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Stories To Read From FNArena

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FNArena
Financial News, Data & Analysis

GPO Box 3145
Sydney NSW 2001

info@fnarena.com

Your editor
Rudi Filapek-Vandyck

Your dedicated team of journo's
Greg Peel
Eva Brocklehurst

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Wesfarmers Exits Homebase, Where Next?

Wesfarmers will sell its troubled Homebase/Bunnings venture in the UK, a move welcomed by brokers as the financial outcome is better than feared.

-Wesfarmers entitled to equity proceeds on further sale by Hilco -New business development management has stronger focus on capital allocation -Brokers expect scepticism regarding any further offshore M&A

By Eva Brocklehurst

Wesfarmers ((WES)) has bitten the bullet, deciding to withdraw from its Bunnings experiment in the UK and Ireland. The company had witnessed some encouraging signs in recent trading as the weather improved but the opportunity, albeit material, did not justify additional capital or management's time.

The Homebase acquisition, which underpinned the Bunnings move after which stores were in the process of being re-branded Bunnings, is being sold to Hilco Capital, a UK-based restructuring and refinancing company.

Hilco will acquire the Homebase brand, store network, property, leases and inventory for a nominal amount. The 24 Bunnings pilot stores will revert back to the Homebase brand following completion of the transaction, expected to close June 30.

Wesfarmers will participate in a value share mechanism whereby it will be entitled to 20% of any equity proceeds on further sale by Hilco indefinitely, and will record a loss of -GBP200-230m at the FY18 result.

While Citi considers such an earnings contribution is unlikely in the near term, the important aspect is the indefinite nature of the equity agreement as this presents earnings upside for Wesfarmers, should Hilco be successful in turning the business around in the long-term.

The move on Homebase was considered a risky decision by brokers in the first place and now that risk is removed from the stock the balance sheet is enhanced. Citi did not expect a buyer would acquire the full lease liabilities (disclosed at GBP1bn), which indicates Homebase may be run as a going concern in the UK.

Ord Minnett calculates the investment eroded shareholder value for Wesfarmers to the tune of -GBP1.3bn, almost a year's worth of dividends, and notes the problems encountered in the UK were much a function of due diligence as well as execution, which the company acknowledges.

Therefore, Ord Minnett remains cautious about future offshore M&A, given Wesfarmers' mixed track record. The company maintains offshore ambitions yet the broker suspects any M&A will be treated with significant scepticism.

Outcome Better Than Expected

One positive emanating from the decision to sell is that the company has avoided significant closure costs. Ord Minnett had expected a -GBP631m exit cost and suggests the deal reflects well on the company's new business development team. Gearing metrics should also improve.

Deutsche Bank calculates that given the cited loss on disposal, and the business being written down to GBP150m in February, the exit costs appear to be around -GBP50-80m. These costs stem from working capital, contributions to the pension scheme and transaction costs.

The outcome is better than Credit Suisse had expected, noting a stronger focus on capital allocation. The broker upgrades earnings estimates by 5% across the forecast horizon to reflect the removal of the Bunnings UK & Ireland losses. The broker also upgrades estimates for dividends to reflect better cash flows.

Hence, Bunnings should now perform well following industry consolidation in Australasia and Coles, under new leadership, could leverage its undemanding comparables and margins to drive performance.

Where Next?

Cost savings have been achieved in the industrial divisions although Ord Minnett notes revenue growth remains difficult. Department stores are increasingly led by Kmart, while earnings ambitions for Target have been reduced. Nevertheless, the broker finds a lack of valuation support in the stock, maintaining a Hold rating.

UBS removes the Bunnings UK & Ireland venture from its estimates beyond FY18, driving a 3% upgrade to FY19 estimates for earnings per share. Beyond FY19 the impact is more muted, as the broker had previously forecast the losses would ease.

UBS considers Wesfarmers has a strong suite of businesses with market leading positions but the general outlook remains soft in the short to medium term, although few catalysts for underperformance are envisaged.

With a significant re-rating of the stock following decisions to de-merge Coles and divest Bunnings UK & Ireland, the market will likely search for sources of further upside and, organic expansion opportunities in industrial businesses exist, Credit Suisse believes, although these are not widely understood by the market.

Citi agrees the earnings profile of Wesfarmers has been re-shaped, following this latest divestment, the sale of the Curragh coal mine and plans to de-merge Coles, so the risk is reduced. Yet, the broker decides to downgrade to Sell from Neutral, following recent appreciation in the share price.

FNArena's database shows two Sell ratings, four Hold and one Buy (Credit Suisse). The consensus target is $42.94, suggesting -5.3% downside to the last share price. Targets range from $39.00 (Morgan Stanley) to $47.36 (Credit Suisse). The dividend yield on FY18 and FY19 forecasts is 4.8% and 5.0% respectively.

See also, What Future For Wesfarmers Without Coles? On March 19, 2018.

Reliance Worldwide Eyes European Expansion

Reliance Worldwide will acquire PTC fitting manufacturer John Guest and tackle expansion in Europe.

-John Guest acquisition complements company's US business -Strong wholesale distribution reduces residual US retail risk -Return-on-capital metrics should gradually improve

By Eva Brocklehurst

Reliance Worldwide ((RWC)) has Europe in its sights for expansion and to this end will make a large UK acquisition, John Guest, to provide growth. John Guest products are manufactured within the UK, with distribution facilities across continental Europe in markets such as Germany, France, Italy and Spain.

Brokers consider this acquisition supports the company's existing business in various ways. Europe currently accounts for less than 10% of Reliance Worldwide revenue and the Americas accounts for only 15% of John Guest revenue.

Other benefits include a highly complementary product range, new product segments for Reliance Worldwide and more diverse customer and distribution channels, creating a strong global PTC (push-to-connect) fittings business in both brass and plastic. The deal is highly accretive but the main negative, Morgans observes, is the impact on returns, which drop to 9% in FY20 from 35% in FY17.

The broker also cites execution risks, given the size of the deal, but believes the acquisition is a good fit strategically and the positives outweigh the negatives. If management can execute well there are growth opportunities, as PTC adoption is still very low globally. Morgans upgrades to Add from Hold.

The acquisition makes strategic sense but Deutsche Bank is less comfortable, as it adds further risk to a business that is considered to have too many strategies. Management must now handle another integration and ensure growth across new products, regions and end markets. While the acquisition multiple appears high at 12.4x, after synergies the broker acknowledges this becomes more reasonable at 10.3x. Deutsche Bank upgrades to Hold from Sell.

Bell Potter, not one of the eight stockbrokers monitored daily on the FNArena database, also upgrades the stock, to Buy from Hold, and increases the target to $5.40 from $4.75. Bell Potter expects the initial negative return-on-capital metrics to steadily improve, forecasting returns to fall to 15.2% in FY19 before moving back to 20% over the medium term.

John Guest

John Guest produces plastic PTC plumbing fittings and associated products, servicing the plumbing, heating and industrial markets, and has approximately 1300 employees. The consideration is GBP687.5m. Reliance Worldwide will fund the acquisition with a $1.1bn equity raising and extended debt facility of $750m with existing lenders.

Expansion opportunities in the near term include adapting some of the company's existing products, such as mixing and safety valves, into the John Guest range. US management has previously identified water quality and filtration as attractive markets, and John Guest provides a foothold in this area for Reliance Worldwide.

Of particular attraction for Bell Potter is the strong wholesale distribution model that lowers dependence on sales through US retail channels, in particular Home Depot, where some residual risk lies. The John Guest business generates strong operating earnings (EBITDA) margins of 33%, achieved through a combination of manufacturing and distribution scale, high levels of automation and a relatively higher proportion of PTC fittings as a percentage of overall sales.

Bell Potter suggests integrating John Guest into the Reliance Worldwide business will result in a significant rise in margins, even before cost synergies are realised. The company has estimated synergies in excess of $20m over three years, with the bulk expected to be reached by the end of FY19. The broker suggests margins should improve in FY19 by around 450 basis points. This results in Bell Potter upgrading estimates for earnings per share by 15.7% for FY19 and 19.9% for FY20.

The company expects to retain a 40-60% dividend pay-out and management has reiterated its FY18 underlying operating earnings guidance of $150-155m, ex John Guest and transaction costs.

Morgans increases FY19 underlying earnings estimates by 70% and underpinning this is a full year contribution from John Guest and $15m in synergies, offset by -$10m in one-off integration costs. The broker's FY20 forecasts assumes underlying growth for John Guest of 9%.

FNArena's database shows two Buy ratings and one Hold (Deutsche Bank). The consensus target is $4.87, signalling -8.5% downside to the last share price.

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APN Outdoor Outlook Improves Substantially

Conditions in the outdoor advertising sector have improved substantially in 2018 and APN Outdoor has upgraded its guidance.

-New revenue streams replacing the lost Yarra Trams contract -New operating model delivering benefits quicker than previously expected -Bid for Adshel may require capital raising

By Eva Brocklehurst

Earnings momentum gathered pace for APN Outdoor ((APO)) over the first five months of 2018. The company upgrades its guidance, indicating revenue growth to date is in the range of mid-single digits versus previous guidance for a flat outcome. The outdoor advertising sector has improved substantially, Morgans notes, in stark contrast to late 2017. Canaccord Genuity estimates this is the first meaningful upgrade to the company's full year guidance since February 2016.

APN Outdoor had previously guided for flat revenue because of the loss of the $15m Yarra Trams contract last year. UBS considers FY18 no longer a transition year as the company has signalled new revenue streams have replaced the drag from the loss of Yarra Trams.

The company provided 2018 operating earnings (EBITDA) guidance of $92-96m. Capital expenditure guidance is unchanged a $25-30m and there are plans to commission 20-25 digital billboards throughout the year. The fact capital expenditure plans are unchanged signals to Morgan Stanley that the extra revenue is not being driven by a larger new digital roll-out.

The broker attributes the growth to a stronger industry and APN Outdoor regaining revenue share, encouraged by the start to the year in a business that usually has revenue and earnings heavily skewed to the second half.

Guidance is a reflection of market growth and recovery of some share that was lost through 2017 so CLSA believes the new operating model is delivering benefits to the bottom line quicker than previously anticipated. The broker, not one of the eight monitored daily on the FNArena database, retains an Outperform rating and raises the target to $6.30 from $4.90.

Canaccord Genuity, also not one of the eight, believes there is potential for upside to the revised guidance and margin expectations, although notes the company will be cycling a soft second half. While tempted to take more positive view, this broker is cautious because of the potential for a capital raising, so a Hold rating is maintained and the target is $5.50.

The upgrade is timely, Citi agrees, although remains surprised at the material improvement in trading conditions, given the company provided an update just five weeks ago at the AGM. The broker's estimates increase by 8% on account of the update.

Costs

Citi does speculate whether the company is deferring cost increases. APN Outdoor had flagged its under-investment relative to competitors, and a one-off reset of the overheads cost base in 2018.

Depending on the outcome for 2018 revenue and operating earnings the broker envisages margins could be expanding and this would be quite surprising given the stated need to re-invest. Citi suspects the cost base will need more than a one-off increase, particularly when compared with how competitors are faring.

Demand for digital outdoor advertising is likely to continue to grow at single digit rates for the next three years, Morgans suggests, and, barring unforeseen economic events or management errors, the company should deliver steady earnings growth. As the stock is trading close to its revised valuation, Morgans maintains a Hold rating.

Credit Suisse is pleased earnings momentum has materialised, citing strengthening industry conditions, better roadside yields and better execution as the drivers. Taking on board the fact that the business is also absorbing a -$3m headwind as the company invests to bolster sales and internal infrastructure, the broker considers this trading update is very strong.

Adshel

The company has a $500m offer for Adshel ((HT1)) on the table. UBS suspects HT&E may prefer a cash bid. If that is the case, and assuming APN Outdoor wishes to maintain its net debt to earnings ratio below 2.0x, an additional capital injection may be required to pursue the acquisition.

The broker notes near-term synergies have not been disclosed, while the strategic synergies for the longer term include building scale for tenders and bargaining power with landlords.

Credit Suisse expects the potential for a deal is likely to weigh on the stock in the near term and, should the transaction proceed, envisages a sizeable equity raising. While it does act as an overhang on the stock for the near term, the broker estimates that cost synergies could mean the deal delivers net accretion of 5-6% to APN Outdoor shareholders.

Canaccord Genuity estimates the company would need to reduce the operating expenditure base of the combined business by -$7m to neutralise the dilution to earnings per share. The broker also calculates an equity raising of around $250m will be required to part fund the acquisition.

Citi is concerned that competitive tension may push the price of Adshel above fair value, given APN Outdoor is competing with oOh!media ((OML)) for the business. The broker calculates that assuming a 60/40 equity/debt funding split, net debt would rise to around 2x and require a $300m capital raising. Still the consolidation potential is positive, which could mean margins improve across the industry.

The database shows three Buy ratings, two Hold and one Sell (Citi). The consensus target is $5.58, suggesting -1.3% downside to the last share price.

Challenges Continue For Metcash

Metcash signalled earnings are likely to be flat in FY18 and it may lose a customer from FY20. Brokers are underwhelmed by the news.

-Earnings growth not materialising to the extent brokers hoped -Cost reduction program may be masking the underlying trend -Prospect of other supermarket exits in the near term is low

By Eva Brocklehurst

Metcash ((MTS)) has been investigating a new distribution centre in South Australia so the news that Drakes Supermarkets will not commit to having its chain supplied is a disappointing development for brokers.

Food distribution operating earnings guidance is for a flat outcome in FY18. Subdued sales in the food distribution business counters hopes of easing deflation and a decelerating impact from Aldi in South and Western Australia.

The announcement of a new distribution centre signals an increase in capital expenditure, an undesirable development in terms of capital allocation, Credit Suisse asserts. The broker observes the company is doubling down on capital being allocated to a low-profit market with significant uncertainty.

Wholesale sales from food distribution has slipped -1.2% in FY18, which the broker suggests is but a marginal improvement on the -1.4% decline reported in the first half. Credit Suisse acknowledges the implied decline in operating earnings in the second half is not as severe as the headline suggests, given the prior corresponding half included the benefit of an extra trading week.

Still, earnings growth is not materialising to the extent CLSA requires to be confident in the stock. While price competition between supermarkets may have abated, the broker is concerned that the major players are targeting the strengths in the independent chain supplied by Metcash, IGA, such as convenience, service and community.

Continued pressure on sales, maket share and margins is likely to continue. CLSA believes management is capable, but is yet to devise a way to grow food & grocery sales, while cost savings will eventually come to an end. The broker, not one of the eight monitored daily on the FNArena database, retains a Sell rating and $2.70 target.

The company's cost reduction program is masking the underlying trend, in Deutsche Bank's view. While further reductions may be found, they will eventually run out and the potential exit of Drakes and the sharp reaction in the share price serve as a reminder, in the broker's view, of the challenges in the business. The company's customer cohort is losing market share and there is the risk that independents source product from elsewhere.

Drakes Impact

Morgan Stanley does not believe the departure of Drakes, while disappointing, will be a signal for further supermarkets to abandon Metcash as a distributor. The broker had considered the departure of Drakes a low probability, as it has no existing distribution capabilities and far less buying power than Metcash.

Therefore, the prospect of incremental independent supermarkets establishing their own distribution channels is low, given the high fixed costs and low profit margins that exist. Morgan Stanley also would not rule out the possibility that Drakes moves back to the Metcash stable in the future after negotiating terms. Drakes is contracted until June 2019 and the impact of its departure is not likely until FY20.

There is little impact on margins, as Drakes only represents 3% of food & grocery sales, and the broker considers the share price reaction to the news overdone, ascribing 51% of the stock's value to its food business and citing increasing earnings diversification.

UBS agrees it is unlikely other supermarkets will follow Drakes in the short term because of the costs and risks associated with establishing a vertical model. Nevertheless, if Drakes is successful, others may explore this option over time. Assuming the sales are lost over the next two years at an incremental earnings margin of 5-10%, UBS calculates an impact equivalent to -4-10% of Metcash FY20 estimated earnings. The broker reduces medium-term forecast by -6%.

Credit Suisse suspects the loss of distribution to Drakes likely reflects the commitment required by Metcash and the difficulty in securing retailer revenue to support its investment, while Citi continues to envisage downside risk to earnings from competitive pressures and further contract losses but believes the risk is more balanced with the share price at current levels. As long as the loss of Drakes is isolated.

The company has three contracts up for re-negotiation over the next 12 months and, if one or two of these are lost, the broker expects Metcash to de-rate from current levels. Ord Minnett is more positive, as food deflation is easing and there are some signs of inflation occurring at a faster rate than previously envisaged. The broker is confident that Metcash will retain its customers as there are few large accounts that could go vertical or be meaningful to a new entrant.

Growth at Aldi is moderating and the Coles ((WES)) de-merger creates an environment where food deflation could subside. Hence, Ord Minnett believes the independent retailer network is in better shape with the investment that is occurring, although acknowledges the risk to contracts.

Capital Management

Several brokers still believe there is capital management potential. UBS estimates Metcash should be net cash in FY18 with a large franking balance and a $150m off-market buyback would be 4% accretive to FY19 EPS. Ord Minnett notes the low earnings multiple and believes previous multiple ranges do not reflect the changing business mix. The broker suspects a buyback could be announced at the FY18 results.

The database shows three Buy ratings, three Hold and one Sell (Credit Suisse). The consensus target is $3.19, suggesting 7.1% upside to the last share price. The dividend yield on FY18 and FY19 forecasts is 4.6% and 5.0% respectively.

ALS Still Needs Accretive Acquisitions

ALS is enjoying positive trends in geochemistry & metallurgy but its life sciences division still lags commodities as margin pressures remain stubborn.

-Commodities division exposed to an improving exploration cycle -Needs accretive acquisitions to generate valuation upside -Life sciences earnings and margin expected to recover slowly

By Eva Brocklehurst

Life sciences remains the weak spot for ALS ((ALQ)) although the growth strategy is being maintained, targeting bolt-on acquisitions, and brokers observe a more cautious outlook at the FY18 results.

No explicit guidance was provided this time, unlike FY17, Macquarie observes, yet the company is expected to return to its previous practice of providing first half guidance at its AGM.

Morgans notes ALS recently flagged $100-150m in acquisitions in FY19 but at the results briefing made no further mention of this target. The broker accepts executing accretive acquisitions in a highly competitive environment is difficult but this is something the company needs to do in coming years to generate valuation upside.

Credit Suisse also found the outlook less upbeat than that provided in November as the company cites continuing cost pressures in many of its businesses. ALS reported net profit of $142.2m, up 21% and at the higher end of its guidance range. This was supported by moving the loss-making oil & gas laboratory assets to discontinued operations.

Nevertheless, CLSA does not believe this feature detracts from the cyclical recovery in the commodities division, which now appears entrenched. Meanwhile, life sciences continues to lag as margin pressures remain stubborn.

CLSA remains positive about the exposure to an improving exploration cycle, and expects rising average realised prices should now supplement volume growth.

The broker, not one of the eight monitored daily on the FNArena database, notes the share price has fallen from its recent highs and the multiple eased materially. Hence, CLSA retains an Outperform rating and $8.00 target.

The company is becoming increasingly reliant on arresting the margin pressure in life sciences and executing on its "Project Everest" strategy but Morgans suspects the market will take a wait-and-see approach on both of these aspects.

This is particularly in light of the fact that the Alcontrol acquisition contributed to a further fall in the earnings (EBIT) margin to 12.5% in the second half. The company has admitted that integration took six months longer than expected but expects a full $10m contribution to operating earnings (EBITDA) in FY19.

Citi continues to be attracted to the cyclical recovery in commodities and the growth potential in life sciences. The broker also likes the industry and geographic diversity of ALS, and the strong balance sheet.

Life Sciences

Management stated that life sciences, 40% of earnings, was affected by integration-related disruptions, particularly in the US, but expects a slowly improving outlook linked to new project approvals and contract wins.

Competitive pricing pressure is reflected in the tempering of medium-term margin guidance for life sciences to 17-18%, from 18% previously, although Morgans points out there was little detail on when this will be achieved. The broker incorporates a 14.6% margin in FY19, implying a slow recovery.

Life sciences earnings were short of Macquarie's expectations, as was the margin. Yet the broker acknowledges recovery is continuing in Latin America and cost reductions in the Americas and the UK should drive higher margins.

Citi expects 17% growth in life sciences earnings in FY19, supported by the uplift from Alcontrol and an improved demand environment in the US.

Commodities

The commodities division reported underlying earnings (EBIT) of $123.5m, up 43%. The company has highlighted that sample flow into the geochemistry business was 26% above the levels of a year ago and remains optimistic about recovery and demand for services.

Citi expects commodities, 50% of earnings, to grow at a three-year compound rate of 18% to FY21, underpinned by cyclical recovery, exploration expenditure and market share gains. The broker forecasts EBIT margins to improve by 180 basis points to 25.6% in FY19.

FNArena's database shows two Buy ratings, two Hold and two Sell. The consensus target is $7.51, suggesting 3.0% upside to the last share price. Targets range from $6.50 (Ord Minnett) to $8.45 (Citi).

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Galaxy Finds Solution To Brine Project Funding

Brokers are keen on the deal between Galaxy Resources and POSCO that will allow for funding of the Sal de Vida lithium brine project in Argentina.

-Main catalysts going forward are project delivery and competitor expansion plans -Deal is evidence of the industry placing a high strategic value on quality lithium assets -Now there are two projects valuation may change as targeted areas change

By Eva Brocklehurst

Galaxy Resources ((GXY)) has found a neat solution to its funding needs for the Sal de Vida lithium brine project in Argentina, brokers observe. The company has entered a non-binding agreement with POSCO to sell 28% of the Sal de Vida measured and indicated (M&I) resource for US$280m. This will enable Galaxy to largely fund development of the broader portfolio.

The company will also have a cooperation agreement with POSCO to maximise any development, infrastructure and logistical synergies. Galaxy retains ownership and the expected cash flow from the deal lifts Macquarie's target to $3.90 from $3.00. Beyond this deal, the main catalysts will be delivery of the project and the broader sector impact of competitor expansion plans.

All up, this is a better outcome than Macquarie envisaged. Delivering improved lithium recoveries at Mount Cattlin is still necessary for forecast cash flow but, longer term, a substantial brine project that has proven challenging for others becomes a key catalyst.

Canaccord Genuity considers the transaction a major positive, as it removes financial uncertainty and is also further evidence of the industry placing a high strategic value on quality lithium assets.

Arrangement Details

Galaxy Resources will sell the northern tenements, which do not include any of the reserve, and retain the southern portion of the project area, which contains all the 1.14mt lithium reserve and which forms the basis of the definitive feasibility study. The northern tenements host 1.6mt of contained lithium in M&I resources. Galaxy will also retain ownership of the bulk of the resources, which now stand at 4.09mt.

Macquarie calculates that on an M&I resource multiple, the sale price implies a valuation of $966m for the company's retained share, a 38% premium to the broker's valuation of 70% of the project. The deal is still subject to POSCO board approval, expected in the September quarter.

Macquarie upgrades to Outperform from Underperform on the back of the deal. While the broker expects the bulk of the funds to be deployed at Sal de Vida, the company is considered likely to further de-risk its funding requirement.

Canaccord Genuity expects the deal to provide a significant boost to the project's financing plans, noting that the company is yet to complete offtake arrangements that may still include product pre-payment. Combined with operating cash flow from Mount Cattlin, and the potential for debt financing, Galaxy Resources is now well-positioned, the broker suggests, without the need for diluted equity and/or a sell down of equity in the project.

Canaccord Genuity emphasises that the comparatively early stage of development, and the likelihood that POSCO will employ its, as yet unproven, proprietary lithium extraction process, will mean little in the way of commercial production from POSCO properties for more than five years. The broker, not one of the eight monitored daily on the FNArena database, upgrades its target by 22% to $5.00 and maintains a Buy rating.

Concerns

While believing the deal is a positive development, Morgan Stanley has some concerns. Supply is being added to the market, as POSCO will operate independently and run a project in parallel with Sal de Vida, increasing global lithium supply. The broker already expects the lithium market to go into surplus in 2019.

Moreover, running two projects from the same salar requires significant cooperation on managing the draw rates, although this sharing is a common theme in Argentina where several companies, including Orocobre ((ORE)), are planning to operate in the same region. The broker suggests a government framework could also be devised for salar management going forward, although none exists at present.

Morgan Stanley also argues that while the reserve estimate is unchanged, the timing of the two projects may change the valuation as different areas are targeted. Citi believes the deal is a good outcome, as it allows Galaxy to largely fund its project without compromising on the intrinsic value. The broker agrees the deal highlights the build-up in supply, given there is likely to be two projects developed at Sal de Vida now.

FNArena's database shows two Buy ratings and two Hold. The consensus target is $3.56, suggesting 6.7% upside to the last share price.

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Technology Sparks Interest In Steadfast

Brokers are enthusiastic about the potential of the new client trading platform demonstrated by Steadfast Group at its investor briefing.

-Around 80% of the network GWP could be transacted through the platform in five years -Should premium rate increases continue then upside risk is considered significant -Benefits expected to accrue to client, broker and insurer

By Eva Brocklehurst

Insurance broking network Steadfast Group ((SDF)) is buoyed by the prospects inherent in its new client trading platform and the potential to take the opportunity global by replicating aspects of its model on the Unison Steadfast network.

At its investor briefing the company demonstrated its technology strategy and client trading platform, offering details on monetisation. Management is spending $50m on monetising the technology although is not yet able to provide hard targets and timeframes.

Still, Steadfast estimates that around 80% of the network gross written premium (GWP) could be transacted through the platform within five years.

Macquarie calculates this implies a target of around $3.7bn in premium. Should the company, therefore, be able to execute on 30% of the targeted opportunity the uplift to operating earnings (EBITA) would be around $13m.This compares with an FY18 guidance range of $160-170m.

Outlook

The broker believes market conditions and the outlook for the trading platform, as well as the capacity for acquisitions, underpin the stock. Ord Minnett agrees, equating the earnings implication of the platform to a 20% uplift to FY22 pre-tax profit. The broker believes the stock will also benefit from the cyclical turn in the Australian commercial cycle.

Unison Steadfast, a network of 200 brokers operating in 130 countries, is not yet on the platform but the company is in the process of aggregating all GWP data to facilitate discussions with global insurers and this aggregation process is likely to be completed by the end of June.

Meanwhile, the performance of underwriting agencies has been strong, driven by early traction on the trading platform, pricing cycle tailwinds and aligning agency product with distribution. Steadfast expects expenditure on technology will reach a maintenance stage by FY21.

The London "super" binder is on the platform and live in four business lines. Credit Suisse suggests this should readily enable Steadfast to scale up business in London and provide exposure to products not yet offered in these markets.

The broker allows for some level of success in its earnings forecasts, incorporating a 5% take up in FY19 and a further 5% in FY21. Assumptions for premium rate increases are pulled back to 1.5% over coming years, from the current 6.5%, which offsets this take-up. Hence, the broker forecasts growth to slow.

Should the positive premium rate environment continue into 2019 and 2020, in addition to the higher technology take up, the upside risk will then be significant. In sum, Credit Suisse adopts a cautious outlook on the potential in regard to hard earnings forecasts.

Macquarie believes network brokers should be attracted to this platform as a result of the improved efficiency and the additional commissions paid by underwriters. The company also shares in improved profitability via the 64 equity brokers as GWP placed through the platform increases.

The platform also facilitates better data analytics and market insights and Ord Minnett expects the company may also be able to charge underwriters for data from its platform.

All the large insurers have already signed up to the trading platform, with the exception of CGU, and this is expected to improve the take-up among brokers.

Benefits

The company envisages benefits for all three levels of the insurance transaction. The platform provides large data analytics capability for insurers, which should facilitate adjustments to pricing as comparisons are made with other market operators.There will also be reduced distribution costs and access to the Steadfast network for all policies on the platform.

For insurance brokers there is minimal data entry for each insurer and the ability to assess all market quotes upon renewal. Time is reduced on generating quotes and comparing policy documents, while there is access to leading insurers with no access costs. There is also a fixed, transparent commission fee structure.

For the client there is improved pricing competition, consistent policy wording to ensure quotes are providing the same level of cover, and firm quotes instead of indicative prices.

FNArena's database shows three Buy ratings for Steadfast. The consensus target is $3.13, suggesting 11.9% upside to the last share price.

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The Coming Copper Crunch

Richard (Rick) Mills Ahead of the Herd

As a general rule, the most successful man in life is the man who has the best information.

Copper had one of its best years ever in 2017, rising 27% on the back of supply disruptions and steady demand from China, by far the largest copper consumer.

Commodities analysts are usually wrong about copper supply, always predicting a glut in the market for the ubiquitous metal used in everything from piping for plumbing to wiring in houses, to components of electric vehicles. What they fail to account for is the inevitable stoppages at the major copper mines due mostly to strikes and weather problems.

In 2017 however they were right. In January last year a collection of analysts - BMI, Goldman Sachs, Citigroup and TD - were all bullish on copper, saying that after a terrible 2015 and 2016, it would be the strongest performing metal of 2017 with predictions of up to $6,200 a tonne come mid-year. By the end of 2017 copper futures trading on the London Metal Exchange (LME) were at their highest in four years, $7,236.50 a tonne or $3.28 a pound. Copper wasn't the best performing metal of 2017 (that would be cobalt) but it was third behind palladium.

So how has copper done so far in 2018? The base metal is showing a V-shaped curve, with LME copper starting the year at $7,200 a tonne, bottoming out at $6,499 on March 26, and currently trades at $6,721. Spot copper follows the same pattern. It started 2018 at just under $7,200 and was at $6,782 ($3.08) as of May 4. Copper has traded up sharply since the end of March but has pulled back since the end of April.

So what's happening with the copper market and what are the prospects for junior copper companies wanting to find the next big discovery to be gobbled up by a major? This article will take a look at the copper market in detail, including uses, the supply-demand trends, and pricing. The overall conclusion is that copper is heading for a major shortfall, which can only mean one thing: higher prices.

Copper uses

Copper is one of the few metals that occur naturally in the earth's crust as opposed to needing to be extracted from ore. For that reason, copper was the first metal ever used by early humans, from around 8,000 BC. Three thousand years later homo sapiens figured out how to smelt copper from its ore, and around 3,500 BC, to alloy it with tin to create bronze. Bronze was useful for tools and weapons, making it one of the most important inventions in the history of civilization. Copper was later used in roofing, and still is, for its strength and oxidized green look, as well as in works of art. Copper, or Cu, is also known to be essential for all living organisms. In humans trace elements of copper are found in the liver, muscle and bone. The body contains between 1.4 and 2.1 mg of copper per kilogram.

The Copper Development Association divides modern-day uses of copper into four categories: electrical, construction, transport and other. By far the largest sector for copper usage is electrical, at 65%, followed by construction at 25%.

Copper is useful for electrical applications because it is an excellent conductor of electricity. That, combined with its corrosion resistance, ductility, malleability, and ability to work in a range of electrical networks, makes it ideal for wiring. Among electrical devices that use copper, are computers, televisions, circuit boards, semiconductors, microwaves and fire prevention sprinkler systems.

In telecommunications, copper is used in wiring for local area networks (LAN), modems and routers. The construction industry would not exist without copper; as mentioned it is essential for wiring in residential and commercial construction. The red metal is also used for potable water and heating systems due to its ability to resist the growth of water-borne organisms, as well as its resistance to heat corrosion.

Lastly, the transportation industry is reliant on copper for core components of airplanes, trains, cars, trucks and boats. A commercial airliner has up to 190 kilometers of copper wiring, while high-speed trains use up to 10 tonnes of copper per kilometer of track.

Automobiles have used copper and brass radiators and oil coolers since the 1970s. More recent applications including on-board navigation, anti-lock braking systems, heated seats, defrosting wires embedded in windows, hydraulic lines, and wiring for window and mirror controls.

In electric vehicles (EVs), copper is a major component used in the electric motor, batteries, inverters, wiring and in charging stations.

UBS recently did a "thought experiment" whereby they visualized what would happen to the demand for metals that go into EVs if consumers suddenly shifted to Chevy Volts from the current auto mix. They found that copper demand would surge 22% - a fairly modest increase compared to other battery metals which would see leaps of use in the triple digits. (see table below) An average electric vehicle contains 85 kilograms of copper compared to 25 kg for regular vehicles.

The latest use for copper is in renewable energy technologies, particularly in photovoltaic cells used for solar power, and wind turbines.

The copper market

According to the US Geological Survey (USGS), 2.1billion tonnes of copper resources have been identified throughout the world, with the most common deposit being porphyries, representing 1.8 billion tonnes. By far the country with the most reserves is Chile, at 170 million tonnes, while Australia is second at 88 million tonnes and Peru a close third at 81 million tonnes. JORC-compliant reserves for Australia though are only about 24 million tonnes so really the top two copper depositories are Chile and Peru. The United States has 45 million tonnes of reserves, around the same as Mexico.

In terms of production, in 2017 Chile produced the most copper, 5.3 million tonnes, with Peru second at 2.3 million and the China third, 1.8 million. The US cranked out 1.2 million tonnes of copper last year. Total mined production was just under 20 million tonnes in 2017.

The top four copper companies produce around two-thirds of the metal, and the 10 biggest firms produced $644 billion worth of copper in 2017 at a price of $3.10 a pound, according to stats from Infomine. The top 10 copper companies are, in order, Codelco, Freeport McMoRan, Glencore, BHP Billiton, Southern Copper, KGHM Polska Miedz, Rio Tinto, First Quantum, Antofagasta and Vale.

Who buys the most copper? By far the largest copper consumer is China - representing about 50% of global demand. Due to its large manufacturing sector, the Chinese import roughly 70% of the copper they use. Other big copper consumers are the manufacturing sectors in Europe and the United States. Global refined copper demand has risen steadily from 2005, when it was around 18 million tonnes, to the current global consumption of about 24 million tonnes. Immediately we can see that demand is currently outstripping supply by about 4 million tonnes, annually. More on this when we get into the details of the copper forecast.

Before that, let's take a look at what happened in the copper market in 2017. As mentioned the copper price had one of its best years, rising 27%. Supply issues were one of the main factors driving the price up. According to the International Copper Study Group (ICSG) copper production declined nearly 3% in the first five months of 2017 due primarily to a 43-day strike at Escondida, the world's largest copper mine in Chile. Lower output from Codelco mines plus a 21-day strike at the Cerro Verde mine in Peru also tightened supply.

Meanwhile in Indonesia, a dispute between US-based producer Freeport McMoran and the Indonesian government saw the country implement a temporary ban on concentrate exports from the Grasberg mine. The ban was lifted three months later. Violent protests erupted at Grasberg last August, after workers were fired for taking part in the strike action. A resolution to the issue was finally reached in October, but the strikes and protests are estimated to have cost Grasberg, which produces around 3% of the world's copper supply, a 5% decline in production. Canada and Mongolia each saw production declines in 2017 of about 20%, according to JLT Specialty, a London-based insurance and risk management firm, due to lower ore grades. In the United States copper production also dropped by nearly 11% due to lower grades, lower mining rates and poor weather.

On the demand side, copper consumption last year was driven by Chinese growth and expectations of US demand for copper based on statements from President-elect Donald Trump, who promised $1 trillion to help repair America's crumbling infrastructure. Soon after Trump won the election in November 2016 the copper price rose nearly 2%.

According to JLT Specialty, China's retail and industrial sectors grew a respective 10.4% and 6.9% in the first half of 2017, spurring demand for more copper. Most of that copper went to, and is going to, China's power grid which accounts for almost half of the country's total copper requirements. The $4-trillion One Belt One Road initiative is meant to open channels between China and its neighbors, mostly through infrastructure investments that will require large quantities of metals including copper.

Other Chinese initiatives that will help drive copper demand include:

The Beijing-Tianjin-Hebei integration, a $1.5 billion fund that promotes the government's plan to integrate the economies of Beijing and Tianjin with the surrounding Hebei province. Made in China 2025 initiative Electric cars. About 375,000 EVs were made in China in 2016 according to consultancy McKinsey & Company - representing 43% of the global market for electric vehicles. China is the leader in the supply of and demand for electric vehicles, overtaking the US in 2016. Six of the 10 biggest EV makers are in China. As noted above copper is a necessary component of EVs so as demand for them grows, so will the need for copper.

The forecast calls for (supply) pain

Given that China is growing (while not at double digits like in the 2000s, 7% is still not bad), it has grand plans for infrastructure, and it is motivated to keep building more electric vehicles in order to cut down on smog that is choking its overpopulated cities, what does the copper market have in store for investors over the next few years? Along with demand calculations the answer should take into account inevitable stoppages due to strikes and weather, which happen every year without fail, thus putting downward pressure on supply.

Here we get some help from the USGS and the ICSG, both of which offer insights into whether we are looking at a deficit or a surplus. The latest numbers from ICSG show a 3.5% increase in world copper production in January, or 60,000 tonnes, owing to: 6% more copper from Chile, a recovery in solvent-extraction-electrowinning (SX-EW) in the DRC and Zambia, and higher production in Indonesia and China.

World refined production (defined as metal containing at least 97.5 % copper by weight) was also up in January, by 5.2%, with China contributing the most (an increase of 8%) due to capacity expansion. Refined copper production in Japan, Indonesia, DRC and Zambia also accounted for the increase.

However on the consumption side, as of January, world apparent refined copper usage increase by around 5.5%, with China again leading the way with usage increasing by 9% due to increases in both refined production and copper imports. The world refined copper balance for January therefore showed a small surplus of about 33,000 tonnes.

That doesn't look like a good number for copper bulls to start the year on, but wait, it gets better. According to the ICSG's copper market forecast from last fall, while 2018 world mine production is expected to reach 20.3 million tonnes (+2.5%), world apparent refined copper usage will also go up, by 2%.

"Sustained growth in copper demand is expected to continue because copper is essential to economic activity and even more so to the modern technological society. Infrastructural development in major countries such as China and India will continue to sustain growth in copper demand," reads the forecast.

But copper demand growth in China for all the above-stated reasons is expected to be around 3% in 2018 for both apparent and real usage, states ICSG, with the rest of the world's demand at 1.5%, meaning that there is expected to be a deficit of world refined copper in 2018 of 105,000 tonnes.

ICSG reports that as of the end of March, copper stocks held at major metals exchanges (LME, COMEX, SHFE) totalled 900,000 tonnes, an increase of 66% from stocks held at the end of December 2017 - the highest level since 2003.

Disruptions in the copper market averaged 900,000 tonnes of copper supply per year between 2004 and 2012, 2015 saw a record mine disruption of 1.33mt. Because copper is infamous for its unpredictable supply, analysts covering copper build a disruption allowance into their estimates, typically 5% of global mined supply.

Consultancy KPMG is a little more dramatic on both the supply and demand end, expecting global mine production to increase 5.5% in 2018, to 21.3 million tonnes - leading to a surplus of 478,000t. The increases would come from the new Cobre Panama mine, with capacity for 330,000t per annum, the Qulong copper mine in China, at 120,000t a year. Codelco's Radomiro mine in Chile and Southern Copper's Toquepalain mine in Peru would each contribute 100,000t in 2018.

In total KPMG expects mine production to increase at a CAGR of 3% from 2017 to 2020, reaching 22 million tonnes that year. Refined copper production would grow from 23 million tonnes in 2017 to 24.6 million by 2020, driven mostly by new refining capacity in China.

However KPMG is predicting that by 2020 global copper demand will outstrip mine output and will pull even with refined copper production. By 2020 the consultancy says copper consumption will reach 24.5 million tonnes "driven by growth in global industrial production and higher investment in energy infrastructure." An acceleration in demand for EVs and renewable energy over the next two years are expected to be the main copper demand drivers.

Looking beyond this decade, the copper deficit widens considerably, according to experts quoted at the 17th World's Copper Conference in Santiago, Chile in April. While supply and demand will remain relatively evenly balanced until 2019 or 2020, after that, "the deficit will become increasingly evident," MINING.com quoted Arnaud Soirat, chief executive for copper and diamonds at Rio Tinto.

CRU analyst Hamish Sampson said unless new investments arise, existing mine production will drop from 20 million tonnes to below 12 million tonnes by 2034, leading to a supply shortfall of more than 15 million tonnes. (see chart below). That's because over 200 copper mines are expected to run out of ore before 2035, with not enough new mines in the pipeline to take their place.

Only if every single copper project currently in development or being studied for feasibility is brought online before then, including most discoveries that have not yet reached the evaluation stage, the market could meet projected demand, the consultant said. - MINING.com

While Rio Tinto has an extension in the works for its Mongolian copper mine, Oyu Tolgoi, there are few major new copper mines (except maybe Cobre Panama) being developed. The copper pipeline as of April is reportedly the lowest seen this century, although according to Hamilton, the CRU analyst, the biggest bottleneck to increasing copper supply is existing operations. For the first 10 months of 2017 copper production trailed consumption by 175,000 tonnes, due to the 43-day strike at Escondida and the ban on concentrate shipments from Grasberg. A copper analyst at BMO quoted by MINING.com said the world's top copper operations in 2007 presently produce 10% to 15% less than they did 11 years ago, and he expects that trend to continue. And things aren't expected to get better on the labor front. Over 30 labor contracts are up for negotiations this year in Chile and Peru - the two largest copper producers - putting around a fifth of global copper supply at risk of disruption. So far this year there is no labor agreement in place at Escondida, the site of last year's record-long strike and violence. The current contract expires on July 31.

Lower ore grades are also expected to be painted into the waning supply picture. As an example, during the first quarter, top 10 copper miner Antofagasta saw its output fall by 10.5% due to lower quality ore. At the World's Copper Conference, the managing director of a mining-focused private equity firm said copper grades have declined about 25% in Chile in the last decade - highlighting the urgent need for grassroots exploration to arrest the trend.

Why everyone can't use copper like an American

The preceding analysis has shown that the copper market will be in relative balance for next few years, but then demand will gradually, or perhaps dramatically, push past supply. This begs the question, with a growing population, and emerging economies, will there be enough copper to go around?

At this moment there are slightly over 7 billion people living on this planet. An urbanization rate of 53% means there are roughly 3.71 billion city dwellers in the world today. It has been estimated that by the year 2050 our global population will reach 10 billion people.

The developing world's urban centers are expected to burgeon, drawing 96% of the additional 1.4 billion people by 2030. Due to the overall growing global population - but especially an exploding urban population (urban populations consume much more food, energy, and durable goods than rural populations) - demand for water, food, housing, heat, energy, clothing, and consumer goods is going to increase at an astounding rate.

We already have one billion people out of today's current population slated to become significant consumers by 2025.

Another 2.8 billion people will be added to the world between now and 2050. Most will not be Americans but they are going to want a lot of things that we in the Western developed world take for granted – electricity, plumbing, appliances, AC etc.

But what if all these new one billion consumers were to start consuming, over the next 10 years, just like an American? What's going to happen to the world's mineral resources if one billion more 'Americans' are added to the consuming class? Here's what each of them would need to consume, per year, to live the American lifestyle...

In 2010, more than 38,000 pounds (19 tons) of minerals and fuels were needed per person to maintain the American lifestyle.

One billion new consumers by 2025. Can everyone who wants to, live an American lifestyle? Can everyone everywhere else have everything we in North America have? The answer is a resounding no!

If we mined every last discovered, and undiscovered, pound of land-based copper, the expected 8.2 billion people in the developing world would only get three quarters of the way towards copper use parity per capita with the US.

Of course the rest of us, the other 1.8 billion people expected to be on this planet by 2050, aren't going to be easing up, we're still going to be using copper at prestigious rates while our developing world cousins play catch up.

Copper use parity isn't going to happen, it can't.

"Concern about the extent of mineral resources arises when the stock of metal needed to provide the services enjoyed by the highly developed nations is compared with that needed to provide comparable services with existing technology to a large part of the world's population. Our stock data demonstrate that current technologies would require the entire copper and zinc ore resource in the lithosphere and perhaps that of platinum as well. Even a lower level of services could not be sustained worldwide because a continuing supply of new metal is needed to make up for inevitable losses in the recycling of the metal stock-in-use.

Substitution has the potential to ameliorate this situation, but one should not automatically assume that technology will produce a satisfactory substitute for every service at an affordable price and precisely when needed.

...anthropogenic and lithospheric stocks of at least some metals are becoming equivalent in magnitude, that world-wide demand continues to increase, and that the virgin stocks of several metals appear inadequate to sustain the modern "developed world" quality of life for all Earth's peoples under contemporary technology...Do we really envision a developed world quality of life for all of the people of the planet...?" R. B. Gordon, M. Bertram, and T. E. Graedel, Metal Stocks and Sustainability

Need for discoveries

It should be apparent by now, that in order to improve the supply-demand imbalance and delay, or maybe even avoid, the coming copper crunch, there needs to be a lot of new copper exploration done. All the low hanging copper fruit has been picked - either mined, refined or recycled - so where are new economic copper deposits to be found? Once again we return to the annual industry conference in Santiago, Chile. According to conference organizer CRU, the supply gap requires that every copper mining project with a feasibility study is developed, and over 90% of new projects "see the light of day", Investorintel reports.

The publication identifies a few trends as far as copper exploration that could help to build up the development pipeline:

Major mining companies that slashed exploration budgets during the lean years 2012-16 have restored those budgets and have more to spend on juniors. Copper exploration teams are too focused on getting quick results using computer data and are losing the art of geoscience to find deposits. With capital costs for new copper projects high, mining companies are teaming up to bring them down. An example is BHP and Rio Tinto's JV to develop the Resolution Copper project in Arizona.

Conclusion

The daily movements of the copper price give some idea of short-term global economic fundamentals, since copper is such an important metal for industrial uses. Demand for copper is a good indication of the relative strength of the economy in question. However it takes a higher-level, longer-term view to see what's really happening in the copper market. And what's happening is that copper supply is NOT going to be able to keep up with demand in the long-term.

Even with expansions at existing mines and the ramp-up of the relatively few new copper mines like Cobre Panama, Radomiro and Toquepalain, it will not be enough to meet the onslaught of demand that is coming from China as it continues to modernize and urbanize, and electric vehicles, which use three times as much copper as regular ones. In 2016, Chinese carmakers sold 28 million cars. If China follows through on its promise to go 100% electric, that would mean 2,380,000,000 kilograms of copper. At the current production rate of 20 million tonnes a year, that's 119 years' worth of copper! Just to produce enough copper for electric cars in China.

Do I expect 100% EV penetration? No, I don't. But the shift to electrification of our transportation system is real, it's not going to go away or stop. Because it's as real as the shift from wood to coal to fossil fuels and now to lithium. That means massive new copper supplies are needed just for Chinese EV's, whatever the EV penetration eventually turns out to be. And remember there's the rest of the world to supply for EV's and all of copper's other uses.

Bottom line? We gotta find more copper. Preferably Tier 1 assets, aka copper "elephants". I've got my eye on junior copper developers (and I'll be introducing them very soon in my newsletter) that can help to fill the massive deficit that is coming the market's way. Do you?

If not, perhaps you should.

Richard (Rick) Mills

rick@aheadoftheherd.com

Richard is the owner of Aheadoftheherd.com and invests in the junior resource/bio-tech sectors. His articles have been published on over 400 websites, including:

WallStreetJournal, USAToday, NationalPost, Lewrockwell, MontrealGazette, VancouverSun, CBSnews, HuffingtonPost, Londonthenews, Wealthwire, CalgaryHerald, Forbes, Dallasnews, SGTReport, Vantagewire, Indiatimes, ninemsn, ibtimes and the Association of Mining Analysts.

If you're interested in learning more about the junior resource and bio-med sectors, and quality individual company's within these sectors, please come and visit us at www.aheadoftheherd.com

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Material Matters: M&A, Coal, Copper & Nickel

A glance through the latest expert views and predictions about commodities. M&A; thermal coal; copper; and nickel.

-M&A environment now more robust, Citi selects buyers and targets -Seaborne market likely to benefit from China's contradictory measures in thermal coal -Credit Suisse expects copper market to turn to surplus -Nickel/stainless steel relationship disrupted

By Eva Brocklehurst

M&A

Globally, Citi notes miners avoided M&A in 2017, as acquisitions were at the lowest level since 2003. Coinciding with this, capital expenditure fell more than 90% since the 2012 peak.

The environment is now more robust and, with cash being generated, the broker expects the sector will look to become more active. The broker summarises the five most-likely acquirers and five most-likely targets in its coverage.

South32 ((S32)), Independence Group ((IGO)), Sandfire Resources ((SFR)), Northern Star Resources ((NST)) and St Barbara ((SBM)) are considered the most likely buyers as they have capacity, clean records with M&A and challenges regarding the maintenance or growth of their production.

The five most-likely targets include Whitehaven Coal ((WHC)), OZ Minerals ((OZL)), Resolute Mining ((RSG)), Perseus Mining ((PRU)) and Galaxy Resources ((GXY)) as these have the best combinations of longevity and growth, with strong margins and value. Each produces a single specific commodity which would offer the motivated buyer targeted exposure to that particular commodity.

Thermal Coal

A 16% rise in China's domestic thermal coal price has instigated a raft of new measures from the government, aimed at bringing the price down to RMB570/t by June 10 while bringing additional supply into the market.

Morgan Stanley notes these are seemingly contradictory goals. The measures have had an immediate impact on the domestic market as power plants have cancelled spot market orders and traders offloaded inventory. The measures are also weighing on seaborne markets as trade stalls.

Beyond the immediate disruption the ultimate impact on the seaborne market is less clear, the broker observes. Bringing on new supply while lowering prices remains a tall order, and previous intervention by the Chinese government has not been wholly successful.

Hydro power generation remains weak and thermal coal is still contributing around 75% of China's total electricity supply. Domestic miners are also likely to be reluctant to commit to significant expansions amid low contract prices, and the reduction in inventory could now lead to shortfalls throughout the Chinese summer.

The broker suggests China's power utilities may become increasingly dependent on the seaborne market for supply, underpinning seaborne prices. India is also struggling to achieve sufficient coal supply through its peak demand season. Morgan Stanley suggests the thermal coal market is set to remain tight over coming months.

Copper

Credit Suisse believes the copper market will turn towards surplus this year, in accordance with copper market indicators which show no tightness exists. The broker suspects the market is hoping for disruptions to mine supply, specifically in Chile as wage negotiations take place.

Yet, little disruption is expected on this front because strong copper prices incentivise mines to settle with unions. The important Escondida negotiations will occur in June and Credit Suisse expects a settlement will be reached. Going forward, the broker expects copper to be in surplus until 2022.

While there are fewer mine expansions underway, equally important, consumption growth is slowing which relieves the need for increased mine production. China's consumption sectors such as grid expenditure, housing sales, infrastructure and appliances are all looking softer than in 2017.

The broker expects prices to fall towards a cost support level, now seen at around US$2.70/lb versus US$2.30-40/lb, and tracking below US$3.00/lb by the September quarter. The broker lifts price forecasts from 2019, given costs have not declined as expected.

This is probably because of the impact of higher oil prices and stronger FX in some producing countries such as Chile. As the impact washes through the market, Credit Suisse expects costs to stabilise and slowly decline. The broker forecasts a price of US$2.70/lb for copper from 2020.

Nickel

Citi observes the relationship between nickel prices and stainless steel stocks has broken down over the last 7-8 months. The nickel price is up 40% since October and European listed stainless steel stocks down -15% on average. Nickel costs constitute around 75% of the price of 304 grade stainless steel, the most common grade.

The broker suggests nickel is being supported by the electric vehicle industry as the key input in new emerging battery technologies.

Although less than 3% of nickel metal currently goes into batteries, and over 80% goes into stainless steel, projections for substantial growth in electric vehicles over the next 15 years have raised expectations that 30-40% of demand could come from batteries. This has led to rises in the nickel price.

Meanwhile, stainless steel is being weighed down by over-production, which has been strong in both Indonesia and China and resulted in inventory spiking to the highest levels ever in China.

Although inventory has started to moderate, the broker notes the high absolute levels mean stainless base prices have struggled. Hence, Citi believes the divergences between stainless steel and nickel is likely to be sustained over the medium term.

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 May 21 to Friday May 25, 2018 Total Upgrades: 7 Total Downgrades: 7 Net Ratings Breakdown: Buy 45.20%; Hold 39.89%; Sell 14.91%

Local plumbers' favourite Reliance Worldwide made a big acquisition in the UK, in what could prove a transformative event in the company's development, and two stockbroking analysts responded by upgrading their ratings for the shares. This proved sufficient to keep upgrades and downgrades in perfect balance for the week ending Friday, 25th May 2018.

FNArena counted seven upgrades and downgrades for the week from the eight stockbrokerages monitored daily. Among the stocks receiving downgrades were OZForex and TechnologyOne; both had reported financial numbers.

There were only a handful of consensus price targets that moved higher during the week, but those that did were worth paying attention to. Perennial outperformer Aristocrat enjoyed yet another boost of nearly 16% -good for top spot for the week- followed by Reliance Worldwide, Metcash and Treasury Wines.

On the negative side, AMP's target suffered most (-3%), followed by Boral and Link Administration. Telstra is in there too, but only with a minor downward adjustment of -0.38%. A sign?

Aristocrat was beaten by James Hardie for the week's top ranking in positive adjustments to earnings estimates. Fletcher Building and CSL enjoyed some sizeable upward amendments too. The flipside looks equally meaty, with Ansell's consensus forecasts losing most (-8.7%), followed by Healthscope (another profit warning) and Asaleo Care.

The local out-of-season reporting season draws to an end, but there could still be plenty of fireworks coming from AGMs and investor days, while confession season has thrown up a few profit warnings yet, albeit mostly from already troubled smaller cap companies.

Upgrade

ARISTOCRAT LEISURE LIMITED ((ALL)) Upgrade to Outperform from Neutral by Credit Suisse .B/H/S: 7/1/0

Credit Suisse' response to Aristocrat's result is to increase forecast earnings by 13%, increase its target to $35 from $28, and upgrade its rating to Outperform. The standout performance was posted by digital.

The broker sees the potential for the company to scope out a much bigger position in the US mobile games industry from a current 2% market share. Even if this is not the case, strong cash flow will rapidly reduce debt. If it is the case, digital earnings should prove more sustainable than those of machines, for which market share shifts over time, the broker notes.

AMP LIMITED ((AMP)) Upgrade to Overweight from Equal-weight by Morgan Stanley .B/H/S: 4/3/1

Morgan Stanley believes AMP offers deep value and a potential path to rebuilding its brand. Elevated uncertainty, fear and speculation around the future of the company's business model appear overdone to the broker.

Morgan Stanley believes the company's resilience will likely surprise and upgrades to Overweight from Equal-weight. Target is reduced to $4.50 from $5.75. Industry view: In line.

FLETCHER BUILDING LIMITED ((FBU)) Upgrade to Neutral from Underperform by Macquarie .B/H/S: 2/4/0

The company has completed its NZ$750m entitlement offer which Macquarie believes will provide a firm of platform on which to execute its strategic objectives. The broker believes the company's move to consolidate its product and geographic spread will be well received.

More about this strategy will be learned in June. Macquarie upgrades to Neutral from Underperform. Target is raised to NZ$6.54 from NZ$5.30.

METCASH LIMITED ((MTS)) Upgrade to Accumulate from Lighten by Ord Minnett .B/H/S: 3/3/1

Ord Minnett reviews the investment thesis and recognises it may have been too hasty in downgrading Metcash. Estimates for EPS are raised by 2.7% for FY19 and 7.4% for FY20 because of forecasts for higher sales and margin in food & grocery and stronger hardware earnings.

The broker is more confident that food deflation is easing while the independent retailer network appears in better shape. Rating is upgraded to Accumulate from Lighten. Target rises to $3.75 from $2.65.

RELIANCE WORLDWIDE CORPORATION LIMITED ((RWC)) Upgrade to Add from Hold by Morgans and Upgrade to Hold from Sell by Deutsche Bank .B/H/S: 2/1/0

The company will acquire John Guest for GBP687.5m. Morgans believes the acquisition makes strategic sense, providing product, geographic and customer diversification. John Guest is headquartered in the UK and has a strong European distribution platform with operations in the US and Asia Pacific.

The acquisition is expected to complement the company's existing portfolio. If management can execute well then there are multiple long-term growth opportunities, Morgans suggests. The broker upgrades to Add from Hold and the target is raised to $5.46 from $4.33.

The company will acquire John Guest, a UK manufacturer of fittings for plumbing, heating and industrial applications. The acquisition make strategic sense to Deutsche Bank, given John Guest's strong PTC offering in Europe.

However, as a word of caution, the acquisition adds further risk to a business that has many strategies, the broker points out. Rating is upgraded to Hold from Sell. Target is raised to $4.35 from $3.90.

TELSTRA CORPORATION LIMITED ((TLS)) Upgrade to Buy from Neutral by UBS .B/H/S: 4/2/2

UBS continues to believe the $0.22 dividend is unsustainable and a reduction from as early as FY20 is likely. However, with the downside largely known and the full 5G/NBN upside being factored in by the market the broker upgrades to Buy from Neutral.

In the short term the June strategy day could be a positive, as the company has flagged that it will show how its $3bn strategic capital expenditure and cost reduction program will allow it to be more "bold".

UBS speculates on an NBN bypass and an aggressive push on market share. Target is raised to $3.00 from $2.80.

Downgrade

ASALEO CARE LIMITED ((AHY)) Downgrade to Underperform from Neutral by Credit Suisse .B/H/S: 0/1/2

Credit Suisse observes the share price has rallied and presents an opportunity to take some profits. The broker downgrades 2018-20 estimates for EPS by -3-16% because of persistent increases in pulp and fluff costs.

Critical to the broker's estimates is the assumption that sales growth will continue beyond 2018, as management is taking action to rejuvenate tissue sales. The company has reported declining sales for the past three years.

Rating is downgraded to Underperform from Neutral. Target is reduced to $1.30 from $1.35.

AIR NEW ZEALAND LIMITED ((AIZ)) Downgrade to Underperform from Neutral by Credit Suisse .B/H/S: 1/1/2

Credit Suisse downgrades to Underperform from Neutral as oil prices have risen, coinciding with a strengthening of the US dollar against the New Zealand dollar.

Taking into account current hedging, the broker expects limited impact on FY18 earnings but the persistent increase in oil suggests negative revisions for FY19.

Neutral maintained. Target is reduced to NZ$2.98 from NZ$3.00.

BORAL LIMITED ((BLD)) Downgrade to Underperform from Neutral by Credit Suisse .B/H/S: 4/1/1

Credit Suisse suspects fly ash earnings will be disappointing. While the US fly ash business has many attributes of a great investment, the broker believes industry success at redirecting easily available supply to high-value applications is approaching a limit.

The broker also points out that the company was unable to grow its fly ash revenue in the last decade and targeted storage and reclamation efforts by Headwaters were not met in the ownership transition.

Credit Suisse suggests growth expectations for North America are too high and downgrades to Underperform from Neutral. Target is reduced to $6.40 from $7.45.

OZFOREX GROUP LIMITED ((OFX)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 0/2/0

FY18 net profit was in line with expectations. The company has noted a more competitive operating environment and lower levels of currency volatility.

Macquarie was disappointed with the active client growth in FY18 and believes client acquisition and overall activity levels are necessary to support an improved outlook for profitability and earnings growth.

The broker downgrades to Neutral from Outperform. Target is raised to $1.83 from $1.71.

PINNACLE INVESTMENT MANAGEMENT GROUP LIMITED ((PNI)) Downgrade to Hold from Buy by Ord Minnett .B/H/S: 0/1/0

The company has outperformed recently and, while Ord Minnett understands newly-formed boutiques are performing well, current pricing appears to be offering little margin of safety.

The broker upgrades assumed funds under management for Firetrail but pairs back those for most other boutiques following a soft investment performance in the third quarter. While remaining positive on the stock Ord Minnett considers the price full and downgrades to Hold from Buy. Target price reduced to $5.19 from $5.31.

SANTOS LIMITED ((STO)) Downgrade to Sell from Neutral by Citi .B/H/S: 1/2/2

Now that Santos has rejected Harbour Energy's higher offer, Citi analysts suggest the company narrative will shift towards growth in the coming months. They also point out, the fact that Harbour Energy said it wasn't impressed from the due diligence "complicates" things just a tad more.

As Citi has reverted back to a Sum-of-the-Parts (SoTP) methodology to value the shares, including long-term oil priced at US$55/bbl, the rating falls to Sell from Neutral. New price target is $5.30.

TECHNOLOGY ONE LIMITED ((TNE)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 0/3/0

FY18 guidance is below Macquarie's expectation and implies flat growth year-on-year. The broker notes issues in the consulting division have carried through into FY18 and the UK business is taking longer to reach a profitable scale.

The broker believes a turnaround in consulting, acceleration of the SaaS platform and clarity around upcoming accounting changes are needed for the stock to re-rate. Rating is downgraded to Neutral from Outperform. Target is $4.77.

Total Recommendations Recommendation Changes

Broker Recommendation Breakup

Broker Rating Order Company New Rating Old Rating Broker Upgrade 1 AMP LIMITED Buy Neutral Morgan Stanley 2 ARISTOCRAT LEISURE LIMITED Buy Neutral Credit Suisse 3 FLETCHER BUILDING LIMITED Neutral N/A Macquarie 4 METCASH LIMITED Buy Sell Ord Minnett 5 RELIANCE WORLDWIDE CORPORATION LIMITED Buy Neutral Morgans 6 RELIANCE WORLDWIDE CORPORATION LIMITED Neutral Sell Deutsche Bank 7 TELSTRA CORPORATION LIMITED Buy Neutral UBS Downgrade 8 AIR NEW ZEALAND LIMITED Sell Neutral Credit Suisse 9 ASALEO CARE LIMITED Sell Neutral Credit Suisse 10 BORAL LIMITED Sell Neutral Credit Suisse 11 OZFOREX GROUP LIMITED Neutral Buy Macquarie 12 PINNACLE INVESTMENT MANAGEMENT GROUP LIMITED Neutral Buy Ord Minnett 13 SANTOS LIMITED Sell Neutral Citi 14 TECHNOLOGY ONE LIMITED Neutral Buy Macquarie Recommendation Positive Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 RWC RELIANCE WORLDWIDE CORPORATION LIMITED 50.0% 13.0% 37.0% 3 2 GOZ GROWTHPOINT PROPERTIES AUSTRALIA -67.0% -100.0% 33.0% 3 3 TWE TREASURY WINE ESTATES LIMITED 21.0% 7.0% 14.0% 7 4 LNK LINK ADMINISTRATION HOLDINGS LIMITED 57.0% 43.0% 14.0% 7 5 MTS METCASH LIMITED 21.0% 7.0% 14.0% 7 6 ALL ARISTOCRAT LEISURE LIMITED 81.0% 69.0% 12.0% 8 7 TLS TELSTRA CORPORATION LIMITED 25.0% 13.0% 12.0% 8 8 AMP AMP LIMITED 31.0% 19.0% 12.0% 8 9 SVW SEVEN GROUP HOLDINGS LIMITED 90.0% 80.0% 10.0% 5 Negative Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 AHY ASALEO CARE LIMITED -67.0% -33.0% -34.0% 3 2 BLD BORAL LIMITED 42.0% 58.0% -16.0% 6 3 FBU FLETCHER BUILDING LIMITED 33.0% 40.0% -7.0% 6 Target Price Positive Change Covered by > 2 Brokers Order

Symbol Company New Target Previous Target Change Recs 1 ALL ARISTOCRAT LEISURE LIMITED 34.159 29.458 15.96% 8 2 RWC RELIANCE WORLDWIDE CORPORATION LIMITED 4.870 4.533 7.43% 3 3 MTS METCASH LIMITED 3.279 3.121 5.06% 7 4 TWE TREASURY WINE ESTATES LIMITED 17.126 16.626 3.01% 7 5 GOZ GROWTHPOINT PROPERTIES AUSTRALIA 3.153 3.130 0.73% 3 Negative Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 AMP AMP LIMITED 4.369 4.525 -3.45% 8 2 BLD BORAL LIMITED 7.605 7.780 -2.25% 6 3 LNK LINK ADMINISTRATION HOLDINGS LIMITED 7.971 8.081 -1.36% 7 4 AHY ASALEO CARE LIMITED 1.333 1.350 -1.26% 3 5 TLS TELSTRA CORPORATION LIMITED 3.380 3.393 -0.38% 8 Earning Forecast Positive Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 JHX JAMES HARDIE INDUSTRIES N.V. 97.759 81.717 19.63% 6 2 ALL ARISTOCRAT LEISURE LIMITED 116.457 107.157 8.68% 8 3 FBU FLETCHER BUILDING LIMITED -6.176 -6.624 6.76% 6 4 CSL CSL LIMITED 490.273 465.930 5.22% 8 5 RWC RELIANCE WORLDWIDE CORPORATION LIMITED 16.150 15.825 2.05% 3 6 BLD BORAL LIMITED 41.188 40.603 1.44% 6 7 DLX DULUXGROUP LIMITED 38.350 37.806 1.44% 7 8 MPL MEDIBANK PRIVATE LIMITED 16.314 16.243 0.44% 7 9 TWE TREASURY WINE ESTATES LIMITED 48.983 48.840 0.29% 7 10 COH COCHLEAR LIMITED 433.000 431.857 0.26% 8 Negative Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 ANN ANSELL LIMITED 127.588 139.770 -8.72% 6 2 HSO HEALTHSCOPE LIMITED 8.950 9.690 -7.64% 7 3 AHY ASALEO CARE LIMITED 9.130 9.660 -5.49% 3 4 OZL OZ MINERALS LIMITED 73.200 75.629 -3.21% 6 5 AMP AMP LIMITED 32.229 32.514 -0.88% 8 6 NHF NIB HOLDINGS LIMITED 29.013 29.225 -0.73% 8 7 SCG SCENTRE GROUP 24.629 24.771 -0.57% 7 8 CTD CORPORATE TRAVEL MANAGEMENT LIMITED 80.580 80.980 -0.49% 5 9 GOZ GROWTHPOINT PROPERTIES AUSTRALIA 23.167 23.250 -0.36% 3 10 ECX ECLIPX GROUP LIMITED 27.425 27.500 -0.27% 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: Interest Building

The spot uranium price ticked up again last week and growing 2019 demand suggests further upside.

-Prices improving -US conundrum -New reactors for Japan

By Greg Peel

Following the prior week's spurt of activity and breakout 5% price jump, the uranium spot market was again busy last week before fading towards the US long weekend. Utilities were once again among the buyers.

Industry consultant TradeTech reports 1.4mlbs U3O8 changed hands in ten transactions. The consultant's weekly spot price indicator rose a further US35c to US$22.85/lb.

Two term market transactions were concluded in the early mid-term delivery window. Prices for 2019 delivery continue to improve. TradeTech's term price indicators remain at US$25.50/lb (mid) and US$28.00/lb (long) pending end of month review.

Regulators and Lawmakers

The US uranium and nuclear power industries continue to present conundrums for US regulators and governments state and federal.

Last week the New Jersey governor signed a bill providing a subsidy for the continuing operation of the state's nuclear power plants via zero emissions certificates. The US nuclear industry has long argued nuclear power offers the same zero emissions as renewable energy and thus should not be undermined by the subsidies renewables enjoy.

The mining of uranium and the lengthy construction period for nuclear reactors is far from zero-emission, but that's another story.

At the federal level, the US Department of the Interior has published a list of 35 commodities, including uranium, which are considered critical to the economic and national security of the country.

All well and good, but the reality is last week at a capacity auction held by regional electricity grid operator PJM, three of Exelon's nuclear power plants failed to clear in the 2012-22 auction to supply the Mid-Atlantic and Midwest regions. The auction cleared 1000MW more gas-fired supply than last year and 500MW more coal-fired, but 7400MW less nuclear supply.

The US government wants to ensure nuclear power remains a necessary inclusion in a diversified electricity supply network for security of transmission sake, and that the uranium required to supply reactors is produced domestically to ensure national security.

The problem is, both industries will continue to run at a loss without taxpayer support.

Old and New

Over in Japan, focus has been on reactors that were operating prior to the Fukushima disaster restarting after a lengthy period of safety upgrades and approvals. However, at the time of the disaster there were also new reactors under construction, the design of which have subsequently had to be remodelled to meet much stricter safety standards.

Chugoku Electric last week moved to complete its Shimane unit 3 reactor, having this month requested consent of both the regulator and local government. Construction first began in 2005 before being suspended in 2011.

Chogoku's request follows a similar application by Japan Electric for its Ohma unit 1 reactor back in 2014, the first request to be made for a new reactor. However, despite the timing difference, Shimane 3's construction is more advanced and as such it would be the first new reactor to come on line in Japan post-Fukushima, assuming approval.

The Short Report

Guide:

The Short Report draws upon data provided by the Australian Securities & Investment Commission (ASIC) to highlight significant weekly moves in short positions registered on stocks listed on the Australian Securities Exchange (ASX). Short positions in exchange-traded funds (ETF) and non-ordinary shares are not included. Short positions below 5% are not included in the table below but may be noted in the accompanying text if deemed significant.

Please take note of the Important Information provided at the end of this report. Percentage amounts in this report refer to percentage of ordinary shares on issue.

Stock codes highlighted in green have seen their short positions reduce in the week by an amount sufficient to move them into a lower percentage bracket. Stocks highlighted in red have seen their short positions increase in the week by an amount sufficient to move them into a higher percentage bracket. Moves in excess of one percentage point or more are discussed in the Movers & Shakers report below.

Summary:

Week ending May 24, 2018

Last week saw the ASX200 plateau, having failed to breach the previous high, before tanking on May 22 despite the Dow being up 300 points. It was all domestic – Telstra exodus, Royal Commission and so forth.

Speaking of the RC, I have been keeping an eye on short positions in the banks and AMP, being top 20 stocks. Little movement has been seen in bank shorts as a result but AMP ((AMP)) shorts did start to tick up quietly, albeit not to an extent worth highlighting.

Last week AMP shorts rose to 3.5% from 2.8%.

I noted in last week's Report that Domino's Pizza ((DMP)) shorts had risen to 18.3% from 16.3% despite a rally in the stock price. Last week's ASIC data have Domino's back at 16.2%, suggesting a data anomaly.

In either case, the stock remains the second most shorted on the ASX.

I also highlighted Afterpay Touch's ((APT)) slide down the table following the signing of its first US customer. Last week the stock dropped off the 5% plus table.

And I highlighted Greencross' ((GXL)) steady move in the opposite direction. Last week Greencross entered the elite 10% plus club with an increase to 10.9% from 9.2%.

Indeed there was a lot of movement in short positions last week, in both directions, as the table below shows. Among the bigger movers are stocks this Report has highlighted in recent weeks.

Skin/haircare company BWX ltd ((BWX)) has received a takeover offer. Its shorts fell to 7.3% from 10.6% last week.

Retail Food Group's ((RFG)) share price had plunged -70% year to date following the company's franchisee scandal, but the appointment of a new CEO last week sparked a 20% rebound. Short-covering was involved, given shorts fell to 8.2% from 10.3%.

And I have noted in recent weeks tin miner Metals X ((MLX)) moving quietly up the table. Last week saw shorts rise to 8.6% from 7.3%.

As there are no new stocks to highlight, no Movers & Shakers this week.

Weekly short positions as a percentage of market cap:

10%+

SYR 19.5 DMP 16.2 JBH 15.4 GXY 14.7 MYR 13.2 NAN 12.5 VOC 12.1 ORE 11.5 AAC 11.5 NWS 11.5 IVC 11.2 GXL 10.9 HT1 10.0

In: GXL Out: BWX, APO, RFG

9.0-9.9

IGO, APO, GEM, MYX

In: APO, GEM Out: GXL, BIN 8.0-8.9%

AAD, MLX, HVN, BIN, IPH, RFG, GMA, PLS

In: RFG, BIN, MLX, GMA, PLS Out: GEM, FLT, WEB

7.0-7.9%

MTS, BGA, FLT, IFL, WEB, TPM, BWX, BKL, QUB, SFR

In: BWX, FLT, WEB, BKL, QUB, SFR Out: PLS, MLX, GMA, TGR, ING

6.0-6.9%

RSG, ING, TGR, CSR, PRY, SEK, KAR, BAP, MOC

In: ING, TGR, KAR, MOC Out: BKL, QUB, SFR

5.0-5.9%

SUL, MQA, NSR, CCP, NXT, MYO, AHG, IMF, BEN, JHC, BOQ, NUF

In: MQA, AHG, JHC, NUF Out: KAR, MOC, APT

Movers & Shakers

See above.

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: Property, Super, Housing & Cars

Weekly Broker Wrap: property; superannuation; cash rates; house prices; automotive retailers; and registry services.

-A-REITs becoming more attractive to global investors -PC proposals threaten retail super sector -Credit tightening likely to be a game changer for Oz house prices -Oz car sales likely to fall following slump in house prices -Ord Minnett suggests outlook for registry sector remains weak

By Eva Brocklehurst

Property

Global investors consider A-REITs more attractive because of their relative underperformance, although they are increasingly concerned about the residential segment. Morgan Stanley has come to this view after meetings with investors in Europe, US and Asia.

Valuation and relative performance are the main reasons A-REITs have increased their appeal over the past 12 months. Those investors that find the sector less attractive cite deteriorating macro conditions. A major debate centres on the penetration of Amazon and online retail for those A-REITs exposed to shopping centres.

The broker's discussions have reinforced its preference for office over retail and, within retail, Vicinity Centres ((VCX)) and Stockland ((SGP)) over Scentre Group ((SCG)) and Mirvac ((MGR)). Developers such as Lend Lease ((LLC)) and Goodman Group ((GMG)) are preferred over the aggregators such as Charter Hall ((CHC)).

The broker finds many investors were surprised by the level of capital expenditure required to maintain sales growth and were also interested in the accelerating momentum in the Lend Lease business, which increases the scope for a re-rating.

Superannuation

The Australian government's Productivity Commission has published a draft report assessing the competitiveness of the superannuation system, suggesting a radical overhaul.

Ord Minnett had expected the report would offer a small positive for retail funds by opening up default awards. Now, the broker believes the major proposals are a threat to the retail sector, to both corporate super and fees on choice products.

As a result of its analysis, Ord Minnett downgrades its rating on AMP ((AMP)) to Hold from Accumulate, believing further negative sentiment on the stock will ensue.

The broker also suggests there may be flow on to other wealth managers such as Link Administration ((LNK)). The government appears reasonably enthusiastic regarding the report and, with a loss of credibility for the super retail sector following the Royal Commission, Ord Minnett envisages the chances of the report being implemented are heightened.

The main issues are the many multiple accounts in the current system, with the PC believing one third of accounts are unnecessary. Most underperforming funds are in the retail segment, with unhealthy competition and a proliferation of funds noted in the choice segment.

There is also a lack of access for members to quality information in order to to make comparisons and the PC stated a need to have a new default allocation process, whereby members rather than employers select the fund.

Cash Rates

Credit Suisse ponders whether the banks could produce rate increases that are out of step with the official cash rate cycle and calculates there is a material risk that this will occur.

If the RBA does not cut official rates, out-of-cycle rate hikes could be expected from major banks, although the pass-through to end borrowers may still be limited. The broker estimates there is downside to calculations of long-term neutral cash rates, when accounting for an incomplete pass-through, and the neutral cash rate could be well below 2%.

Persistently wide interbank credit spreads may cause the banks to hike rates out of the cycle, the broker suspects, and a case can be made that, if these wide spreads persist, cash rates are actually above neutral, even before accounting for the growth and inflation outlook.

Hence, Credit Suisse contends that the interbank funding situation is the one element that may re-shape the RBA's outlook. If spreads narrow, the RBA is well placed to carry on with its medium-term plan to hike official rates. However, if spreads widen even further then the RBA needs to revise down its view of the neutral cash rate and the appropriateness of current settings.

All up, the broker suggests that de-leveraging risks emanating from the banking sector are likely to contribute to more revisions in the RBA's outlook, curve flattening and more inversion of Australian-US yield differentials. In this environment, within the equity market, Credit Suisse believes this supports quality over value.

House Prices

UBS takes a deep dive into the housing market, noting tighter credit and falling prices and dwelling commencements. March 2018 dwelling approvals rebounded to 235,000, nonetheless, supported by population growth. Given a dovish view on official rates (Reserve Bank is expected to hold the cash rate steady until at least the second half of 2019), the broker upgrades estimates for housing commencements.

The next phase of macro prudential tightening is likely to be a game changer, UBS speculates, amid higher living expenses and debt-to-income limits, which will cut borrowing capacity by around -30-40%. Housing is already weakening more quickly than the broker anticipated, with home loans dropping by -10% since August 2017, even before the impact of the Royal Commission into the financial services industry.

UBS shifts its base case towards a credit tightening scenario where home loans fall -20%, credit growth is flat and house prices drop persistently. Meanwhile, the RBA is expected to keep rates on hold for longer. Record housing supply in coming years and a drop in foreign buyers means UBS downgrades its outlook for house prices, expecting prices to drop more than -5% over the next year.

Automotive Retailers

UBS also believes car sales will follow falling house prices. House price data has already revealed recent weakness is in NSW and Victoria. In analysing the relationship with Australian car sales - indicative for Automotive Holdings ((AHG)) - and prestige/luxury sales - indicative for Autosports Group ((ASG)) - UBS maintains a Neutral rating on the former and downgrades the latter to Neutral from Buy.

The broker cuts FY19 estimates for earnings per share for Automotive Holdings by -12% and by -21% for Autosports. While UBS expects these two stocks to outperform on industry volumes, margins are likely to be lower in FY19 as a result of aggressive competition.

The broker's modelling estimates a -10% fall in house prices, which translates to total new car sales falling by -10% and new prestige/luxury cars by -8% over a two-year period. The rise of ride sharing and eventual onset of robotaxis could also lead to lower new car sales in the future, UBS suggests, expecting autonomous vehicles to be in operation in certain markets from 2026.

Registry Services

Ord Minnett concludes from surveys of Australian registry services that Computershare ((CPU)) has continued to lose market share to Link Administration and Boardroom, based on the number of contracts. Historically, this did not translate to loss of market share based on the number of shareholders administered, which is a better proxy for revenue, but this appears to the broker to be no longer the case.

The majority of respondents to the surveys indicated either an improved cost structure or no change to cost structures over the past 12 months. Ord Minnett notes that the percentage of registry contracts put to tender has increased materially since 2016. Costs were the main reason flagged by those who manage internally, which implies scale players with lower fees have opportunities to grow.

The broker also observes that smaller providers, primarily Boardroom, appear to be using employees share plan service contracts as a means of winning registry contracts, as companies show a preference for using the same provider.

Growth in the Australian registry sector has been muted historically and Ord Minnett believes the outlook remains weak, in particular for Computershare if it continues to lose shareholder administration as per recent trends. Its new investment in technology, through Equatex, may provide some competitive advantage.Computershare and Link Administration command 94% of domestic registry share based on the number of shareholders administered.

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

Treasure Chest: Australia Facing A Credit Crunch?

Credit conditions for Australian housing are set to tighten further as a result of the Royal Commission than they already had, suggesting what most assumed would be a market cooling may now become a more disorderly affair, UBS warns.

-Australian housing market already cooling -Royal Commission to lead to further tightening -Risks of a credit crunch growing

By Greg Peel

Australia's housing market was raging out of control through to the middle of this decade on a combination of strong investor and foreign demand. Investors were spurred on by historical low interest rates while foreigners were spurred on by their own growing wealth and the desirability of an Australian address.

While politicians grappled with the issue of plummeting housing affordability and a complete crowding out of first home buyers in a surging market, the RBA began to become concerned over growing household debt levels, growing mortgage repayment to income ratios, and the possibility of the housing bubble bursting with dire results.

The RBA thus sent in its attack dog, financial regulator APRA, which slowly began to tighten the screws on bank mortgage lending practices, flowing through to tougher borrowing conditions for investors. At the same time, FIRB tightened the screws on foreign buyers when evidence suggested many were finding their way around the regulations.

Initially APRA attacked investor loans, and immediately demand from investors dropped off. But this only lasted about six months. Sydney and Melbourne house prices continued to rise.

APRA was then forced to up the ante, moving to attack interest-only loans. The net result of combined APRA tightening was a move by the banks to reprice their mortgage rates in order to comply with the new rules by discouraging demand.

The Australian housing market did begin to then show signs of easing, but not in any significant way. Then along came the Royal Commission.

The revelations of the Commission became a shock to all and sundry from day one. Prior to commencement, bank analysts had suggested the bad news was likely already in the market and bank share prices had already de-rated, meaning there was probably limited further downside.

They have since conceded they never saw anything like it coming.

Risks Growing

Prior to the Commission, the general assumption is that APRA tightening would cool the housing market, but not crash it. There remained too much latent demand from a rising population enjoying still-low mortgage rates.

But in light of what has since transpired, UBS analysts have asked the question: Will the Australian housing market correction become disorderly? UBS is not suggesting it will, but expects credit growth to slow sharply and believes the risk of a Credit Crunch is rising. The analysts have cited seven factors now weighing, or set to weigh, on housing lending.

Seven Deadly Signs

The Royal Commission appears to have arrived at a much more rigorous interpretation of "responsible" lending when it comes to banks making "reasonable enquiries" and taking "reasonable steps" to verify a borrower's financial situation. The banks are now moving to make a more thorough assessment of stated income and living expenses.

Bank boards are likely to become a lot more risk averse following the Treasurer's threat of gaol time.

Were mortgage brokers to be forced to shift to a flat fee rather than a commission-based charge, mortgage broker penetration may reduce and this would flow to reduced access to credit for some borrowers.

The adoption of mandatory Comprehensive Credit Reporting from July 1 enables lenders to have a more complete view of borrowers' financial positions. APRA is yet to specifically set a limit on borrower debt to income ratios, but the regulator, bank boards and bank shareholders would not be comfortable with any concentration of "very high debt to income" (in excess of six times) on banks' books.

Labor's policy to limit negative gearing will likely weigh on investor sentiment as the election approaches (April/May).

FIRB approval of foreign investment in Australian housing plunged -65% from FY16 to FY17, to a four-year low.

Some $120bn of interest only loans will revert to principal & interest loans each year until 2021. With mortgage repayments subsequently jumping 30-50% on reversion, and rising house prices no longer a given, many an investor may be tempted to sell.

Remain Cautious

UBS is not suggesting all of the above seven factors will eventuate, but believes it's likely some combination of risks plays out, weighing on credit availability and the housing market. The risk of a Credit Crunch is rising, the analysts believe.

During the recent bank reporting season the analysts downgraded their housing credit growth assumptions to 4-5% for FY18 and 0% for FY19-20. For FY20, UBS' forecast currently sits some -9% below consensus.

Value Versus Growth - The Uncomfortable Truth

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

-Value Versus Growth - The Uncomfortable Truth -Conviction Calls (1) -Compare The Pair: REA vs DHG -Conviction Calls (2) -Pressure-Points In Aussie Staff Costs -Rudi Talks -Rudi On TV -Rudi On Tour -At The AIA Conference

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Value Versus Growth - The Uncomfortable Truth

By Rudi Filapek-Vandyck, Editor FNArena

Very few occurrences can be as testing as a falling share price. And let's be honest: it happens to the best of us, irrespective of how much research and preparation we put in before jumping on board.

Last year, a falling share price for Eclipx ((ECX)) caught my attention. For those not familiar with this company: this is the same core management that once was responsible for success at FlexiGroup. Today CEO & MD Doc Klotz and his team are building a sophisticated financial services company including fleet leasing, equipment hire and consumer motor vehicle financing.

But the share market has been a harsh judge on early news flow and potential risks from stripping down and integrating Graysonline, despite management's assurances everything is converging and growing according to plan. While the share price has recovered from recent lows near $3, it is but a fair assessment the inclusion of Eclipx in my equities portfolio has to date fallen well short of expectations.

Another inclusion that has failed to perform recently is TechnologyOne ((TNE)), in my view one of the absolute super stars in the local IT sector. Up until mid-2017 there was little management at the Brisbane-headquartered enterprise software company could possibly do wrong, and the returns for shareholders were commensurate. Since then, it seems, the market has turned in sentiment and now prefers to punish first, then ask questions later.

All the while, the company is steadily migrating its customer base into the cloud, and increasing annually recurring revenues. Management anticipates in a few years time it will be able to lift the annual growth guidance to 15-20% from 10-15% at present. Again, the share price is off its recent bottom, but it has been a rocky slide south over the past year or so.

Reflecting upon both stocks brings back memories about two other stocks that have been in my portfolio for quite a while: Bapcor ((BAP)) and Hansen Technologies ((HSN)). The latter fell out of favour between October 2016 and September last year, for various reasons, but the stock has made a strong come-back since. Bapcor is one of the best performing portfolio inclusions this calendar year. Shareholders had to wait until April. Nobody knows why.

These four examples touch upon one of the most difficult dilemmas to solve for investors in the share market: at what point exactly does one throw in the towel and declare enough is enough?

The question is one that haunts every investor, from time to time. Once upon a time I owned shares in iSentia ((ISD)) and in Vocus Group ((VOC)) but, by gosh, am I glad I waved goodby to both long time ago. It helps when one has a deep understanding of what exactly makes a company tick, and what doesn't, and where are the risks. But things are never this easy, of course. Negative surprises aside, businesses go through changes on a daily basis; corporate life never is but a static concept. And then there is the share market itself. Piping hot one day, Antarctic cold the next.

Whereas every day a trader tells himself: the market is always correct, we, the investors, we know that is simply not true. We observe the CSL share price getting smacked to $92.25, and then it adds 100% in the following 1.5 years. Equally astounding, between October and late November last year shares in Big Un quadrupled -yes, that is multiplying by a factor four- but everyone still on board the company register today is trying to come to terms with the probable loss of -100% of all capital invested in the shares.

Plenty of dilemmas for professional investors too. Most funds managers in Australia are 'value' investors, which means core strategies are built around cheap looking share prices, and as they become cheap-er, portfolio allocations widen further into overweight positions in anticipation of the upward correction that surely must follow. Such strategies have had an incredibly tough time in the past four to five years, in particular post May 2015.

Even with Australian bank shares going through one of the longest, and most pronounced, periods of underperformance in Australia, many Australian equities funds barely manage to beat the share market's overall lacklustre performance. This is because most run a large allocation to those same banks. Luckily, for some, returns have been exceptionally good for miners and energy producers; at least until recently.

Just how much of a hard time these professional funds managers (and many a self-managing SMSF) have had can be deduced from the fact the ASX20 Accumulation Index (including dividends) has generated no more than 3% per annum in total return over the three years since 1st June 2015. This compares with 6% (twice as much) for the broader ASX200 Accumulation Index, and with 8% p.a. for FNArena's All-Weather Model Portfolio.

Of course, in a share market that is predominantly 'value'-oriented, momentum-driven, and myopic in attention span, the big conversations around the traps as we approach the final month of the financial year are: when might the Telstra share price (finally) stop falling? Are the banks finally ready for that big rally? Shouldn't we stop fretting about the potential impact from Amazon and higher bond yields on local retailers?

With High Quality, Modern Era Champion Stocks (CSL, REA Group, et al) outperforming in significant fashion, all these questions can be summarised as: when is the bottom of the share market ready for a come-back?

The last time we saw such a large disparity in valuations for top performers and bottom dwellers in the Australian share market was in mid-2016 after which money flowed out of the first segment into the second, causing a serious correction for High Growth and a fierce come-back for the share market laggards. But here we are, two years later (actually, less) and we, investors, find ourselves again confronted with the same dilemma.

Note that while many among today's share market laggards are by now trading on lower share prices in comparison with two years ago, stocks like CSL, Aristocrat Leisure ((ALL)), REA Group, ResMed ((RMD)), Cochlear ((COH)), et cetera have surged to new all-time highs.

Maybe investors, large and small, have been too focused on price, and on relative valuations, and not enough on how much is changing in today's economy, impacting in particular on large cap Australian quasi-monopoly operators that have been lulled into boardroom hubris and management over-confidence that all shall be alright, just like it always has been in the past.

Instead of being bamboozled by short term impacts such as the NBN and/or the Royal Commission, maybe a more correct way of viewing share market stragglers such as AMP, Telstra, CommBank and Scentre Group (among many others) is through the prism of market leaders that have rested on their laurels for way too long, while the world kept changing around them. Now that the Day of Reckoning has arrived, these businesses are not ready for today's changing landscape, let alone for tomorrow's challenges.

If this assessment proves correct, these businesses need to switch course, and pretty quickly too. But adaptation requires fresh ideas, new structures, new products, additional investments (probably lots of it) and time. Meanwhile, how patient are you as an investor? How much underperformance are you willing to stomach, relative or otherwise? Does the promise of ongoing dividend payments outweigh the prospect of little to no capital appreciation, or worse?

In a share market that is increasingly dominated by automated execution and short-term momentum strategies, there is always the risk investors are willing to pay too much for growth and certainty, in the short term, but maybe the real question here is how much sustainable upside is there, realistically, from under-priced share prices in companies that have very little to offer, other than a cheap looking share price?

That is the $64m question that will distinguish the winners from the losers in the Australian share market in the year ahead, and beyond.

Conviction Calls (1)

The most recent update on Conviction Calls at Goldman Sachs certainly has a bias towards under-priced shares ("value'), but with a few strong growers added as well. The current list consists of twelve Conviction Buys ranging from ANZ Bank ((ANZ)) and Telstra ((TLS)), to Aristocrat Leisure ((ALL)), Netwealth Group ((NWL)), Bingo Industries ((BIN)), BWX ltd ((BWX)), Huon Aquaculture Group ((HUO)), Lifestyle Communities ((LIC)), Origin Energy ((ORG)), Propertylink Group ((PLG)), Sims Metal Management ((SGM)), and Suncorp ((SUN)).

More Conviction Calls in Part Two on Thursday.

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Rudi's View: The FAANG Stocks Of Australia

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Compare The Pair: REA vs DHG

By Rudi Filapek-Vandyck, Editor FNArena

The more I research the share market, the more I come to similar conclusions.

One of my recent pet observations is that certain stocks are trading on a higher valuation than others, simply because they are "better quality" companies. Cue Aristocrat Leisure ((ALL)) versus Ainsworth Gaming ((AGI)); Xero ((XRO)) versus MYOB ((MYO)); Ramsay Health Care ((RHC)) versus Healthscope ((HSO)), et cetera.

Under different circumstances I would also have included any of the banks versus CommBank ((CBA)), but maybe when CBA is involved in so many more scandals and mistreatments of its customers, while the share price is shedding its usual sector premium, maybe in this particular case the standard rule no longer applies?

Otherwise, and I have done the historical analysis to back this up, any relative outperformance by either ANZ Bank ((ANZ)), National Australia Bank ((NAB)), or Westpac ((WBC)), to stick with the major four, was always but a temporary phenomenon and investors have been best served by sticking with CBA over the past two decades.

In similar fashion, while short term momentum changes might well favour the lesser quality alternatives of Ainsworth, MYOB and Healthscope, to stick with the examples mentioned earlier, long term investors are most likely best off by ignoring the short term and keeping faith in the fact that time always works in favour of the better quality companies.

Take a look at long term price charts, if you don't believe me, and discover it for yourself.

The "better quality" theme featured prominently in a recent research update on online property platforms by Citi. In the local context this means REA Group ((REA)), still partially owned by News Corp ((NWS)), and Domain Holdings ((DHG)), partially spun off by Fairfax Media ((FXJ)) in mid-November last year.

At face value, REA Group shares seem quite "expensive" trading on 40x FY18 multiple and 33x FY19 consensus EPS forecast. In contrast, Domain Holdings trades on 36x FY18 estimates and on 28x FY19 consensus EPS forecast. The usual conclusion is thus that Domain Holdings is "cheaper" than REA Group, with the underlying suggestion it thus makes for a better investment option between the two.

I've said this before, and I will keep repeating it, backed up by hours of historical data research, this is not how it works.

Detailed analysis, as reported by Citi, has revealed REA Group is increasing its dominance over Domain Holdings in property sector ad displays in just about every region in Australia, leaving but a few small pockets where the number two in this sector can genuinely flex its muscles and beat its chest.

In simple terms, this means REA Group's current growth is much broader based. No surprise thus, Citi analysts anticipate its residential growth numbers will look strongest when both companies will be reporting financials in August.

But here is not where this story ends. Domain Holdings must act if it wants to stay relevant in the long run. In practice this translates into higher marketing spend, which means less profits for shareholders, and probably lower margins too. Citi has identified "price" as the key growth engine for Domain, while REA Group's top line growth is supported by both higher volume increase and a better product mix, plus market share gains.

Citi analysts are worried about rising costs for Domain, which, surely, is not what is priced in or anticipated at present elevated multiples? (Note: Citi is one of two brokers that has a Sell rating for the shares in the FNArena universe).

On the other hand, Macquarie just downgraded REA Group to Underperform with a price target of $86 and the main motivation behind the move is that the share price/valuation might be a tad high, or as they say in the sector: the stock looks priced for perfection.

REA Group shares might have to consolidate for a while after yet another strong rally since early April, but this doesn't change one iota from the analysis you have just been exposed to.

Readers who follow my research into All-Weather Performers know REA Group is a solid member and it goes without saying its shares are being held inside the FNArena Vested Equities All-Weather Model Portfolio with the aim of still owning it when the shares cross the $100 mark in (hopefully) the not too far off future.

Conviction Calls (2)

When it comes to investing in miners and energy stocks, there is no greater bull in Australia than Shaw and Partners senior commodity analyst, Peter O'Connor. His Conviction dates all the way back to 2016, and it definitely has won him a large number of fans across the country.

Imagine the smiling faces of the stockbrokers working at the firm who put their clients' money into the likes of BHP ((BHP)), Woodside Petroleum ((WPL)), and Rio Tinto ((RIO)) over the past two years. O'Connor still thinks the current cycle won't be over until the BHP share price reaches $40. He also believes Fortescue Metals ((FMG)) is an absolute steal, but that call carries a whole lot less enthusiasm from the mere mortals with the share price refusing to decisively rally past $5 since last year.

While it appears the sector is ripe for a retreat in the short term, O'Connor maintains it won't be anything else but a short term dip in an ongoing uptrend. His advise is therefore: don't lose your nerve, instead use any weakness from here onwards to add to your positions. The miners have added some 150% since bottoming in late January 2016 and the Shaw superstar analyst observes there have been six upswings of 18-20% over that period, followed by so-called "higher lows" during consolidation periods.

This time won't be any different, he predicts - with ongoing Conviction.

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Talking about ongoing Conviction... a little while ago I saw an email from one fund manager in Australia questioning: what does UBS know that we don't? This was in response to banking analyst Jonathan Mott and his team releasing their negative stance on Australian banks, when most investors elsewhere are salivating at the prospect of acquiring exposure to the sector at (seemingly) below fair value share prices.

The answer is Mott & Co have grown convinced a much more rigorous interpretation of Responsible Lending, thanks to a number of scandals and revelations at the Royal Commission, is translating into a domestic credit crunch. In UBS's mind, the only question that remains unanswered is whether the inevitable housing market slow down will be orderly or disorderly.

As the team of banking analysts continues to update their views and thoughts, it appears Conviction is only growing stronger. UBS's latest update is best summarised with the following sentence: "We expect credit growth to slow sharply and believe the risk of a Credit Crunch is rising".

The UBS view received some extra back up from the team of economists at Westpac this week. It shouldn't surprise the House of Bill Evans whose prediction that lower-than-forecast inflation and economic growth will keep the RBA on hold for much longer, shares a few key common views with the team at UBS.

Try "another year of below trend consumer spending". As the official cash rate in the US continues rising while the RBA won't do a thing, Westpac is predicting that by end 2018 the Australian cash rate is set to be -63 basis points below the Federal Funds Rate; by end 2019 the gap could well be -112 basis points below the Federal Funds Rate.

If that isn't eye-catching enough, the team at Westpac also throws in the forecast that Australia has entered "an extended period of falling house prices", explained as "up to 10% over the course of the next two years". Needless to add, the expectation is this rather dramatic change in the housing market dynamics is expected to add further downward pressure on consumer spending.

In Westpac's words: "While the wealth effect was modest in the period of rising house prices it is reasonable that there will be a more marked effect through the downswing".

It goes without saying that if these forecasts prove correct, UBS's negative view on the outlook for banking shares will likely be justified as well. In addition, UBS analysts already published the prediction that falling house prices will be followed by a drop in new car sales.

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As if the above is not enough to worry about, UBS strategist David Cassidy and his side-kick Jim Xu wonder whether High PE, High Growth stocks are now priced for perfection?

Key risks have been identified as potentially a sharp increase in government bonds (not happening right now, but it remains a risk), much weaker economic growth which unexpectedly could also impact on operations that are not directly leveraged, and then there is always the risk that somehow expectations cannot be met; the good old profit warning from left field.

With Price Earnings (PE) ratios at historically high levels, market response to any of these risks materialising could be quite savage, one assumes. Look at Domino's Pizza ((DMP)) post August 2016, or Blackmores ((BKL)) over the past two years.

What the UBS research does not point out is that companies like CSL ((CSL)) and Aristocrat Leisure ((ALL)) have only just updated investors about strong momentum in their operations and this, all else remaining equal, should reduce the risk for a negative surprise from the company itself in the short to medium term.

One most interesting piece in the UBS analysis, is that ten large cap stocks in Australia have dominated the local share market in significant fashion, and for an extended period of time. There has been a large degree of consistency as well. On UBS' assessment, the Top Ten of Growth Companies in Australia from three years ago is almost identical to the Top Ten today, considering eight members of the ten have remained the same.

The current ten names are: Aristocrat Leisure, Treasury Wine ((TWE)), CSL, a2 Milk ((A2M)), ResMed ((RMD)), Carsales ((CAR)), REA Group, Cochlear ((COH)), Seek ((SEK)), and James Hardie ((JHX)). Have been de-rated from three years ago are Ramsay Health Care ((RHC)) and TPG Telecom ((TPM)), while the analysts also include Domino's Pizza, Blackmores, and Vocus Group ((VOC)) as growth companies that have been de-rated.

Further analysis of the strong gains these ten stocks have booked over the past three years suggests investors in local indices should worship their inclusion because UBS' calculations suggest industrials as a group, and without these ten stocks, would have only returned 3% in capital gains and 14.9% in dividends over the past three years for a total return of 18.4%, i.e. some 6% per annum.

Put simply: these ten major growth achievers are the FAANG stocks of Australia. Their total return has been 123.9%, of which only 5.4% stems from dividends. This also easily explains why CSL is now larger in market capitalisation than either ANZ Bank or National Australia Bank.

The UBS strategists cannot genuinely pin down any reasons as to why investors should now adopt a more cautious approach, other than pointing out potential risks and the fact that each of these ten stocks has experienced a period of being out of market favour in the past.

Then there is the second half of 2016, when a rapid change in bond markets and portfolio rotation in equity markets meant these share prices went down quickly. But as I have highlighted myself on numerous occasions, that period of share price weakness only lasted so long, and here we are, less than two years later and share prices involved in many cases have rallied to new all-time highs.

For what it is worth, drawing conclusions from current valuations and forecasts put forward by UBS analysts, the strategists suggest it appears accumulating positions in Aristocrat Leisure and Treasury Wines still seems to make sense, while investors are cautioned that negative returns might lay ahead when buying into today's share prices of Cochlear and REA Group.

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Over at stockbroker Morgans, portfolio strategists recently added Rio Tinto ((RIO)) to increase exposure to the resources sector, while watching share prices in Link Administration ((LNK)), Australian Finance Group ((AFG)) and Aristocrat Leisure for any weakness in order to buy.

Morgans' Growth Model Portfolio has increased the weighting of Macquarie Atlas Roads, now continuing corporate life as Atlas Arteria ((ALX)). The Cross Asset Income Model Portfolio has added new positions in Westpac ((WBC)) and Aventus Retail Property ((AVN)) while trimming its exposure to Sydney Airport ((SYD)).

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Finally, and adding some bullish optimism in this week's collection of Conviction views, equity strategists at Ord Minnett (erm, JP Morgan) expressed their general optimism that better corporate growth prospects, helped by an improving economic back drop, have been responsible for a recovery in share prices after early-year weakness.

Apart from a weakening Aussie dollar and stronger-for-longer commodity prices, JP Morgan strategists (erm, Ord Minnett's) also believe there are currently positive currents flowing through the corporate sector in Australia.

Obviously, it has to be said, their forecast for the local economy is not in-line with either UBS, or Westpac, or my own forecasts.

But as they say (again, and again, and again): different views are what maketh the market.

Pressure-Points In Aussie Staff Costs

Analysts at Credit Suisse have taken another deep dive into why wage increases in Australia are currently below levels that historically marked economic recessions, with no real prospect for improvement.

They have identified four key factors:

-De-unionisation of the labour pool -Rising female participation (with the RBA suggesting this is caused by household's high indebtedness) -Ageing workforce -Casualisation and increased flexibility for labour

The analysts also believe the current situation (persistent low wages growth, at or below annual inflation) is leading to a strong rise in Protection Action Ballots, i.e. the precursor to carrying out strikes. According to the Fair Work Commission, such Protection Action Ballots are now running at decade highs. Is Australia about to experience an outbreak of major industrial actions? Or will this pressure cooker situation show up through other avenues?

Below are the sectorial pressure points as identified by Credit Suisse:

Rudi Talks

Audio interview about falling share prices and when do we, investors, get rid of disappointing underperformers in portfolio:

http://boardroom.media/broadcast/?eid=5b0cc86f7a67720d3fe99acb

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