairman taking the company private?

By Eva Brocklehurst

Pact Group ((PGH)) provided a disappointing trading update as raw material prices continued to put pressure on earnings. The company now expects FY19 operating earnings (EBITDA) of around $245m versus prior guidance of $270-285m. This represents a -12% downgrade at the mid point.

Earnings for the first half are expected be weaker, adversely affected by delays in recovering higher resin costs amid higher costs for contract manufacturing. More efficiency benefits should be recognised in the second half as well as a full six-month contribution from TIC Retail Accessories.

Macquarie observes this was a big change in outlook in the short space of time since the August results, but also points to uncertainty stemming from the departure of the CEO in September. The broker acknowledges ongoing Australian drought is also a negative factor.

The headwinds from resin costs appear to have lingered longer than expected but higher costs for contract manufacturing present a new issue and were the largest cause of the latest downgrade. This relates to surfactants & caustic soda used in the company's Jalco business, which makes detergents and shampoos for Aldi, exacerbated by a weaker Australian dollar.

Deutsche Bank believes guidance is extremely conservative, as it no longer assumes any recovery in raw material costs. The broker believes such an outcome is unlikely because resin prices are stabilising or beginning to decline.

Moreover, around 60% of rigid plastics volumes are contracted with a three-month lag rise & fall clause, as is around 30% of contract manufacturing volumes. Despite the downgrade, the broker maintains a Buy rating.

CEO Uncertainty

Macquarie points out that as rise & fall recovery for contract manufacturing is less than that for resins, there is greater exposure to volatility. The uncertainty regarding a new CEO, yet to be appointed, keeps the broker on a Neutral footing, despite a reasonable return from the stock.

Morgans was surprised by the magnitude of the downgrade, given prior guidance was only delivered three months ago. A recent easing of the oil price and the stabilisation of the AUD/USD should help with some flattening in resin prices. However, there is further downside risk if oil prices and FX resume unfavourable trajectories.

On top of this, the company is implementing efficiency programs, integrating acquisitions and seeking a new CEO. Despite a reasonably attractive valuation, the broker considers the operating environment difficult, with further risks possible in relation to raw material costs.

Credit Suisse still expects investors can achieve a 25% total return over the next 12 months, highlighting that the stock is trading on a 6% dividend yield on 10% FY20 free cash flow yield.

The broker acknowledges the trading update reflects a more conservative outlook for profits but believes prior guidance was aggressive. New guidance assumes raw material costs will not change and there is no further recovery in output prices. Yet, Credit Suisse now envisages resin costs are no longer threatening and if this remains the case there is some potential for margin recovery.

Ord Minnett considers the stock price depressed and, while there is fundamental valuation support, the poor track record of organic growth warrants caution about the outlook and earnings prospects.

Case For Going Private?

Credit Suisse reflects on whether the chairman, who owns around 38% of the company, may consider privatising the business, given the present situation. The broker points out, the rationale for going public was the vision of a much larger business. Now, five years later, the logic for remaining public is being tested.

The broker points out that scrip is valued at a lower multiple and, therefore, costly to issue, and neither sellers of potential bolt-on businesses nor passive shareholders would appreciate being issued additional scrip, given the track record and risk. Moreover, the stock market is valuing the stock cheaper than when the company was listed. All up, Credit Suisse believes Pact Group is at a point where investors face little downside.

FNArena's database shows two Buy ratings and three Hold. The consensus target is $4.02, suggesting 28.1% upside to the last share price. This compares with $4.64 ahead of the update. Targets range from $3.24 (Morgans) to $5.50 (Deutsche Bank). The dividend yield on FY19 and FY20 forecasts is 6.1% and 6.4% respectively.

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The Hottest Metal In The World Right Now

By Marin Katusa, Katusa Research

One of the trendiest metals on the tip of investors' tongues right now is vanadium.

The metal is named after Vanadis, a Norse goddess. Vanadium is very ductile, malleable and corrosion-resistant.

It's rare for vanadium to exist as a free element and it's usually found in minerals such asvanadinite, carnotite and magnetite. Thus, metallurgy is the key question when you find a largeamount of vanadium.

Vanadium has incredible properties which increase the strength of alloys containing it, such asrebar which is heavily used in construction. China has just raised their steel rebar limits. Vanadium is also used in everything from jet engines to dentalimplants.

This past weekend I was down at the Katusa/Cambridge House Gold and Silver Summit in San Francisco. The main theme was precious metals, but I couldn't escape questions about vanadium.

Here's why…

Below is a chart which shows the price of vanadium over the past 3 years.

I've seen this type of small sector hype many times before. And so have you with lithium and cobalt.

Like those two niche metals, many "vanadium" stocks have spiked in price, returning doubles and triples in a short time. And some have even become 5 baggers in the month of October alone. Those kinds of gains are enough to hit everyone's radar screens. Traders, investors and "me-too" companies alike will start piling on the momentum train.

Here's what you need to know about Vanadium

Vanadium is a small, niche sector. In 2017, global consumption was roughly 95,000 tonnes (209 million pounds).

For comparison, in 2017 the world consumed roughly 23 million tonnes of copper (50 billion pounds). Below is a chart which shows annual vanadium consumption since 2007.

Vanadium is mainly used as a stiffening agent in steel. Around 90% of annual vanadium production is sold to the steel sector. This makes the 2 industries highly correlated. The majority of vanadium production comes from 4 countries: China, Russia, South Africa and Brazil.

So why is everyone getting excited?

There are a few reasons why the vanadium sector has been exploding.

Vanadium Excitement Reason #1: Steel demand and changes to Chinese building codes

The steel sector itself is correlated to the health and strength of economies around the world.

As economies expand and develop they need vast amounts of new infrastructure. A lot of this infrastructure requires steel, which in turn requires vanadium.

Building codes in China are edging closer towards building codes in places like the U.S. and Europe.

For example, in the U.S., you'll find steel has about 0.1 kilograms of vanadium (3.4 ounces) per tonne of steel. Whereas in China, you'd find a tonne of steel contains about 0.05 kilograms (1.7 ounces) of vanadium.

One of the main catalysts that spiked interest in the metal is new steel regulations that China will be imposing in November 2018.

The new Chinese regulations are phasing out Grade 2 rebar which uses no vanadium in favour of grades 3, 4 and 5. Each of these new rebar grades requires vanadium. The higher the grade, the more vanadium that is required.

Vanadium Excitement Reason #2: Utility scale battery storage

Renewable energy projects are springing up around the globe.

But the biggest issue with renewable power is that it is intermittent.

You can't generate much in the way of solar electricity in the middle of the night. That's why battery storage is so crucial to large scale renewable power. Think oil production before pipelines and rail takeaway. This is going to happen and will be a major game changer for electricity generation dynamics.

Vanadium flow batteries are now being pilot tested as a solution to industrial scale battery storage issues. But it is still very early stage.

If vanadium flow batteries do become a go to metal for utility size energy storage, it would open up a huge amount of new demand for vanadium.

Dirty Secrets in the Vanadium Sector

Just because the vanadium sector is small, doesn't mean that vanadium is rare.

Vanadium is actually fairly common, and can be found as a secondary metal in many types of deposits.

Most of these secondary deposits contain low grade vanadium mineralization. But at current vanadium prices, those marginal deposits become economic. Which opens up a plethora of new potential supply. This is very similar to the crappy/low grade copper and nickel projects which magically turned into cobalt projects last year.

You will see many crappy uranium projects now be touted as vanadium stories. It's neither cheap nor easy to produce a radioactive material. Buyer beware.

The second dirty secret is that there is actually a sizable amount of production capacity which is currently offline.

Total production capacity in the vanadium market is around 150-160 thousand tonnes per year. But right now, production is only around 95,000 tonnes.

A large amount of vanadium is produced through Chinese co-production facilities, which produce both steel and vanadium. Some of these facilities are currently shutdown or operating at lower capacity rates.

It's no secret China has a huge pollution problem. To curb some of these effects the government has forced the closure of several large steel and vanadium facilities.

Katusa's Vanadium Outlook and Play

I believe that both steel and battery manufacturers will want to secure a long-term supply of low cost, metallurgically recoverable (metallurgy that actually works) vanadium production in a non-AK47 nation that is friendly to mining.

I do like commodities that don't just depend on continued growth in China.

Vanadium has the benefit of growth demand from China. But the reality is, 30-40% of global vanadium demand is directly correlated to the Chinese rebar market. If Chinese rebar demand slows down or contracts, vanadium prices will pull back significantly.

In these niche markets it's important to not get too over exposed.

Be careful and invest only with speculative capital that you can truly afford to lose 100% of.

I've been looking for years for the right vanadium project. I have a database of every single deposit globally.

Do not invest in any projects that are using anywhere near current spot prices in their economics. I specifically asked a large producer of vanadium if he could get an off take at $25 per pound, while vanadium was $32 per pound and he couldn't lock in a hedge or off-take.

So, if you are going to play a niche market like vanadium, make sure you are using say $15 per pound not the current $30+ per pound spot price.

Also, make sure you invest with a management team that not only understands the niche metal markets, but have direct success in the niche markets. Just because you know how to finance or build a mine, doesn't mean you understand the complexities of the niche markets.

Niche markets are very different than the large commodities such as copper or gold.

katusaresearch.com

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Material Matters: Iron Ore, Nickel & Copper

A glance through the latest expert views and predictions about commodities. Iron ore; nickel; copper; and mining services.

-Tightness in iron ore pellet supply may be easing -Macquarie calculates 70-80% of China's iron ore imports could be displaced -Nickel unlikely to be supported as trade war plays out -Upside likely to be limited in copper until trade tensions ease -The more east coast exposure the better for mining services contractors

By Eva Brocklehurst

Iron Ore

Credit Suisse is surprised by the compression in iron ore grades as China's winter curtailment period commences. In 2017 the price of lower-grade ore, particularly Fortescue Blend, was slashed in winter, as it is an undesirable product when blast furnace capacity is restricted.

Winter reductions are just starting, so the broker acknowledges it may be a little early early in calling out the procurement strategies of the steel mills. Nevertheless, steel profits and outlook are considered to be less buoyant and mills may be more cautious. Hence, aggressive premiums and discounts for grade may not occur. As margins weaken for flat steel, the mills become more cost conscious and seek cheaper alternatives.

Meanwhile, the broker's analysts are calling the end of the Chinese property boom although, while authorities are trying to restart infrastructure investment, they are considered unlikely to embark on another major round of stimulus.

The fact that low-grade iron ore has rallied, despite rebar steel spreads being robust, is a sign of a tight market, Ord Minnett believes. The broker expects steel prices to remain buoyant into the first quarter, because of the lagged effect of fiscal easing, shutdowns of capacity over winter and low steel inventory and upgrades forecasts for iron ore prices over the next two quarters to US$70/t, expecting 2018 to average US$69/t, on the back of higher Chinese steel demand.

Since the collapse of the Samarco dam took a chunk out of the export market in 2015, iron ore pellets have been in tight supply, reflected in a contract premium of US$58/t in 2018. While miners remain bullish on 2019, Morgan Stanley notes China's spot price has been falling, to US$64/t from a US$90/t peak in September. This suggests a pick up in domestic feed supply.

China is mainly served by Indian exports and, while being the largest pellet consumer imports only 10% of its requirements, manufacturing pellets from its domestic high-grade concentrate. Morgan Stanley observes the country's appetite to pay for pellets increases when steel margins are high and increased productivity is required, as during winter capacity reductions.

Given spare pelletising capacity and ample feed, the broker believes a sustainable premium should be close to marginal cost on the pellet conversion curve, i.e. around US$30/t.

While pellet feed supply may recover in 2019, as Minas Rio re-starts and Canada's Bloom Lake ramps up, this may not be reflected in premium settlements as yet. Meanwhile, India's pellet exports are likely to continue falling as more iron ore is consumed domestically.

All three major Australian iron ore miners continue to look compelling from a valuation perspective, in Ord Minnett's opinion. Rio Tinto ((RIO)) remains the preference versus BHP ((BHP)). The broker envisages a greater risk/return ratio in Fortescue Metals ((FMG)) although the catalyst, the ramp up of the new West Pilbara fines production, is 6-9 months away.

The stigma surrounding the company's low-grade iron ore is overdone, in Ord Minnett's view, and the stock offers greater potential upside than other majors should it deliver on the West Pilbara strategy.

Macquarie suggests an investment boom in metal shredding capacity is rapidly boosting China's capability. The constraints that have historically held back recycling in China, such as lack of scale, investment and poor quality, may soon be overcome. The broker believes, for investors in dry bulks, it is important to track the pace of development of the Chinese electric arc furnace (EAF) industry and the local scrap market. Yet information is scarce.

Nevertheless, a big expansion program in EAF is underway. Mysteel estimates total capacity of 50mt is under construction. Macquarie suspects increased capacity will allow plenty of room to lift scrap consumption as this becomes more available.

The broker also highlights the fragmented nature of the Chinese recycling industry is changing and estimates China will consume nearly 200mt of scrap this year, significantly above 2017. The majority still comes from domestic sources but, with almost twice as much shredding capacity, China will soon be able to process a lot more. Macquarie calculates that, given the maturing of the Chinese economy, between 70-80mt of iron ore requirements, most probably imports, may soon be displaced.

Nickel

Citi notes nickel fell last week to its lowest level in around 11 months on both the London and Shanghai exchanges, as rebar steel prices fell. This stems from concerns over slowing demand in China.

The broker suggests a de-escalation of the trade conflict and further Chinese stimulus could mean prices rally over the next 3-12 months but, given a trade war is becoming the base case for many investors, points out nickel is unlikely to be supported by either cost or fundamentals in that scenario.

Copper

ANZ analysts continue to observe a dislocation between fundamentals and investor sentiment in the copper market, the latter predicated on escalating trade tensions. Nevertheless, strong growth in Chinese imports suggests demand remains robust but, until any trade tension eases, upside is likely to be limited.

The analysts note inventories at both the London and Shanghai exchanges have been on a steady decline for most of the year and Chinese premiums are elevated. Moreover, tariffs on scrap imports have boosted demand for refined metal.

The fundamentals are not positive enough to offset the expected weakness from the trade conflict while, in some downstream sectors such as grid investment, demand is weak.

Mining Services

Bailieu Holst has identified several developments from a visit to Western Australian mining services businesses. The pipeline of work remains robust but margin pressures are persisting.

Moreover, those with exposure to the east coast are gaining more than just diversification. The broker believes broader earnings growth across the sector will be driven by revenue growth. A highly competitive tender landscape can be illustrated by gross margins, which have been steadily falling over the last five years as activity subsided.

The significant amount of work on the east coast reduces some of the competitive tightness versus Western Australian mining-related work for these companies. The east coast exposure for all three of the stocks the broker covers has increased, via acquisitions and organic growth, and all three have strong track records.

Monadelphous ((MND)) has won several wind farm contracts as well as appointment to the Hunter Valley Water Corporation Panel. Global Construction Services ((GCS)) has had a number of wins on the east coast including a $30m contract in Brisbane. Veris Ltd's ((VRS)) guidance for surveying work of $125m is weighted towards the east coast.

Among those companies the broker does not cover, east coast revenue for MACA ((MLD)), Southern Cross Electrical ((SXE)) and Decmil ((DCG)) has increased as a percentage of their respective order books.

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

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 October 29 to Friday November 2, 2018 Total Upgrades: 22 Total Downgrades: 6 Net Ratings Breakdown: Buy 43.98%; Hold 42.30%; Sell 13.72%

If there is one conclusion that can be drawn from the week past it is that stockbroking analysts overwhelmingly see opportunities emerging in a shocked and beaten down Australian share market. October has been brutal on multiple accounts, but at least analysts are responding by issuing far more recommendation upgrades than downgrades for individual ASX-listed stocks.

For the week ending Friday, 2nd November 2018, FNArena registered no less than 22 upgrades and only six downgrades, with multiple stocks receiving multiple upgrades. Medium cap mining conglomerate Independence Group received three upgrades during the week, of which two went to Neutral/Hold.

Equally worth pointing out is that upgrades are coming thick and fast for ongoing "growth" stories in the share market, countering the narrative that has been dominating the Australian share market for weeks that the future is now all about "value" stocks outperforming in the face of rising global bond yields.

Beach Energy, Boral, Carsales, nib Holdings, and REA Group all received multiple recommendation upgrades during the week.

The six downgrades went to one automotive dealer, two gold producers, one wealth manager, an owner of shopping centres and one troubled engineering firm currently under threat of falling 100% into Belgian ownership. Maybe the double representation of gold is a sign in itself?

Target prices, they didn't move much on the upside during the week, with Northern Star and ResMed enjoying increases of 3.4% and 2.85% rewspectively, but others not worth mentioning. A clear negative is, however, the observation there are far more and deeper cuts to take note of on the opposing side of the ledger.

Biggest casualty for the week is the consensus price target for AMP, which fell yet another -24%. Apart from this well-known, idiosynchratic train wreck, Blackmores' target fell by -19%, followed by Lovisa Holdings on -9.99%, Boral on -5.68% and Automotive Holdings on -5.24%.

There was more encouraging news from changes in estimated earnings with the positive side equally showing large numbers. Top for the week goes to Alacer Gold, whose forecasts enjoyed a boost of 67% during the week, handsomely beating AMP (yes, you read that correctly), Perseus Mining, National Australia Bank (yes, indeed), ANZ Bank (idem), and Beach Energy.

Independence Group's three upgrades were countered by a -18% reduction in EPS estimates, followed by Orocobre on -12.3%, Northern Star, Senex Energy, Mineral Resources, and Wagners Holding Co.

With AGM updates ongoing, and the out-of-season financial reporting season heating up locally, the week ahead should see plenty of changes yet again, amidst ongoing events on the macro-calendar.

Upgrade

BLACKMORES LIMITED ((BKL)) Upgrade to Neutral from Underperform by Credit Suisse .B/H/S: 0/2/2

Share price weakness has brought the stock closer to fair value and Credit Suisse upgrades to Neutral from Underperform. The broker reduces the target to $115 from $130, given China's consumer sector has de-rated.

Critical to the broker's valuation is the assumption that direct Chinese sales growth in FY19 decelerates to 15% through to FY23, from 20%.

Sales in the first quarter were ahead of expectations while operating earnings (EBITDA) growth of 11% was close to the projected growth rate.

BORAL LIMITED ((BLD)) Upgrade to Buy from Neutral by Citi and Upgrade to Neutral from Underperform by Credit Suisse .B/H/S: 5/2/0

Citi observes Boral shares have sharply underperformed the broader market, largely because of concerns over the US housing cycle and disruptions caused by wet weather.

The company remains bullish on demand conditions. Boral has also reiterated a preference to fund a possible acquisition of USG's 50% stake via asset sales and debt.

Citi believes the stock is oversold and upgrades to Buy from Neutral. Target is clipped to $7.00 from $7.50.

A laundry list of weather events contributed to a weak performance in the September quarter yet Credit Suisse believes, weather-related delays aside, the opportunities in the Australian business remain strong.

The order book is robust and price increases are coming through in concrete and aggregates. Nevertheless, despite unchanged guidance, the company's task is becoming more difficult because of a moderation of the US housing market.

Credit Suisse upgrades to Neutral from Underperform, although maintains the view that a discount to fair value is justified because of the moderating end market outlook. Target is reduced to $5.80 from $6.40.

BEACH ENERGY LIMITED ((BPT)) Upgrade to Buy from Hold by Ord Minnett and Upgrade to Neutral from Underperform by Macquarie .B/H/S: 2/1/1

September quarter production growth and higher commodity prices generated strong cash flow and helped reduce debt in the September quarter. Ord Minnett calculates the company is trading on an annualised free cash flow yield of 17%.

FY19 guidance is reaffirmed, signalling the business is trending towards the upper end of the guidance range for production and earnings. Rating is upgraded to Buy from Hold. Target is steady at $2.10.

The company reported stronger production and sales in the September quarter, offset by hedging losses and weaker pricing. Production is expected to come in at the upper end of FY19 guidance.

Macquarie upgrades to Neutral from Underperform and, at current levels, believes the stock is fair value, despite expecting a beat on production and earnings in FY19. Target is raised to $1.65 from $1.60.

CARSALES.COM LIMITED ((CAR)) Upgrade to Outperform from Neutral by Macquarie and Upgrade to Buy from Neutral by UBS .B/H/S: 6/1/0

The company has reported a slowing for Display and Stratton which has caused a softer financial performance in the first quarter.

The bias to the second half for earnings from the Display business signals to Macquarie that an improvement should be expected, although the basis for the assumption is not apparent. The second half bias for Stratton is based on operating improvements.

Macquarie, while aware of the near-term macro concerns, upgrades to Outperform from Neutral, envisaging broad-based earnings drivers including increased take up of premium/promote products. Target is $13.90.

UBS makes modest earnings downgrades after the AGM update, which suggests FY19 core revenue growth is expected to be more moderate.

UBS reduces domestic core earnings growth forecasts to 6% but, with the benefit of the SK Encar acquisition, still expects the company to deliver headline earnings growth of 14%.

Nevertheless, the broker considers the valuation now undemanding and upgrades to Buy from Neutral. Target is reduced to $13.50 from $14.00.

CSL LIMITED ((CSL)) Upgrade to Accumulate from Hold by Ord Minnett .B/H/S: 4/4/0

Ord Minnett believes Seqirus, the company's flu vaccine, will be able to price Flucelvax at a premium to egg-based vaccines. This opportunity has come after CSL gained regulatory approval for its new manufacturing process that should deliver a doubling of output in FY20.

The broker believes the vaccine business will deliver FY20 EBIT comfortably in excess of the US$200 guidance. Rating is upgraded to Accumulate from Hold and the target is raised to $215 from $201.

INDEPENDENCE GROUP NL ((IGO)) Upgrade to Buy from Neutral by Citi and Upgrade to Neutral from Underperform by Credit Suisse and Upgrade to Neutral from Underperform by Macquarie .B/H/S: 2/3/1

Citi acknowledges that downside risk is ongoing for nickel and copper in the face of US-China trade tensions but this is partly offset by gold's re-emerging sensitivity to geopolitical risk. Nova production was soft in the Sep Q, leading to a target price cut to $4.70 from $5.00, but the broker believes there is clear upside potential from Nova exploration.

Citi considers a -13% sell-off for Independence is overdone, and upgrades to Buy from Neutral.

September quarter production was in line with expectations. Credit Suisse notes there were no changes to FY19 budgets while a stronger second half for Nova should deliver lower unit costs.

Management has indicated its dividend policy is up for a review with a possible switch to a free cash flow pay-out from the first half of FY19.

The broker upgrades to Neutral from Underperform because of weakness in the share price. Target is steady at $3.95.

Macquarie incorporates an underground development of Boston Shaker into its forecasts for Tropicana. Adjustments to grade profile means cuts of -1% and -10% to FY19 and FY20 production estimates.

The move underground will extend the life of the Tropicana project and improve the potential for exploration success at depth.

Rating is upgraded to Neutral from Underperform. Target is raised to $4.30 from $4.20.

IRESS MARKET TECHNOLOGY LIMITED ((IRE)) Upgrade to Buy from Hold by Ord Minnett .B/H/S: 2/3/0

The share price has fallen -15% in October and Ord Minnett now believes the valuation is compelling enough to warrant an upgrade to Buy from Hold. The broker now considers IRESS one of the cheapest stocks in the sector.

First half results were ahead of expectations and the commentary at the time suggested growth in the UK would accelerate in the second half. Target is reduced to $11.73 from $12.36.

LOVISA HOLDINGS LIMITED ((LOV)) Upgrade to Add from Hold by Morgans .B/H/S: 3/0/1

The trading update revealed a softer start to FY19 with like-for-like sales down -0.9%. Morgans suggests the volatility and weakness is likely to persist over the balance of the year but believes the rolling out of stores has potential as a positive driver of the business.

The broker believes 2019 will be the year the company takes a more assertive stance on the pilot market footprint. Rating is upgraded to Add from Hold.

The broker remains unconcerned about the short-term sales blip and emphasises the global growth potential and growing cash position. Target is reduced to $8.06 from $10.93.

MONADELPHOUS GROUP LIMITED ((MND)) Upgrade to Neutral from Sell by Citi .B/H/S: 1/3/1

Citi continues to envisage downside risk to FY19 earnings but upgrades to Neutral from Sell because of the improving outlook for core markets. Target is raised to $13.95 from $12.70.

The broker expects investors will look through the decline in FY19, anticipating earnings growth in FY20 and beyond. The maintenance division is expected to benefit from increased demand as LNG projects ramp up production.

The broker also believes Monadelphous will be able to capitalise on an expected increase in iron ore construction work in Western Australia, yet envisages risk to FY19 given any potential iron ore contract will contribute materially only in FY20, and competition remains in tense.

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

Because of market volatility and the resultant fall in the share price, which is down - 20% from its peak, Morgans upgrades to Add from Hold.

The broker expects new products to be launched over the next 18 months which will drive substantial growth in profit. Target is unchanged at $3.32.

NIB HOLDINGS LIMITED ((NHF)) Upgrade to Add from Hold by Morgans and Upgrade to Neutral from Sell by UBS .B/H/S: 2/5/1

The company has upgraded FY19 profit guidance by 5.5% because of a benign claims environment. Morgans suggests previous guidance was always conservative and upgrades forecasts by 4-7% over FY19-20.

The recommendation is moved to Add from Hold. The broker believes the recent sell off in the shares has been overdone, particularly in light of the upgrade. Target is reduced to $6.49 from $6.77.

The company now believes net margins can be sustained at FY18 levels in FY19 despite lower premium rate increases.

Benefits are likely to be short lived, however, in the broker's view, as wider margins will add to mounting political pressure for lower premium rate increases.

Rating is upgraded to Neutral from Sell, as the broker envisages limited downside. Target is reduced to $5.95 from $6.10.

PERPETUAL LIMITED ((PPT)) Upgrade to Neutral from Sell by UBS .B/H/S: 0/7/0

The shares are down -31% in the year to date and UBS believes the downside is now limited, upgrading to Neutral from Sell.

The Corporate Trust and Perpetual Private divisions are on track and represent 58% of operating earnings versus 38% five years ago, as the company has diversified away from its stagnant Perpetual Investment earnings.

While net outflows will continue to affect the latter, the broker expects earnings elsewhere to grow by around 5% per annum.

As a result, UBS believes the stock offers fair value and the cash on the balance sheet provides strategic options. Target is reduced to $33.50 from $41.50.

REA GROUP LIMITED ((REA)) Upgrade to Accumulate from Lighten by Ord Minnett and Upgrade to Neutral from Sell by UBS .B/H/S: 4/3/0

Ord Minnett notes the share price has fallen -23% since peaking in August following the weak update from Domain ((DHG)). This formed the basis for a Lighten rating, exacerbated by global de-rating of technology stocks.

Ord Minnett now believes the correction has run its course and there is greater-than-expected growth in depth penetration, amid a soft property market.

While lowering first quarter estimates because of a steeper decline in listings, the broker envisages potential upside to its numbers. Rating is upgraded to Accumulate. Target is steady at $79.

UBS reduces earnings estimates because of slower Premiere growth, particularly in NSW, as well as a view that house prices will decline around -10% from peak to trough.

FY19 and FY20 estimates for earnings per share are reduced by -2% and -4% respectively. Still, despite the reductions to expectations the broker believes REA Group is more resilient as the number one player, despite the soft housing environment.

Rating is upgraded to Neutral from Sell. Target is reduced to $75 from $80.

RESMED INC ((RMD)) Upgrade to Outperform from Neutral by Credit Suisse .B/H/S: 4/3/1

First quarter results were strong, with operating earnings up 28% and 13% above Credit Suisse estimates.

The broker believes growth in both the US and the rest of the world for flow generators stems from the company's connected care strategy and the data capabilities on its AirView and Brightree platforms.

Credit Suisse upgrades to Outperform from Neutral. Target is raised to $15.10 from $14.30.

WISETECH GLOBAL LIMITED ((WTC)) Upgrade to Buy from Hold by Ord Minnett .B/H/S: 2/2/0

The share price has fallen -27% in October, reflecting a broader sell-off in technology stocks. This is the opportunity Ord Minnett was waiting for.

Earnings have recently been upgraded and, while the stock still trades at a substantial premium to software peers, it is now modestly below the broker's valuation.

The broker believes the volatility presents an opportunity to take a stronger view on the growth story and the rating is upgraded to Buy from Hold. Target is raised to $17.87 from $17.00.

Downgrade

AUTOMOTIVE HOLDINGS GROUP LIMITED ((AHG)) Downgrade to Underweight from Equal-weight by Morgan Stanley .B/H/S: 1/4/2

Morgan Stanley has lowered forecast earnings for AP Eagers ((APE)) by -5-10% and for Automotive Holdings by -14-17% due to lower commissions, lower organic growth expectations based on falling vehicle sales, and sentiment around wealth effects. The broker sees house prices declining -10-15% from their peak, and thus vehicle sales -6%.

Morgan Stanley prefers AP Eagers to Auto Holdings and notes previous periods of falling house prices and vehicle sales have led to a de-rating for Auto Holdings, which the market is underestimating. The balance sheet is more constrained this time around. Downgrade to Underweight from Equal-weight, target falls to $1.55 from $2.50. Industry view: In line.

EVOLUTION MINING LIMITED ((EVN)) Downgrade to Hold from Add by Morgans .B/H/S: 3/5/0

Morgans observes gold production in the September quarter, if annualised, would be at the top of the projected range for the year. At the flagship Cowal mine work continued on the tails leach project with some success with high-grade exploration reported.

Meanwhile, treatment of stockpiles will continue at Mt Rawdon with a focus on the stage 4 pit cutback. The board has also approved the underground mine development at Mt Carlton.

Rating is downgraded to Hold from Add, given the rise in the share price. Morgans envisages the primary risk to valuation comes from the gold price, with the copper price less significant. Target is raised to $3.28 from $3.17.

OCEANAGOLD CORPORATION ((OGC)) Downgrade to Neutral from Outperform by Credit Suisse .B/H/S: 4/2/0

Credit Suisse expects production is on track to deliver on full year guidance, supported by a surprise contribution in the September quarter from the previously-unknown high-grade breccia ore.

This, in all likelihood, was added to the Didipio production schedule to offset the weaker-than-expected result from Haile.

The broker retains a positive outlook but downgrades to Neutral from Outperform on valuation. Target is raised to $4.00 from $3.80.

PENDAL GROUP LIMITED ((PDL)) Downgrade to Underperform from Neutral by Credit Suisse .B/H/S: 2/3/1

Weak equity markets are expected to affect growth in funds under management and could potentially affect industry flows to equities. Credit Suisse notes Pendal Group is overweight equities.

The broker downgrades to Underperform from Neutral because of these near-term headwinds. Hambro performance fees are likely to be lower for longer, the broker suspects.

Earnings forecast for FY19-20 are lowered by -12-14%. Target is reduced to $7.10 from $9.00.

SHOPPING CENTRES AUSTRALASIA PROPERTY GROUP ((SCP)) Downgrade to Hold from Accumulate by Ord Minnett .B/H/S: 0/3/2

The stock has re-rated, Ord Minnett believes, because of its superior operating results compared with other retail portfolios, as well as relatively predictable earnings growth.

Pricing on the assets acquired from Vicinity Centres ((VCX)) was also favourable. The broker continues to believe the portfolio is well-positioned with an attractive return on capital and relatively low risk.

As the stock is trading in line with the target, steady at $2.70, the rating is downgraded to Hold from Accumulate.

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

Watpac has received an off-market takeover bid from BESIX, which currently has a 28.1% stake. The board has unanimously recommended the offer and it has been deemed fair and reasonable by an independent expert.

Morgans had suggested previously that an earnings-led recovery in the share price would take time and, therefore, believes shareholders should accept the offer. A superior offer, while possible, is considered unlikely.

The broker downgrades to Hold from Add. The target is raised to $0.92 a share, in line with the offer price, from $0.86.

Total Recommendations Recommendation Changes

Broker Recommendation Breakup

Broker Rating Order Company New Rating Old Rating Broker Upgrade 1 BEACH ENERGY LIMITED Neutral Sell Macquarie 2 BEACH ENERGY LIMITED Buy Neutral Ord Minnett 3 BLACKMORES LIMITED Neutral Sell Credit Suisse 4 BORAL LIMITED Buy Neutral Citi 5 BORAL LIMITED Neutral Sell Credit Suisse 6 CARSALES.COM LIMITED Buy Neutral Macquarie 7 CARSALES.COM LIMITED Buy Neutral UBS 8 CSL LIMITED Buy Neutral Ord Minnett 9 INDEPENDENCE GROUP NL Neutral Sell Macquarie 10 INDEPENDENCE GROUP NL Buy Neutral Citi 11 INDEPENDENCE GROUP NL Neutral Sell Credit Suisse 12 IRESS MARKET TECHNOLOGY LIMITED Buy Neutral Ord Minnett 13 LOVISA HOLDINGS LIMITED Buy Neutral Morgans 14 MONADELPHOUS GROUP LIMITED Neutral Sell Citi 15 NANOSONICS LIMITED Buy Neutral Morgans 16 NIB HOLDINGS LIMITED Buy Neutral Morgans 17 NIB HOLDINGS LIMITED Neutral Sell UBS 18 PERPETUAL LIMITED Neutral Sell UBS 19 REA GROUP LIMITED Neutral Sell UBS 20 REA GROUP LIMITED Buy Sell Ord Minnett 21 RESMED INC Buy Neutral Credit Suisse 22 WISETECH GLOBAL LIMITED Buy Neutral Ord Minnett Downgrade 23 AUTOMOTIVE HOLDINGS GROUP LIMITED Sell Buy Morgan Stanley 24 EVOLUTION MINING LIMITED Neutral Buy Morgans 25 OCEANAGOLD CORPORATION Neutral Buy Credit Suisse 26 PENDAL GROUP LIMITED Sell Neutral Credit Suisse 27 SHOPPING CENTRES AUSTRALASIA PROPERTY GROUP Neutral Buy Ord Minnett 28 WATPAC LIMITED Neutral Buy Morgans Recommendation Positive Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 BPT BEACH ENERGY LIMITED 25.0% -25.0% 50.0% 4 2 IGO INDEPENDENCE GROUP NL 8.0% -42.0% 50.0% 6 3 CAR CARSALES.COM LIMITED 86.0% 57.0% 29.0% 7 4 REA REA GROUP LIMITED 50.0% 21.0% 29.0% 7 5 BLD BORAL LIMITED 64.0% 36.0% 28.0% 7 6 NHF NIB HOLDINGS LIMITED 13.0% -13.0% 26.0% 8 7 LOV LOVISA HOLDINGS LIMITED 50.0% 25.0% 25.0% 4 8 WTC WISETECH GLOBAL LIMITED 50.0% 25.0% 25.0% 4 9 IRE IRESS MARKET TECHNOLOGY LIMITED 40.0% 20.0% 20.0% 5 10 RWC RELIANCE WORLDWIDE CORPORATION LIMITED 70.0% 50.0% 20.0% 5 Negative Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 NST NORTHERN STAR RESOURCES LTD -43.0% -7.0% -36.0% 7 2 OGC OCEANAGOLD CORPORATION 58.0% 75.0% -17.0% 6 3 AVN AVENTUS RETAIL PROPERTY FUND 33.0% 50.0% -17.0% 3 4 PDL PENDAL GROUP LIMITED 17.0% 33.0% -16.0% 6 5 EVN EVOLUTION MINING LIMITED 31.0% 44.0% -13.0% 8 6 AHG AUTOMOTIVE HOLDINGS GROUP LIMITED -21.0% -8.0% -13.0% 7 7 SCP SHOPPING CENTRES AUSTRALASIA PROPERTY GROUP -40.0% -30.0% -10.0% 5 8 ALL ARISTOCRAT LEISURE LIMITED 79.0% 81.0% -2.0% 7 Target Price Positive Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 NST NORTHERN STAR RESOURCES LTD 8.157 7.886 3.44% 7 2 RMD RESMED INC 15.080 14.662 2.85% 8 3 MND MONADELPHOUS GROUP LIMITED 14.365 14.157 1.47% 6 4 WTC WISETECH GLOBAL LIMITED 18.600 18.383 1.18% 4 5 CSL CSL LIMITED 215.325 213.575 0.82% 8 6 OGC OCEANAGOLD CORPORATION 4.667 4.633 0.73% 6 7 BPT BEACH ENERGY LIMITED 1.885 1.873 0.64% 4 8 EVN EVOLUTION MINING LIMITED 3.029 3.015 0.46% 8 Negative Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 AMP AMP LIMITED 2.853 3.791 -24.74% 8 2 BKL BLACKMORES LIMITED 113.000 140.000 -19.29% 4 3 LOV LOVISA HOLDINGS LIMITED 9.953 11.058 -9.99% 4 4 BLD BORAL LIMITED 7.113 7.541 -5.68% 7 5 AHG AUTOMOTIVE HOLDINGS GROUP LIMITED 2.317 2.445 -5.24% 7 6 AVN AVENTUS RETAIL PROPERTY FUND 2.227 2.315 -3.80% 3 7 PDL PENDAL GROUP LIMITED 9.650 9.967 -3.18% 6 8 IGO INDEPENDENCE GROUP NL 4.392 4.533 -3.11% 6 9 CAR CARSALES.COM LIMITED 15.519 15.889 -2.33% 7 10 SFR SANDFIRE RESOURCES NL 7.440 7.597 -2.07% 7 Earning Forecast Positive Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 AQG ALACER GOLD CORP 3.260 1.949 67.27% 4 2 AMP AMP LIMITED 23.157 20.200 14.64% 8 3 PRU PERSEUS MINING LIMITED 3.580 3.280 9.15% 3 4 NAB NATIONAL AUSTRALIA BANK LIMITED 228.543 210.214 8.72% 8 5 ANZ AUSTRALIA & NEW ZEALAND BANKING GROUP 232.750 217.486 7.02% 8 6 BPT BEACH ENERGY LIMITED 22.333 20.900 6.86% 4 7 FMG FORTESCUE METALS GROUP LTD 39.259 36.744 6.84% 8 8 OGC OCEANAGOLD CORPORATION 29.869 28.665 4.20% 6 9 NHF NIB HOLDINGS LIMITED 77.368 76.117 1.64% 8 10 ILU ILUKA RESOURCES LIMITED 76.936 75.836 1.45% 5 Negative Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 IGO INDEPENDENCE GROUP NL 20.828 25.432 -18.10% 6 2 ORE OROCOBRE LIMITED 13.824 15.766 -12.32% 8 3 NST NORTHERN STAR RESOURCES LTD 55.383 60.685 -8.74% 7 4 SXY SENEX ENERGY LIMITED 1.620 1.760 -7.95% 5 5 MIN MINERAL RESOURCES LIMITED 140.733 152.033 -7.43% 3 6 WGN WAGNERS HOLDING COMPANY LIMITED 15.770 16.837 -6.34% 3 7 WSA WESTERN AREAS NL 15.670 16.580 -5.49% 7 8 SFR SANDFIRE RESOURCES NL 72.757 76.413 -4.78% 7 9 LOV LOVISA HOLDINGS LIMITED 38.020 39.920 -4.76% 4 10 IFL IOOF HOLDINGS LIMITED 65.600 68.800 -4.65% 5 Technical limitations

If you are reading this story through a third party distribution channel and you cannot see charts included, we apologise, but technical limitations are to blame.

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Uranium Week: Producer Power

Cameco's guidance on intended purchases prompted another step-up in the uranium spot price last week.

-Cameco reveals buying intentions -Spot price rises yet again -Forward curve narrowing

By Greg Peel

Canada is the world's second largest producer of uranium and Canadian-listed Cameco is the world's largest corporate producer of uranium. Or at least it was, until the company temporarily but indefinitely slashed production in the face of non-commercial prices.

Rather than producer uranium at a loss, Cameco has spent the year buying uranium on the spot market to satisfy delivery contracts. The company's September quarter earnings report, released last week, showed a year on year drop in uranium production of -52% to 1.5mlbs U3O8, but a 15% increase in sales volumes to 10.6mlbs. Sales averaged US$30.18/lb or -7% less than last year.

Producer purchases, along with investor interest, has driven the uranium spot price up 27% above the 2017 average price, with the impact more noticeable in past weeks. The question is: How long will Cameco and others keep buying in uranium for before the price is sufficient to restart production?

Cameco has not revealed that price, but it did reveal at its result release that it intends to buy another 1-3mlbs in the spot market through to year-end and a further 10-12mlbs in 2019.

The spot market was quiet for most of the week as market participants attended the annual International Uranium Fuel Seminar in Boston, and industry consultant TradeTech's spot price indicator remained unchanged. Right up until Friday, when Cameco released its report.

TradeTech's weekly spot price indicator closed up US80c on Friday at US$28.80/lb on 2mlbs of U3O8 equivalent changing hands during the week, most of it on Friday.

Flattening Curve

The month of October ended Wednesday, at which point the spot indicator was US$28.00/lb, up from US$27.65/lb at end-September. A total of 47 transactions were recorded in the month, representing 6mlbs U3O8 equivalent.

Increased activity in the spot market has come at the expense of the term markets. The bulk of requests at present is for 2019 delivery, which counts as spot, or mid-term delivery, while interest in longer term delivery has gone quiet, TradeTech notes. There are term market tenders out there but last month saw little action.

The result is the gap between spot and term pricing is continuing to narrow. TradeTech's end-October mid-term price indicator of US$30.00/lb remains unchanged from end-September, and spot is closing the gap fast, while the consultant has lowered its long-term indicator to US$30.00/lb as well, down from US$31.00/lb.

At this rate, the market will be in backwardation by next year. That might spark up some utility interest.

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

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 UIKeyInputLeftArrowamounts 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 November 1, 2018

Last week began with the ASX200 still correcting, but then came the sharp bounce.

In the prior couple of weeks, as the correction played out, I had noted that the plunging market had sparked little in the way of profit-taking on short positions. Well it appears the shorters were either expecting more downside, or were poised to cash in on any sign of a turnaround, or both.

There is an awful lot of green on the table below, and some big moves in percentage point terms.

The stocks with the biggest short reductions include JB Hi-Fi ((JBH)), BWX ((BWX)), Super Retail ((SUL)), all of which held AGMs last week, and IOOF Holdings ((IFL)), which provided a quarterly update.

Other big movers, for which there was no specific news last week, include Inghams Group ((ING)), Nine Entertainment ((NEC)) and CSR ((CSR)). CSR's earnings result came out earlier this week. Yesterday Ingham's announced a capital return.

All these stocks rate as "Movers & Shakers" for the week, and I will highlight the actual short position changes below. Those holding AGMs did see direct market responses, good or bad, but in the context of the market in general bottoming out, we might assume it was a rush to lock in profits before it was too late that drove most of the short-covering.

As an aside, we note AMP ((AMP)), which fell -25% at the beginning of last week, saw only a slight short reduction, to 5.5% from 6.3%.

We might also note that while Corporate Travel Management ((CTD)) has been under siege recently from a short-side hedge fund, its short position was recorded last week as only 4%.

Weekly short positions as a percentage of market cap:

10%+

ORE 16.5 GXY 15.8 JBH 15.8 SYR 15.8 IVC 12.0 DMP 11.6 MYR 11.1 BWX 10.6 NXT 10.2

Out: ING, MTS

9.0-9.9

GEM, MTS, SDA

In: MTS Out: CSR, IFL, NEC, SUL, NUF, HVN 8.0-8.9%

HVN, NWS, NUF, BAL, LYC, NAN, KDR, GXL

In: HVN, NUF, KDR

7.0-7.9%

PLS, MND, FLT

In: FLT Out: KDR, BOQ, AAC

6.0-6.9%

AAC, MLX, HT1, SUL, IFL, RSG, BKL, IGO, MSB

In: SUL, IFL, AAC, BKL Out: FLT, AMP, BIN, SIG, SEK

5.0-5.9%

GMA, BIN, SIG, BGA, KAR, AMC, ING, VOC, APT, CGF, CCP, A2M, AMP, CLQ, CSR, CAB, MOC, PTM, RCR, ASL, RFG, ALX, NEC, AHG, CQR

In: ING, CSR, NEC, AMP, BIN, SIG, ASL, RFG, CQR

Out: BKL, NWL, GNC, MYO, SGM

Movers & Shakers

JB Hi-Fi shorts fell to 15.8% from 19.8%. AGM trading update was positive.

BWX shorts fell to 10.6% from 12.3%. Trading update was negative.

Super Retail shorts fell to 6.5% from 9.3%. Trading update was negative.

IOOF shorts fell to 6.4% from 9.9%. Broker responses to a trading update were mixed. We might note IOOF is basically a share market proxy.

Inghams shorts fell all the way to 5.8% from 13.1%. Last month the company appointed a new CEO. Yesterday a capital return was announced. No news last week.

CSR shorts fell to 5.5% from 9.9%. Last week saw brokers tweaking forecasts ahead of this week's earnings result, which was a net miss of broker forecasts.

Nine Entertainment shorts fell to 5.0% from 9.7%. The company does not have to worry about poor cricket ratings but it is in the process of merging with Fairfax Media ((FXJ)). It was last month when Nine provided more details of merger expectations.

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: Health, Housing, Auto And PRRT

Weekly Broker Wrap: health insurers; housing; automotive dealers; airlines; PRRT; Security Matters; and Netwealth.

-Catalysts ahead in private health insurance carry downside risk -Household de-leveraging expected to restrain spending growth into 2019 -Headwinds persisting for automotive dealerships -Woodside most affected by changes to PRRT

By Eva Brocklehurst

Health Insurers

The private health industry is facing substantial challenges, with Macquarie assessing that over 85% of funds could have insufficient excess capital in order to sustain two consecutive years of a 2% price cap.

Margins in the largest states are improving but premiums per policyholder are increasing more in states where participation is slipping the most. The earnings gap between the for-profit and not-for-profit funds almost doubled in FY18, which the broker suggests raises the chances for different capital rules to be imposed.

The next catalysts for the industry carry material downside risks, Macquarie believes. These include the April 2019 price increases, first half earnings results and the outcome of the federal election, due by May 2019.

Current valuations appear supportive but the broker does not believe all the catalysts are completely priced into consensus estimates and maintains a Neutral rating for both Medibank Private ((MPL)) and nib Holdings ((NHF)).

While UBS assesses the insurers are in good shape it cannot say the same for consumers or hospitals. A soft claims environment appears to have continued into FY19, positively skewing the risk to margins in the near term, although the broker acknowledges the conditions are unsustainable over the medium term.

Medibank Private has made progress in stemming its market share losses but this could prove challenging, in the broker's opinion, should the tailwind from taking share from Bupa moderate. UBS retains a Sell rating on the stock with a Neutral rating for nib Holdings.

More broadly, the sustainability challenge is highlighted by the virtual absence of any growth in policy numbers. The broker also questions whether the historical margin cap of 5.6% will prove irrelevant in a soft claims environment.

Housing

While the broader economic impact of sliding house prices has been limited to date, Morgan Stanley believes household de-leveraging will restrain spending growth into 2019. National house prices are now down -4.6% in the year to date, nationally, and auction clearance rates and sentiment have also weakened sharply.

Surveyed house price expectations have now fallen to record low levels. Meanwhile, construction appears to be responding to weaker prices and tighter credit, with a declining trend in both apartments and detached houses.

A further consideration is the proposed changes to negative gearing and capital gains tax discounts being mooted by the ALP ahead of next year's federal election. Morgan Stanley assesses the policies as positive for affordability and negative for prices and turnover.

The broker considers the decline in house prices a catalyst for de-leveraging and a meaningful headwind for bank revenues and consumer spending. However this is not necessarily recessionary while global growth and public expenditure are supportive.

Automotive Dealers

Australian car sales fell -5.3% in October 2018. All states deteriorated besides Tasmania. Passenger car sales continued to lead the decline, down -24% and partly offset by an 8% rise in sports utility vehicles.

UBS believes reductions in house prices are continuing to affect new car sales. When adjusting sales by each dealership over the 12 months, in each state, the broker estimates new car volumes over July-October, combined, were down -8.8% for Autosports Group ((ASG)) and -6.6% for Automotive Holdings ((AHG)).

The broker believes it will be difficult for Autosports to grow like-for-like volumes because of the macro outlook although, given the improving earnings and minimal exposure to flex commissions, estimates new car revenues could fall -5% and still hit FY19 estimates.

Meanwhile, Automotive Holdings has headwinds from its exposure to the slightly faster rate of decline in new car sales in Western Australia as well as the ongoing effects of regulatory changes that, UBS estimates, could reduce finance commissions by -25%.

Wilsons believes WA held up reasonably well in the latest figures as it cycled strong growth, albeit remains cautious about the near-term outlook for Automotive Holdings as there are no notable catalysts for a recovery in consumer activity in WA.

The broker downgraded its outlook for dealerships following the July figures and believes the latest three months justifies the revised outlook. Wilsons assesses conditions remain more favourable for AP Eagers ((APE)).

Airlines

Domestic passenger growth for airlines slowed in September, with Sydney Airport ((SYD)) reporting a decline of -0.5%. Ord Minnett calculates, using bookings data from Travelport, that yields for Qantas ((QAN)) across key international routes were down -1.9% in August from a year ago. The broker notes Qantas reported domestic passenger yields increased by just 3.6% in the first quarter versus 7.0% in the prior corresponding quarter.

The broker admits the analysis focuses on just a handful of routes but believes both Qantas and Virgin Australia ((VAH)) are facing headwinds and a challenging operating environment a missed increased competition, weak demand, excess capacity and higher fuel costs. The broker has a Sell rating for Qantas and Lighten rating for Virgin Australia.

PRRT

The Australian government has responded to the Callaghan review of the Petroleum Resource Rent Tax (PRRT), reducing uplift rates over the next 10 years to Long-Term Bond Rate (LTBR) +5% from the current LTBR +15% for all production licenses granted after July 1, 2019. Historical exploration will continue to be uplifted at the prior rate and switch on July 1, 2019 to the new rate.

The government will also remove the obligation for all onshore projects. Companies had been using onshore credits to reduce PRRT on profitable offshore projects. A 12-18 months review on how LNG projects use transfer pricing to reduce PRRT obligations will also be conducted.

Macquarie envisages Woodside Petroleum ((WPL)) will be most affected by the changes, as Scarborough could potentially lose -15% of its value and the impact could be even larger for Browse, as a compounding effect of the tax shield will be diminished with the project being further away from first production.

The bigger concern is the gas transfer pricing review, which could delay projects and potentially reduce future earnings. Oil Search ((OSH)) is unaffected by the changes as its operations are in PNG and the US.

The changes are relatively modest compared to what the industry feared, Credit Suisse points out. The broker envisages a negligible impact on Woodside's earnings, for the next five years at least, and no impact on the North West Shelf. The impact on Pluto/Wheatstone is expected to be limited and there is modest impact for Scarborough and Browse.

The changes do not materially affect the broker's base case valuation. Credit Suisse concurs that the transfer pricing review into integrated LNG projects remain a more material risk to the value of existing LNG projects.

Security Matters

Security Matters ((SMX)) has a technology which can be used to mark products during the packaging and production process. Such products can be tracked throughout the supply chain to the end customer.

TMT Analytics suggests, by invisibly marking branded products and packaging, product authenticity can be guaranteed by retailers, noting losses from counterfeiting alone are in excess of US$500bn globally. The company, an Israeli B2B business, recently listed on ASX and TMT Analytics values the stock at $1.13 a share, initiating coverage with a Speculative Buy rating.

Netwealth Group

Wilsons was concerned that the trading multiples of Netwealth ((NWL)) would not accommodate a broadening of price-led competition after BT Panorama cut platform administration fees.

However, the broker is increasingly of the view that incumbent platforms will need to open up to external providers to appease the Hayne Royal Commission. This would significantly increase the addressable market for Netwealth. Removing previous discounts leads Wilsons to double upgrade to Buy from Sell. Target is $8.49.

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

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 November 5 to Friday November 9, 2018 Total Upgrades: 26 Total Downgrades: 5 Net Ratings Breakdown: Buy 44.84%; Hold 41.89%; Sell 13.27%

An interesting dynamic is unfolding inside the Australian share market post October slaughter fest. While price targets and earnings estimates are, on a net basis, falling, stockbroking analysts nevertheless see sufficient value to issue a tsunami of recommendation upgrades, only offset by a small number of downgrades; the latter mostly because corporate market updates do not meet market expectations.

For the week ending Friday, 9 November 2018, FNArena registered no less than 26 recommendation upgrades for individual ASX-listed stocks versus only four stocks receiving downgrades, of which Domino's Pizza received two. McMillan Shakespearre too is among the small selection of stocks receiving a downgrade but in this case the negative move is being compensated with two upgrades to Buy on the other end of the ledger.

The 26 upgrades represent a true potpourri of Australia's corporate variety; from the ASX, to CommBank and Corporate Travel (2x), to CSL, Lovisa, Mineral Resources, QBE Insurance, and Treasury Wine Estates (2x).

Meanwhile, four of the five downgrades only went to Neutral, with Orica and REA Group the receivers that haven't been named yet.

Offsetting the clear bias towards "value is opening up" is the observation that trends for valuations & price targets, and for underlying earnings estimates has clearly turned to the negative.

Among positive revisions to price targets, only Xero, Macquarie Group and QBE Insurance are worth mentioning. Instead, there is plenty to look out for among the negative adjustments, with CSR receiving the largest hit (-22.8%), followed by Corporate Travel, Unibal-Rodamco-Westfield, McMillan Shakespeare and Blackmores.

It's pretty much a similar picture that emerges from the tables showing revisions to earnings estimates. Certainly, Alacer Gold, National Australia Bank, Unibail-Rodamco-Westfield, a2 Milk and Macquarie Group are all enjoying positive adjustments, but their wins couldn't possibly outweigh the many heavy downward adjustments that are befalling companies including Xero, Syrah Resources, Suncorp, Wagners Holdings, CSR, and many more.

As AGM season and the release of out-of-season financial earnings reports continue this week, it will be interesting to watch whether this new dynamic is turning into the new trend for the Australian share market.

Upgrade

ASX LIMITED ((ASX)) Upgrade to Hold from Sell by Deutsche Bank .B/H/S: 0/3/5

ASX has made a strong start to FY19 from a cash market perspective, Deutsche Bank observes, with the value traded up 17% for the first four months of the year on a 17% increase in volume traded.

The recent market correction, nevertheless, is expected to drag on capital raisings for the next six months.

The pullback in the share price now means the stock is in line with fair value and the broker upgrades to Hold from Sell. $58.50 target maintained.

COMMONWEALTH BANK OF AUSTRALIA ((CBA)) Upgrade to Outperform from Neutral by Credit Suisse .B/H/S: 2/5/1

Following the first quarter trading update Credit Suisse upgrades FY19-21 earnings estimates by 3%. Compositionally, the broker notes a robust update, with falling operating expenses and a strong capital position.

It seems to the broker that many of the regulatory and compliance headwinds have been, or are being, dealt with. Therefore, a focus on cost reductions is expected and capital management also enters the scene.

Credit Suisse upgrades to Outperform from Neutral and raises the target to $78 from $75.

COCHLEAR LIMITED ((COH)) Upgrade to Buy from Neutral by Citi .B/H/S: 1/4/2

A US court has awarded damages of US$268m against Cochlear in a patent infringement case. As the patent in the litigation has expired the judgment will not disrupt the company's business in the US.

Cochlear will appeal the judgment, a process that is expected to take up to two years. To stay the execution of the outcome pending appeal Cochlear will need to lodge a US$335m insurance bond with the court.

As a consequence of the recent fall in the share price Citi has upgraded to Buy from Neutral and reduced the target price to $202 from $220.

CSL LIMITED ((CSL)) Upgrade to Buy from Neutral by UBS .B/H/S: 5/3/0

UBS has had a look at third quarter results from CSL competitors and also adjusted for forex in lowering its earnings forecasts by -6% across the forecast period, resulting in a target price cut to $220 from $232.

However despite competitive pressures, the broker believes CSL can still deliver compound earnings growth of 11% over three years. UBS looks forward to the company's investor day on December 5 and on valuation has upgraded to Buy from Neutral.

CSR LIMITED ((CSR)) Upgrade to Buy from Hold by Deutsche Bank .B/H/S: 2/4/0

First half net profit was below expectations, largely because of a worse result from property, which is now heavily skewed to the second half. Deutsche Bank believes the company's varied end markets help offset a decline in residential volumes and building product margins.

The broker recognises some earnings risk in aluminium but believes the alumina/aluminium link is likely to return to its historical ratio by the time CSR has a new contract in January 2020.

Rating is upgraded to Buy from Hold as the stock is trading at a significant discount to peers.

CORPORATE TRAVEL MANAGEMENT LIMITED ((CTD)) Upgrade to Add from Hold by Morgans and Upgrade to Buy from Hold by Ord Minnett .B/H/S: 3/2/0

Having reviewed the VGI reports and the increased disclosure from Corporate Travel, Morgans has more confidence in the company's business model, growth strategy and financials.

The broker continues to believe the reports contained a number of inaccuracies and are unfounded. The broker retains forecasts and expects strong earnings growth.

Morgans believes the stock has been severely oversold, which provides the opportunity to buy a company with solid long-term growth potential.

Rating is upgraded to Add from Hold. Target is raised to $26.72 from $23.30.

Ord Minnett suggests investors take the opportunity to build a position in the stock, after weakness stemming from the issues raised in the recent report on the company's business signalled some sloppy attention to detail regarding patents and the status of offices.

Organic growth, acquisitions and investment in technology are driving margins higher, and the broker believes the key to understanding this business is the importance of the scale and leverage this creates.

Ord Minnett upgrades to Buy from Hold. Target is steady at $30.30.

GALAXY RESOURCES LIMITED ((GXY)) Upgrade to Overweight from Equal-weight by Morgan Stanley .B/H/S: 4/1/0

After a significant correction in the share price Morgan Stanley upgrades Galaxy Resources to Overweight from Equal-weight.

While maintaining a negative house view on lithium prices, the broker envisages a valuation gap has emerged which may close as near term catalysts approach, such as the sale process at Sal de Vida and resource drilling results at

Mount Cattlin.

Moreover, after receiving cash from POSCO the broker expects a cash balance of around US$270m, roughly 1/3 of the market capitalisation. Target is raised to $2.90 from $2.85. Industry View: In-Line.

INDEPENDENCE GROUP NL ((IGO)) Upgrade to Equal-weight from Underweight by Morgan Stanley .B/H/S: 2/4/0

After recent commodity price weakness Morgan Stanley envisages upside for the near term for both nickel and gold prices. Hence, valuation support has emerged for Independence Group, leading to an upgrade to Equal-weight from Underweight.

Drilling currently underway at Nova could provide a near-term catalyst for the stock, the broker adds. Moreover, management has flagged a move to dividends based on free cash flow in the near future, which could improve yield significantly.

Industry view is: In-Line. Target is raised to $4.40 from $4.15.

INCITEC PIVOT LIMITED ((IPL)) Upgrade to Outperform from Neutral by Credit Suisse .B/H/S: 4/3/0

Ahead of the FY18 result on November 13, Credit Suisse upgrades to Outperform from Neutral. The broker suspects the market is playing catch up on fertiliser prices and the tightening supply for explosives in eastern Australia.

Assumptions for fertiliser prices drive upgrades to the broker's earnings estimate and the target is increased to $4.33 from $4.02.

As the company is intent on maintaining its dominance of the Bowen Basin the next major capital project is likely to be an expansion of the ammonia capacity at Moranbah to support additional ammonium nitrate production, Credit Suisse suggests.

LOVISA HOLDINGS LIMITED ((LOV)) Upgrade to Equal-weight from Underweight by Morgan Stanley .B/H/S: 3/1/0

The stock has traded down -40% from its peak and, while headwinds continue, Morgan Stanley believes it is far more reasonably priced now. The broker envisages increased traction from the global roll-out of stores and e-commerce offering.

Further softening is envisaged ahead of Christmas as tough comparables are cycled.

The risk/reward is now more balanced and the broker upgrades to Equal-weight from Underweight. Target is reduced to $8.40 from $9.50. Industry view is In-Line.

MINERAL RESOURCES LIMITED ((MIN)) Upgrade to Accumulate from Hold by Ord Minnett .B/H/S: 2/1/0

Ord Minnett notes the global lithium sector has shown signs of life following a price increase for battery and industrial grade in China's spot market. Despite the continued focus on spot prices, which the broker deems irrelevant, all other electric vehicle link data remain positive.

Ord Minnett upgrades to Accumulate from Hold, given share price weakness and a view that the risk/reward ratio is now skewed to the upside. Target is steady at $18.

MCMILLAN SHAKESPEARE LIMITED ((MMS)) Upgrade to Outperform from Neutral by Macquarie and Upgrade to Outperform from Neutral by Credit Suisse .B/H/S: 3/2/0

The company has announced an intention to merge with EclipX ((ECX)). Macquarie calculates the bid, of $0.46 cash and 0.1414 McMillan Shakespeare shares, represents a 17% premium to the last close for EclipX.

Macquarie calculates more than 30% accretion post synergies. The broker upgrades to Outperform from Neutral and suspects the market is either not rating the combined business, does not trust EclipX earnings or does not believe the synergies. Target is raised to $17.41 from $16.54.

The company has agreed a merger with EclipX ((ECX)), offering 0.1414 shares plus $0.46 cash per each EclipX share. Credit Suisse upgrades to Outperform from Neutral, regarding the stock is attractively valued even prior to the proposed merger.

The broker believes the strategic rationale is sound and the majority of the synergy benefits are achievable. Target is reduced to $17.65 from $18.55 because of a lower market multiple.

See also MMS downgrade.

MACQUARIE GROUP LIMITED ((MQG)) Upgrade to Accumulate from Hold by Ord Minnett .B/H/S: 4/3/0

Net profit in the first half was ahead of Ord Minnett forecasts. The upgrade to guidance has come more quickly than usual, which the broker suggests reflects confidence in the outlook, as it does not yet include the Quadrant Energy sale.

Strength appears set to continue for the near term and the broker raises FY19-21 profit forecasts by 7-9%. Rating is upgraded to Accumulate from Hold and the target elevated to $132 from $117.

ORICA LIMITED ((ORI)) Upgrade to Outperform from Neutral by Credit Suisse .B/H/S: 1/5/1

Credit Suisse is confused as to whether the FY18 result is merely about optics from a business that has been under pressure. The broker cites several reasons to be cautious because of the recent history and operating issues at Burrup.

The upside case is created by a tightening of supply/demand in the Australia Pacific region. While not 100% convinced, Credit Suisse still suspects profits will be carried higher over the medium term and upgrades to Outperform from Neutral. Target is raised to $19.08 from $17.60.

See also ORI downgrade.

OIL SEARCH LIMITED ((OSH)) Upgrade to Neutral from Sell by Citi .B/H/S: 2/4/0

Citi now considers the ASX energy sector fairly priced but ASX names are not being priced at a premium to global peers. Under price assumptions of US$70/bbl for oil and US$9/mmbtu for LNG in the long term the stock would be trading at a -21% discount to the broker's valuation, before considering the dividend yield.

The broker upgrades to Neutral from Sell. Target is raised to $7.42 from $7.07.

QBE INSURANCE GROUP LIMITED ((QBE)) Upgrade to Outperform from Neutral by Credit Suisse .B/H/S: 6/2/0

While the company has operated in a difficult market over the past five years, Credit Suisse notes premium rates have turned positive in early 2018 and premium rate increases have been maintained.

The broker reassesses the growth opportunity and has a more optimistic view. The company is expected to update the market in early December on potential cost reductions.

Credit Suisse upgrades to Outperform from Neutral and raises the target to a $13 from $11.

REA GROUP LIMITED ((REA)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 4/3/0

Macquarie observes a very strong first quarter result, with the drivers being the take-up of depth products as well as new revenue from commercial and developer segments.

The broker finds it hard to fault the trajectory of the business, despite the macro trends. A strong FY19 is expected and Macquarie upgrades to Outperform from Neutral. Target is unchanged at $90.

See also REA downgrade.

SMARTGROUP CORPORATION LTD ((SIQ)) Upgrade to Add from Hold by Morgans .B/H/S: 6/0/0

Smartgroup's share price has fallen some -20% since its peak post result in August, Morgans notes. While new car sales have indeed been weak in the Sep Q, the broker expects novated demand has remained resilient, as suggested by peer McMillan Shakespeare ((MMS)).

Consistent demand, combined with a focus on operational efficiencies and further acquisition potential, leads Morgans to consider the stock is now trading at a reasonable valuation. Target falls to $11.65 from $12.62 but rating upgraded to Add from Hold on the gap to share price.

TREASURY WINE ESTATES LIMITED ((TWE)) Upgrade to Overweight from Equal-weight by Morgan Stanley and Upgrade to Outperform from Neutral by Macquarie .B/H/S: 4/2/1

Morgan Stanley believes the sell-off since the FY18 results provides an attractive entry point to a unique growth story. Concerns regarding growth in China are overplayed and the broker suggests Treasury Wine's earnings drivers are under appreciated.

The broker's view across multiple stocks/countries indicates there is no slowdown in China and a healthy 18% compound earnings growth is still envisaged for FY19-21.

Rating is upgraded to Overweight from Equal-weight. $20 target retained. Industry view: Cautious.

Macquarie reviews the investment thesis for Treasury Wine following the recent de-rating of the stock. The broker is increasingly convinced about margin improvement in the US, which remains a significant growth opportunity.

The broker also expects the company to remain on the acquisition trail, principally focused on the US. Successful execution of US distribution changes presents margin upside of around 2-2.5%, in Macquarie's opinion.

Rating is upgraded to Outperform from Neutral. Target is raised to $18.22 from $17.15.

WORLEYPARSONS LIMITED ((WOR)) Upgrade to Outperform from Neutral by Credit Suisse .B/H/S: 3/3/0

Since the company announced an intention to buy the ECR business from Jacob's Engineering the stock has traded well below the entitlement issue price. Still, Dar Group's intention to take up all its entitlement is a sign of confidence in the deal, Credit Suisse suggests.

Despite the amount of entitlement stock to be absorbed, which may suppress the share price, Credit Suisse moves to Outperform from Neutral on the medium-term outlook. Target is steady at $17.60.

WOODSIDE PETROLEUM LIMITED ((WPL)) Upgrade to Neutral from Sell by Citi .B/H/S: 3/3/1

Citi now considers the ASX energy sector fairly priced but ASX names are not being priced at a premium to global peers. Under price assumptions of US$70/bbl for oil and US$9/mmbtu for LNG in the long term the stock would be trading at a -14% discount to the broker's valuation, before considering the dividend yield.

Meanwhile, the changes announced by the Commonwealth government to the petroleum resource rent tax have resulted in a -5% reduction to the broker's valuation of Woodside.

Rating is upgraded to Neutral from Sell. Target is reduced to $32.91 from $34.64.

WESTERN AREAS NL ((WSA)) Upgrade to Equal-weight from Underweight by Morgan Stanley .B/H/S: 5/2/0

As the project metrics at Odysseus have improved and there is upside for the nickel price, Morgan Stanley upgrades to Equal-weight from Underweight.

Nevertheless, limited mine life at the Forrestania assets and risks related to construction and commissioning of Odysseus provide higher pre-production expenditure estimates of $299m.

Industry view is In-Line. Target is reduced to $2.50 from $2.55.

XERO LIMITED ((XRO)) Upgrade to Buy from Lighten by Ord Minnett .B/H/S: 2/4/1

Ord Minnett observes the business has underperformed global peers over the past month, falling to what is now deemed an attractive entry price. First half results are due on November 8 and the broker believes the focus will be on subscriber growth and acquisitions.

Ord Minnett envisages 17% upside to its valuation and upgrades the rating to Buy from Lighten. Target is increased to $48 from $42.

Downgrade

DOMINO'S PIZZA ENTERPRISES LIMITED ((DMP)) Downgrade to Neutral from Buy by UBS and Downgrade to Reduce from Hold by Morgans .B/H/S: 2/1/4

At its AGM, Domino's reiterated FY19 earnings guidance and planned store openings, albeit the latter comes with a greater skew to the second half. UBS has trimmed its first half earnings forecast slightly.

The broker is a fan of the company but having outperformed the ASX200 Industrials by 24% year to date, valuation is now fair and the broker thus pulls back to Neutral from Buy. Target unchanged at $57.

The trading update has revealed a further slowing in same-store sales momentum, particularly in Australasia and Europe. FY19 underlying operating earnings guidance of $227-247m was reiterated, although Morgans suggests the upper end is stretched following this latest update.

While the launch of new menus should assist sales growth, the broker awaits greater clarity on the top-line momentum. Rating is downgraded to Reduce from Hold, based on fundamentals. Target is reduced to $50.01 from $51.28.

MCMILLAN SHAKESPEARE LIMITED ((MMS)) Downgrade to Hold from Buy by Ord Minnett .B/H/S: 3/2/0

The transaction with EclipX ((ECX)) has caused Ord Minnett to pause, downgrading to Hold from Buy, as further assessment is made of the combined entity. The combined entity becomes much more of a fleet management play with less salary packaging/novated leasing as a percentage.

The broker is uncertain regarding the ongoing contribution from the Right2Drive business, as McMillan Shakespeare management were unwilling to commit to this on the conference call. Target is reduced to $16.00 from $20.50.

See also MMS upgrade.

ORICA LIMITED ((ORI)) Downgrade to Equal-weight from Overweight by Morgan Stanley .B/H/S: 1/5/1

FY18 results were ahead of Morgan Stanley's estimates. Australia Pacific and Latin America stood out. EMEA disappointed. The broker considers the guidance vague albeit consistent with forecasts.

Permanent repairs are expected to make the Burrup ammonium nitrate plant fully available for use in the first half of FY20. These issues of reliability cloud the medium-term outlook for the broker.

Rating is downgraded to Equal-weight from Overweight. Target is reduced to $17.90 from $18.90. Industry view is Cautious.

See also ORI upgrade.

REA GROUP LIMITED ((REA)) Downgrade to Hold from Accumulate by Ord Minnett .B/H/S: 4/3/0

First quarter results were stronger than expected, benefiting from continued growth in depth products and softer-than-expected declines in new listings. There was strong growth in the developer and commercial segments.

Ord Minnett increases developer revenue growth estimates to 10% for FY19 and continues to expect 10% growth in commercial revenues.

As the stock is trading in line with the $79 target the broker downgrades the rating to Hold from Accumulate.

See also REA upgrade.

Total Recommendations Recommendation Changes

Broker Recommendation Breakup

Broker Rating Order Company New Rating Old Rating Broker Upgrade 1 ASX LIMITED Neutral Sell Deutsche Bank 2 COCHLEAR LIMITED Buy Neutral Citi 3 COMMONWEALTH BANK OF AUSTRALIA Buy Neutral Credit Suisse 4 CORPORATE TRAVEL MANAGEMENT LIMITED Buy Neutral Morgans 5 CORPORATE TRAVEL MANAGEMENT LIMITED Buy Neutral Ord Minnett 6 CSL LIMITED Buy Neutral UBS 7 CSR LIMITED Buy Neutral Deutsche Bank 8 GALAXY RESOURCES LIMITED Buy Neutral Morgan Stanley 9 INCITEC PIVOT LIMITED Buy Neutral Credit Suisse 10 INDEPENDENCE GROUP NL Neutral Sell Morgan Stanley 11 LOVISA HOLDINGS LIMITED Neutral Sell Morgan Stanley 12 MACQUARIE GROUP LIMITED Buy Neutral Ord Minnett 13 MCMILLAN SHAKESPEARE LIMITED Buy Neutral Macquarie 14 MCMILLAN SHAKESPEARE LIMITED Buy Neutral Credit Suisse 15 MINERAL RESOURCES LIMITED Buy Neutral Ord Minnett 16 OIL SEARCH LIMITED Neutral Sell Citi 17 ORICA LIMITED Buy Neutral Credit Suisse 18 QBE INSURANCE GROUP LIMITED Buy Neutral Credit Suisse 19 REA GROUP LIMITED Buy Neutral Macquarie 20 SMARTGROUP CORPORATION LTD Buy Neutral Morgans 21 TREASURY WINE ESTATES LIMITED Buy Neutral Macquarie 22 TREASURY WINE ESTATES LIMITED Buy Neutral Morgan Stanley 23 WESTERN AREAS NL Neutral Sell Morgan Stanley 24 WOODSIDE PETROLEUM LIMITED Neutral Sell Citi 25 WORLEYPARSONS LIMITED Buy Neutral Credit Suisse 26 XERO LIMITED Buy Sell Ord Minnett Downgrade 27 DOMINO'S PIZZA ENTERPRISES LIMITED Sell Neutral Morgans 28 DOMINO'S PIZZA ENTERPRISES LIMITED Neutral Buy UBS 29 MCMILLAN SHAKESPEARE LIMITED Neutral Buy Ord Minnett 30 ORICA LIMITED Neutral Buy Morgan Stanley 31 REA GROUP LIMITED Neutral Buy Ord Minnett Recommendation Positive Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 CTD CORPORATE TRAVEL MANAGEMENT LIMITED 60.0% 20.0% 40.0% 5 2 TWE TREASURY WINE ESTATES LIMITED 36.0% 7.0% 29.0% 7 3 LOV LOVISA HOLDINGS LIMITED 75.0% 50.0% 25.0% 4 4 XRO XERO LIMITED 14.0% -7.0% 21.0% 7 5 REA REA GROUP LIMITED 57.0% 36.0% 21.0% 7 6 GXY GALAXY RESOURCES LIMITED 80.0% 60.0% 20.0% 5 7 MMS MCMILLAN SHAKESPEARE LIMITED 60.0% 40.0% 20.0% 5 8 CSL CSL LIMITED 56.0% 38.0% 18.0% 8 9 MIN MINERAL RESOURCES LIMITED 50.0% 33.0% 17.0% 3 10 SIQ SMARTGROUP CORPORATION LTD 100.0% 83.0% 17.0% 6 Negative Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 URW UNIBAIL-RODAMCO-WESTFIELD 33.0% 67.0% -34.0% 3 2 DMP DOMINO'S PIZZA ENTERPRISES LIMITED -31.0% -6.0% -25.0% 8 3 BKL BLACKMORES LIMITED -50.0% -33.0% -17.0% 4 Target Price Positive Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 XRO XERO LIMITED 44.086 41.514 6.20% 7 2 MQG MACQUARIE GROUP LIMITED 128.114 122.100 4.93% 7 3 QBE QBE INSURANCE GROUP LIMITED 12.108 11.858 2.11% 8 4 IPL INCITEC PIVOT LIMITED 4.177 4.133 1.06% 7 5 IGO INDEPENDENCE GROUP NL 4.433 4.392 0.93% 6 6 TWE TREASURY WINE ESTATES LIMITED 18.396 18.244 0.83% 7 7 OSH OIL SEARCH LIMITED 9.065 9.007 0.64% 6 8 GXY GALAXY RESOURCES LIMITED 3.420 3.410 0.29% 5 9 CSL CSL LIMITED

213.825 213.575 0.12% 8 Negative Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 CSR CSR LIMITED 3.742 4.848 -22.81% 6 2 CTD CORPORATE TRAVEL MANAGEMENT LIMITED 28.144 31.900 -11.77% 5 3 URW UNIBAIL-RODAMCO-WESTFIELD 16.290 17.645 -7.68% 3 4 MMS MCMILLAN SHAKESPEARE LIMITED 17.380 18.286 -4.95% 5 5 BKL BLACKMORES LIMITED 113.000 117.333 -3.69% 4 6 LOV LOVISA HOLDINGS LIMITED 9.678 9.953 -2.76% 4 7 MIN MINERAL RESOURCES LIMITED 17.833 18.167 -1.84% 3 8 COH COCHLEAR LIMITED 180.730 183.105 -1.30% 8 9 SIQ SMARTGROUP CORPORATION LTD 12.778 12.940 -1.25% 6 10 WPL WOODSIDE PETROLEUM LIMITED 37.507 37.754 -0.65% 7 Earning Forecast Positive Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 AQG ALACER GOLD CORP 3.264 1.493 118.62% 4 2 NAB NATIONAL AUSTRALIA BANK LIMITED 228.543 204.957 11.51% 8 3 URW UNIBAIL-RODAMCO-WESTFIELD 101.058 92.872 8.81% 3 4 A2M THE A2 MILK COMPANY LIMITED 33.837 31.325 8.02% 6 5 MQG MACQUARIE GROUP LIMITED 855.233 812.817 5.22% 7 6 EVN EVOLUTION MINING LIMITED 13.799 13.656 1.05% 8 7 OGC OCEANAGOLD CORPORATION 30.160 29.862 1.00% 6 8 CMW CROMWELL PROPERTY GROUP 7.800 7.733 0.87% 3 9 IPL INCITEC PIVOT LIMITED 18.308 18.183 0.69% 7 10 REA REA GROUP LIMITED 255.271 253.871 0.55% 7 Negative Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 XRO XERO LIMITED -1.395 7.964 -117.52% 7 2 SYR SYRAH RESOURCES LIMITED -6.041 -5.045 -19.74% 5 3 SUN SUNCORP GROUP LIMITED 75.017 88.383 -15.12% 8 4 WGN WAGNERS HOLDING COMPANY LIMITED 14.453 16.837 -14.16% 3 5 CSR CSR LIMITED 34.182 37.678 -9.28% 6 6 GXY GALAXY RESOURCES LIMITED 5.325 5.848 -8.94% 5 7 NST NORTHERN STAR RESOURCES LTD 50.550 55.383 -8.73% 7 8 SXY SENEX ENERGY LIMITED 1.500 1.620 -7.41% 5 9 MIN MINERAL RESOURCES LIMITED 134.433 140.733 -4.48% 3 10 JHX JAMES HARDIE INDUSTRIES N.V. 95.357 98.886 -3.57% 7 Technical limitations

If you are reading this story through a third party distribution channel and you cannot see charts included, we apologise, but technical limitations are to blame.

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Uranium Week: The Chase Is On

As interest from financial investors and ongoing producer purchases continue to push up the uranium spot price, utilities are now in a hurry to top up supplies before year end.

-UTC launches IPO -Purchases for year-end increasing -Utilities back in the game

By Greg Peel

As producer purchases of uranium continue to underpin spot prices, with Cameco now having specifically disclosed its purchase intentions through 2018-19 (See: Producer Power from last week), the spotlight swung back last week to the other non-end-users of uranium, financial investors.

Investment vehicle Uranium Trading Corp launched its initial public offering last Wednesday, looking to raise US$50m, with pricing expected this week. UTC will list on the NYSE.

According to UTC's statement, the company will focus on 1) commercial business and trading opportunities in the international uranium market to generate value for UTC investors with defined risk exposure; and 2) a pathway for interested investors to invest in the storage of physical uranium with the goal of achieving capital appreciation as a result of price increases due to expected future fundamental supply and demand imbalances.

At this stage at least, the latter focus dominates. At least 85% of proceeds will initially be directed towards the purchase of U3O8.

The pending IPO was announced in June so no surprises, and while Cameco may have the week before disclosed its actual shopping list, purchaser buying has been underpinning the market for some time, as utilities seemingly dither about if or when to jump in.

Utilities have mostly stayed on the sidelines in past months given the uncertainty surrounding the US section 232 investigation by the Trump administration into whether support for US uranium producers should be considered a matter of "national security" in the face of cheap imports from both friend and foe. The outcome of the investigation, which could yet be some time off, could well impact on uranium pricing.

But with the spot uranium price now up 45% from its 2018 low and 64% up from the twelve-year low of US$17.75/lb marked in December 2016, utilities appear to have become more anxious.

Two utilities are currently negotiating with potential suppliers for mid-term deliveries, industry consultant TradeTech reports, one for 10.8mlbs over 2019-23.

Two new utilities entered the market last week looking for sizeable quantities in both the mid and long term periods, one for 2.65mlbs beginning 2020.

At the short end of the curve, things are getting shorter. Until last week the bulk of material traded in the spot market involved delivery in 2019, last week the majority of traded volume called for delivery before year-end. A total of 1.3mlbs U3O8 equivalent changed hands over the week at consistently rising prices.

TradeTech's weekly spot price indicator rose US30c to US$29.10/lb.

With the consultant's term price indicators set at US$30.00/lb (mid) and US$31.00/lb (long), the forward curve continues to flatten.

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

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 UIKeyInputLeftArrowamounts 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 November 8, 2018

Last week the ASX200 continued to rally back ahead of the week's renewed tumble.

Last week I was very close to adding a caveat to the Report, being "assuming ASIC data is correct". I should have. Last week's ASIC data were rubbish.

Last week had JB Hi-Fi ((JBH)) shorts falling from 19.8% to 15.8%. This week they're back to 19.0%.

Ditto Super Retail ((SUL)), 9.3% to 6.5% and back to 9.6%.

IOOF ((IFL)): 9.9%, 6.4%, 10.4%.

Inghams Group ((ING)): 13.1%, 5.8%, 13.0%.

CSR ((CSR)): 9.9%, 5.5%, 10.2%.

Nine Entertainment ((NEC)): 9.7%, 5.0%, 8.6%.

The most frustrating thing about these data anomalies is my attempts to justify the previous week's move both individually and in terms of a general market rebound. A lot of the other smaller moves of last week have also reversed, suggesting the whole data set was, for reasons I cannot fathom, completely misleading. It cannot simply be shorters being slow to report positions.

It is with this in mind I hold by breath and note that in this week's table, reflecting last week's positions, Greencross ((GXL)) shorts have fallen to 5.8% from 8.0% and Lynas Corp ((LYC)) shorts have fallen to 5.8% from 8.2%.

Greencross confirmed a private equity takeover bid last week and fears regarding Lynas' processing plant in Malaysia have been easing. Both stocks rallied last week and short position reductions are justifiable.

If they're true.

Weekly short positions as a percentage of market cap:

10%+

JBH 19.0 SYR 16.5 GXY 15.4 ORE 15.0 ING 13.0 MTS 12.3 DMP 11.7 IVC 11.2 BWX 11.1 MYR 10.8 IFL 10.4 CSR 10.2 NXT 10.0

Out: ING, MTS, IFL, CSR

9.0-9.9

GEM, SUL

In: SUL Out: MTS, SDA 8.0-8.9%

HVN, SDA, NEC, BAL, NWS, NUF, LYC, NAN, KDR, GXL

In: SDA, NEC Out: NUF, LYC, NAN, KDR, GXL

7.0-7.9%

KDR, NUF, NAN, FLT, MND

In: KDR, NUF, NAN Out: PLS

6.0-6.9%

PLS, BOQ, AMP, AAC, BKL, MLX, HT1, AMC, MSB, GMA

In: PLS, BOQ, AMP, AMC, GMA Out: IFL,SUL. RSG, IGO

5.0-5.9%

GXL, A2M, LYC, RSG, SEK, APT, KAR, CLQ, CCP, CGF, BGA, IGO, VOC, RCR, CAB, SIG, BIN, AHG, PTM

In: GXL, LYC , RSG, IGO, SEK

Out: ING, CSR, NEC, AMP, AMC, GMA, MOC, ASL, RFG, ALX, CQR

Movers & Shakers

I do not wish to make a fool of myself two weeks in a row.

ASX20 Short Positions (%)

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

IMPORTANT INFORMATION ABOUT THIS REPORT

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

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

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

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

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

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

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

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

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

The Wrap: Canaries, 5G, Telcos & IP Services

Weekly Broker Wrap: canaries; monetary policies; 5G; telcos and IP services.

-Early warnings growing for deterioration in Australian economy -Global monetary policies remain on a gradual path -Southern Asia-Pacific at the centre of the next-generation technologies -Telstra obtains greater share of net NBN additions in the September quarter -Recovery indicated in IP services market

By Eva Brocklehurst

Canaries

The list of early warning indicators of a deterioration in the Australian economy has grown. Bailieu Holst has now found seven "canaries in the coal mine" and is increasingly concerned about the outlook for the domestic economy.

The seven indicators include: vehicle sales, down -4.1% year-on-year; home prices, down -4.6% with a -45% decline in auction sales; housing finance, down -27% for investors and -14% for owner occupiers from peaks; money supply growth, down -2%; business confidence (NAB survey) below average; drought; and slowing job advertisements (ANZ series).

The signals are for lower consumption, slower business investment and weaker jobs growth, which in turn indicates demand and earnings growth in the private economy will be soft. The broker remains underweight on domestic sectors such as retail, media, housing and banks.

Monetary Policies

ANZ analysts point out that while US GDP momentum remains above trend, there are signs the interest-rate sensitive sectors are coming under pressure. The analysts expect the effects of the US tax cuts will fade from the second quarter in 2019 and growth will moderate towards trend. The analysts are also sceptical of any meaningful progress on the US/China trade tensions.

Meanwhile, oil prices have weakened and headline rates of inflation are expected to ease. The US Federal Reserve has indicated it may still be some way from creating a neutral rate setting, and there is no evidence the analysts can find that the Fed considers interest rates have reached an appropriate level. Estimates suggest the Fed may be close to neutral but current growth rates remain a concern.

Growth in the euro area has disappointed over 2018 and while expansion is in place, the analysts note manufacturing is suffering. The European Central Bank will reassess the outlook at its policy meeting on December 13. The ANZ analysts still expect quantitative easing to end next month but risks exist for the forward guidance to be even more gradual.

At the October meeting, the Bank of Japan reduced its inflation view, which indicates an extended period of keeping rates low has become even longer. The Bank of Japan is also growing more concerned about the downside risk to inflation and mounting financial instability risks.

5G

MIT's Technology Review puts the southern Asia-Pacific in the centre of next-generation technologies such as a artificial intelligence, big data, blockchain, robotics and connected devices. The robotics and advanced manufacturing that are well established in eastern Asia are now spreading to Singapore and Malaysia. Consumer application in emerging markets such as Indonesia and the Philippines are booming on the back of widening access to the internet.

The analysis finds deep knowledge of local consumption and needs allowed home-grown companies to excel and brush off overseas competitors. The first impact is expected on manufacturing and subsequently smart cities and autonomous vehicles.

The majority of companies surveyed across the six markets in the review expect 5G to be launched in 2020. 5G is expected to boost efficiency and 51% of companies are investing in technologies that can be deployed when 5G is launched.

The review calls for clear, robust rules in order to put digital innovation on a sound footing as 5G intensifies the challenges surrounding data privacy. One forecast canvassed by the review predicts that 60% of the wider Asia Pacific region's GDP will be derived from digital products or services by 2021.

Telcos

The latest Australian Competition and Consumer Commission disclosures on the NBN indicate Telstra ((TLS)) obtained a greater share of net additions. UBS estimates Telstra won 52.4% in the September quarter versus its overall share of 49.8%. TPG Telecom ((TPG)) has also lifted its share to 19.6% of net additions. Vocus ((VOC)) has lost momentum, taking only 7.1% share of net additions.

The roll-out retains its original skew with around 61% of net additions in the September quarter in regional areas. Macquarie notes Telstra has stronger share in regional areas and expects the overall share to ease back as the connections become more biased towards metro.

UBS believes, while a high NBN share is strategically favourable for Telstra's customer relationship, this will only translate to higher near-term profitability if wholesale prices change. The broker also believes slower subscriber growth for TPG Telecom is somewhat factored into expectations. Macquarie points out TPG Telecom tends to outperform in metro areas and may experience improvement as the roll-out shifts in coming quarters.

The slowdown in net additions for Vocus is an incremental negative. Still, UBS believes the challenges for Vocus are well understood and the company has already flagged a skew to the second half. Macquarie observes Vocus has changed its strategy to concentrate on digital channels over the more expensive customer acquisition channels. The Dodo brand was relaunched in late August.

Overall, Macquarie remains cautious on the outlook for the Australian telecommunications market as competitive dynamics pressure revenue and earnings across all segments.

IP Services

A market recovery is being signalled for the intellectual property services industry. Bell Potter analyses the market based on data sourced from IP Australia. Filing numbers in the nine months to September 30 were up 3.0% and the data is likely to be revised higher, the broker suspects. The number of patent filings provides a relatively early indicator of potential examination workflow.

The number of directions to request patent examinations was up 13.9%, with gains mostly in the June half year because of the depressed prior comparable period. In the September quarter directions were broadly stable.

Examination requests for the period were up 4.6%, broadly stable. This, in the broker's estimates, provides a more direct indicator of workflow over the next 12-24 months. Bell Potter maintains Buy ratings for IPH Ltd ((IPH)), Qantm IP ((QIP)) and Xenith IP ((XIP)).

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Wagners Anticipates Flat Earnings In FY19

A gap in major projects in the first half has meant earnings for concrete business Wagners will be skewed to the second half and likely to be flat over FY19.

-Market may have over-reacted to the reference to "challenges" -Main concerns centre on ability to secure concrete work with higher margins -Significant customer will be lost in FY20

By Eva Brocklehurst

The weather has played havoc with the performance of Wagners Holding Co ((WGN)) and, hence, expectations for FY19. The company has downgraded forecasts at its AGM, citing gaps in project work in its key state of Queensland.

Few major new projects getting off the ground means first half earnings will be down and a stronger second half will simply lead to a more balanced or 'flat' FY19. Projects such as Sydney's cross-city tunnel are still committed, although the timing is uncertain.

Credit Suisse believes the market has seemingly over-reacted to the company's reference to "challenges" which is likely to refer principally to the commencement of the Southern Cross cement import terminal, which is well understood and theoretically priced in to the stock.

The continuation of the sell-off in the share price, Morgans suspects, is partly attributable to the lack of visibility on FY20 trading. While major projects will be forthcoming, competition is also increasing. Still, the broker finds it hard to envisage Wagners is ex growth.

Revenue growth is being sustained from increased contributions from lower-margin divisions and and Morgans emphasises the lumpy nature of infrastructure projects that are prone to delays. Ultimately, the broker believes Wagners is well placed as a low-cost producer in south east Queensland and can achieve earnings growth in FY20.

Macquarie is more cautious about the outlook, as there is limited visibility on the pipeline of projects and the potential for margin compression. Given peer trading multiples, the broker envisages potential for further de-rating. The main concerns centre on the ability to secure the concrete work that attracts higher margins.

The slow recovery in Queensland for infrastructure and a tight fiscal position in that state indicates that volumes could remains somewhat challenged. This in turn reinforces the broker's concerns regarding the top line and earnings certainty.

Wilsons found the trading update rather ambiguous and was surprised by the lack of quantitative guidance, as the end of the first half is less than two months away. The broker's revised forecasts reflect a first:second half split of 60:40%.

Wilsons estimates concrete products and precast concrete are the most affected divisions and there are some lingering concerns regarding medium-term earnings. This is largely emanating from sector concerns regarding infrastructure delays and the increasing costs of cement grinding. The company also faces the loss of a significant customer, Neilson Group, in FY20.

Beyond Neilson

Credit Suisse models the loss of the entire 100,000t of cement volumes supply to the Neilson Group. Yet, the company has a growing base and there are several upside opportunities that may drive a step change to earnings in coming years.

The most immediate is the Anadarko LNG, targeting an investment decision in the first half of 2020. This alone could almost double the company's operating earnings (EBIT), providing annual revenue of over $100m and margins above 30%.

Wagners did not provide an update on the Mozambique project. Revenue of $200m is expected with operating earnings' margins of 30-50%. Whilst margins appear attractive, Wilsons suspects this project may involve a high degree of risk.

The broker, not one of the eight monitored daily on the FNArena database, points out contractor-derived earnings are increasing while construction materials-derived earnings are declining, and this will be particularly evident in

FY20. Moreover, this is not factored into current valuation multiples.

Wilsons maintains a Sell rating and $2.95 target. FNArena's database has two Buy ratings and one Sell (Macquarie). The consensus target is $3.60, suggesting 3.8% upside to the last share price.

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Rhipe For The Picking

Rhipe Ltd has substantial leverage to the trends in cloud computing and brokers are increasingly confident after the company upgraded FY19 guidance.

-Growth to be driven increasingly by higher-margin public cloud product -An opportunity for investors to gain exposure to Microsoft cloud -Corporate appeal a significant factor in the stock

By Eva Brocklehurst

Rhipe Ltd ((RHP)) has made a strong start to FY19, resulting in brokers upgrading forecasts substantially. The company's fortunes have been driven by an acceleration in sales from cloud service provider (CSP) channels, Microsoft Office 365 and Azure.

The company has upgraded FY19 guidance by 10%, to an operating profit of $10.5-11.5m. Compared with the prior year, at the mid point, this represents 41% growth. Brokers assert the company has substantial leverage to trends in cloud computing as a structural shift is changing the way IT resources are being used globally.

Shaw and Partners notes the first quarter produced a strong result in typically the slowest quarter for the business, with revenue of $55m up 30% and gross profit up 22.5%. The business is on track for a positive operating cash flow in the first half for the first time and adoption across the Asia-Pacific region is strong and growth is accelerating. The broker maintains a Hold rating and $1.44 target

Morgans observes investment and subsequent growth in the cloud remains robust despite fears of a slowdown and, as Rhipe is very late in the process, Morgans expects capital expenditure to slow considerably before the company's trajectory slows. The Office 365 seat count was exceptionally strong, at 325,000 as of October 31, not far off the broker's forecasts for where it would be in December, which represents an acceleration in monthly additions.

The main upside risk, in the broker's opinion, relates to the potential to exceed guidance, should cost investment not be as significant or if revenue growth exceeds expectations. Morgans upgrades FY19 and FY20 forecasts by 17% and 14% respectively.

Public Cloud Drives Growth

Larger legacy contracts that were resigned at the end of FY18 eroded the gross margin over that year but Bell Potter points out this rebounded in the first quarter. Growth is expected to be driven increasingly by higher margin public cloud product.

Bell Potter considers the updated guidance range conservative and maintains a Buy rating with a $1.60 target. The broker's forecasts are driven by an incremental improvement in the solutions margin, growth expectations from Azure and resilience in the private cloud (SPLA) market.

Shaw and Partners continues to be surprised by the strength in public cloud. Net seat additions are running at over 16,500 a month. Annualised recurring revenue for Azure also accelerated strongly, to around 4x the average monthly growth rate of FY18 and this business is becoming increasingly material to the company.

The broker takes a conservative stance on operating leverage, as the company continues to invest in one-off partner arrangements. However, medium and longer term forecasts are raised, as the suspected cannibalisation of the private older cloud business is not apparent.

Shaw and Partners likes the recurring revenue model which continuously grows as each period is rolled forward and the operating leverage is demonstrated as the business scales are. The broker reiterates a Buy rating and $1.55 target.

Rhipe represents the purest play for cloud growth within the Asia-Pacific region, the broker asserts. In particular this is a way for investors to gain exposure to Microsoft, VMware, Symantec, IBM and Citrix as these are Rhipe vendors. The broker suggests investors that desire Microsoft cloud exposure should consider Rhipe as a proxy in markets of US$12.5bn in size. Continuing strength in profitability is expected as scale is reached in many of its key markets.

Takeover Potential

Brokers also consider corporate appeal a significant factor factor. Deutsche Bank has recently initiated coverage on the stock, with a Buy rating and $1.65 target and suggests the company has an attractive business model with strong potential for earnings growth amid corporate appeal.

Brokers also expect the share buyback, renewed until September 6, 2019, will continue to provide support to the share price. The company intends to spend a similar amount in FY19 as in the previous year.

Rhipe provides cloud-based subscription software-as-a-service licenses to IT service providers across the Asia-Pacific region. The company also provides consulting, marketing and support to a network of IT service providers in conjunction with their subscriptions. The company is one of just 11 licensing partners with Microsoft and the only one headquartered in the Asia-Pacific.

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Think Upside

An impressive update from child care centre operator Think Education has brokers lining up their Buy ratings after a tough year for the industry.

-Occupancy rates improving -Guidance retained despite headwinds -Signs of industry turnaround

By Greg Peel

The share prices of child care centre operators have been in a downward trend all year as growing supply outstrips occupancy growth despite new government child care subsidies. But more recent signs suggest the industry could now be turning the corner.

After hitting a low late last month, listed industry leader G8 Education ((GEM)) has since enjoyed a rebound, albeit buoyed by improvement in macro sentiment (until today) and the fact the stock was over 9% shorted as of last week.

Smaller rival Think Education ((TNK)) similarly bounced off a low of $1.13 having peaked at $2.29 in January, closing at $1.45 yesterday. Yesterday the company provided a September quarter update which left brokers rather impressed.

Think had suffered a drop in occupancy levels of -6.2% year on year in the period February to June but this number improved to -2% in August and is now at -0.5% according to yesterday's update. The company has guided to earnings of $10.6m in 2018 compared to a prior $10-11m range.

While this might represent the barest of upgrades, brokers find guidance very encouraging considering the earnings headwinds the company has faced to this point. Given Think posted earnings of only $2.7m in the first half, guidance is for $7.9m in the second half. This comes despite delays in the settlement of a previous acquisition costing -$200,000, greenfields sites underperforming by -$500,000 and an additional -$300,000 spent on marketing.

Bottom-Of-The-Cycle Opportunity?

Stockbroker Wilsons suggests the company's improving occupancy trend reflects the early success management is having turning around 14 of its underperforming centres, the impact from a successful marketing campaign directed at better performing centres, and more favourable centre locations.

Greenfield underperformance remains a concern but timing was unfavourable as the company missed the key second half enrolment period.

Moelis Australia estimates Think's centres currently operate at around a 67% occupancy level compared to G8's 74% and Goodstart's (not for profit) 80%. The broker expects Think's occupancy to continue to increase in line with significant reinvestments being undertaken across all areas of asset and service quality.

Think operates under a unique model which provides the opportunity to compound capital at high rates of return. The company can achieve around a 20% return on capital deployed, Moelis notes, thanks to its "incubator" program.

This program sees Think managing centres from commencement to 75% plus occupancy before actually acquiring them. The company has more than 100 centres within its incubator pipeline and yesterday announced the acquisition of five new centres.

Canaccord Genuity assumes eight more centres will be acquired in 2019.

Canaccord recently conducted its third child care industry survey for the year, which showed some improvement in several operating metrics including occupancy and the impact of supply. Of those centres surveyed which have begun enrolments for 2019, 63% reported enrolments at either equivalent of higher levels than a year ago.

The broker believes occupancy is improving, initial child care subsidy teething problems have largely been resolved and supply issues may start to ease in 2019.

Moelis sees a "bottom of the cycle" opportunity on an improving sector outlook, as the new subsidy supports demand and as supply moderates.

Canaccord believes management has done an exceptional job in positioning the company to both weather the challenges and take advantage of improving industry conditions.

All three brokers see value in the stock after a year-long decline in share price.

Wilsons maintains Buy and $1.69 price target, Moelis retains Buy with a $2.00 price target, and Canaccord upgrades to Buy from Hold, lifting its target to $1.78.

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Treasure Chest: Treasury Wine Oversold

FNArena's Treasure Chest reports on money making ideas from stockbrokers and other experts. Several brokers point out there is more to Treasury Wine than just China and the recent sell-off may be overdone.

-US market changes may be a significant growth opportunity -US should receive more luxury wine, boosting margins -Acquisition opportunities abound in the US

By Eva Brocklehurst

Slowing demand in China has preoccupied investors recently but Treasury Wine Estates ((TWE)) boats more than just China among its earnings drivers, and these may be under-appreciated.

Morgan Stanley believes the sell-off on the back of growth concerns emanating from China is overdone. China has been the greatest contributor to the company's earnings growth recently so, when macro economic indicators weaken, investors become, understandably, cautious.

One of the drivers for Treasury Wine, Morgan Stanley observes, is the lift in the price of the Penfolds range. The increase in the median recommended retail price was 11.1% at the annual launch in October.

The broker also expects Maison de Grand Esprit margins may be approaching those of Penfolds and expects this brand to continue expanding as the company secures greater supply. A similar opportunity is also expected with the new Italian portfolio that was launched in September.

While reflecting slower growth in China in its forecasts, Morgan Stanley still expects 18% compound growth in earnings per share from FY19-21. The broker envisages little risk to FY19 guidance for 25% growth in operating earnings (EBITS) and upgrades to Overweight from Equal-weight, with a target of $20.

On the other hand, Citi wonders whether earnings risks are building. The value of Australian bottled red wine exports to China fell -24% in the September quarter versus growth of 106% a year ago. Citi suggests the large growth numbers in the prior year imply the outlook is flat at best. This is a growth business, the broker acknowledges, but that growth and margin expansion is expected to moderate.

Deutsche Bank points out that the data signalling exports to China slowed materially is based on Wine Australia's report, and the Chinese business of Treasury Wine constitutes a large portion of that data. Citi concurs, in this respect, that demand for wine in China has largely been driven by a switch to imports not by per capita consumption growth.

US Wine

Macquarie is increasingly convinced about the margin improvement that is likely in the US. This is a significant growth opportunity for Treasury Wine, as changes to the route to market will deliver control over around 25% of its US distribution. Successfully executing distribution changes will deliver margin upside of around 2-2.5% in FY20, on the broker's calculations.

While execution risk is high in the mandated US three-tier distribution structure, recent feedback from the industry implies that Treasury Wine has laid a strong foundation for success. In comparing Treasury Wine with Constellation Brands, Morgan Stanley is confident that the company can lift its margins in the Americas over the long-term. Constellation Brands makes 20% more profit per litre than Treasury Wine, despite achieving a 12% lower average selling price per litre.

US wine distributors make margins of 16-20% on average and occasionally as high as 30%. Macquarie calculates a reinvestment rate of 50% would allow Treasury Wine to build the business and invest in assets & branding. The broker believes, as the business already has a sales, marketing & distribution team, reinvesting half of the distributor margin is realistic.

Along the same lines Morgan Stanley suggests, as Treasury Wine benefits from its investment in winemaking and luxury conversion capabilities, the US business should receive a greater allocation of luxury wine and this, in turn, should boost margins. The company also has an ability to build new brands in the US such as 19 Crimes, which in FY18 was a 2m case per annum brand.

Meanwhile, the stock has underperformed the market by -12% in the three months to October 30 and its multiple has de-rated to a five-year low, Macquarie points out. The broker also expects the company to remain on the acquisition trail, with the principal focus on the US.

While a deal is unlikely until the route-to-market changes are finalised, the broker estimates an acquisition of the likes of Ste Michelle, owned by Altria, would be around 6% accretive to earnings, assuming a 15:85% debt:equity funding structure. A combination of the recent sell-off and increased confidence leads Macquarie to upgrade to Outperform from Neutral, raising the target to $18.22.

FNArena's database shows four Buy ratings, two Hold and one Sell (Citi). The consensus target is $18.40, suggesting 16.2% upside to the last share price.

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When Uncertainty Is The Only Certainty

In this week's Weekly Insights:

-When Uncertainty Is The Only Certainty -Rudi On Tour

When Uncertainty Is The Only Certainty

By Rudi Filapek-Vandyck, Editor FNArena

"There is nothing new in Wall Street. There can't be because speculation is as old as the hills. Whatever happens in the stock market today has happened before and will happen again." [Jesse Livermore, legendary speculator]

After an unusually savage October sell-off, the subsequent bounce-back rally has been rather mild and unconvincing in character, raising the obvious question: is there a message in there somewhere about the future direction of risk assets?

To some with a negative mindset, and on my observation there is a growing number of bears out there, the answer is unequivocally affirmative. The weak bounce, these expert voices argue, is but another bad omen for what the future holds for global investors in risk assets.

I am not yet convinced by this argument, as there simply is too much uncertainty out there to allow for a quicker and bolder move upwards. Within this context, I'd suggest it would have been rather surprising if equity markets by now had rallied strongly at a time when corporate results in the US are rather lukewarmly received, while stress is rising in Europe, the Federal Reserve is about to provide an update, bond yields are on the rise (again), and all eyes are on deteriorating indicators for the Chinese economy.

We also have mid-term congressional elections in the US this week and here the short term outlook is actually positive. Below is a chart released by Tracey McNaughton, global strategist at Wilsons this week. It shows that, irrespective of the outcome, US equity markets have always rallied post the mid-term elections; at least going back as far as 1950.

Hence if history repeats we should see the return of positive momentum later in the week, which no doubt is what short term traders are looking forward to. For investors looking beyond this week, however, there is no certainty but for the fact that uncertainty remains a key ingredient for financial markets, and is likely to remain exactly that for the weeks ahead.

In Australia, the banks' financial results have been "encouraging", at least for the short term, but for the fact they were not worse than feared, but these results are not good enough to trigger a sharp rally, potentially dragging the rest of the market along. Banks are the most and closest researched sector of the local market, by a long way, thus hoping for something substantially better than what the crowd is already anticipating almost never pays off.

Share prices of domestic banks look cheap, yes they do. But a lot more is needed to re-rate the sector and within the present context that simply does not seem feasible. Investors should note the best the Big Four can do under the circumstances is keep costs contained and pay out a flat dividend. In contrast, Macquarie Group ((MQG)) has no such operational restraints, again lifting guidance for the full year with analysts confident guidance for 10% growth can still be beaten.

Compare the pair, and draw your own conclusions. But I'd add: if you ever wonder why "value" investors are having such a hard task at hand, the evidence is right in front of us. Macquarie versus ANZ/CBA/NAB/WBC/BOQ/BEN. The riddle to solve is only too difficult for those who refuse to see.

Meanwhile, profit warnings from the likes of Wagner Holding Co ((WGN)) are yet more evidence it isn't easy for local investors to position for the boom in infrastructure spending that will underpin domestic GDP in the next three years, while investors are visibly truly uncomfortable with the outlook for housing, and the flow-on effect for Australian households' spending next year, and possibly beyond.

Note the yield on ten-year US Treasuries only fell marginally as equities tanked in October, and it's back to 3.20% alongside the relief rally. The threat of more mayhem because of rising bond yields is not going away in a hurry.

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For investors (as opposed to short term speculators) the general context is that calendar year 2018 remains on course for the worst annual performance since the GFC for many an investor across the globe. US equities have become the last asset holding up, whereas others have faltered along the way, and even US indices are finding it tough to remain in positive territory as the end of year beckons, with a smaller number of stocks providing positive support.

Investors in Australia like to bemoan the fact local shares seldom are able to keep up with the US, but they certainly would not like to swap with peers in Germany, Italy, Hong Kong or China, to name but a few (far) less attractive alternatives. Global equities ex-USA peaked in the first quarter of 2017 already and the number of positive performances since has gradually reduced.

This development has escaped most investors in Australia because the local share market remained until recently among the few ongoing up-trending share markets. The trend was brutally broken during the October sell-off, which also pushed year-to-date performance, including dividends, into the negative, albeit only marginally.

Now consider the stats published by Deutsche Bank this week. Of the 38 assets monitored, only four (4) managed to escape a negative performance in October. Gold, UK government bonds, German government bonds and one share market: the Bovespa in Brazil, as investors welcomed the new strongman as the country's freshly elected president on the perception he'll put in place business friendly policies.

All this implies, of course, that just about everyone has been losing money in October, regardless whether portfolios were tilted towards US treasuries, credit, commodities, energy or equities. The only real saviours turned out to be cash and gold. US bonds, including high yielding corporate bonds, only helped to stem losses through lesser negative returns, but returns for the month were still negative regardless.

October's sell-off also pushed an additional five assets into negative return year-to-date with the total in assets still positive now reduced to nine, in local currency terms (see table below). Year-to-date Australian equity markets are down -0.5% on a total return basis (meaning: in local currency, including dividends, as at the end of October) while Australian 10-year government bonds are up 2.65% (all through coupons), the main credit bond index is up 2.64%, and the AUD has fallen -9.4% against the USD. Again: not too bad on a relative comparison.

In light of the public debate about whether October's sell-off is but the opening salvo for the next emerging bear market, or not, maybe the better question to consider is whether the global bear market for risk assets already started sometime back in 2017, and a shrinking group of assets, including equities in Australia and in the US, are only now starting to fall in-line with the rest?

Even if the answer to that question turns out positive, with hence negative consequences for the Australian share market, this need not automatically become a repeat experience of 2008, but I suggest keeping an open mind, preparing for potential scenarios to both upside and downside from here onwards seems but the prudent strategy to employ right now.

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In terms of the shorter term outlook for the Australian share market, a study by Longview Economics into share market corrections of at least -10% since May 1928 might provide us with a blueprint of sorts of what to expect in the weeks, if not months ahead.

Longview's analysis has over the period identified 19 such "crashes" and only one (April 1937) did not follow the pattern of a severe sell-off, followed by a relief rally, subsequently followed up by another sell-off so the underlying message here seems clear: be prepared for another leg to the downside, exact timing unknown.

Equally interesting, and I am sure you'll all agree with me on this one, is there's more than a 50% chance the second sell-down might go deeper than the first, but usually the extra percentages to the downside remain quite limited, with Longview setting the range between -0.1% & -3.9%. In a small number of cases, there is another rally higher, which then is followed-up by yet another test of the earlier lows established during the two prior sell-offs.

While history seems to provide a pretty straightforward pattern (with one exception to date), there is no guidance on timing or duration for the various stages or the full process. Sometimes the relief rally is only short and selling resumes within a few days, whereas in 1962 it took the US market 85 trading sessions (circa four months) to revisit the low point of the first sell-off.

Special note: Longview excluded from its analysis the heavy sell-offs that led to protracted bear markets further down the road.

Readers who missed my recent updates might also like to read:

-What Beyond The Rally

-Could This Be The Start Of Something Different

-Out With The Garbage

-Investing Used To Be So Much Easier

Alternatively, paying subscribers can simply visit Rudi's Views on the website; the archive goes back more than ten years.

Rudi On Tour

-ASA Parramatta, on November 14, 5.30-7pm

Rudi On Tour In 2019

-ASA Inner West chapter, Concord, Sydney, March 12 -ASA Sydney Investor Hour, March 21 -ASA Toowoomba, Qld, May 20 -U3A Investor Group Toowoomba, Qld, May 22

(This story was written on Tuesday 6th November 2018. It was published on the Tuesday in the form of an email to paying subscribers at FNArena, and again on Thursday as a story on the website).

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

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Autumn Has Arrived

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

-Autumn Has Arrived, Plus Seven Quotes -ESG Focus Should Be Yours Too -Conviction Calls -Bond Yields & Decelerating Growth -Rudi On TV -Rudi On Tour

[Non-highlighted parts will appear in Part Two on Friday]

Autumn Has Arrived, Plus Seven Quotes

By Rudi Filapek-Vandyck, Editor FNArena

This week, while thinking about how best to describe the changed dynamic for global equities, I came up with the idea of "autumn has arrived". The message here is that while winter is not yet announcing itself, investors should stop acting like it is still summer, which means: reduce risk, prepare for tougher times ahead.

In line with this, here are six quotes from other sources, each with their own viewpoint about what is happening with global equities since mid-September:

"Markets have changed in 2018 as monetary policy normalizes and peak growth is evident. Nothing captures this better than our Quantitative Derivatives Strategy team's observation that the buy-the-dip strategy that performed so well in the QE era is no longer working.

"October was not just a technical sell-off like the one in February. We now have fundamental drivers: higher interest rates, slowing economic growth next year, margin risk, and tighter financial conditions.

"They all add up to investors holding less risk and, without incremental money flows, this new primary downtrend will likely take time to reverse." Morgan Stanley Chief US Equity Strategist, Michael Wilson

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"The bounce in the market since the October 26th low has been all PE, not EPS. The EPS picture is deteriorating fast, so worthwhile being a little bit cautious despite value." Shaw and Partners Chief Investment Officer, Martin Crabb

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"The recently completed bank reporting season suggests the outlook for the banks remains challenging. However, we believe the rapidly deteriorating housing market is a signal of even tougher times ahead.

"We remain cautious the banks despite the share price correction and believe the risk of the current housing Credit Squeeze turning into a Credit Crunch is real and is rising." UBS's team of banking sector analysts led by Jonathan Mott

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"Lead indicators of global growth continue to lose momentum. In October, ANZ's Global Lead Indicator fell into negative territory for the first time in over two years.

"Weakness is mainly being driven by China and the euro area, but US manufacturing new orders have also fallen noticeably over the past two months." ANZ Bank Chief Economist, Richard Yetsenga

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"Use rallies as opportunities to sell, rather than buy." The Trader column in Barron's

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"The markets themselves have flashed enough information to make the assertion that the bull market is over and in transition to the next bear market. Topping processes are exactly that - a process. We have already witnessed all three major averages -the S&P500, the Dow and the Nasdaq- this year with two, not one but two, intra-day corrections of at least 10%.

In recent memory, this has happened in 1973, 1974, 1987, 2000, 2001, 2002 and 2008. Note that all but 1987 involved recessionary bear markets; and 1987 still involved a summertime-fall period where we had a 30% market plunge. There is no get-out-of-jail-free card to play here." Glushkin Sheff Chief Economist & Strategist, David A. Rosenberg

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"The market's enthusiastic response to the US midterm elections does not alter the fact macros are either peaking or deteriorating.

"The bounce in equity markets provides another, possibly the last opportunity, to reduce exposure to stretched equities before a traditional end-of-bull market correction of 15-20% proportions occurs." Head of Equities Research at Morningstar, Peter Warnes

ESG Focus Should Be Yours Too

There is widespread misunderstanding about investing in the share market and risk, not helped by gung-ho declarations such as "without risk, no gains".

However, the simple truth is that putting money into shares already equals taking a big leap up on the risk ladder. One need not add another layer of additional risk. Successful investing is closely correlated with assessing and reducing risk. This is what makes investing in the share market different from having a go at the metropolitan casino.

One additional factor is that share markets, similar as the weather outside, morph through various stages of risk vulnerability. There are times when everything seems hunky-dory and bad news has a lesser chance of impacting negatively on our investment choices; that's when risk taking more often than not is being rewarded with handsome returns.

Other times there appears to be no end to negative trends and bad news flow. Right now, I believe, we are somewhere in between these two opposing statuses.

It would take a Grand Optimist to assume share market indices will soon rally back to the highs from only a few weeks ago, which I think is now unlikely given the focus has shifted to decelerating global growth and rising bond yields, an unfavourable combination for equities likely to stick with us for longer.

Avoiding Bombs

For our investment portfolios, this means avoiding bomb shells has become even more important as the winners won't be able to compensate for the losses incurred from vulnerable losers taking a big hit.

I am not solely referring to speculative micro cap propositions. Lend Lease ((LLC)), a member of the ASX50, has just lost in excess of -23% in a couple of days only on the back of more write-downs from troubled engineering contracts and general risk-off selling.

Corporate Travel ((CTD)) shares are still down -27% since VGI Partners went short and issued an explosive attack on the company's communication with investors, including subpar corporate governance and opaque accountancy.

Shares in James Hardie ((JHX)) are now -18% lower than when the company released its quarterly update last week, revealing yet another disappointment. They had already lost -14% from their peak earlier in the year prior to this latest punishment.

RCR Tomlinson ((RCR)) whose shares were trading at $4 at the beginning of the calendar year has just requested yet another trading halt. The previous trading halt occurred on July 30, lasted for a whole month and uncovered -$57m in write-downs on two solar farm projects in Queensland. The company was subsequently forced to raise $100m in fresh capital at $1 per share. The CFO and CEO are now gone. The shares traded last on $0.87.

These are only a few examples from recent days. There are plenty of share prices out there that have equally felt the impact from portfolio rotation and retreating liquidity, though this should not obscure the fact there are different types of risk at play at the moment; apart from general share market risk triggered by macroeconomic events, there remains the observation that some individual stocks are simply riskier than others at the micro-level.

Pay Attention To The Past

Using broad filters such as small caps versus large caps, or cyclicals versus defensives can be a great starting point to reduce portfolio risk, alongside potential over- and under-valuations, but it doesn't necessarily cover enough ground to avoid the next shock announcement a la Lend Lease or James Hardie, or possibly worse.

One additional factor investors can use is past indications and performance. This is not the first time James Hardie issued a disappointing market update and Lend Lease first acknowledged it had uncovered some operational problems in its engineering division late last year.

While it is much easier in hindsight to draw tough conclusions, just about everybody was taken by surprise by the magnitude of Lend Lease's engineering problems, and this most likely includes group management.

This is not about "knowing", this is about weighing up the overall risk profile inside an investment portfolio that is already subjected to extreme volatility and plenty of uncertainties at the macro level. One way to protect yourself from knee-deep losses and sleepless nights is through having a safety net of cash, but decisions need to be made about where to raise this cash from.

Investors need not look further than the share price of Fletcher Building ((FBU)), still trading near five-year lows, having gone through a similar troubled experience as is today the case at Lend Lease and RCR Tomlinson. And who can forget this is what finished off the once highly regarded Forge Group?

I am by no means suggesting Lend Lease and/or RCR Tomlinson are about to go out of business, but there is enough anecdotal evidence that the emergence of problems -small or big- is often a reflection of processes, corporate culture and execution inside a listed business.

Remember when Vocus ((VOC)) was experiencing mass exodus from middle management staffers? The share price is a lot lower now, and so are the company's general standing, reputation, shareholders' satisfaction as well as the group's operational performances.

Bad Versus Good Companies

In recent times I have come across numerous negative media reports about European budget airliner Ryanair. It seems to me, the founder-operator is fighting wars with everyone from his own pilots to the rest of his personnel, baggage handlers, airports, and regulatory authorities. Even the passengers are unhappy.

How can such a business continue to reward its shareholders? The obvious answer is, of course, it cannot. At some point all the bad vibes and internal frictions will translate into bad news, and the share price will respond accordingly. Judging from Ryanair's share price over the past twelve months, this process has already well and truly kicked in.

In similar vein, the Deepwater Horizon oil spill that caused the BP share price to crash in April 2010 had been preceded by a number of problems with smaller projects that essentially indicated the company was not on top of its operational risk management.

As things stand, problems in the Gulf of Mexico caused eleven human casualties, on top of the largest marine oil spill impact in history. The BP share price is still a long way off from its level prior to the disaster.

ESG Focus; A New Tool

The answer to how best to avoid any of such idiosyncratic disasters directly affecting our investment portfolios seems to be through using an extra filter; one that is increasingly gaining traction among professional investors is the so-called "ESG" filter. ESG stands for Environmental, Social & Governance and is sometimes referred to as "green", "ethical" or "sustainable" investing.

Let's not start off on the wrong footing here: ESG is not a Trojan horse for world peace loving, tree hugging, anti-capitalism hippies. The reason why the concept is rapidly becoming more popular around the world is because investors increasingly are coming to the conclusion it is an effective tool to distinguish lower quality operators from higher quality companies, and higher quality companies are better for shareholders, even without unpredictable disasters.

Such conclusions are supported by a growing number of academic studies into the subject.

Let's be brutally honest about this: a company that adheres to the highest moral and legal standards, delivers excellent products and services, takes good care of its staff, and treats its customers well, such a company most likely will also prove a more rewarding investment for shareholders. Using ESG simply gives investors one extra tool to identify such gems, and to distinguish between lower and higher levels of corporate quality, which equals investment risk.

Also, there is no reason as to why using this extra layer of insight should remain the exclusive domain of institutional investors only. FNArena is currently preparing for the addition of a dedicated "ESG Focus" news section on its website, to be officially launched later this month.

Few Observations

Leading into the next addition to our news service, I thought I'd share a few thoughts and observations about ESG and the Australian share market:

-Earlier this year, successful online retailer Kogan ((KGN)) was caught out trying to offload shares on behalf of core management, including founder Ruslan Kogan, on the back of a press release that appeared to have only one aim; to get the share price up while stockbrokers were trying to offload stock.

This might well be crowned 2018's worst case of bad corporate governance in Australia. I suspect these events are one major reason as to why the share price has since collapsed from nearly $10 to now below $3. Admittedly, the company has disappointed investors since, while management did sell some shares; both would have been contributing factors as well.

-Harvey Norman ((HVN)) chair and founder Gerry Harvey likes to deride hedge funds that take short positions and everybody who criticises management and the company, really, but it can hardly be denied the company's accounting hides liabilities to and from franchise operators and Gerry himself decides on frivolous investment endeavours, such as the Coomboona Dairies, which should arguably be done on a personal leve and not through the listed Harvey Norman, ultimately forcing shareholders to pay for the investment failure.

Australia has a long legacy of listed family businesses being run as if they are still 100% family owned, long after shareholders have come on board through a public listing. I don't like either of these companies, and on my long-standing observation, ultimately these vehicles (with the wrong prime focus) do not provide good outcomes for shareholders in the long run.

-There was an overwhelming majority who thought a Royal Commission to hold the banks to account would be a gigantic waste of everybody's time and government resources, but the result proved the exact opposite. In the cases of AMP ((AMP)), IOOF ((IFL)) and Freedom Insurance ((FIG)) there are some very harsh lessons to be learned by value investors now regretting only looking at the short-term financials.

Cheap value alone does not a rewarding investment make. All three companies would score low on any decent ESG assessment. The same case can be made of the banks who truly dug their own hole and might now have to face the consequences for years into the future.

-What do the numerous outages tell us about what is going on internally at Telstra ((TLS))? Or the fact that a BHP ((BHP)) train loaded with iron ore, but without its driver, takes off and cannot be stopped other than by de-railing it (effectively demolishing the train) only three years after that costly Samarco dam-disaster in Brazil?

-Also, anyone else noticed how both BHP and Rio Tinto ((RIO)) have quietly extricated themselves from "dirty" coal?

-Macquarie researchers recently put a human capital management filter through the companies covered by the firm in Australia, essentially assessing companies on how well they are in managing the labour part of their businesses.

Coming out positively, while also carrying a positive rating from Macquarie analysts, were Aristocrat Leisure ((ALL)), Amcor ((AMC)), ANZ Bank ((ANZ)), Aurizon Holdings ((AZJ)), CSL ((CSL)), Dexus ((DXS)), Fortescue Metals ((FMG)), Goodman Group ((GMG)), Lend Lease, Mirvac Group ((MGR)), Oil Search ((OSH)), Qantas ((QAN)), South32 ((S32)), Transurban ((TCL)) and Westpac ((WBC)).

The presence of Lend Lease in this group shows ESG at best should be but one of multiple tools used to find the best risk-reward opportunities.

On the negative side, while also carrying an Underperform rating from Macquarie, we find Bendigo & Adelaide Bank ((BEN)), Insurance Australia Group ((IAG)), and Woolworths ((WOW)).

Finally (for now), CLSA analysts recently highlighted that anyone looking to leverage the "it's great to be green" theme that is now emerging on the horizon of the financial sector worldwide, will be hard pressed to ignore Macquarie Group ((MQG)). Apart from having some $4bn invested through its infrastructure asset management business, Macquarie also purchased the Green Investment Bank from the UK government in mid-2017.

Note also: new CEO Shemara Wikramanayake is a commissioner for the Global Center on Adaption, a global climate change initiative, alongside Bill Gates and Ban Ki-Moon.

It is CLSA's view that, "regardless of whether investors believe in climate change, financial markets economics for carbon-emitting industries will be pressured as the economics of renewables improve".

Investors take note, and keep an eye out for that launch later this month.

Rudi On TV

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Rudi On Tour

-ASA Parramatta, on November 14, 5.30-7pm

Rudi On Tour In 2019

-ASA Inner West chapter, Concord, Sydney, March 12 -ASA Sydney Investor Hour, March 21 -ASA Toowoomba, Qld, May 20 -U3A Investor Group Toowoomba, Qld, May 22

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Rudi's View: Reliance Worldwide, ResMed, And Equity Trustees

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

-Autumn Has Arrived, Plus Seven Quotes -ESG Focus Should Be Yours Too -Conviction Calls -Bond Yields & Decelerating Growth -Rudi On TV -Rudi On Tour

[Non-highlighted parts appeared in Part One on Thursday]

Conviction Calls

By Rudi Filapek-Vandyck, Editor FNArena

Amidst plenty of share market commentary and controversy, portfolio managers at stockbroker Morgans have stuck by Corporate Travel ((CTD)), telling clientele they're are satisfied with management's response to short seller VGI, believing share price weakness might stick around for a while but it doesn't appear to be justified.

In addition, Morgans' Balanced Model Portfolio has added exposure to Sydney Airport ((SYD)) while also reporting a watchlist is being kept with specific focus on major banks, ResMed ((RMD)), Reliance Worldwide ((RWC)) -to buy some more- PWR Holdings ((PWH)), Ramsay Health Care ((RHC)) -with possible intention to sell- and Motorcycle Holdings ((MTO)). The latter is considered "too cheap to sell".

Those responsible for managing the stockbroker's Growth Model Portfolio have been left licking their wounds, as the portfolio includes Corporate Travel and Motorcycle Holdings, but portfolio managers see "compelling value" emerging in lots of places now that the share market experiences melt downs regularly.

For now, the portfolio has added shares in Oil Search ((OSH)) and OZ Minerals ((OZL)), while trimming its position in People Infrastructure ((PPE)). Here the watchlist consists of ResMed, Reliance Worldwide, PWR Holdings, and Motorcycle Holdings.

In terms of yield plays, Morgans' favoured exposures remain Viva Energy REIT ((VVR)) and Centuria Metropolitan REIT ((CMA)) and, in case large cap exposure is a requirement, Stockland Group ((SGP)) and Mirvac Group ((MGR)).

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Stock pickers at Wilsons have brushed off and updated their selective list of Conviction Calls which triggered the removal of Afterpay Touch ((APT)) and also the fresh inclusions of Equity Trustees ((EQT)) and GWA Group ((GWA)).

Keeping their spot on the list: Bravura Solutions ((BVS)), ARQ Group ((ARQ)), Collins Foods ((CKF)), Ruralco ((RHL)), Ridley Corp ((RIC)), Nanosonics ((NAN)), ImpediMed ((IPD)), Pinnacle Investment ((PNI)), Noni B ((NBL)), Ausdrill ((ASL)), Mastermyne ((MYE)), and NRW Holdings ((NWH)).

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Analysts at Morningstar also updated their "Best Stock Ideas"; ideas picked because, on their assessment, share prices are below fair value and thus too cheap. Four changes were made: Link Administration ((LNK)) and Macquarie Group ((MQG)) are now included, while MYOB Group ((MYO)) and Ramsay Health Care ((RHC)) lost their spot.

Remaining on the list: a2 Milk ((A2M)), Aveo Group ((AOG)), G8 Education ((GEM)), InvoCare ((IVC)), Pendal Group ((PDL)), Telstra ((TLS)), Westpac ((WBC)), and Woodside Petroleum ((WPL)).

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Stockbroker Morgans also updated its selection of High Conviction Stocks last week which saw the removal of Noni B, alongside the inclusion of ResMed and Lovisa Holdings ((LOV)).

Retaining their spot on the list: OZ Minerals, Reliance Worldwide, Westpac, PWR Holdings, Volpara Health Technologies ((VHT)), Kina Securities ((KSL)), CML Group ((CGR)), and Australian Finance Group ((AFG)).

Bond Yields & Decelerating Growth

The global sell-off in equities is no longer about readjusting to higher rates and higher bond yields, as was the case earlier in the year; this time around the world is increasingly uncomfortable with the prospect of decelerating

growth into 2019.

The chart that illustrates (almost perfectly) the worries that have seeped into global investors' minds was taken from a recent edition from The Gartman Letter, though it probably originates from a report issued by Credit Suisse.

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