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AUSTRALIA

Woodside Offers Potential, And Potential Delays

Scarborough appears to be progressing but there was no update in the December quarter report regarding a gas agreement for Browse. Hence, delays feature in broker assessments of the outlook for Woodside Petroleum.

-2018 capital raising likely finances Scarborough, but not Browse
-Capital expenditure in 2020 revised up sharply
-Some brokers are asking whether Woodside still offers value

By Eva Brocklehurst

Delays feature highly in broker assessments of the outlook for Woodside Petroleum ((WPL)) after a December quarter production report that was generally regarded as solid. There were no major updates on growth milestones such as tolling agreements and it could be some months before Scarborough and Browse bear fruit.

Production and sales were higher than many expected in the quarter while 2020 production guidance implies growth of 12%, driven by higher LNG volumes and increased oil output from Greater Enfield.

Final approvals have been reached for Sangomar phase 1 and this Senegalese project will move into execution and development. Woodside is targeting first production in 2023 from 23 sub-sea wells tied back to an FPSO that can produce at 100,000 bbl/day.

Meanwhile, Scarborough appears to be progressing. Credit Suisse considers the **upside for Scarborough and Interconnector growth, as well as possible premium group pricing, more than offset risks posed by weak LNG spot prices.**

There was no update on the gas agreement between Browse and North West Shelf. Browse was meant to be ready for FEED (front end engineering and design) by the end of 2019 but this required a binding agreement to be finalised, suggesting there is some slippage in the timeline.

UBS flags a cautious approach regarding cost over-runs and a soft LNG pricing environment as well as downside risk from delays across a number of other projects coming on line in the next few years.

Macquarie agrees there are challenges in the medium term, given the potential for further delays at North West Shelf/Pluto, while Morgan Stanley envisages any clear progress at Browse over coming months could enhance the stock.

Woodside remains the preference in the sector because it offers good value and strong production but Ord Minnett acknowledges the largest risk is the funding of growth. The 2018 capital raising possibly provided enough finance to the end of the Scarborough project, the broker points out, but not for Browse.

Capital Expenditure

2019 capital expenditure was -20% below guidance, with the difference expected to shift into 2020. Woodside has guided to capital expenditure of US$4.1-4.4bn for 2020, which includes a US$450m contingent payment to ExxonMobil and BHP Group ((BHP)) for successful FID (final investment decision) at Scarborough.

Morgan Stanley notes there is potential for Woodside to farm down its interest in Scarborough over 2020, from 75%, which would lower payments. The broker points out, typically, E&P companies do not perform well during periods of higher expenditure. This may turn out a little differently for Woodside as, if a large proportion of shareholders continue to take up the dividend reinvestment program this will buffer cash flow.

Credit Suisse, too, suspects expenditure will end up being lower because of a delay at Scarborough. Furthermore, the broker assesses the balance sheet is comfortable, even without any sell-down of interests.

Credit Rating

On the other hand, Citi continues to highlight the risk of an equity raising in 2020 and assesses **Woodside is racing against the clock to sell assets and protect its credit metrics**.

Ratings agencies will use prevailing working interest to calculate capital expenditure forecasts and the company had stated at its strategy briefing that it would not sell down assets unless at full value.

The broker doubts Woodside would want to be downgraded, although a downgrade to the credit rating could be tolerated. Either an equity raising, or the potential of disappointment on value, appears to be the tough choice for management going forward.

The broker calculates a -US$2.5bn funding shortfall, if no assets are sold and the credit rating agency continues to use a US$55/bbl oil deck. (Woodside's planning assumption is US$65/bbl). While a credit rating agency can look through 1-2 years of weakness, Citi doubts it will look through a protracted capital expenditure phase.

Morgans assesses the share price has gained support in recent months on a recovery in the oil price amid some progress on growth projects. Despite this, the broker continues to envisage value is on offer and estimates a total shareholder return of around 10%. Woodside also boasts the best margin, balance sheet and elevated dividend yield among large-cap peers, in the broker's view.

FNArena's database has three Buy ratings and four Hold. The consensus target is $37.02, suggesting 3.5% upside to the last share price. Targets range from $35.00 (Morgan Stanley, UBS) to $40.50 (Ord Minnett).

AUSTRALIA

Shareholder Returns In Focus At Rio Tinto

While Rio Tinto's 2020 outlook remains buoyed by commodity prices, copper production guidance is lower than expected. The focus for brokers at the 2019 results in February will be shareholder returns.

-Analysts see scope for further substantial capital management
-December quarter iron ore seasonally strong, benefit from strong pricing
-Main disappointment is copper outlook at Kennecott

By Eva Brocklehurst

Rio Tinto ((RIO)) achieved on most production fronts in the December quarter, albeit the outlook for copper is somewhat weaker than many were expecting. The main focus for the February results will be a continuation of shareholder returns. Credit Suisse assesses the company can provide **further substantial capital management** at this time.

Macquarie, too, believes there is scope for a special dividend to be announced, expecting free cash flow yields will remain a proxy for cash returns to shareholders. The broker forecasts a US$1 special dividend on top of an ordinary US$2.50 dividend assumption.

2020 iron ore shipments are guided at 330-343mt, a number assessed to be conservative by Ord Minnett. Iron ore is a key commodity for Rio Tinto, as it drives a significant majority of earnings and the December quarter was seasonally the best for the company's exports.

Koodaideri is on track for first ore in late 2021 and the broker believes this project could allow Rio Tinto to blend product back to the Pilbara specifications. Material movements over in 2019 were the highest on record and an increased attention to waste material movement and pit development will continue in 2020.

The iron ore price achieved of US$79/t for the year was slightly higher than Ord Minnett forecast, albeit still below the benchmark. Macquarie assesses buoyant iron ore prices will underpin upgrade momentum and drive free cash flow yields of more than 10% at spot prices.

Ord Minnett downgrades to Accumulate from Buy, largely because of the strong run up in the share price. The broker remains attracted to the strong shareholder returns, expecting dividend yields of 5-6% over the coming year. Additionally, positive macroeconomic sentiment should be supportive.

Kennecott

The main disappointment for brokers are the copper grades at Kennecott. A higher, more consistent grade is not anticipated until late 2020 and the smelter will be shut for half the June quarter for standard maintenance.

This caused copper numbers in guidance to be around -10-20% below Morgan Stanley's estimates and is a driver of a negative revision to 2020 revenue estimates. Mined copper guidance is in the range of 530-570,000t, with refined copper at 205-235,000t.

A -US$200m provision will be charged to Escondida in Chile from cancelling the coal contracts after the signing of the renewable power agreements. Escondida production was -3% lower in 2019 on lower grades.

Oyu Tolgoi

There was no further insight for Oyu Tolgoi (copper/gold) and cost and schedule ranges are similar to what was announced in July last year. However, the company has decided to remove two of the three mid-access drivers, retaining one on the level of panel 0. UBS considers this quite a material re-design of the mine plan and Rio Tinto has acknowledged an unfavourable impact on the scheduling.

First sustainable production from Oyu Tolgoi is expected in May 2022 through to June 2023, having been delayed 16-30 months compared with the 2016 feasibility study. Capital expenditure of US$6.5-7.2bn has been outlined which does not include a US$1.5bn power plant.

Oyu Tolgoi may be less than 5% of the company's net present value but is strategically important, in the broker's opinion, given it is a flagship growth project that diversifies medium term production.

Bauxite production is forecast to be 55-58mt, along with alumina at 7.8-8.2mt and aluminium at 3.1-3.3mt. Continuing challenges have been noted in Pacific aluminium. The company has highlighted the challenges the industry faces and is currently in discussions with stakeholders, in particular with a view to energy pricing, in order to ensure global competitiveness. A decision on Tiwai Point in New Zealand is still to be made.

Meanwhile, a phased re-start of Richards Bay Minerals commenced at the end of December and normal production of titanium feedstock is expected early this year. Construction at Zulti South remains on hold. Titanium dioxide production guidance is 1.2-1.4mt in 2020.

The decline in diamond production is occurring at a more rapid pace than Macquarie anticipated, with Argyle expected to close in the fourth quarter of 2020 and Diavik in 2022. Guidance has been lowered to 12-14m carats in 2020 from the 17m carats produced in 2019.

There are two Buy, four Hold and one Sell rating (Credit Suisse) on FNArena's database. The consensus target is $99.27, suggesting -6.3% downside to the last share price. Targets range from $86 (Credit Suisse) to $112 (Ord Minnett).

The dividend yield on 2019 and 2020 forecasts is 6.5% and 5.4% respectively. Shaw and Partners, not one of the seven stockbrokers monitored daily on the database, has a Buy rating and $100 target.

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AUSTRALIA

The Last Of Downgrades For Nufarm?

Minimal rain and major reductions in summer planting in Australasia have caused Nufarm to, again, make substantial reductions to earnings forecasts for the first half.

-Loss anticipated in first half operating earnings in Australasia
-Prospect for further challenging conditions in the second half
-Key issue of margin headwinds in the second half in Europe

By Eva Brocklehurst

Weather conditions continue to plague Nufarm ((NUF)), which has made a further downgrade to expectations for the first half, although the issues are unchanged from the AGM trading update.

Operating earnings (EBITDA) guidance of $55-65m compares with $121m achieved in the first half of FY19. While disappointing, Morgan Stanley assesses the downgrade is largely confined to FY20, and a result of known issues worsening.

The broker calculates a decline of -45% in first half operating earnings. Assuming the absence of one-off difficulties, Morgan Stanley expects the second half earnings will increase by 5% which would represent a modest improvement.

Given the outlook, Ord Minnett remains hesitant about the near-term return of the dividend, assessing the risk/reward is balanced at the current share price. Macquarie downgrades to Neutral from Outperform, envisaging limited shareholder returns and the potential for conditions to remain challenging in the second half. The stock is also assessed as trading at a PE premium to global peers on an EV/EBIT basis.

Nufarm anticipates a loss at the operating earnings level in the first half on the back of dry conditions continuing in Australasia. That said, the company is not overly worried about the impact of the bushfires on its Australian business as dairy farmers have been the main victims, rather than cereals, and this is not a large market for Nufarm.

<u>More To Come?</u>

The uncertainty over the weather provokes the question: is this the end of the downgrades? Ord Minnett notes the Australian Bureau of Meteorology envisages only a "roughly equal" chance of average conditions through to April.

The area planted to summer crops is forecast to fall by -49% in 2019/20, reflecting very low moisture levels in Queensland and northern NSW. Summer crop production is forecast to decline by -52%. Drought-breaking rain is required and, to Ord Minnett, this appears an unlikely outcome in the second half of FY20 as temperature forecasts remain warmer than average.

Credit Suisse is more positive, assessing the seasonal outlook in Australia appears consistent with average winter rainfall and this should support more normal second half crop input requirements.

Regardless, the earnings bias to the second half - 30/70 - is now even higher, given the selling windows in the US, Europe and Australia. As a result, Morgans downgrades FY20 and FY21 underlying operating earnings forecast by -14.5% and -28.2% respectively.

Europe

Sales have lifted in Europe although gross margins are weaker amid higher raw material costs and greater levels of competition. In this region the company's forecast operating earnings loss compares with Bell Potter's prior forecast for a minor positive outcome.

The main issue, the broker perceives, is just how material the margin headwinds are in the second half, and the potential impact of softer winter wheat plantings in some European markets.

Credit Suisse, too, is cautious about Europe and assesses execution is variable, although higher costs, a legacy from the prior period, should be worked through. The company has indicated its cost base will be more leveraged in the second half, when the majority of sales are generated.

Americas

There has been no recovery in North America from the -$20m adverse impact highlighted in the first quarter update. Revenue has shifted to the second half because of a delay in purchasing activity.

The sale of the South American crop protection business appears likely to close in the second half, which Credit Suisse suggests will make first half debt appear high. Still, there should be no persisting issue if the sale proceeds. The sale of the business will de-leverage the balance sheet, Morgans acknowledges, although, given a full valuation and operating challenges, this broker sticks with a Hold rating.

Macquarie notes **some positive signs for the North American spring planting season**, albeit the market is competitive. Credit Suisse is also positive about a more normal North American spring.

Elsewhere, Ord Minnett envisages further growth opportunities in the form of Omega-3 commercialisation but notes seasonal and regulatory risks continue and the ramp up of commercialisation activities will weigh on the seeds business.

Bell Potter, not one of the seven stockbrokers monitored daily on the FNArena database, has a $5.45 target with a Hold rating. FNArena's database has two Buy and three Hold ratings. The consensus target is $5.97, suggesting 7.0% upside to the last share price. Targets range from $5.05 (Morgans) to $7.14 (Credit Suisse).

See also, Sale of Sth American Assets Revitalises Nufarm on October 1, 2019.

AUSTRALIA

Super Retail Outlook: Not Alone Am I

Super Retail has reported a fire and drought-related impact on its 'outdoor' division sales for the first half but several brokers question whether this curtailment of consumer activity has run its course.

-Impact of fires/drought on activity likely to continue into the second half
-Concerns centre on the longer-term impact on regions and tourism
-Stock is not priced for growth, hence little downside risk

By Eva Brocklehurst

Super Retail ((SUL)) has been hit by the recent bushfires, downgrading expectations for its 'outdoor' operations. Like-for-like sales growth slowed to nil over November/December and the company has now flagged first half earnings (EBIT) of $113-115m, down -8% on the prior corresponding half.

While the update is well below most broker expectations, Credit Suisse suspects investors will look through the fire-related impact. Nevertheless, the broker asserts a reflection on the longer-term risk implied by climate change is required. **More frequent and extreme events have the potential to impact retail performance**.

There remain near-term risks for Super Retail with respect to the second half. Expenditure on camping-related activities is likely to be soft and inventory elevated. That said, the broker believes Super Retail is not alone in terms of underperformance in the first half.

The prospect of Super Retail being more susceptible to external factors such as natural disasters and competition has also unsettled CLSA. This has led the broker, not one of the seven monitored daily on the FNArena database, to downgrade to Underperform from Buy and reduce its target to $9.80 from $13.15.

The main issue UBS confronts is the extent to which the drivers of the current downgrade are one-off. Assuming sales rates from the first 16 weeks were maintained, the broker assesses earnings would have been $10-15m higher if it were not for the devastating impact of the fires on the subsequent 10 or so weeks.

Moreover, fire-related closures are likely skewed to January, as opposed to December, Morgan Stanley points out, and conditions and demand remain of concern, as is the longer-term impact on regional communities and tourism. There is also the risk of higher promotional intensity after such a challenging period.

BCF, Macpac

BCF and Macpac sustained the majority of the impact and were the main sources of concern for brokers as execution risks remain elevated. BCF had more than 50 stores where sales activity was affected by the bushfires and around 40% of BCF stores have been directly disrupted by the fires and drought in NSW. Like-for-like sales growth for BCF contracted by -0.5% in the first half and Macpac's by -7%.

Management did not provide a trading update for the second half to date but these businesses are expected to remain under pressure. There is also the risk of higher promotional intensity after such a challenging period. The company decided not to pass on FX-related price increases from the winter period at Macpac.

Credit Suisse is surprised by the decision to reduce promotional intensity to mitigate costs rather than increase the retail price. As a consequence, this has reduced clarity in respect of the performance of the Macpac Adventure Hub stores and expansion strategies. Despite this, the stock is not priced for growth and Credit Suisse suspects, therefore, there is not a lot of downside risk.

Positive Aspects

Meanwhile, Supercheap Auto like-for-like sales growth was 2.4% and Rebel Sport was relatively resilient, with growth of 3.3%. While acknowledging the near/medium-term uncertainty associated with fire and drought Morgan Stanley highlights the strength of the automotive and sports divisions.

The broker believes the stock's -50% discount to the ASX industrials ex financials is excessive. UBS also notes second quarter gross margin trends improved and points to the expected growth in earnings for Macpac in the second half.

All up, **UBS is positive about the balance sheet, scope for industry consolidation, improving cash flow and the attractive valuation**. On the other hand, Ord Minnett would be more constructive at a lower share price and when there is greater evidence of improvement in the outdoor divisions.

Morgans agrees the timing around a recovery in outdoor is uncertain, although prefers to look through these events, highlighting the reasonable valuation. That said, the broker does not believe the February results update will reveal any meaningful reversal of recent top-line trends and now expects an earnings decline of -2.2% in the second half.

FNArena's database has four Buy ratings and two Holds. The consensus target is $10.07, suggesting 4.8% upside to the last share price. The dividend yield on FY20 and FY21 forecasts is 5.0% and 5.3% respectively.

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AUSTRALIA

BHP Group Riding China's Steel Wave

As BHP Group rides China's steel production wave, brokers anticipate the first half result in February will provide an opportunity for the new CEO to outline priorities and opportunities.

-Petroleum now at the lower end of guidance range
-Copper prospects excite several brokers
-Earnings upgrade momentum driven by buoyant iron ore

By Eva Brocklehurst

A strong outlook for iron ore and metallurgical coal is providing momentum for BHP Group ((BHP)). Brokers eagerly anticipate the first half result on February 18, which will be the first opportunity for CEO Mike Henry to publicly address the market and provide answers on how opportunities and priorities are being viewed by the company.

Copper production in the December quarter was the main positive surprise compared with broker forecasts, having benefited from record concentrator throughput across the first half that more than offset the impact related to stoppages in Chile.

Copper and energy (thermal) coal production increased 6% and 8% respectively quarter on quarter, while metallurgical (coking) coal rose 17% after major maintenance was completed in the prior quarter.

Nickel production was down -24% but that was because of maintenance at the Kwinana refinery and Kalgoorlie smelter although this is expected to lift production going forward.

Production guidance is unchanged, although petroleum is expected to come in the lower end of the prior forecast range of 110-116 mmboe. This stems from unfavourable weather conditions in the Gulf of Mexico.

There is also **some risk to thermal coal guidance** in the instance of any bushfire events near the NSW production hub but at this time guidance is unchanged. Smoke and dust have reduced air quality and this did affect volumes in the second quarter.

Cost guidance was unchanged for FY20. Escondida (copper) is running below cost guidance because of higher by-product credits, which UBS suspects relate to gold. An abnormal charge of -US$500m relating to the cancellation of power contracts at Escondida is included in first half estimates. Brokers point out Rio Tinto ((RIO)), which has called out -$200m for its share, will take the charge against underlying operating earnings.

Meanwhile, funds of US$581m have been released to support the Renova foundation in 2020 which will be offset against Samarco provisioning following the dam failure.

BHP Group Versus Rio Tinto

Credit Suisse continues to believe the company's portfolio provides two benefits compared with rival Rio Tinto. These include greater breadth of commodity exposure that helps it to withstand any swings in any particular commodity, and a broader range of opportunities in petroleum and potash.

Shaw and Partners loves both companies and points out they have landed on exciting copper prospects, with the main determinant just how large these turn out to be. BHP Group's Spence growth option is on track for first production in the first half of FY21.

Ord Minnett maintains a preference for Rio Tinto because of its cheaper valuation metrics although acknowledges there is little to differentiate the investment case between the two. Both have good balance sheets, solid returns, a similar free cash flow yield and catalysts from the strength in iron ore markets.

China Steel

Credit Suisse now has a more constructive view about China's crude steel output in 2020, and upgrades the company's numbers to reflect the increase in its forecasts for iron ore and metallurgical coal.

With strong Chinese rhetoric around infrastructure in particular, the broker assumes a 1.6% increase in Chinese steel demand in 2020, although by the second half steel production is likely to slow. This will coincide with seasonally strong supply of iron ore and allow depleted inventory to be somewhat rebuilt.

A similar pattern is expected in 2021. As a result, Credit Suisse iron ore price forecasts are raised to US$90/t for 2020 and to US$80/t for 2021. Metallurgical coal price forecasts are moderated slightly, given the risks around Chinese import restrictions, to US$166/t for 2020 and US$175/t for 2021.

Macquarie calculates the spot price scenario for iron ore is driving around 35% and 50% upside to its FY21 and FY22 earnings forecasts, respectively. That said, the broker's production forecasts for Pilbara iron ore are now below guidance.

Shaw and Partners, not one of the seven stockbrokers monitored daily on the FNArena database, has a Buy rating and $40 target. The database has five Hold ratings and one Buy (Macquarie). The consensus target is $39.65, suggesting -3.6% downside to the last share price. The dividend yield on FY20 and FY21 forecasts is 4.8% and 4.5%, respectively.

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AUSTRALIA

Stock Selection Key For A-REITs In 2020

Prospects exist for strong returns from the A-REITs in 2020 but brokers point out the secret is in stock selection.

-Cash flow, asset growth and sub-sector performance key in 2020
-Mixed views on outlook for residential A-REITs
-Industrial/office remain most in demand

By Eva Brocklehurst

They may be underperforming the rest of the market but Australian Real Estate Investment Trusts (A-REITs) have begun 2020 strongly, adding 6% in the first few weeks.

Official rate cuts anticipated in 2020 - JPMorgan economists forecast two - should drive further compression in required returns. Moreover, the broker suggests considerable acquisition capacity exists in many cases and the cost of capital remains competitive.

As global growth accelerates, Macquarie anticipates yields on 10-year bonds will increase to 2.5% in the US and 1.9% domestically over 2020. This is, in isolation, a negative for the A-REITs sector, given the negative correlation historically.

Nevertheless, the broker assesses yields under 2% domestically are still positive for A-REITs, and in this environment the fundamentals of the specific stock will come into greater focus.

Hence, a combination of earnings revisions, cash flow certainty, asset growth and sub-sector performance will be key to deriving returns from the sector, which is screening value, albeit skewed by retail A-REITs.

Half the sector sits in the retail segment, the broker points out, which warrants a higher yield or lower multiple, given structural headwinds continue. This will impact earnings and distributions in the medium term.

While Macquarie considers it too early to make a call on retail conditions, offshore retail property experience indicates the grocery-anchored malls have historically outperformed discretionary malls.

The broker has upgraded **Charter Hall Retail** ((CQR)) to Outperform from Underperform and **Shopping Centres Australasia** ((SCP)) to Neutral from Underperform.

Over 2019 A-REITs as a group returned 19.4%, Macquarie calculates, below the markets 23.4% and, as Australian 10-year bond yields fell post August, any earlier outperformance by A-REITs was more than reversed in subsequent months.

However, there were a wide range of returns, JPMorgan points out, from 55% for **Charter Hall** ((CHC)) to 2% for retail laggards such as **Vicinity Centres** ((VCX)) and Charter Hall Retail. The broker agrees stock selection will be most important in 2020 highlighting a preference, in fund management A-REITs, for Charter Hall over **Goodman Group** ((GMG)).

Residential

Macquarie's preferred segment is residential, given a supportive regulatory backdrop, low mortgage rates and favourable demand/supply dynamics. The broker prefers **Mirvac** ((MGR)), rated Outperform, in this area. Improving markets in residential along with earnings upside from the proceeds of the equity raising are expected to support a re-rating of the stock in the short to medium term.

In contrast, a more demanding valuation for **Stockland** ((SGP)) is already pricing in future residential upside, while there is downside risk to the company's retail book, which is 45% of capital. Hence, Macquarie has an Underperform rating.

Citi finds the residential business, as with retail, has been over-earning and there are a range of impediments weighing on the growth outlook, particularly for Stockland. While a residential recovery may be underway, a record FY19 is being cycled.

Stockland's residential earnings are expected to decline over the next two years as a result of the cycling of peak earnings, and despite the large fall in house prices. Citi maintains a Sell rating on Stockland. In contrast, Goldman Sachs notes the stock still offers a 4% 12-month total return at current pricing and maintains a Buy rating.

Office

Office rents are expected to remain subdued because of increasing vacancy rates in most markets, although asset value should underpin returns and Macquarie upgrades **Dexus Property** ((DXS)) to Outperform. **Charter Hall Long WALE REIT** ((CLW)) is also upgraded, to Neutral.

JPMorgan prefers Dexus Property over **GPT** ((GPT)) in the office/diversified A-REITs segment, highlighting the varied growth rates in industrial rents, ranging from 1% to 5%.

This remains the asset class most in demand from institutional investors as Goldman Sachs notes many are of the view that a further tightening of return hurdle rates over the next 12 months will drive valuation upside and, in turn, lift asset values.

This may even result in increased M&A activity as some asset-heavy A-REITs are taken private. Yet the offset will be the adoption of more realistic long-term rental assumptions, resulting in minimal net valuation moves.

In explanation, the broker points out that prime western Sydney and Melbourne logistics rental growth has failed to match inflation over the last 10, 20 or 30-year periods. Hence, there is doubt about the current rental growth of 2% per annum factored into valuations and whether it will be sustained over the next decade.

Goldman Sachs has upgraded Goodman Group to Neutral, assessing the stock is now fairly priced after a -4% decline over recent months. **Charter Hall Social Infrastructure** ((CQE)) is upgraded to Buy from Neutral.

The broker believes the weakness in the latter's share price has been driven by management changes and a potential change in strategy away from childcare. Although this is likely to remain a core holding in the portfolio, Goldman Sachs expects earnings growth will come through external opportunities including non-childcare acquisitions.

AUSTRALIA

Downer Downgrades, Again. More To Come?

Downer EDI has warned profit will be lower in FY20 than previously assumed and brokers wonder whether this will be the last of the downgrades.

-Investor confidence may take time to recover following Downer EDI's profit warning
-Company's focus on urban services should provide more sustainable earnings base
-Progressing planned sale of laundries and mining businesses

By Eva Brocklehurst

Cost over-runs, reduced construction activity and delays to mining projects have sent Downer EDI ((DOW)) back to the drawing board for FY20 guidance, with a resultant downgrade to net profit forecasts.

The company has lowered FY20 net profit guidance to $300m from $365m, representing an -18% reduction.The downgrade stems from the ECM (electrical, construction and maintenance) and mining businesses.

A small number of loss-making ECM construction contracts and lower forecast revenue have combined with a delay in the commencement of two mining projects; all contributed to the downgrade.

ECM is the largest driver, with a -$43m pre-tax impact from underperforming projects. There is also a -$20m impact from lower revenue in construction because of a smaller pipeline of work and a -$10m impact from redundancies.

The question brokers ask is whether there is more to come, given there have been two downgrades from the company in less than a year. This is particularly vexatious, Citi asserts, as problem contracts were meant to have been identified and provisioned for at the last result.

Management has historically taken pride in its record of meeting guidance and Credit Suisse suspects the downgrade will be viewed poorly by investors and, while a material recovery is likely beyond FY20, it may take time for confidence to recover.

Despite the sell off, the broker's rating is downgraded to Underperform from Neutral. Management has reiterated cash conversion will be lower in comparison to recent years.

Citi, albeit disappointed, does not believe confidence has been destroyed. The broker expects most of the issues will be contained to FY20 and, while contracting is inherently risky, Citi analsts believe the **re-positioning of the business away from fixed-price construction will reduce risk in FY21** and beyond.

Setbacks

UBS agrees the latest underperformance in construction is likely to add to concerns around the company's position vis-a-vis ECM projects going forward. Over the past 12-18 months Downer EDI has suffered setbacks on the Clare solar project, the Murra Warra wind farm and two additional undisclosed ECM projects.

This is in addition to the cost over-runs incurred on the Carrapateena copper-gold project and the Orbost gas plant upgrade. Nevertheless, Citi considers further downside to FY20 is limited as some of the problem projects are nearly complete. Macquarie finds consolation in this as well. Orbost is being de-mobilised and Carrapateena will de-mobilise in a few weeks, while the Murra Warra wind farm is nearing completion.

Restructure

The company has decided to restructure the ECM division, which brokers expect will create a lower overall risk profile. UBS assesses the corporate strategy is moving towards a capital-light, urban services model which has a more sustainable earnings base.

While re-positioning ECM to long-term service related contracts, execution has clearly fallen short, in Macquarie's view, suggesting a greater focus on operations is required. A narrowing of the portfolio via asset sales should assist, the broker acknowledges. Meanwhile, Downer EDI is making progress on the planned sale of the laundries and mining businesses and a more detailed update is expected at the first half result on February 12.

FNArena's database has three Buy ratings, one Hold (UBS) and one Sell (Credit Suisse). The consensus target is $8.01, signalling 5.4% upside to the last share price. Targets range from $7.00 (Credit Suisse) to $9.50 (Ord Minnett, yet to comment on the negative market update).

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COMMODITIES

Material Matters: Oil, Gold, Coal & Iron Ore

A glance through the latest expert views and predictions about commodities. Oil; gold; thermal coal; and iron ore.

-Oil price likely to remain volatile over 2020 as geopolitical risks cannot be ignored
-Credit Suisse assesses best performing gold stocks are those promising returns to shareholders
-Broader recovery in manufacturing across Asia augurs well for thermal coal
-Buoyant iron ore price could persist amid momentum in Chinese property and infrastructure

By Eva Brocklehurst

Crude Oil

The **oil** market appears to view the emerging shale industry in the US as a buffer to geopolitical risks in the Middle East. The oil price spiked after recent US killing of General Qassem Soleimani and the subsequent retaliation by Iran.

However, once it was evident there was no direct hit to oil supply the price lost all gains, ANZ Bank analysts note. The market is fundamentally different from a couple of decades ago when similar tensions would mean prices were higher for sustained periods.

The analysts point out US shale production is amongst the most flexible in the industry. While traditional deep-sea wells can take several years to come online, US shale producers can have oil flowing within months.

The US also appears less threatened by disruptions to global oil supply because of its shale production. Still, oil inventory remains relatively high and OPEC (Organisation of Petroleum Exporting Countries) is ready to boost output if disruptions become significant.

Nevertheless, the analysts caution that the market would be naive to completely ignore geopolitical risks and, as a result, the oil price is likely to remain volatile over 2020.

Last year the European Union threatened to re-impose sanctions following Iran's resumption of uranium enrichment. The probability of this occurring rose significantly recently after Iran announced it would remove the curb on its atomic energy program that was agreed under the 2015 nuclear deal.

Also, Iraq supply has been steadily increasing over the past decade and the country is OPEC's second largest producer, behind Saudi Arabia. The Iraqi parliament has resolved to expel foreign forces and this has triggered an angry response from the US. Hence, the analysts suspect the likelihood of US sanctions on Iraq has risen.

Gold

Gold prices are likely to remain strong in 2020, Credit Suisse asserts, amid lingering fears of a global economic slowdown. Central banks have generally been cutting official rates, supporting gold prices and, while the US Federal Reserve has signalled a pause, this could change quickly if economic fundamentals weaken.

Meanwhile, over US$10trn in bonds globally are yielding negatively. Low or negative yields support gold prices as the opportunity cost for holding gold diminishes and gold screens as a more attractive safe haven.

Credit Suisse expects prices in 2020 to average US$1540/oz and peak in the first half at US$1560/oz. Typically, a gold bull market has a growth focus but this time around the broker notes capital returns to shareholders appear to matter more.

The report states the best performing gold stocks over the year are expected to be those that generate meaningful cash flow at current gold prices and can return capital to shareholders via increased dividends and/or buybacks. Investors appear wary of production growth via acquisition.

Thermal Coal

Macquarie assesses the fundamentals for the **thermal coal** market have improved, particularly in the Pacific. While the broker still struggles to define a clear direction, divergent performances and regional spreads are expected to present opportunities for investors.

It appears sustained reductions in supply and some re-stocking demand in Asia have placed a floor under prices for thermal coal. Moreover, a recovery in manufacturing activity in China has boosted the country's thermal coal usage whereas hydro output, which dragged on thermal coal power generation for most of 2019, has moderated.

Macquarie's bull case for thermal coal features a broadening of the recovery in manufacturing across the rest of Asia, particularly to export-driven economies of Japan and South Korea where coal still fuels 29% and 43% of power generation, respectively.

A re-stocking event and curtailment of seaborne supply could mean a rally unfolds in thermal coal. However, for that to occur, the broker acknowledges there needs to be a change in two of the features that hit coal prices in 2018/19, notably Chinese domestic supply growth and the **gas** surplus.

The latter remains very much the issue and Macquarie forecasts a surplus in 2020 equivalent to 22mt of seaborne coal demand.

Iron Ore

Large volumes of **iron ore** have been arriving at Chinese ports since early December although inventory levels have not moved as steel mills replenish stocks ahead of Chinese New Year.

Morgan Stanley assesses the pre-holiday re-stocking is complete yet market tightness has not abated. Cyclone Blake caused significant seasonal disruption to Australian supply yet the price has shown no signs of easing, remaining at the mid US$90/t level.

Turning more positive on China's **steel** demand, the broker believes another year of a surprisingly high iron ore price could be in store.

Morgan Stanley calculates China will need 20mt more ore in 2020 amid positive momentum in the two key pillars of demand: property and infrastructure. The broker envisages limited scope for supply to meet demand growth this year, although Vale, **Rio Tinto** ((RIO)) and **BHP Group** ((BHP)) are all expected to increase shipments on a year-on-year basis.

With supply growth constrained and the first disruptions from the cyclone season commencing, Morgan Stanley considers it unlikely the price will step down and stands by forecasts of US$93/t for the first quarter and US$85/t for the second quarter of 2020.

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WEEKLY REPORTS

Weekly Ratings, Targets, Forecast Changes - 17-01-20

By Rudi Filapek-Vandyck, Editor FNArena

Guide:

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

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

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

Summary

Period: Monday January 13 to Friday January 17, 2020
Total Upgrades: 11
Total Downgrades: 16
Net Ratings Breakdown: Buy 37.41%; Hold 45.78%; Sell 16.81%

Local equity indices rallying to new all-time highs can only mean one thing when it comes to stockbroker ratings: more downgrades than upgrades. Last week truly delivered, with FNArena counting 16 downgrades versus 11 upgrades. In the bigger scheme of things, that's not even that big a gap between the two opposite moves.

Looking into the finer details reveals junior gold producers in particular proved a popular subject for an upgrade in rating, with Evolution Mining, OceanaGold, Perseus Mining and St Barbara all receiving one upgrade during the week ending Friday, 17th January 2020. Gold stocks delivered four of the seven fresh Buy ratings for the week.

Evolution Mining and Perseus Mining also received one downgrade during the week; to Neutral/Hold and Underperform/Sell respectively.

On the other side of the ledger we find seven fresh Sell ratings and without one single exception all were inspired by a rallying share price... and fundamentals that don't support a share price surging to where it is. At least that's the opinion of the stockbroking analysts downgrading to Sell during the week.

Magellan Financial Group is among those downgraded to Sell, as are Coles, Domain Holdings and Independence Group.

Valuations and target prices seem to have a bias to the upside pre-February reporting season with Flexigroup commanding the week's top position in terms of positive amendments to price targets, followed by Woolworths, Woodside Petroleum, and Netwealth Group.

Negative revisions are noticeably smaller, with only Audinate Group, Evolution Mining and Monadelphous worth mentioning.

This does not apply to the week's tables for positive and negative revisions of earnings forecasts. Clearly, analysts are starting to get busier ahead of reporting season. OceanaGold, Karoon Gas, Ardent Leisure and Orocobre all enjoyed meaty increases during the week.

Heavy negative revisions were reserved for Zip Co and South32, at a respectful distance followed by Audinate Group, Whitehaven Coal, and Saracen Mineral.

Ahead of the Australia Day long weekend, the local calendar remains item-light, with the odd LIC releasing their financial performance and with the likes of BHP Group and Netwealth Group issuing quarterly updates.

Two more weeks and corporate results will start trickling in. That might be the first test for an exuberant share market this early in the fresh first calendar year of the decade ahead.

Upgrade

EVOLUTION MINING LIMITED ((EVN)) Upgrade to Outperform from Underperform by Credit Suisse .B/H/S: 2/5/0

Preliminary operating results for the December quarter reveal Mount Carlton production is expected to be at the bottom end of the guidance range. Credit Suisse suspects, while cost guidance is unchanged, achieving the target may be at risk.

FY20 guidance for Mount Carlton of 70-75,000 ounces reflects 10% of group production. While a small component, this mine has been an historical outperformer and strong generator of cash for the company.

Credit Suisse believes the water risk is moderating at Cowal as the company's strategy to secure more water from alternative sources such as bores is progressing well. Rating is upgraded to Outperform from Underperform on share price weakness. Target is $4.30.

See also EVN downgrade.

FLEXIGROUP LIMITED ((FXL)) Upgrade to Buy from Neutral by UBS .B/H/S: 3/1/0

UBS explores the merits of the company's refreshed strategy around 'buy now pay later' amid the launch of new products. The broker believes a simplified brand strategy makes sense and should help drive cost cutting.

The broker also considers the market is becoming more positive on the new strategy and assesses value is on offer, upgrading to Buy from Neutral. Target is raised to $2.30 from $1.90.

INCITEC PIVOT LIMITED ((IPL)) Upgrade to Equal-weight from Underweight by Morgan Stanley .B/H/S: 2/5/0

Morgan Stanley observes diammonium phosphate markets have demonstrated improved pricing and this is now coupled with more reasonable valuations.

This leaves the risks for the stock evenly balanced and the rating is upgraded to Equal-weight from Underweight. Cautious industry view. Target is steady at $3.20.

It appears the recent capacity curtailments may have prompted some upside to prices. Meanwhile, explosives markets remain relatively supportive, with robust volumes and stable supply and demand.

METCASH LIMITED ((MTS)) Upgrade to Neutral from Underperform by Credit Suisse .B/H/S: 2/3/1

Credit Suisse upgrades to Neutral from Underperform as the stock reflects better value. The target is raised to $2.64 from $2.39.

Nevertheless, Credit Suisse understands it is challenging to resolve the competitive issues facing the business and there is no easy solution to the heavy risk weighting applied to the company's food division.

The broker floats the idea that, whilst not a perfect solution, the sale of food distribution to retailers could achieve a better alignment of interests and facilitate a high level of investment.

NETWEALTH GROUP LIMITED ((NWL)) Upgrade to Buy from Neutral by Citi .B/H/S: 1/2/3

Citi upgrades Netwealth Group to Buy from Neutral, envisaging upside to near-term earnings from better-than-expected flows. Target is steady at $9.60.

Findex, an advisory firm with $17bn under advice, has launched a new platform offering. Pricing is materially lower than current platform pricing but Citi does not expects this to impact the near-term earnings of its competitors, given the likely time required to gain traction among independent wealth firms.

OCEANAGOLD CORPORATION ((OGC)) Upgrade to Buy from Accumulate by Ord Minnett .B/H/S: 4/1/0

Ord Minnett upgrades to Buy from Accumulate based on valuation. Target is raised to $4.20 from $4.10.

The broker continues to be attracted to the turnaround potential in the business, expecting the strategies will become clearer in February when guidance is provided.

PERSEUS MINING LIMITED ((PRU)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 1/1/1

Production in the December quarter was better than Macquarie expected. The broker considers the company comfortably within its first half guidance range, while the stronger second half guidance will be driven by grade.

A maiden reserve at Zanikan near Sissingue is expected. Macquarie lifts estimates for earnings per share by 34% in FY20 and upgrades to Outperform from Neutral. Target is raised 14% to $1.20.

See also PRU downgrade.

QBE INSURANCE GROUP LIMITED ((QBE)) Upgrade to Outperform from Neutral by Credit Suisse .B/H/S: 4/3/0

Credit Suisse observes questions are being asked about the nature of the outlook statements for FY20. The broker concludes that the FY20 combined operating ratio guidance is achievable and should improve further in FY21.

The broker remains confident in the recovery potential of QBE's earnings as well as balance sheet strength and believes any reserving risk is manageable. Rating is upgraded to Outperform from Neutral and the target raised to $15.00 from $12.55.

ST BARBARA LIMITED ((SBM)) Upgrade to Buy from Accumulate by Ord Minnett .B/H/S: 2/2/0

Ord Minnett upgrades to Buy from Accumulate based on valuation and raises the target to $3.40 from $3.10.

The broker continues to be attracted to the deeper value and turnaround potential, expecting more clarity in February when the company provides guidance and plans for key projects.

WHITEHAVEN COAL LIMITED ((WHC)) Upgrade to Hold from Lighten by Ord Minnett .B/H/S: 4/3/0

Ord Minnett upgrades to Hold from Lighten, assessing the downside risk is limited. As the stock is yet to move, even though thermal coal prices have rallied 16% in the year to date, the broker suspects it will trade sideways for some time.

Overall, Ord Minnett found the December quarter production result poor quality, revealing even lower Maules Creek volumes and limited Narrabri production. Target is steady at $2.80.

WOOLWORTHS LIMITED ((WOW)) Upgrade to Equal-weight from Underweight by Morgan Stanley .B/H/S: 0/4/1

Morgan Stanley believes Woolworths is now better positioned, as industry margins have re-based and there is scope for operating leverage. Deflationary pressures are easing, and valuation now reflects this as well as a range of supply chain initiatives and improving online profitability.

Hence, the broker upgrades to Equal-weight from Underweight and raises the target to $36.50 from $28.00. Adjusted earnings estimates are raised by 1-3% over the forecast period. Industry view: Cautious.

Downgrade

BEACH ENERGY LIMITED ((BPT)) Downgrade to Hold from Accumulate by Ord Minnett .B/H/S: 0/5/1

Ord Minnett is positive on the outlook for Beach Energy as it offers good production growth and strong cash flow.

However, the share price has outperformed in recent months and the broker downgrades to Hold from Accumulate. Target is raised to $2.65 from $2.60.

COLES GROUP LIMITED ((COL)) Downgrade to Underweight from Equal-weight by Morgan Stanley .B/H/S: 0/3/3

Morgan Stanley observes supermarket industry margins have re-based and this has paid off for the major operators. The broker believes execution will be a differentiator in supermarkets in 2020 and Woolworths has a margin advantage, partially reflecting its scale advantage. This is considered unlikely to be eroded over the medium term.

While acknowledging a benign backdrop, the broker still struggles to find meaningful valuation upside for Coles and downgrades to Underweight from Equal-weight. Target is raised to $13.50 from $13.00. Industry view: Cautious.

DOMAIN HOLDINGS AUSTRALIA LIMITED ((DHG)) Downgrade to Sell from Neutral by UBS .B/H/S: 3/0/3

UBS believes new listings are now on track to return to positive growth in the second half. FY20 earnings forecasts are unchanged but FY21-22 are increased by 11-12% on higher assumed listings growth.

However, even on these expectations, the stock now trades above the broker's discounted cash flow valuation and the rating is downgraded to Sell from Neutral. Target is raised to $3.50 from $3.20.

EVOLUTION MINING LIMITED ((EVN)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 2/5/0

The company has experienced a soft December quarter with Mount Carlton the main area of weakness. A geological review has reduced FY20 production expectations. Given a narrowing of the ore lode is also being noted in the underground mine, Macquarie assesses there will be an impact on longer-term production.

The company is also taking steps to mitigate the effects of an escalation of water restrictions at Cowal. An increase in the salinity of processing water will affect near-term costs at the mine. Macquarie downgrades to Neutral from Outperform and reduces the target by -10% to to $3.80.

See also EVN upgrade.

FORTESCUE METALS GROUP LTD ((FMG)) Downgrade to Hold from Buy by Ord Minnett .B/H/S: 1/2/4

Ord Minnett notes the shares have surged more than 150% in 2019, but as iron ore approaches US$100/t investors may be reluctant to chase the stock, fearing the market will become overheated.

The stock still offers a strong dividend yield but has approached fair value and the broker downgrades to Hold from Buy. Target is raised to $11.00 from $10.50.

INDEPENDENCE GROUP NL ((IGO)) Downgrade to Lighten from Hold by Ord Minnett .B/H/S: 1/3/1

While the macro outlook remains favourable, Ord Minnett believes several stocks in the base metals sector are overvalued.

The rating on Independence Group is downgraded to Lighten from Hold with the target steady at $5.70.

MAGELLAN FINANCIAL GROUP LIMITED ((MFG)) Downgrade to Underperform from Neutral by Macquarie .B/H/S: 0/2/5

Macquarie downgrades to Underperform from Neutral on valuation grounds. The broker acknowledges the company is a stand-out performer but cannot justify the current multiple of 25x.

That said, inflows have accelerated in the December quarter and market conditions remain supportive. Target is raised to $55 from $49.

MOSAIC BRANDS LIMITED ((MOZ)) Downgrade to Hold from Add by Morgans .B/H/S: 0/1/0

The company's first half trading update was below expectations, with the Christmas period being affected by the recent bushfires. As a result first half operating earnings (EBITDA) are expected to be $33m.

The impact of the fires has continued into the start of the second half and management will provide an update at the first half result in late February. This could mean the full year outcome is below revised expectations.

The stock remains attractively priced from a valuation perspective but Morgans downgrades to Hold from Add to reflect elevated earnings uncertainty. Target is reduced to $2.40 from $3.46.

MEGAPORT LIMITED ((MP1)) Downgrade to Neutral from Buy by UBS and Downgrade to Hold from Accumulate by Ord Minnett .B/H/S: 1/2/0

UBS observes the business continues to grow at an impressive rate but remains conscious that the majority of December quarter KPIs did not record an acceleration in growth momentum.

The broker downgrades to Neutral from Buy and wants more tangible signs of an acceleration in KPI growth rates before becoming more positive. Target is raised to $11.75 from $11.55.

Top-line growth in the December quarter was better than Ord Minnett expected, although there was a slight miss in some key performance indicators (KPIs).

The broker remains positive on the company because of its high-quality business model and exposure to strong sectoral growth.

As the stock is trading in line with the revised target, the rating is downgraded to Hold from Accumulate. Target is raised to $11.30 from $10.50.

OROCOBRE LIMITED ((ORE)) Downgrade to Sell from Hold by Ord Minnett .B/H/S: 3/2/2

Ord Minnett downgrades to Sell from Hold, raising the target to $2.55 from $2.25. The broker expects global GDP growth could rebound by mid year, linked to a fading drag from political conflict.

However, miners largely reflect this improved outlook and inexpensive valuations will be harder to find.

PENDAL GROUP LIMITED ((PDL)) Downgrade to Hold from Add by Morgans .B/H/S: 2/3/2

First quarter funds under management of $101.4bn were up 1% on the prior quarter. Further net outflows were experienced at JO Hambro. Morgans observes the stock has rallied from a previously undemanding valuation because of improved sentiment in UK markets.

As the stock is now trading in line with valuation the rating is reduced to Hold from Add. Some risk of sustained outflows, amid a preference for the growth path being less reliant on market direction, prevents the broker from taking a more positive view. Target is reduced to $8.83 from $8.85.

PERSEUS MINING LIMITED ((PRU)) Downgrade to Underperform from Outperform by Credit Suisse .B/H/S: 1/1/1

December quarter production was in line with guidance. FY20 guidance has tightened to 275-295,000 ounces at a cost of US$850-950/oz. Development has progressed at Yaoure.

The impact of the wet season appears to have been considerably less than in the prior corresponding period, with Sissingue well prepared. The gold price assumption is increased to US$1300/oz, driving an increase in reserves, predominantly at Edikan.

Credit Suisse downgrades to Underperform from Outperform on valuation. Target is raised to $0.93 from $0.88.

See also PRU upgrade.

PLATINUM ASSET MANAGEMENT LIMITED ((PTM)) Downgrade to Underperform from Neutral by Macquarie .B/H/S: 0/0/5

Macquarie downgrades to Underperform from Neutral on valuation grounds. The rate of outflows remains elevated in the December quarter, albeit moderating.

While the easing of outflows is encouraging, it occurred without a meaningful improvement in performance, the broker notes. Target is raised to $4.30 from $3.85.

SANTOS LIMITED ((STO)) Downgrade to Hold from Add by Morgans .B/H/S: 2/4/0

Having achieved the target, Morgans downgrades its rating on Santos to Hold from Add. Target is raised to $8.86 from $8.67.

Production growth, fuelled by development and acquisition, will remain a feature of the company's near-term operating results, in the broker's view. Morgans expects the low end of the guidance range of 73-77 mmboe to be achieved in 2019.

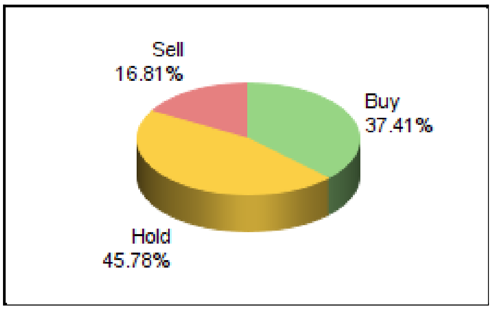
SUPER RETAIL GROUP LIMITED ((SUL)) Downgrade to Hold from Accumulate by Ord Minnett .B/H/S: 4/3/0

Ord Minnett assesses there is downside risk to FY20 sales growth as the company is exposed to the Australian bushfires because of its focus on camping and outdoor goods.

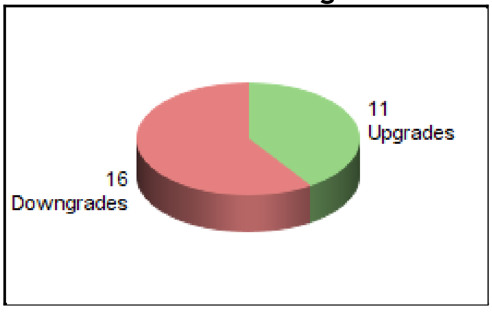
The strong share price performance in 2019 has reduced the valuation support, although the broker acknowledges the PE multiple remains at a discount to peers.

Ord Minnett would become more constructive at a lower share price and downgrades to Hold from Accumulate. Target is steady at $10.

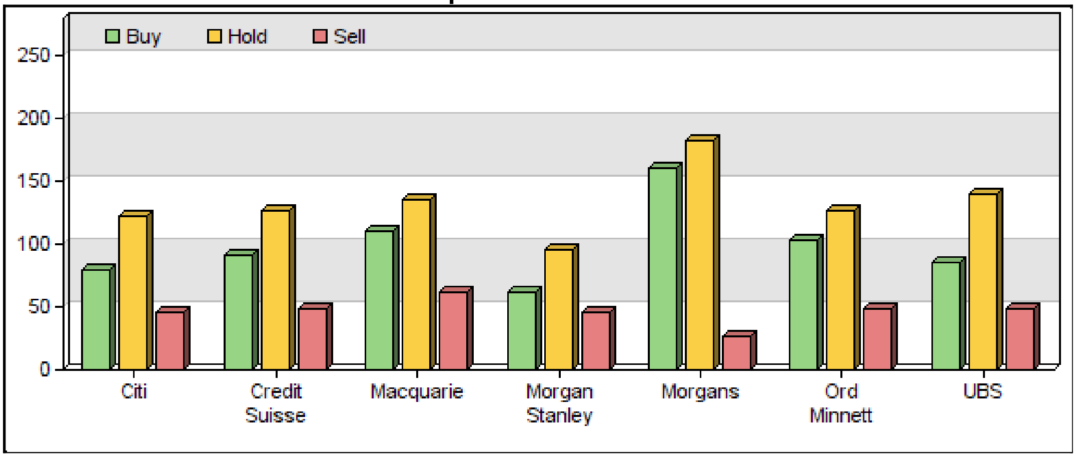
Total Recommendations



Recommendation Changes



Broker Recommendation Breakup



Broker Rating

Order	Company	New Rating	Old Rating	Broker
Upgrade				
1	EVOLUTION MINING LIMITED	Buy	Sell	Credit Suisse
2	FLEXIGROUP LIMITED	Buy	Neutral	UBS
3	INCITEC PIVOT LIMITED	Neutral	Sell	Morgan Stanley
4	METCASH LIMITED	Neutral	Sell	Credit Suisse
5	NETWEALTH GROUP LIMITED	Buy	Neutral	Citi
6	OCEANAGOLD CORPORATION	Buy	Buy	Ord Minnett
7	PERSEUS MINING LIMITED	Buy	Neutral	Macquarie
8	QBE INSURANCE GROUP LIMITED	Buy	Neutral	Credit Suisse
9	ST BARBARA LIMITED	Buy	Buy	Ord Minnett
10	WHITEHAVEN COAL LIMITED	Neutral	Sell	Ord Minnett
11	WOOLWORTHS LIMITED	Neutral	Sell	Morgan Stanley
Downgrade				
12	BEACH ENERGY LIMITED	Neutral	Buy	Ord Minnett
13	COLES GROUP LIMITED	Sell	Neutral	Morgan Stanley
14	DOMAIN HOLDINGS AUSTRALIA LIMITED	Sell	Neutral	UBS
15	EVOLUTION MINING LIMITED	Neutral	Buy	Macquarie
16	FORTESCUE METALS GROUP LTD	Neutral	Buy	Ord Minnett
17	INDEPENDENCE GROUP NL	Sell	Neutral	Ord Minnett
18	MAGELLAN FINANCIAL GROUP LIMITED	Sell	Neutral	Macquarie
19	MEGAPORT LIMITED	Neutral	Buy	UBS
20	MEGAPORT LIMITED	Neutral	Buy	Ord Minnett
21	MOSAIC BRANDS LIMITED	Neutral	Buy	Morgans
22	OROCOBRE LIMITED	Sell	Neutral	Ord Minnett
23	PENDAL GROUP LIMITED	Neutral	Buy	Morgans
24	PERSEUS MINING LIMITED	Sell	Buy	Credit Suisse
25	PLATINUM ASSET MANAGEMENT LIMITED	Sell	Neutral	Macquarie
26	SANTOS LIMITED	Neutral	Buy	Morgans
27	SUPER RETAIL GROUP LIMITED	Neutral	Buy	Ord Minnett

Recommendation

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New Rating	Previous Rating	Change	Recs
1	FXL	FLEXIGROUP LIMITED	75.0%	50.0%	25.0%	4
2	WOW	WOOLWORTHS LIMITED	-20.0%	-40.0%	20.0%	5
3	NWL	NETWEALTH GROUP LIMITED	-33.0%	-50.0%	17.0%	6
4	MTS	METCASH LIMITED	8.0%	-8.0%	16.0%	6
5	EVN	EVOLUTION MINING LIMITED	29.0%	14.0%	15.0%	7
6	WPL	WOODSIDE PETROLEUM LIMITED	36.0%	21.0%	15.0%	7
7	IPL	INCITEC PIVOT LIMITED	29.0%	14.0%	15.0%	7
8	QBE	QBE INSURANCE GROUP LIMITED	50.0%	36.0%	14.0%	7
9	SBM	ST BARBARA LIMITED	50.0%	38.0%	12.0%	4

10	OGC	OCEANAGOLD CORPORATION	80.0%	70.0%	10.0%	5

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New Rating	Previous Rating	Change	Recs
1	AD8	AUDINATE GROUP LIMITED	67.0%	100.0%	-33.0%	3
2	MP1	MEGAPORT LIMITED	50.0%	83.0%	-33.0%	3
3	SVW	SEVEN GROUP HOLDINGS LIMITED	75.0%	100.0%	-25.0%	4
4	PTM	PLATINUM ASSET MANAGEMENT LIMITED	-100.0%	-80.0%	-20.0%	5
5	SAR	SARACEN MINERAL HOLDINGS LIMITED	83.0%	100.0%	-17.0%	3
6	STO	SANTOS LIMITED	33.0%	50.0%	-17.0%	6
7	DHG	DOMAIN HOLDINGS AUSTRALIA LIMITED	-8.0%	8.0%	-16.0%	6
8	ORE	OROCOBRE LIMITED	14.0%	29.0%	-15.0%	7
9	MND	MONADELPHOUS GROUP LIMITED	10.0%	25.0%	-15.0%	5
10	COL	COLES GROUP LIMITED	-50.0%	-36.0%	-14.0%	7

Target Price

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New Target	Previous Target	Change	Recs
1	FXL	FLEXIGROUP LIMITED	2.135	1.973	8.21%	4
2	WOW	WOOLWORTHS LIMITED	36.364	34.664	4.90%	5
3	WPL	WOODSIDE PETROLEUM LIMITED	37.091	35.503	4.47%	7
4	NWL	NETWEALTH GROUP LIMITED	7.982	7.748	3.02%	6
5	PDL	PENDAL GROUP LIMITED	8.583	8.350	2.79%	7
6	QBE	QBE INSURANCE GROUP LIMITED	13.489	13.139	2.66%	7
7	SBM	ST BARBARA LIMITED	3.025	2.950	2.54%	4
8	PTM	PLATINUM ASSET MANAGEMENT LIMITED	3.870	3.780	2.38%	5
9	MTS	METCASH LIMITED	2.807	2.757	1.81%	6
10	MFG	MAGELLAN FINANCIAL GROUP LIMITED	50.401	49.544	1.73%	7

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New Target	Previous Target	Change	Recs
1	AD8	AUDINATE GROUP LIMITED	9.633	9.950	-3.19%	3
2	EVN	EVOLUTION MINING LIMITED	4.109	4.209	-2.38%	7
3	MND	MONADELPHOUS GROUP LIMITED	16.288	16.610	-1.94%	5
4	SAR	SARACEN MINERAL HOLDINGS LIMITED	4.033	4.050	-0.42%	3
5	SVW	SEVEN GROUP HOLDINGS LIMITED	21.125	21.167	-0.20%	4
6	SUL	SUPER RETAIL GROUP LIMITED	9.849	9.864	-0.15%	7

Earning Forecast

Positive Change Covered by > 2 Brokers

Order	Symbol	Company	New EF	Previous EF	Change	Recs
1	OGC	OCEANAGOLD CORPORATION	11.632	8.416	38.21%	5
2	KAR	KAROON ENERGY LTD	4.130	3.250	27.08%	3
3	ALG	ARDENT LEISURE GROUP	-0.167	-0.200	16.50%	3
4	ORE	OROCOBRE LIMITED	-1.625	-1.853	12.30%	7
5	WOW	WOOLWORTHS LIMITED	145.217	140.883	3.08%	5
6	COL	COLES GROUP LIMITED	64.527	63.527	1.57%	7
7	NCM	NEWCREST MINING LIMITED	150.321	148.850	0.99%	7
8	TAH	TABCORP HOLDINGS LIMITED	20.280	20.113	0.83%	6
9	PTM	PLATINUM ASSET MANAGEMENT LIMITED	26.100	25.900	0.77%	5
10	MP1	MEGAPORT LIMITED	-22.367	-22.500	0.59%	3

Negative Change Covered by > 2 Brokers

Order	Symbol	Company	New EF	Previous EF	Change	Recs
1	Z1P	ZIP CO LIMITED	-2.367	-1.200	-97.25%	3
2	S32	SOUTH32 LIMITED	9.804	11.622	-15.64%	7
3	AD8	AUDINATE GROUP LIMITED	1.863	2.000	-6.85%	3
4	WHC	WHITEHAVEN COAL LIMITED	12.086	12.883	-6.19%	7

5	SAR	SARACEN MINERAL HOLDINGS LIMITED	20.300	21.450	-5.36%	3
6	EVN	EVOLUTION MINING LIMITED	21.857	22.507	-2.89%	7
7	WBC	WESTPAC BANKING CORPORATION	181.829	185.814	-2.14%	7
8	FXL	FLEXIGROUP LIMITED	20.475	20.750	-1.33%	4
9	SUL	SUPER RETAIL GROUP LIMITED	76.698	77.456	-0.98%	7
10	NWL	NETWEALTH GROUP LIMITED	17.717	17.883	-0.93%	6

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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WEEKLY REPORTS

Uranium Week: Interest Up, But Price Still Down

Utilities are increasingly taking an interest in uranium market developments, but so far the spot price continues to slide further south.

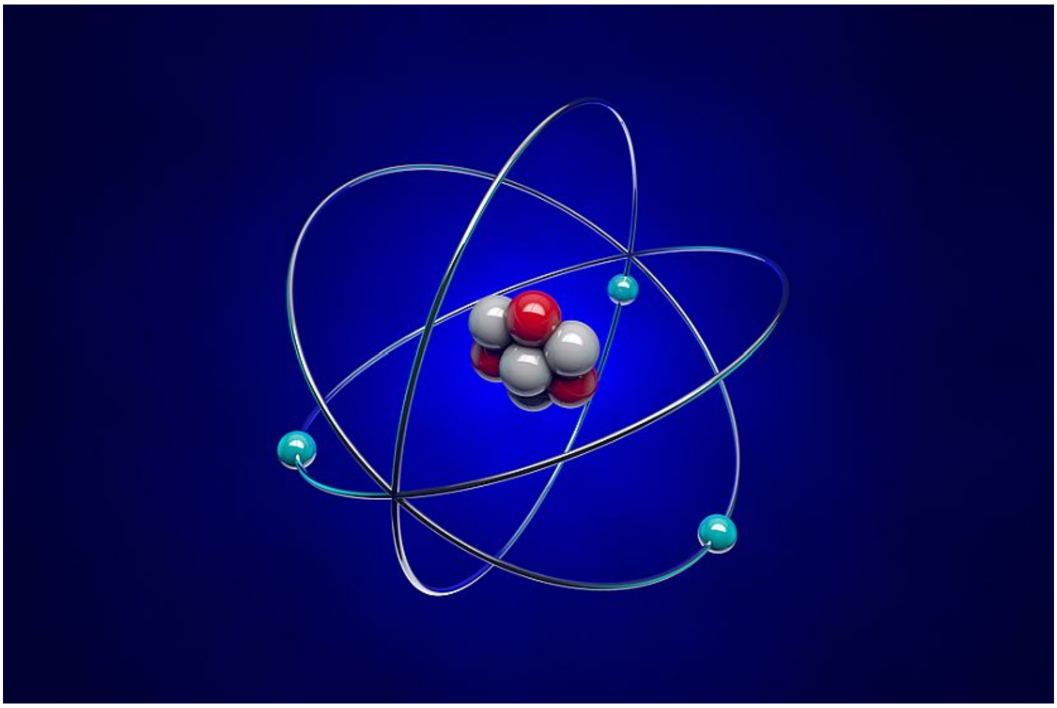
-General interest from utilities is rising, with the number of active discussions on the increase
-Uranium demand is anticipated to lift later this quarter
-Global transitioning towards carbon neutral does not always involve nuclear power generation

By Rudi Filapek-Vandyck

Spot uranium continues to slide downwards as the pricing pressure that started to exert itself during the final weeks of calendar 2019 simply won't go away.

Industry consultant TradeTech does report, however, buying interest is returning with a variety of parties showing renewed interest, though this has, to date, not prevented the price of uranium weakening further.

On TradeTech's assessment, spot U3O8 weakened yet another -US10c last week to US24.50/lb. This is despite four spot transactions totaling over 400,000 pounds U3O8 being concluded during the week.



Utilities Increasingly Showing Interest

One source of industry optimism stems from the fact a number of utilities have started up preliminary discussions with potential suppliers. TradeTech reports some of these discussions have already led to concrete purchases, with some market participants expecting demand to return throughout this quarter.

According to the industry consultant, utilities that have thus far not shown too much concrete activity remain keen observers of market developments, signalling they are prepared to enter the market in 2020 depending on further developments and on how market and political uncertainties play out.

TradeTech reports several utilities are pursuing offmarket discussions with potential suppliers regarding the purchase of material for mid-term deliveries as well as longer-term commitments.

TradeTech's mid-term and long-term price indicators have remained unchanged since late December at US$29/lb and US$33/lb respectively.

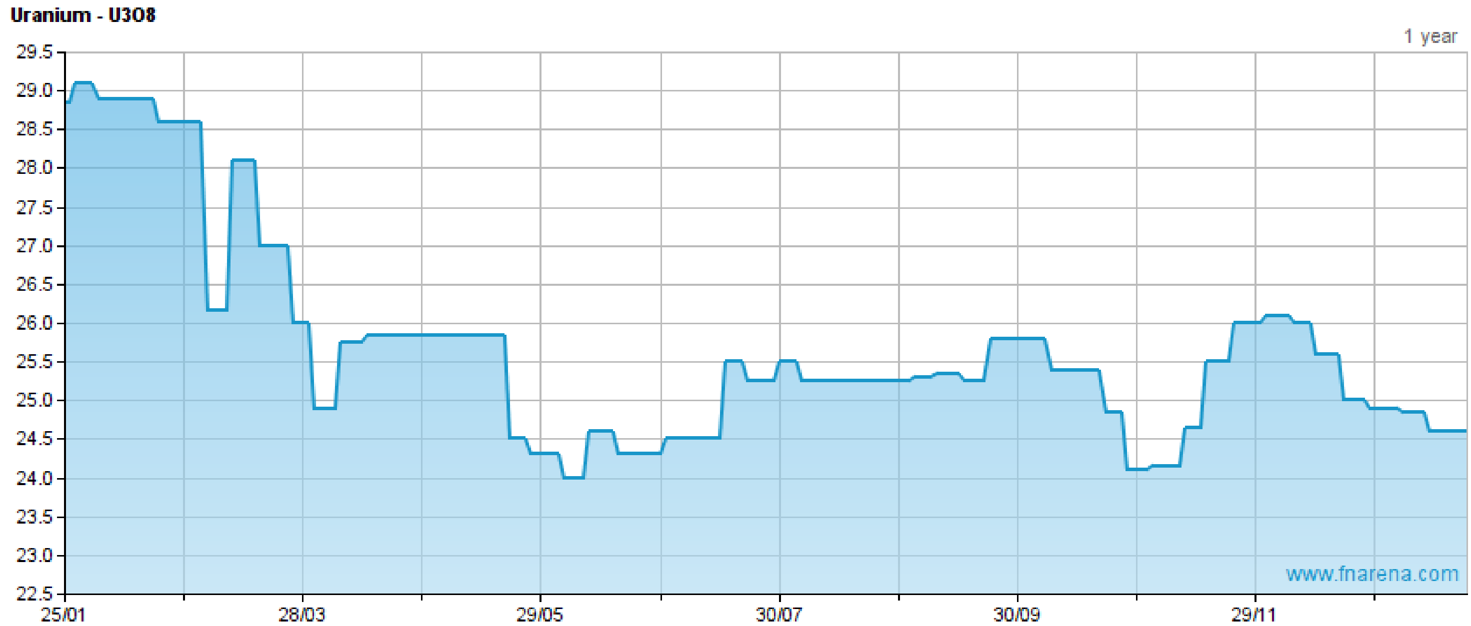
Going Green Not Automatically Benefiting Uranium

Meanwhile, global aspirations and initiatives to become more energy efficient and to replace heavy polluting sources of energy with greener, more sustainable practices are multiplying and increasingly attracting attention.

In what is undoubtedly seen as a major disappointment by the uranium industry globally, not all of such initiatives involve the inclusion of uranium for the transition towards economies and economic sectors becoming carbon neutral by 2050.

The 13th World Future Energy Summit in Abu Dhabi saw Dr. Sultan Al Jaber, UAE Minister of State, announcing ambitious greenhouse gas reduction plans which also involves nuclear power generation.

The European Commission, on the other hand, has launched a EUR1bn program to make the European Union carbon neutral by 2050. Europe's Green Deal involves no uranium, with the Commission excluding any of the funds being used for nuclear power plants.



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WEEKLY REPORTS

The Short Report - 23 Jan 2020

See **Guide** further below (for readers with full access).

Summary:

Month ending January 16, 2020

Welcome to the first FNArena Short Report for 2020. As the Short Report has been taking its annual leave this past month, the first report of the year will track changes in short positions over the period of the month to January 16. As of next week, the report will revert to its usual mode of weekly updates.

Over the month to January 16, the ASX200 rallied a net 3.7%, and rallied 5.3% from the December 31 book-squaring sell-off. As of yesterday the index was up 5.3% and 6.7% respectively.

It may be hard to fathom exactly what, beyond momentum and FOMO, has driven the market to such giddy heights when there'd be every excuse to think otherwise, but we can note that short-covering has had little to do with it. Over the period, only four stocks saw moves in either direction of one percentage point or more.

We can dismiss the first stock straight up. Kirkland Lake Gold ((KLA)) is a Canadian-based miner listed in all of Toronto, New York and Australia and as such its short position – up to 28.8% now from 22.6% a month ago – is almost certainly the reflection of a geographical arbitrage play (sell in one location and buy in another) and is not worth analysing again in this Report in 2020, as it was tedious enough in 2019.

In the real world, shorts in graphite miner Syrah Resources ((SYR)) have risen to 16.8% from 15.8%, shorts in Resolute Mining ((RSG)) have risen to 11.1% from 9.0%, shorts in Mineral Resources ((MIN)) have fallen to 8.8% from 10.7%, and shorts in oOh!media ((OML)) have fallen from 6.6% to below 5%. Hence the latter stock has fallen off the table.

See Movers & Shakers below.

Weekly short positions as a percentage of market cap:

10%+

KLA	28.8
GXY	17.8
SYR	16.8
ORE	13.7
SDA	13.0
ING	12.1
NEA	12.0
GWA	11.9
NXT	11.9
JBH	11.4
RSG	11.1
BGA	11.0
CGC	10.7
WEB	10.2
MTS	10.0

In: RSG Out: MIN, DMP, BKL

9.0-9.9

DMP, BKL, SUL

In: DMP, BKL, SUL Out: RSG

8.0-8.9%
MIN, HUB, IVC, NUF, PLS

In: MIN, PLS Out: SUL, A2M

7.0-7.9%
PPT, CUV, HVN, NCZ, A2M, CTD, MYR, IFL

In: A2M, CTD Out: PLS, CGF, BIN

6.0-6.9%
BEN, BIN, BOQ, RWC, CGF, PNI, SGM, NEC, BWX

In: BIN, CGF, PNI Out: CTD, OML

5.0-5.9%
CLH, MND, AMP, RFF, CLQ, MYX, GMA, MSB, COE, JIN, WOR

In: MSB, JIN Out: PNI, DCN, GNC, CMW, BEN, SLR

Movers & Shakers

The problem for **Syrah Resources**, as with lithium miners such as Galaxy Resources ((GXY)) and Orocobre ((ORE)), is that they are ahead of their time. Few question the assumption the demand for new-age batteries will surge in the years ahead, for EVs and power storage in particular, but at this stage the supply curve remains well ahead of the demand curve.

To that end, Syrah has been forced to reduce production at its Balama graphite mine in order to sustain commercial pricing. Lithium is in similar oversupply and battery-related commodity prices in general (which includes nickel) were highly volatile over 2019, and thus so too miner share prices.

2020 will likely bring more of the same. Hence we can expect these stocks to remain atop the most shorted table for now, and weekly moves one percentage point or more in short positions to be common. Over the month, Syrah shorts rose to 16.8% from 15.8%.

Shorts in **Resolute Mining** were on the rise late in 2019 as the company struggled with production problems at its Syama gold sulphide processing plant. The company has since divested of its high-cost Ravenswood mine, alleviating a risk of further capital requirement and allowing a greater focus on its West African assets. December quarter production was mixed but not unexpected; shorts have risen to 11.0% from 9.0%.

Most notable is that with gold at US$1550/oz, Resolute Mining is the lone gold miner on the 5% plus shorted table.

Mineral Resources ((MIN)) is a lithium miner, hence no surprise it had moved up into the 10%-plus shorted group late last year. What is often overlooked in the company is also a mineral processor – the revenues from which are far more stable than mining – and also an iron ore miner. With the iron ore price hanging in there around the US$95/t mark, shorts on MinRes have fallen to 8.8% from 10.7%.

Out-of-home (OOH), meaning outdoor, advertiser **ohH!media** surprised the market with a downgrade to forward guidance at its full-year result back in August last, due to weak trading conditions. And then lo and behold didn't trading conditions suddenly snap back in the December quarter. The result was a brief period of the stock appearing in the 5%-plus shorted table last year, before last month it dropped off from 6.6% shorted.

ASX20 Short Positions (%)

Code	Last Week	Week Before	Code	Last Week	Week Before
AMC	0.7	0.7	NCM	1.4	1.4
ANZ	0.5	0.5	RIO	4.0	4.1
BHP	3.1	3.1	SCG	0.5	0.6
BXB	0.3	0.2	SUN	0.6	0.6
CBA	0.7	0.7	TCL	0.4	0.5
CSL	0.1	0.1	TLS	0.3	0.3
GMG	0.3	0.3	WBC	0.5	0.5
IAG	0.5	0.4	WES	0.7	0.8

MQG	0.4	0.3	WOW	0.6	0.6
NAB	0.5	0.5	WPL	0.8	0.8

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

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.

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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WEEKLY REPORTS

The Wrap: Bushfires, Coronavirus & Kaufland Exit

Weekly Broker Wrap: bushfires, coronavirus, Kaufland, building materials, and global wild cards.

-Bushfires increase potential for an RBA rate cut and downgraded economic outlook
-Economic impact of coronavirus dependent on seriousness and duration of outbreak
-Kaufland exit suggests food inflation is likely to persist
-Brokers see value in building materials stocks exposed to the US

By Eva Brocklehurst

Bushfires

The value of insurance claims for the recent catastrophic bushfires is approaching that of the 2009 Black Saturday bushfires. UBS estimates this could drag on Australia's GDP by -0.25% per quarter for the fourth quarter of 2019 and first quarter of 2020.

The sectors likely to be hit hardest include agriculture, retail, tourism and construction, although the impact is difficult to determine. The federal government has announced a $2bn relief package over three years with an indicative $500m to be spent this financial year. The expected budget surplus of $5bn is unlikely to be at risk.

UBS believes stocks with exposure to retailing, insurance, food & beverage and transport will sustain the largest negative effects while resources, building materials and infrastructure are likely to be marginally affected.

Overall, UBS suspects the bushfires increase the likelihood of an official rate cut from the Reserve Bank of Australia in February and expects a reduction of -25 basis points ahead of the downgrade to the economic outlook in the February statement on monetary policy.

Coronavirus

Chinese stocks have fallen over the past two days as market participants become increasingly aware of the potential economic damage of the coronavirus. Ultimately, Commonwealth Bank analysts believe the economic impact will depend on both the seriousness and duration of the outbreak.

So far there is no vaccine for the virus. The situation has been aggravated by hundreds of millions of Chinese travelling around the Lunar New Year between January 24 and January 30. This could accelerate the spread of the virus.

The analysts believe there are some reasons for optimism compared to the SARS outbreak in 2003. SARS caused a temporary recession in Hong Kong because of its heavy reliance on tourism and trade, although the coronavirus outbreak could exacerbate Hong Kong's recent economic slump caused by the China/US trade dispute and social unrest.

However, this time around the most-affected local economies are relatively small. Hubei province, where the outbreak was first noted, accounts for only 4% of national GDP. Secondly, China's health system has improved since 2003 and experience has been gained in dealing with SARS and the outbreak of bird flu in 2013-14.

The analysts believe the virus will have little direct impact on industrial production and investment because factories and construction sites are likely to be shut during the period. Retail sales and food inflation are the main indicators to watch to measure the impact on consumer spending.

Nomura expects increased downward pressure on China's growth, particularly in the services sector if the infection rate expands. Despite a large deterioration in the services sector, the analysts agree the adverse impact of SARS was less severe on industrial production, property, exports and fixed asset investment.

The main focus for the near term is around new infections and whether mortality rates change. If not then Nomura expects the market will increasingly shift back to focus on an economic and semi-conductor recovery.

If mortality is worse then markets will focus on what happened with SARS. Back then there was significant selling pressure in equity markets and currencies were sold off against the US dollar while interest-rate curves in Asia flattened.

Under similar conditions, Nomura would expect most of the pressure would be concentrated on the renminbi and Korean won. If infections expand in the region then the Singapore dollar and Thai baht could suffer.

If the disease cannot be contained in the short term, UBS expects China's retail sales, tourism and travel-related activities will be hit. Forecasts of growth rebounding would then face some downside risk. However, importantly, the broker believes China has learnt valuable lessons from the SARS outbreak.

Kaufland

While the gap Kaufland was filling was never obvious, the decision to exit Australia before opening its first store was a surprise to brokers, given the size of the company's investment. However, the planned roll-out had often been delayed, most recently to 2021.

Therefore, this is a significant positive for the incumbents in the industry. **Woolworths** ((WOW)) was considered least likely to lose share to Kaufland whereas the independents, supplied by **Metcash** ((MTS)), and **Coles** ((COL)) were considered vulnerable.

The main positive is food inflation is likely to persist. Ord Minnett points out the reason dry grocery inflation has ended is that Woolworths allowed it to happen in the first place, to offset rising labour costs and any execution issues with its new model and distribution centre.

Morgan Stanley suspected Kaufland would have limited impact until it reached a critical mass of around 20 stores by FY23 and considers Woolworths best positioned to realise operating leverage over the medium term.

Citi had expected Kaufland would drive competition across private label products, primarily against Aldi, which would then affect Woolworths and Coles. Hence, the withdrawal reduces the risk to long-term earnings margins.

Citi believes the Australian grocery industry will remain highly consolidated as barriers to entry are high, particularly around securing a consistent supply of fresh categories and finding well-located sites. Moreover, Australia is no longer the global outlier on margins it once was.

Building Materials

While trading multiples across the building materials sector have jumped over the past 12 months, helped by falling interest rates, Ord Minnett finds some value still exists. Key variables for **James Hardie**'s ((JHX)) North American division, such as housing demand and input costs, remain supportive.

The broker expects the upgrade cycle will continue and the stock remains the sector preference. Ord Minnett also has an Accumulate rating for **Reliance Worldwide** ((RWC)), noting early signs of improvement in the UK. The broker likes the fact the stock is relatively defensive with a structural growth dynamic such as the ageing housing stock in the US.

On the other hand, Ord Minnett assesses **Boral**'s ((BLD)) guidance for FY20 is too optimistic and a downgrade is expected as the year progresses. Earnings (EBIT) in the second half for CSR ((CSR)) should decline significantly, in the broker's view, as commencements are expected to stabilise near current levels rather than rebound to the highs seen over 2015-17, with the share price of CSR appearing to factor in the latter.

Citi assesses James Hardie, Boral and **Brickworks** ((BKW)) are leveraged to a US housing market recovery and James Hardie is the top pick. Housing starts in the US in December were up 41%, to the highest level in 13 years. Of the three stocks, James Hardie provides the highest leverage, with its US business accounting for 76% of FY21 operating earnings forecasts.

Global Wild Cards

Citi reviews the wild cards for 2020. The US/China trade relationship looms large and President Trump and his policies dominate several issues. This is not only in the economic challenges to China and to multilateralism, which allowed trade flows to fall into negative territory in 2019, but also across large areas of the world.

The retreat of the US from globalism and global rules looms large, in the broker's view, as does the rise of China and the implications for trade and investment. The stand-off between the US and Iran and disruption risks to the oil market appear particularly large.

The probability that a deal will be reached and sanctioned oil is brought back to market, with prices below US$50/bbl, is considered very low. There is also a low probability of a surprise US recession in the second half of 2020, in Citi's view. Markets are pricing in a soft landing in the US despite the persistence of weak manufacturing.

Environmental and social issues are also affecting how the year will unfold in many commodity-producing countries and emerging markets. This is putting pressure on cost curves and creating the potential for widespread problems ahead.

High on the broker's probability list are expectations the EU will ramp up its de-carbonisation policies, while social instability will become a prominent source of commodity supply disruptions.

In contrast, Citi considers there is a high probability of a protein shortage in China, with food inflation soaring. This stems from the outbreak of African swine fever in China, which has spread across every province. China will need to increase imports of pork for the next several quarters, perhaps to the benefit of the US, Brazil, EU and Oceania producers.

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SMALL CAPS

Syrah Resources Does Not Have All The Answers

While several factors combined to drive the price of graphite higher in the December quarter, brokers remain concerned this may not be enough to pull Syrah Resources out of the woods.

-Lack of clarity on Syrah Resources' price realisation and costs
-Demand for graphite remains the main catalyst
-The business is consuming cash and needs prices/volumes to rise

By Eva Brocklehurst

Restructuring and materially reduced production featured for Syrah Resources ((SYR)) in the December quarter, amid some success in stabilising prices after a disastrous slump in 2019.

Tonnage was heavily skewed to lower-value fines and, although the sales price rose, reflected a greater proportion of sales coming from coarse product stocks. To Morgan Stanley, this could mean the price drops again in the March quarter if the amount of fines increases. Coarse flake is a higher-priced material.

Yet, prices for fines started to rise late in the quarter as the impact of production cuts and a lower inventory tightened the market. This coincided with Chinese winter production cuts and reduced supply from Madagascar.

Management at Syrah Resources has also pointed out the proportion of its sales to China, the lowest-priced market, were aggressively cut. The Balama project, Mozambique, is only operating at the level required for maintenance, given the current price environment.

Recoveries were 68%, below the company's target of more than 80%. Achieving the targeted recovery and product splits at Balama are critical goals and Morgan Stanley also believes there is a lack of clarity on price realisation and costs.

A higher price was achieved in December, at US$458/t, compared with the US$391/t obtained in the September quarter when Syrah Resources initiated production cuts in response to deteriorating market conditions.

Subsequently, inventory at Balama fell in the December quarter, to 14,000t from 31,000t, so the excess supply has largely been removed from the market. Nevertheless, **the largest driver of price recovery was the seasonal disruptions to natural graphite production in China, UBS asserts.**

Chinese production is expected to ramp up in March/April 2020 so the company's disciplined production rates will be critical to maintaining a balanced market, the broker adds.

Costs (C1) for the December quarter were not disclosed, but Credit Suisse considers this would be meaningless anyway, given inventory depletion and the reductions in production.

Supply/Demand

Improved demand for graphite remains the main catalyst for the company. While scaling back Balama has helped bring the market back into balance, it remains difficult for Macquarie to envisage how, at full production, the product will be able to re-enter the market without a significant increase in demand, and an improvement in product quality.

The company has initiated a restructure designed to reduce costs by -20-25%. To date cost reductions of around -15% have been achieved, Macquarie points out, as the option is retained to rapidly ramp up the plant if market demand improves.

There have been some announcements, UBS flags, which may lead to improved demand conditions, such as the EU committing EUR3.2bn to battery research and China announcing that subsidies for new electric vehicles will not be cut at the end of the March quarter. Volkswagen intends to become a market leader in e-mobility with EUR33bn set to be invested by 2024 and POSCO has also announced it will invest to add anode production capacity.

Strategy

The important issue is the price response and the company is in an increasingly vulnerable position, Credit Suisse asserts. The corporate note has now been drawn down, adding potential medium-term pressure for much-needed liquidity in the short term.

The business is consuming cash and if prices and volumes do not increase substantially this will create further pressure, despite the planned cost reductions. The company's strategy is to restore the balance to the market and have the superior quality product at Balama recognised and rewarded appropriately.

Moreover, the broker notes customers are increasingly recognising the production subsidy is ending and sustaining supply, on which China is dependent, is no longer the company's strategy.

While a stabilisation of prices in late December has indicated this strategy may be working, whether the market tightens further and allows the price to increase or, as the broker fears, simply allows an alternative producer to take the company's share is unknown.

The main positive, the broker concludes, is that Madagascan production has been demonstrated to be price sensitive, with deep cuts to exports in the December quarter from that region.

FNArena's database has one Buy rating (Credit Suisse), two Hold and one Sell (Macquarie). The consensus target is $0.64, suggesting 4.1% upside to the last share price. Targets range from $0.35 (Macquarie) to $1.30 (Credit Suisse).

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