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Stories To Read From FNArena

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Brokers Wary Of Ardent Leisure

Sales momentum has failed to hold up recently at Ardent Leisure's Main Event business and brokers are increasingly wary about FY18.

-Disappointing update, given recent initiatives on food, refurbishment and advertising -High chance the roll-out of new Main Event centres slows down again -Private equity interest envisaged likely to support the stock on the downside

By Eva Brocklehurst

Ardent Leisure ((AAD)) has signalled a cautious outlook for its Main Event business, as the pace of rolling out new centres slows and sales momentum appears to have slackened after an up-tick in March.

The company has provided guidance for operating earnings (EBITDA) of $73-75m and Main Event contributing US$44-45m. A loss of -$2-4m has been reiterated for theme parks. After a positive March at Main Event, and the benefit of price increases, sales momentum has dropped back to negative, although the company is still suggesting a solid improvement on prior quarter trends. Brokers were disappointed with this aspect of the update, given the tailwinds that exist in terms of recent initiatives on food, refurbishment and advertising.

Ord Minnett sticks with a Hold rating, despite the upside risk to like-for-like sales on the back of the said initiatives, and suspects consensus estimates may be downgraded. The new CEO, Simon Kelly, has emphasised the importance of maintenance expenditure and the broker believes this is sensible for long-term returns.

Nevertheless, any further slowdown of guidance regarding the rolling out of centres could put pressure on the share price. Ord Minnett considers this scenario most probable and cannot find valuation support, even with the declines in the share price witnessed over the past three years.

Main Event

Deutsche Bank finds the weakness in sales and margins at Main Event of particular concern, as the company is relying on this division to drive earnings growth. This underscores wider concerns around strategy. The company has flagged specific issues at several centres as contributors to weakness, as well as a general lack of investment in older centres and weaker underlying conditions in some markets.

Deutsche Bank has a general issue with the adaptability of the concept to new markets and the resilience of the brand in the face of increasing competition. Deutsche Bank revises forecasts down to account for lower margins at Main Event and a more conservative roll-out strategy as well as slower return of foot traffic at Dreamworld, which was affected by a tragedy last year.

In terms of valuing Main Event, Citi is of the opinion that a 30% multiple discount is appropriate to competitor Dave & Buster, given that company's superior execution and a concept that is proven in more regions across America. If the discount were removed, Citi arrives at a valuation of $2.13, which is only 7% above the current share price.

This does not compensate for the risk that value has been eroded from the continuing underperformance of the operating business and the broker retains a Sell rating. Citi also notes FY17 guidance also implies bowling is underperforming expectations, either that or corporate costs have increased.

Citi is cautious about extrapolating an improving June run rate into FY18, as the competitive environment is intense and previous sales improvements proved to be unsustainable. Given the need to improve the underlying performance the broker envisages downside risk to the roll-out target of eight new centres and now expects just six in FY18.

Citi reduces FY17-19 earnings estimates by -17-24%. The broker acknowledges a takeover or corporate activity led by Ariadne/Viburnum represents the key risk to its recommendation.

Private Equity

Brokers are well aware of private equity interest on the share register, which is expected to support the stock on the downside. Short-term risks are also in focus, given a general meeting has been called for September 4, as Deutsche

Bank notes certain shareholders are seeking to appoint four new directors in order to "fix" the group.

There are two Sell ratings on FNArena's database (Citi, UBS - yet to comment on this update), four Hold and one Buy (Credit Suisse - yet to comment on this update). The consensus target is $1.83, signalling -6.6% downside to the last share price. Targets range from $1.25 (Citi) to $2.25 (Credit Suisse).

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Metcash Delivers, Yet Challenges Remain

Supermarket and hardware business Metcash delivered cash flow and cost reductions ahead of expectations in FY17. Nevertheless, brokers suggest structural challenges remain daunting.

-Market share losses in WA and SA and market-wide deflation continues -Reinstatement of FY18 dividend and pay-out policy welcomed -Opportunity in hardware may be under appreciated

By Eva Brocklehurst

Metcash ((MTS)) pulled a rabbit out of the hat in FY17, delivering cash flow and cost reductions ahead of expectations. Nevertheless, brokers do not overlook the structural challenges that still exist, while noting that cost reductions will necessarily come to an end.

Underlying net profit growth of 9% overstates momentum in the business, in Citi's view. Consistent treatment of the "working smarter" implementation costs and normalising for the extra trading week in the year reduces underlying FY17 net profit growth to 3.2%. The broker expects modest earnings growth, as synergies and savings offset the operating de-leverage in grocery in FY18 and FY19.

While trading is characterised by competitive pressures, Credit Suisse found the food result better than previously expected. The broker was also surprised by the reintroduction of the dividend, at a final 4.5c. The main problems continue to be market share losses in Western Australia & South Australia, and market-wide deflation. Share price appreciation and valuation adjustments lead Credit Suisse to downgrade to Neutral from Outperform.

Morgan Stanley suspects capital management will now become the focus, given the FY18 estimated net cash position, and maintains an Overweight rating. Importantly, the broker notes earnings held up as cost reduction initiatives were carried out and the convenience business was brought back to break even.

Morgan Stanley believes a surprise FY17 dividend and a reinstating of the 60% dividend pay-out policy sends a clear signal that the company is confident in the outlook. The very low price/earnings multiple, low borrowing costs and franking credit balance would make a buy-back very accretive, in the broker's opinion.

Food & Grocery

Looking forward, Morgan Stanley suspects the impact of store closures will reduce and deflation will moderate, so the comparables will get easier as the supermarket sales performance improves. When this occurs the broker expects the stock to re-rate.

Citi, on the other hand, believes the challenging conditions in WA grocery are more structural. The WA grocery market is moderating at a similar pace to the eastern seaboard but at lower levels of growth, partly affected by interstate migration. Meanwhile, ongoing competitive pressure in SA and WA as well as incremental price investment from Coles ((WES)), Woolworths ((WOW)) and Aldi suggests the company will still have to re-invest benefits from its cost-saving initiatives into prices, in order to remain competitive.

UBS believes management is controlling costs effectively and diversifying away from the challenge grocery division but agrees cost reductions are set to come to an end and there will be a need to reinvest in price. Meanwhile competitive pressures are seen emerging down the east coast which will mean top-line pressures accelerate. UBS maintains a Sell rating, acknowledging the business is not expensive, but with the stock trading on around four times FY18 operating earnings (EBIT), downgrades to expectations are needed to re-rate.

Deutsche Bank is now more comfortable that the food business can stabilise and the cost reductions continue. Hence, the broker upgrades to Hold from Sell.

The company has noted a material increase in multi-store owner activity in terms of acquisition, refurbishment and new supermarket expansion in NSW. Macquarie believes this is an important development, given the company's under-utilised distribution assets in this state and addresses and under penetrated market in New South Wales, particularly for differentiated in premium retail formats.

Hardware

The "working smarter" cost saving target has been increased to $120m from around $100m and there is a risk it could again be upgraded, although Ord Minnett observes the restructuring costs in order to achieve this appear to have also increased.

In contrast, there is a significant opportunity in hardware although it is too early to determine the reception to new buying terms from Home Timber and Hardware (HTH) members. All up, the broker considers the investment thesis mixed which underpins a Hold rating although the absence of valuation support is an increasing concern.

The company has reiterated its synergy target for HTH at $15-20m by the end of FY18, after sharing benefits with retailers. Citi expects long-run hardware margins to reach 3.75%, well above Mitre 10 and the former HTH, because of synergies and the closure of under-performing corporate-owned stores. Morgan Stanley believes growth potential in hardware is under appreciated.

While the wider hardware market will slow over the next 12-18 months with a softer housing cycle, the broker believes the company's FY18 earnings will be driven higher by the annualisation of the acquisition, incremental synergies and continued turning around of corporate stores.

Management Succession

The company has announced CEO Ian Morrice will retire in 2018. During his tenure, Mr Morrice focused on repairing the balance sheet, making efficiency gains and improving supermarket standards. As significant achievements have been made across these areas, Macquarie suspects the focus of the future CEO could swing backs towards re-asserting a growth strategy.

There are two Buy ratings, four Hold and one Sell (UBS) on FNArena's database. The consensus target is $2.39, suggesting 7.9% upside to the last share price. Targets range from $2.00 (UBS) to $2.80 (Morgan Stanley). The dividend yield on FY18 and FY19 forecasts is 6.0% and 6.4% respectively.

Link's UK Expansion Adds Accretion And Risk

Link Administration will acquire Capita Asset Services in the UK. A large equity raising is involved but brokers suggest the accretion to earnings justifies the risk.

-Highly accretive although long lead time to obtain full synergies -Broadens Link's footprint in the UK and Europe -Changes Link's profile, introducing material currency risk

By Eva Brocklehurst

Link Administration ((LNK)) will acquire Capita Asset Services in the UK, an administrative/financial platform which generated around $87m in earnings last year. A large equity raising is involved but brokers suggest the accretion to earnings justifies the risk. Link believes it is acquiring a business that has been neglected, which leaves scope to generate efficiencies.

UBS revisits the outlook for Link in the wake of the acquisition, taking into account a softer revenue base in FY17 and double-digit accretion from the deal. The broker lifts outer year forecasts for earnings per share by 10%, but this is largely reliant on low-cost debt funding and a realisation of synergy benefits.

Strategically, UBS believes the deal provides the appropriate platform to grow offshore, but there is limited visibility around divisional revenue and margin drivers, which means the broker's conviction is reduced in terms of taking a more upbeat view on medium-term growth prospects.

Citi suspects the sizeable equity raising will create near-term risks, while the acquisition will take the company into uncharted waters and provide a significant challenge for management. The broker suggests the acquisition changes the investment profile of Link from a very stable Australian annuity-style earnings stream that is driven mainly by superannuation funds administration.

While it still expects 90% of revenue to be recurring, 45% of revenue will be earned outside Australasia and that introduces material currency risk especially, in the broker's opinion, if the UK pound displays further volatility as the Brexit process is worked through. Citi believes the price of the acquisition is full but acknowledges accretion will eventually be significant and this is hard to ignore. The broker upgrades to Buy from Neutral.

Capital Raising

Link will pay GBP888m for Capita Asset Services and undertake an equity raising of $883m. The equity raising will be via a fully underwritten 4-for-11 pro rata, accelerated, renounceable entitlement offer and the balance of the price funded by $664m in debt from existing and new facilities.

Macquarie considers the capital raising large relative to the company's current market capitalisation but expects it should be supported, underpinned by the promise of around 30% accretion to earnings per share. The size of the acquired assets and associated integration risks, as well as diminished financial flexibility, suggest to the broker there will be some compression in the stock's multiple, which will partly offset some of the upside.

Macquarie also recognises this as an opportunity, given the recent devaluation of the pound. The broker suggests the market was already pricing in financial flexibility and scope for acquisitions that were accretive, but some of the upside will be offset by exposure to an arguably lower-growth EU market.

Capita Asset Services

Morgans has a positive view on the deal, believing it is a reasonably strategic fit and highly accretive, although acknowledges risks exist. Around 50% of revenue comes from funds solution and shareholder registry and Link has material operations experience in similar areas, albeit centred on Australia. The other 50% of revenue comes from what Morgans believes are rational extensions for Link, such as UK debt servicing.

The various businesses exhibit defensive characteristics but the broker points out this is a lower quality business versus Link's existing funds administration operations and deal integration remains a risk. The acquisition appears to be accretive in double-digits when factoring in expected efficiency benefits, and around 5% accretive excluding efficiency benefits.

The broker understands around $25m in benefits accrue over the medium term and is confident that these can be achieved from the opportunity for property optimisation, as the business has 15 separate UK properties, and removal of duplicate shared service functions. Morgans believes the price paid is fair versus current peer multiples. The acquisition is not included forecasts as completion of the capital raising and transaction is required.

Citi observes the Capita Asset business needs a technological overhaul and should benefit from being a business in its own right rather than a division within a large conglomerate. Capita plc is selling the business as it needs the proceeds, rather than because of problems per se.

Nevertheless, a significant part of the banking and debt solutions are in run-off and the registry is likely to be difficult to grow substantially, in Citi's view, while the funds solution business has arguably hit saturation point in the UK. Still, the acquisition will broaden Link's geographic footprint and offering in both the UK and Europe.

On FNArena's database there are three Buy ratings and two Hold. The consensus target is $8.85, suggesting 13.0% upside to the last share price. Targets range from $8.29 (Morgans) to $9.50 (Macquarie).

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Brokers Neutral On REA'S Mortgage Services

REA Group has expanded its real estate financial services to include mortgage products via a traditional broking channel. Brokers suggest accretion is minimal at this stage.

-Expands offering to home owners that do not want acquire a mortgage online -Headwinds are looming for the mortgage broking industry -Mortgage broking likely to be more volatile than core business

By Eva Brocklehurst

REA Group ((REA)) has expanded its real estate financial services to incorporate a suite of mortgage products via a traditional broking channel. The company has acquired an 80.3% stake in Smartline, an Australian mortgage broking franchise, for $67m. Current management retains the balance.

REA Group has also announced the extension of its strategic mortgage broking partnership with National Australia Bank ((NAB)). The company previously flagged the entry into financial services with the establishment of its home loan product and co-branding with NAB, expected to go live later this year.

This model is extended to offer a more complete suite of mortgage products via a broking channel. This expands the product offering to home owners that do not want to conduct mortgage business online and seek independent advice from mortgage brokers.

Smartline

Smartline has over 300 advisers nationally and a $25bn loan book, providing a platform that is profitable and can be scaled if warranted. Macquarie believes this reduces the risk versus trying to build or grow REA Group's own mortgage broking business. REA Group has extensive data and understands customer behaviours which places it in a good position to deliver timely leads in this area. Holding ownership of a broking business will also create options over time, in the broker's opinion.

In isolation, if the company executes well, the financial services platform should offer good returns on capital and complementary growth for the core business, albeit on a relatively small scale. In its main business, Macquarie believes REA Group is well-placed given recent price rises and a return to modest growth in property listings. The broker retains a Neutral rating on valuation grounds. There is one clear strategic purpose in the move UBS believes, in that those willing to sign up to a residential home loan over the internet without the option of a physical broker may have been limited. Now, the company will be able to leverage this network of advisers to promote its home loans product. UBS believes it will eventually be possible to sign up to a new home loan directly on the REA websites after browsing for a home.

Nevertheless, headwinds are looming for the mortgage broking industry. There are risk to fees, where average industry commissions to brokers are around $4, 600 per mortgage. Banks may look to negotiate lower fees in coming months and, in the longer term, open data and analytics may mean the value addition from brokers becomes more marginalised.

The potential impact of these headwinds on REA Group are uncertain but UBS believes there could be offsets, as growth in loan volumes may negate any yield pressures and the Smartline back book is unlikely to be retrospectively affected.

Valuation

The transaction may be accretive to earnings but UBS does not believe incremental Smartline earnings should be valued on the existing online classifieds multiple and suspects a slight premium to Mortgage Choice ((MOC)) is appropriate for strategic value and synergies. As a result UBS considers the transaction broadly neutral to valuation.

In Deutsche Bank's opinion the investments increase exposure to what is a large, addressable market, as mortgage brokers in Australia generate revenues of around $2.2bn per annum. Nevertheless, the investment also signals expansion into what is effectively a lower-multiple business.

Deutsche Bank remains of the view that REA Group is better positioned than a traditional mortgage broker to capture share in this market given the leads it can generate from its site but this is also a business which is likely to be more volatile than the core operations. The accretion at this stage is minimal in the broker's opinion and a Hold rating is maintained.

The purchase price represents less than 1% of the company's enterprise value and Macquarie calculates the FY18 contribution to earnings of $8.5m for financial services, most of which would be derived from Smartline, represents less than 2% of group operating earnings (EBITDA) prior to the acquisition.

Macquarie agrees there is some risk that any growth in market share a volume of business written could face offsets from fee pressures over time as there is some risk with the industry pertaining to two separate reviews from both the ACCC and Sedgwick.

FNArena's database has two Buy ratings, four Hold and one Sell (UBS). The consensus target is $63.43, signalling -4.7% in downside to the last share price. Targets range from $56.75 (Deutsche Bank) to $72.50 (Citi, yet to comment on the acquisition).

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OceanaGold Hits A Few Bumps At Haile

OceanaGold has hit a few bumps at its Haile project and reduced production estimates for 2017. Brokers are not overly concerned as prospects elsewhere should mitigate the downgrade.

-Downgrade to Haile offset by higher guidance from Didipio -Risk of suspension at Didipio reduced considerably -Further considerable upside to New Zealand portfolio

By Eva Brocklehurst

OceanaGold ((OGC)) has hit a few bumps at its Haile project in the US. The ramp-up has been slower than expected and has led to a 25% reduction in 2017 production estimates to 120,000 ozs. Nevertheless, ramping up mines is seldom a smooth going and this reduction does not change broker forecasts, or their longer term favourable views of the project.

The Haile optimisation study projects a mine life of more than 16 years at an expanded 4mtpa rate from 2021. Commissioning challenges still exist but should be resolved by the end of the year for little expenditure. Meanwhile, the company also offered a positive update across its other projects, and brokers note the downgrade to Haile has been offset by higher guidance from Didipio in the Philippines.

Haile

The company is disappointed by the commissioning challenges that have resulted in a downgrade to 2017 guidance at Haile and suggests that the commissioning risk may have been better understood if the plant was designed in-house. Macquarie is encouraged by the plans in place to rectify the problems, noting the company has one of the best mine building teams but acquired the project during construction and, therefore, was not in complete control of the design.

As a result, the broker continues to monitor operational performance, including grade control reconciliation, as the company defines controls and the geological picture. Many of the problems stem from design issues, which the company intends to resolve over the next six months at a cost of US$3-4m. At this point, capital expenditure of US$250m is expected to be outlaid between late 2018 and 2020.

UBS is mostly concerned that the market's current focus on the enterprise value/operating earnings (EBITDA) may overlook the cash that is generated by the business over the next few years because of the significant re-investment. The delays warrant some conservatism, in Deutsche Bank's opinion, perhaps even into early 2018. Permits remain the key challenge and for this reason the broker keeps the 4mtpa option outside of the base case valuation.

Exploration has also been successful at the Palomino and Snake open pit targets, part of a prospective 1km corridor that includes the Horseshoe target. Credit Suisse finds this aspect most compelling, as it demonstrates continuity of high-grade gold mineralisation beyond current mine designs.

Didipio

Credit Suisse observes a subtle change in that the company is acknowledging looking at opportunities to further mitigate the geopolitical risk in the Philippines. A final resolution of the suspension order is expected in the next couple of months but the mine continues to operate without any disruption, other than a deliberate high-grading strategy that is being maintained to offset the weaker contribution from Haile.

This essentially takes grade from 2018 and brings it forward to 2017. The implied “hole” in 2018 is expected to be addressed by increasing mill throughput to 4mtpa from the current limit of 3.5mtpa, subject to approval, and a revised underground mining sequence.

UBS observes the risk of suspending Didipio has reduced materially with a change of leadership in the relevant government department. A formal suspension order remains in place but, assuming the company's appeal is treated favourably - with a decision in the December half expected - this should remove any residual overhang.

UBS believes this will then signal the stock is more appealing to the general investor. Australian investors have considerable choice locally but the company's leading position on costs and its diversified asset base should not be overlooked, in the broker's opinion.

The exposure to the Philippines accounts for around 30% of UBS forecasts revenues and valuation and sentiment has been adversely affected by the changes to mining policy. As the company appears committed to reducing geopolitical risk further, the broker suspects acquiring assets could be difficult, as most of the sector, at least in Australia, has de-geared and this leads to higher competition for assets.

Nevertheless, further diversifying away from the Philippines would probably be well received over the longer term although in the short term it may cause investors to stay cautious.

New Zealand

Macraes continues to extend the high-grade Coronation North resource and there is potential for modest extensions to Golden Point and Frasers West while Waihi continues to yield results from multiple vein extensions that are currently being mined. Drilling at Waihi continues to intercept typical grades and widths and supports management's aspiration for more than 10 years of mine life. Credit Suisse observes these all “fill the mill” and buy time before future commitments are necessary for the potential 10-year opportunity if Round Hill can be extracted economically.

OceanaGold remains one of Macquarie's top picks in the sector for 2017. Haile is now the company's largest asset at 39% of net asset value and there is upside in the New Zealand portfolio, as the company benefits from the weakening New Zealand dollar and the potential at the Waihi asset.

There are three Buy ratings and three Hold on FNArena's database. The consensus target is $4.73, suggesting 14.7% upside to the last share price. Targets range from $4.20 (UBS) to $6.00 (Macquarie).

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Material Matters: Coal, Steel, Metals & Oil

A glance through the latest expert views and predictions about commodities. Coal; steel; metals and oil.

-Chinese coal prices diverge versus the seaborne market -Alternative sources of coking coal may have covered Oz shortfall -Steel demand in China expected to slow in the second half of 2017 -Deutsche Bank retains positive outlook for base metals -Deutsche Bank scales back medium-term outlook for oil prices

By Eva Brocklehurst

Coal

Australian GDP in the June quarter may be weak because of the impact of Cyclone Debbie on economic activity. Yet, Commonwealth Bank analysts suggest that concerns about the large drop in coal export volumes in April may be misplaced. The reason is that production is what matters to GDP, not exports.

The cyclone hit the Queensland coast late in March and three of the four main rail networks were back up and running by mid April, albeit at reduced capacity. The fourth, Goonyella, was up and running at reduced capacity on April 26. This suggests that the economic impacts will largely be limited to the June quarter.

While, the analysts suggest that export volumes will be around 1.2% lower than otherwise, some of the decline will be offset by an increase in inventories, as coal production was less affected than actual exports. Coal accounts for around 12% of Australia's total exports yet the net drag on June quarter GDP is expected to be less than 0.13 percentage points. In contrast, Cyclone Yasi in 2011 is estimated to have subtracted at least 0.5 percentage points from growth.

Credit Suisse suspects, given the coking (metallurgical) coal price slipped in May-June despite strong Chinese imports and weaker Australian exports, that additional supply from other sources must have covered the shortfall. New supply appears to be primarily from Mongolia and the US. Credit Suisse suspects that US coal companies, crippled by Chapter 11 insolvencies in the first half of FY16, have been restructured and are now back in the market, lifting output.

Credit Suisse also envisages demand for coking coal will slow steeply in China. In 2018 stimulus for political reasons may not be required and, therefore, completion of current projects means steel demand will fall. Credit Suisse does not forecast any new stimulus and, instead, expects China to resume its long-term project of re-balancing the economy. Without infrastructure stimulus, the broker believes Chinese steel demand may fall steeply toward 650mt by 2020.

Macquarie observes coal prices in China versus on the seaborne market have diverged over the past month. Also, thermal coal prices started to rise early in June while coking coal prices eased. The broker attributes the rise in thermal coal prices to a sharp drop in inventories in China, which forced a re-stocking before the peak summer power consumption period. In contrast, coking coal prices continued to drop in June because of softness in the steel price.

Supply growth for coking coal has been slower than thermal, and the broker suspects the environmental inspections in China's Shanxi province have affected production of coking coal in that region. The falling price also discourages miners from lifting production.

In the seaborne coking coal market, meanwhile, buying interest from China has risen, as prices are now more than US$20/t cheaper than domestic annual contract prices and, if the domestic coking coal price holds up, Macquarie suggests demand for seaborne coking coal should rise.

In contrast, in the medium term, the broker believes Chinese thermal coal supply will grow, and demand fade, as will the company's appetite for imports. Hence, seaborne thermal coal prices are expected to follow Chinese thermal coal prices lower.

Steel

Macquarie's survey of steel mills and traders suggests opinions on the outlook for steel and iron ore have diverged. Mills and traders are more optimistic about steel prices and margins while iron ore traders are increasingly negative. Nevertheless, the broker finds a little more appetite for re-stocking of raw materials which could support iron ore and coking coal prices after recent falls.

Steel demand in China is holding up, especially for infrastructure and construction, which the broker suggests goes against the long-held expectation that demand would fade into the summer months. This bodes well for margins in the near term, although Macquarie expects a slowdown in demand in the second half of the year as investment in infrastructure and property fade.

Meanwhile, Chinese steel markets are less focused on export orders. As domestic demand slows in the second half and prices ease exports are expected to make a recovery.

Metals

Deutsche Bank remains positive on base metals, despite downgrading forecasts for nickel, zinc, and copper. Nickel price forecasts are trimmed around -6% but the broker's year-end target for nickel prices is 22% above the three-month forward price, as demand for stainless steel remain strong.

The broker remains convinced of longer-term deficits in copper after 2018, but is concerned that the metal may be in a holding pattern at present because of weakness in demand for grid investment and automobile manufacturing.

Zinc remains one of the broker's preferred metal commodities, given constrained mine supply over the next couple of years. Although demand indicators for China remain subdued, infrastructure investment and consumer exports are improving and this suggests the worst may have passed for the metal if automobile output can stabilise.

The broker raises aluminium forecasts and envisages prices will be supported by supply-side reform, environmental initiatives and rising raw material prices in China. Deutsche Bank remains neutral on gold.

Mining sector earnings are downgraded by -3-4% but valuations remain undemanding, in the broker's opinion, given the recent sell-off in the stocks. The broker upgrades Alumina Ltd ((AWC)) to Hold and downgrades Northern Star Resources ((NST)) to Sell.

Ord Minnett also updates long-term assumptions for copper, aluminium and the Australian dollar, now US$2.85/lb, US$0.85/lb and US$0.76 respectively. The revisions equate to reductions of around -15% to estimates for the metals and -5% for the currency.

Oil

Deutsche Bank suggests, despite the extension of OPEC oil production cuts, the likelihood of reaching the five-year average in inventories by the end of the year is diminished, without a deepening of the cuts. The broker envisages a shrinking market deficit this year and a return to surplus in 2018 on upgraded US supply growth and higher output from Libya and Nigeria. The broker scales back medium-term forecast by -15% to US$54-56/bbl for Brent in 2018-19.

Material Matters: Zinc, Cobalt, Oil & Oz Miners

A glance through the latest expert views and predictions about commodities. Zinc; cobalt; oil; precious metals; base metals; and Oz miners.

-Bullish factors lining up for zinc -Demand for cobalt continues to rise -Have oil prices found a bottom? -Palladium performance tops precious metals -Price performance of aluminium & lead solid in 2017 -Morgan Stanley retains positive outlook for Oz miners

By Eva Brocklehurst

Zinc

Macquarie suggests the stars are aligning for zinc. Speculators have reacted to signals from London Metals Exchange warehouse data and Chinese output numbers, something the broker was anticipating. This is on the back of falling Chinese production and global stocks, and rising ingot premiums and imports. The issue of hidden stocks has been ongoing and, now stocks appear to be drawing down inside China, Macquarie sets about estimating the state of the market.

The broker notes there was a substantially large number of cancelled warrants recently in New Orleans, which means the metal has been earmarked for delivery and the warrants can no longer be traded within the system. The broker finds it difficult to believe that this tonnage, of which more than 90% is in New Orleans, is all the zinc that exists outside of China, noting the LME has admitted that the storage network is a location of last resort.

Hence, the broker suggests there must have been inventory hidden from view in order for the market to function. On the supply side, zinc ingot output, officially, in China was down -9.9% in May following a -5.6% drop in the month before.

All up, Macquarie believes the bulls are in play, in line with a forecast full year deficit in 2017 of 689,000t. The broker reiterates its view that zinc prices will move above US$3, 000/t by the end of the year and average US$3, 200/t in the first quarter of 2018 before a demand-led re-balancing begins.

Cobalt

Morgan Stanley attempts to model prices for cobalt, a small and opaque trade for which the end use is dominated by rechargeable batteries. Investor anticipation of an automobile-lead demand spike for cobalt has prompted aggressive stockpiling and lifted the spot price to US$29/lb from US$11/lb a year ago. Last year only 7% of the world's cobalt supply went to electric vehicles and most was consumed by rechargeable batteries.

However, Morgan Stanley's European automotive analyst expects global emissions legislation to prompt an investment in electric vehicle production in coming years, and forecasts sales of electric vehicles to total 9.4m by 2025. This suggests an extra 63,000tpa of cobalt demand.

Meanwhile, other applications such as superalloys are expected to deliver strong demand and there is only a minor substitution risk, the broker estimates. Most of the cobalt supply is a by-product of copper and nickel mining and around 62% of last year's output came from the Democratic Republic of Congo alone.

As a result, Morgan Stanley lifts the outlook for the cobalt price, expecting a small trade deficit in 2017-18 that should support the price at US$26-27/lb, above its historical level. After this, new mine supply should bring the market closer to balance and undermine the medium-term price.

Oil

Citi suggests oil may be close to the bottom of its trading range. Money managers have a record level of short positions open on ICE Brent contracts. Moreover, long positions on both Brent and West Texas Intermediate are around similar levels seen at the end of January 2016, when oil prices were at the recent historical lows. The broker considers it unlikely that investor net length will go lower.

Citi observes the three-way struggle for price determination is being dominated by financial flows at present and the bears are winning as market fundamentals appear confusing and geopolitics remains the bullish factor in the background. The bears' position is partly based on fund losses for those who expected the OPEC/non-OPEC extension of production cuts would be a time to add length. The broker suggests the pain is great enough to delay a significant price rebound any time soon.

There are other factors which may overwhelm this bearish outlook, although there is a chance any rebound will fall short of US$60/bbl this year. Citi is lowering its expectations that Brent will breach US$60/bbl in 2017, yet still expects drawing down of inventories throughout the year to bring the days of forward cover down into the five-year range.

This should help to repair sentiment and tighten physical markets, although the broker expects a lid on sharp price rises unless guidance for shale production is lowered, stocks move to 5-year absolute levels and/or OPEC decides to cut production further and for longer.

Precious Metals

Morgan Stanley observes palladium has delivered the top price performance for precious metals so far in 2017, in an otherwise quiet market that has rallied on a lack of inventory. Meanwhile, gold investors appear more concerned about rising political and trade tensions than a hit from the US Federal Reserve rate hike cycle, hence the yellow metal is level pegging for now.

Prices for the platinum and silver year-to-date have generally tracked gold but are now being undermined by flagging industrial drivers, the broker observes.

Base Metals

Aluminium and lead are the most uninteresting base metals, in Morgan Stanley's opinion, but have actually reported solid price performances and are up 10% so far this year. Investors are engaged by the possibility of large reductions in smelter output in China, while lead has benefited from a lack of concentrates on the tail end of the strong global automotive sector in 2016. Nevertheless, lead and zinc face bearish mine re-starts and a drag on prices going into 2018, in the broker's opinion.

Meanwhile, the weak price action in copper this year confirms the broker's belief that this is what happens when buyers defer consumption and wait for fleeting trade shocks to pass. Price upside has been delayed in nickel, the broker suspects, probably until a restocking in 2018, by a surprise return of Southeast Asian exports.

Australian Miners

Morgan Stanley remain positive on Australian miners, envisaging opportunities, particularly on a relative basis. Investors may be cautious but the broker finds the reasons to be positive include a favourable macro outlook, low risk of a growth slump in China and likely rotation towards miners on the ASX as credit rationing puts pressure on the domestic economy.

Moreover, bulk commodities are expected to find support levels. The optimistic setting is not rampantly so but the broker remains constructive. Topping the list is South32 ((S32)) as the stock has a strong free cash flow yield. There is also net cash to reinvest or return on a favourable, commodity exposure through thermal coal, manganese and aluminium.

Majors BHP Billiton ((BHP)) and Rio Tinto ((RIO)) remain at the top of the broker's list, given their strong margins and upside potential to the price target. In terms of the leverage to specific themes the broker likes Mineral Resources ((MIN)) with its exposure to lithium. Whitehaven Coal ((WHC)) rounds out the top five.

Weekly Ratings, Targets, Forecast Changes

By Rudi Filapek-Vandyck, Editor FNArena

Guide:

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

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

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

Summary

Period: Monday June 19 to Friday June 23, 2017 Total Upgrades: 15 Total Downgrades: 13 Net Ratings Breakdown: Buy 41.87%; Hold 42.00%; Sell 16.13%

Stockbroking analysts proved rather busy during the week ending Friday, 23rd June 2017. FNArena registered no less than 15 upgrades in ratings for individual ASX-listed stocks against 13 downgrades. Moreover, ten upgrades moved to Buy, while seven downgrades ended at Sell.

There is clearly a lot more going on underneath the surface than is commonly being paid attention to.

Banks, retailers, yield stocks, they all feature, but resources stocks are the prominent driver behind most changes made. As share prices are falling, and speculation is rife about a low point being near, while public debate rages about the sector outlook for the year ahead, there's no double guessing about the various dynamics in play.

Resources stocks are also prominent among downgrades, including downgrades to Sell. QBE Insurance received both one downgrade and one upgrade during the week, illustrating how divided the experts are post yet another profit downgrade.

Total Buy and Neutral ratings seem to be on course towards equal share, currently at 42% (Hold ratings) and 41.87% (Buys) respectively.

It was equally busy for changes made to valuations and price targets with Janus Henderson enjoying the biggest increase for the week (+9.94%), at arm's length followed by Orocobre, Breville, Amcor, Smartgroup and Charter Hall Long WALE REITt who all enjoyed 2-3% increases.

On the negative side, Flexigroup post investor presentations is now worth -12.40% less, followed by Fortescue (-7%), Syrah Resources (-4.9%) and Domino's Pizza (-4.6%). Underlining the negative trend since April, negative adjustments remain noticeably larger in size than the positive adjustments, on average.

The latter observation also stands for adjustments made to earnings estimates with Syrah Resources, a2 Milk, Bellamy's and Santos stealing the show on the positive side, but negative changes are noticeable larger for Western Areas, Vicinity Centres, Rio Tinto, Tabcorp, and others.

Upgrade

ADAIRS LIMITED ((ADH)) Upgrade to Buy from Neutral by UBS .B/H/S: 2/0/0

The company has responded to a large rise in the share price, stating it is not aware of any information that would lead to earnings differing materially from current guidance. UBS observes the share price increased further and closed up 47% on the day but, while the move was substantial, the share price is 30% below its closing level at the first half result.

The broker believes, if the business can stabilise, the upside could be material. Rating is upgraded to Buy from Neutral based on forecast shareholder returns.

UBS downgrades FY17 forecasts for earnings per share slightly and removes the risk discount in the price target methodology. While the company is moving away from its previous bed-linen range in-store it still has headwinds across the macro conditions as well as competitive intensity to deal with, the analysts highlight.

UBS finds it difficult to have a high degree of confidence in the sales margin profile. Target is reduced to $1.16 from $1.25.

AGL ENERGY LIMITED ((AGL)) Upgrade to Accumulate from Hold by Ord Minnett .B/H/S: 3/2/2

Ord Minnett has upgraded to Accumulate from Hold on the premise that there remains a risk of electricity shortages through next summer, which implies wholesale prices for electricity are to remain elevated while retail prices have to date surprised on the upside.

The stockbroker, clearly, is not convinced that any measures attempted to address the issues in the National Electricity Market (NEM) by the Federal and state governments are sufficient. All else, for the time being, is but a distraction, argue the analysts. Price target lifts by 20c to $28.20.

ALTURA MINING LIMITED ((AJM)) Upgrade to Neutral from Underperform by Macquarie .B/H/S: 0/1/0

Macquarie upgrades lithium price forecasts by 19% for 2020-21. The broker also upgrades cobalt forecasts.

As a result, Macquarie upgrades Altura's rating to Neutral from Underperform. Target price is lifted by 14% to $0.16.

AMCOR LIMITED ((AMC)) Upgrade to Equal-weight from Underweight by Morgan Stanley .B/H/S: 3/5/0

Innovation is expected to support stronger volumes for Amcor's rigids business in the near term, Morgan Stanley believes. The broker believes superior capabilities in technology have created a mechanism to offset volume pressure in the Americas beverage market.

Therefore, the broker is more positive on the stock in the near term and upgrades to Equal-weight from Underweight. Increasing regulation and a growing anti-sugar movement will present structural challenges, nonetheless, the broker adds.

Target is raised to $15.35 from $12.20. Sector view is Cautious.

ALUMINA LIMITED ((AWC)) Upgrade to Hold from Sell by Deutsche Bank .B/H/S: 2/2/3

Deutsche Bank is upgrading aluminium and alumina price forecasts by 5% and 8% in 2017 respectively. Forecasts are upgraded by 8% and 7% respectively for 2018.

The broker notes the alumina market continues to swing to surplus from deficit and then back again with Chinese refinery re-starts and curtailments. Deutsche Bank believes US$290-310/t is the equilibrium price.

The broker upgrades to Hold from Sell and the target to $1.85 from $1.65.

CHARTER HALL LONG WALE REIT ((CLW)) Upgrade to Accumulate from Hold by Ord Minnett .B/H/S: 1/1/1

Ord Minnett economists (read: JP Morgan's) have now changed their view in that there will be no more RBA rate cuts in the foreseeable future. This, they say, will translate into more interest from investors into property trusts with long weighted-average lease expiries (WALE).

Charter Hall Long WALE is one such AREIT and thus the rating has been lifted to Accumulate from Hold. Target price jumps to $4.45 from $4.15.

GALAXY RESOURCES LIMITED ((GXY)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 2/1/0

Macquarie upgrades lithium price forecasts by 19% for 2020-21. The broker also upgrades cobalt forecasts. Galaxy's rating is upgraded to Outperform from Neutral.

Given a preference for hard rock projects over brine developments, Macquarie increases its discount for the company's Sal De Vida project, which results in an -8% reduction in the target to $2.10.

HOTEL PROPERTY INVESTMENTS ((HPI)) Upgrade to Accumulate from Hold by Ord Minnett .B/H/S: 2/0/0

Ord Minnett economists (read: JP Morgan's) have now changed their view in that there will be no more RBA rate cuts in the foreseeable future. This, they say, will translate into more interest from investors into property trusts with long weighted-average lease expiries (WALE).

Hotel Property Investments is one such AREIT and thus the rating has been lifted to Accumulate from Hold. Target price jumps to $3.35 from $2.90.

ILUKA RESOURCES LIMITED ((ILU)) Upgrade to Outperform from Neutral by Credit Suisse .B/H/S: 4/1/2

Credit Suisse believes the recent share price softness presents a buying opportunity. The broker finds no reason why the strong first quarter will not carry through to the second.

The decision to re-start Jacinta Ambrosia on the back of a tight zircon market provides further confidence. The company has indicated that, if Balranald does proceed, it will be pursued with a staged approach.

Credit Suisse upgrades to Outperform from Neutral. Target is $9.40.

METCASH LIMITED ((MTS)) Upgrade to Hold from Lighten by Ord Minnett .B/H/S: 3/2/2

Ord Minnett observes the food & grocery business is challenged while the home improvement division is strong and has upside to current synergy targets.

The broker believes the share price is now trading closer to its valuation, which assumes that the risk to earnings in food & grocery is supported by cost savings versus structural challenges to market share.

Ord Minnett upgrades to Hold from Lighten on valuation grounds.

PILBARA MINERALS LIMITED ((PLS)) Upgrade to Outperform from Underperform by Macquarie .B/H/S: 2/0/0

Macquarie upgrades lithium price forecasts by 19% for 2020-21. The broker also upgrades cobalt forecasts.

While more bullish price forecasts are a driver of improved earnings expectations, the broker observes the company has significantly de-risked funding and technical delivery of its project.

Rating is upgraded to Outperform from Underperform. Target is raised to $0.50 from $0.38.

QBE INSURANCE GROUP LIMITED ((QBE)) Upgrade to Add from Hold by Morgans .B/H/S: 4/2/1

Amid higher claims from emerging markets, the company has downgraded FY17 guidance. Morgans asserts the bumps on the road to recovery for the company remain annoying, although the drivers of this announcement are largely considered one-off.

The broker believes the fall in the share price is overdone and value is re-emerging for the stock. FY17 forecasts for earnings per share are downgraded by -10%. Target is reduced to $13.09 from $13.47. Rating is upgraded to Add from Hold.

See also QBE downgrade.

SOUTHERN CROSS MEDIA GROUP ((SXL)) Upgrade to Outperform from Neutral by Credit Suisse .B/H/S: 1/3/1

Credit Suisse does not believe the current share price is factoring in the potential upside from proposed regulatory changes. The company stands to benefit from the media reforms such as the abolition of licence fees and the removal of the 75% audience reach rule.

Meanwhile, the metro radio market has returned to positive territory in May with a five-city year-on-year growth rate of 0.5%. Credit Suisse considers the stock inexpensive and upgrades to Outperform from Neutral. Target is raised $1.35 from $1.30.

WESTPAC BANKING CORPORATION ((WBC)) Upgrade to Outperform from Neutral by Credit Suisse .B/H/S: 3/4/1

Credit Suisse upgrades to Outperform from Neutral, based on the relative value and potential catalysts in APRA's upcoming capital announcements as well as the latest round of mortgage re-pricing.

The latter is considered to be firming up the company's near-term net interest margin outlook. Target is $34.

WESTERN AREAS NL ((WSA)) Upgrade to Neutral from Underperform by Macquarie .B/H/S: 0/5/2

The company has upgraded the resource base at Cosmos, with massive sulphides up 311%, which Macquarie believes has materially improved the economics of the project.

The increase in the high-grade massive sulphide has caused the broker to upgrade estimates for an internal rate of return to 25% from 18%. Cosmos still needs higher nickel prices before development is likely to progress, the broker acknowledges.

As the stock has fallen over -13% this month, and incorporating the improved economics, Macquarie upgrades to Neutral from Underperform. Target rises to $2.15 from $2.00.

Downgrade

AINSWORTH GAME TECHNOLOGY LIMITED ((AGI)) Downgrade to Sell from Neutral by UBS .B/H/S: 1/0/1

Ainsworth has outperformed the ASX300 by 42% in the past six weeks, driven by hype around new game releases and particularly the highly anticipated Pac-Man offering, UBS notes. While the stock has been neglected and was due a bounce, the broker believes the market is factoring in a too ambitious broad game improvement.

Data and anecdotal feedback are not supporting such strength. With currency acting as a headwind and a forward PE now at 18x, UBS downgrades to Sell. Target unchanged at $1.77.

BREVILLE GROUP LIMITED ((BRG)) Downgrade to Neutral from Outperform by Credit Suisse .B/H/S: 2/2/0

While the company is well-positioned for the current retail environment and growth opportunities are still viable offshore, Credit Suisse believes recent share price strength leaves the stock with a multiple that provides no margin for slippage.

Rating is downgraded to Neutral from Outperform. The broker has few concerns about the near-term outlook and expects growth into FY18 of around 7%. Target is raised to $10.75 from $9.30.

DEXUS PROPERTY GROUP ((DXS)) Downgrade to Sell from Neutral by UBS .B/H/S: 1/0/3

Dexus has raised $500m to buy 25% of the MLC centre, 100% of another Sydney office block and an industrial property in Melbourne. UBS is surprised at the MLC acquisition given Dexus usually shows more price discipline.

Dexus has outperformed the market by 10% and the REIT sector by 20% recently, UBS notes, largely due to being a REIT without exposure to retail. Cap rate compression over the last quarter is now largely priced in, hence the broker downgrades to Sell. Target unchanged at $9.57.

FORTESCUE METALS GROUP LTD ((FMG)) Downgrade to Sell from Neutral by Citi .B/H/S: 4/3/1

Citi is bearish on the iron ore price, noting Chinese port inventories have built and more low-cost supply is coming onto the market. The broker has downgraded its price forecasts, suggesting a level below US$50/t is required to close down high cost Chinese domestic production.

Discounts for lower grade ore have also widened and while the broker sees this as more cyclical than structural, the trend may remain in place for a while.

Fortescue target cut to $3.90 from $5.80, downgrade to Sell.

FLEXIGROUP LIMITED ((FXL)) Downgrade to Neutral from Outperform by Credit Suisse .B/H/S: 2/4/0

Credit Suisse previously had an Outperform rating based on cheap valuation and a view the company could start to produce growth.

However, despite valuation looking compelling, the stock is still in a downgrade cycle and the broker is increasingly cautious about Certegy, which could offset growth in other areas.

The broker has low conviction on earnings and still envisages downside risk, preferring to wait until growth concerns are alleviated. Hence the move to Neutral. Target is reduced to $1.85 from $2.70.

GPT ((GPT)) Downgrade to Underweight from Overweight by Morgan Stanley .B/H/S: 1/4/1

In-depth research into prospects and changing dynamics for owners of shopping malls have led Morgan Stanley analysts to take a more sombre view on the outlook for Net Operating Income (NOI) for the sector in Australia.

The rating for GPT has been double-whammy downgraded as a direct result; to Underweight from Overweight. Target price loses 20c to $4.80.

It is Morgan Stanley's view that retail landlords are now facing a combination of a severe cyclical consumer slowdown and the structural pressure from e-commerce. This is expected to accelerate the pressure on retailer margins, and reduce demand for physical space. Updated forecasts assume NOI growth will halve from FY17 levels, while risk remains to the downside, in the analysts' view.

HEALTHSCOPE LIMITED ((HSO)) Downgrade to Underweight from Equal-weight by Morgan Stanley .B/H/S: 2/2/2

Morgan Stanley analysts are weighing up the perceived defensive characteristics of the health insurance industry, with obvious implications for hospital operators such as Healthscope.

In a nutshell: the analysts have come to the conclusion that structural dynamics are shifting on the back of decreasing household budgets and increasing competition.

The end result, argue the analysts, is profit growth for private health insurers and for private hospital operators will prove more cyclical. The result is a downgrade for Healthscope to Underweight from Equal-Weight as virtually no growth is expected for the near term. Price target falls to $1.90.

Sector view remains In-Line.

MAGELLAN FINANCIAL GROUP LIMITED ((MFG)) Downgrade to Hold from Buy by Ord Minnett .B/H/S: 4/2/0

Ord Minnett believes the market has become too excited/too optimistic about the performance of Magellan’s Global Fund. The result is that a welcome spike in performance fees is not going to stick.

Downgrade to Hold from Buy. Price target rises to $28.13 from $27.47. Part of the conviction behind the move is the observation that June is proving a softer month already. Valuation has become a problem, suggest the analysts.

NORTHERN STAR RESOURCES LTD ((NST)) Downgrade to Sell from Hold by Deutsche Bank .B/H/S: 2/2/2

Deutsche Bank downgrades mining sector earnings in 2017 by an average -3-4%. The broker downgrades Northern Star to Sell from Hold on valuation. Target is raised to $4.30 from $4.10.

OROCOBRE LIMITED ((ORE)) Downgrade to Neutral from Buy by Citi .B/H/S: 3/2/0

Citi downgrades to Neutral, High Risk on the back of the recent share price performance.

The company has downgraded FY17 production guidance to 11,700-800 tonnes of lithium carbonate equivalent from earlier guidance of around 12,300t, following adverse weather conditions at Olaroz.

The broker believes the announcement will have limited impact on valuation and that the company has sufficient cash to complete the necessary optimisation and stabilise phase one production. Target is $3.90.

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

Guidance has been downgraded, with the company expecting its first half insurance margin to be 8.5-9.5%. The fall in the share price exceeds Citi's estimated magnitude of the downgrade but the broker acknowledges credibility of management has taken a hit.

Of the main causes for the downgrade the rise in the frequency of medium-sized claims in Asia is of most concern to Citi as QBE has far less pricing power in Asia compared with Australia.

Citi reduces estimates for earnings per share in FY17 by -7% and FY18 by -5%. Rating is downgraded to Neutral from Buy and the target reduced to $12.75 from $14.10.

See also QBE upgrade.

SCENTRE GROUP ((SCG)) Downgrade to Underweight from Overweight by Morgan Stanley .B/H/S: 2/2/2

In-depth research into prospects and changing dynamics for owners of shopping malls have led Morgan Stanley analysts to take a more sombre view on the outlook for Net Operating Income (NOI) for the sector in Australia.

The rating for Scentre Group has been double-whammy downgraded as a direct result; to Underweight from Overweight. Price target dives to $3.90 from $4.70.

It is Morgan Stanley's view that retail landlords are now facing a combination of a severe cyclical consumer slowdown and the structural pressure from e-commerce. This is expected to accelerate the pressure on retailer margins, and reduce demand for physical space. Updated forecasts assume NOI growth will halve from FY17 levels, while risk remains to the downside, in the analysts' view.

SENEX ENERGY LIMITED ((SXY)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 2/4/0

Macquarie reduces oil price forecasts for 2017, 2018, and 2019 by -8%, -12%, and -13% respectively because of lingering concerns surrounding the oversupply of oil.

Hence, the broker downgrades Senex to Neutral from Outperform and reduces the target to $0.30 from $0.35, believing the stock is fairly valued at current prices.

Total Recommendations Recommendation Changes

Broker Recommendation Breakup

Broker Rating Order Company New Rating Old Rating Broker Upgrade 1 ADAIRS LIMITED Buy Neutral UBS 2 AGL ENERGY LIMITED Buy Neutral Ord Minnett 3 ALTURA MINING LIMITED Neutral Sell Macquarie 4 ALUMINA LIMITED Neutral Sell Deutsche Bank 5 AMCOR LIMITED Neutral Sell Morgan Stanley 6 CHARTER HALL LONG WALE REIT Buy Neutral Ord Minnett 7 GALAXY RESOURCES LIMITED Buy Neutral Macquarie 8 HOTEL PROPERTY INVESTMENTS Buy Neutral Ord Minnett 9 ILUKA RESOURCES LIMITED Buy Neutral Credit Suisse 10 METCASH LIMITED Neutral Sell Ord Minnett 11 PILBARA MINERALS LIMITED Buy Sell Macquarie 12 QBE INSURANCE GROUP LIMITED Buy Neutral Morgans 13 SOUTHERN CROSS MEDIA GROUP Buy Neutral Credit Suisse 14 WESTERN AREAS NL Neutral Sell Macquarie 15 WESTPAC BANKING CORPORATION Buy Neutral Credit Suisse Downgrade 16 AINSWORTH GAME TECHNOLOGY LIMITED Sell Neutral UBS 17 BREVILLE GROUP LIMITED Neutral Buy Credit Suisse 18 DEXUS PROPERTY GROUP Sell Neutral UBS 19 FLEXIGROUP LIMITED Neutral Buy Credit Suisse 20 FORTESCUE METALS GROUP LTD Sell Neutral Citi 21 GPT Sell Buy Morgan Stanley 22 HEALTHSCOPE LIMITED Sell Neutral Morgan Stanley 23 MAGELLAN FINANCIAL GROUP LIMITED Neutral Buy Ord Minnett 24 NORTHERN STAR RESOURCES LTD Sell Neutral Deutsche Bank 25 OROCOBRE LIMITED Neutral Buy Citi 26 QBE INSURANCE GROUP LIMITED Neutral Buy Citi 27 SCENTRE GROUP Sell Buy Morgan Stanley 28 SENEX ENERGY LIMITED Neutral Buy Macquarie Recommendation Positive Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 JHG JANUS HENDERSON GROUP PLC. 50.0% 25.0% 25.0% 4 2 CLW CHARTER HALL LONG WALE REIT -17.0% -33.0% 16.0% 3 3 AWC ALUMINA LIMITED -21.0% -36.0% 15.0% 7 4 ILU ILUKA RESOURCES LIMITED 21.0% 7.0% 14.0% 7 5 WSA WESTERN AREAS NL -29.0% -43.0% 14.0% 7 6 AMC AMCOR LIMITED 38.0% 25.0% 13.0% 8 7 WBC WESTPAC BANKING CORPORATION 25.0% 13.0% 12.0% 8 8 MTS METCASH LIMITED 14.0% 7.0% 7.0% 7 9 SYR SYRAH RESOURCES LIMITED 80.0% 75.0% 5.0% 5 Negative Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 SCG SCENTRE GROUP -8.0% 25.0% -33.0% 6 2 RWC RELIANCE WORLDWIDE CORPORATION LIMITED 13.0% 38.0% -25.0% 4 3 BRG BREVILLE GROUP LIMITED 38.0% 63.0% -25.0% 4 4 DXS DEXUS PROPERTY GROUP -50.0% -25.0% -25.0% 5 5 DMP DOMINO'S PIZZA ENTERPRISES LIMITED 29.0% 50.0% -21.0% 7 6 CSL CSL LIMITED 58.0% 75.0% -17.0% 6 7 FXL FLEXIGROUP LIMITED 33.0% 50.0% -17.0% 6 8 SXY SENEX ENERGY LIMITED 33.0% 50.0% -17.0% 6 9 MFG MAGELLAN FINANCIAL GROUP LIMITED 67.0% 83.0% -16.0% 6 10 ORE OROCOBRE LIMITED 60.0% 75.0% -15.0% 5 Target Price Positive Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 JHG JANUS HENDERSON GROUP PLC. 45.297 41.200 9.94% 4 2 ORE OROCOBRE LIMITED 4.346 4.183 3.90% 5 3 BRG BREVILLE GROUP LIMITED 9.763 9.400 3.86% 4 4 AMC AMCOR LIMITED 16.101 15.658 2.83% 8 5 SIQ SMARTGROUP CORPORATION LTD 7.475 7.290 2.54% 4 6 CLW CHARTER HALL LONG WALE REIT 4.163 4.063 2.46% 3 7 AWC ALUMINA LIMITED 1.829 1.800 1.61% 7 8 CSL CSL LIMITED 138.700 137.550 0.84% 6 9 RWC RELIANCE WORLDWIDE CORPORATION LIMITED 3.460 3.445 0.44% 4 10 MFG MAGELLAN FINANCIAL GROUP LIMITED 26.910 26.800 0.41% 6 Negative Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 FXL FLEXIGROUP LIMITED 2.168 2.475 -12.40% 6 2 FMG FORTESCUE METALS GROUP LTD 5.831 6.281 -7.16% 8 3 SYR SYRAH RESOURCES LIMITED 4.680 4.925 -4.97% 5 4 DMP DOMINO'S PIZZA ENTERPRISES LIMITED 64.446 67.603 -4.67% 7 5 SCG SCENTRE GROUP 4.592 4.725 -2.81% 6 6 SXY SENEX ENERGY LIMITED 0.322 0.330 -2.42% 6 7 CMW CROMWELL PROPERTY GROUP 0.952 0.973 -2.16% 5 8 WSA WESTERN AREAS NL 2.263 2.306 -1.86% 7 9 DXS DEXUS PROPERTY GROUP 9.218 9.338 -1.29% 5 Earning Forecast Positive Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 SYR SYRAH RESOURCES LIMITED -5.330 -6.413 16.89% 5 2 A2M THE A2 MILK COMPANY LIMITED 10.483 9.772 7.28% 4 3 BAL BELLAMY'S AUSTRALIA LIMITED 22.167 20.833 6.40% 3 4 STO SANTOS LIMITED 18.941 18.025 5.08% 8 5 JHG JANUS HENDERSON GROUP PLC. 317.764 305.176 4.12% 4 6 SXY SENEX ENERGY LIMITED -0.988 -1.005 1.69% 6 7 SGM SIMS METAL MANAGEMENT LIMITED 70.379 69.430 1.37% 7 8 MTS METCASH

LIMITED 19.611 19.354 1.33% 7 9 AMC AMCOR LIMITED 77.829 77.014 1.06% 8 10 DMP DOMINO'S PIZZA ENTERPRISES LIMITED 129.829 128.650 0.92% 7 Negative Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 WSA WESTERN AREAS NL 0.424 0.867 -51.10% 7 2 VCX VICINITY CENTRES 18.250 20.550 -11.19% 6 3 RIO RIO TINTO LIMITED 659.338 691.172 -4.61% 8 4 TAH TABCORP HOLDINGS LIMITED 22.012 22.862 -3.72% 4 5 ORE OROCOBRE LIMITED 8.689 8.911 -2.49% 5 6 OSH OIL SEARCH LIMITED 26.239 26.879 -2.38% 8 7 ORG ORIGIN ENERGY LIMITED 15.583 15.926 -2.15% 7 8 FMG FORTESCUE METALS GROUP LTD 99.126 101.202 -2.05% 8 9 EVN EVOLUTION MINING LIMITED 16.124 16.410 -1.74% 7 10 ILU ILUKA RESOURCES LIMITED 15.197 15.447 -1.62% 7 Technical limitations

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

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Uranium Week: Break Up?

It was only a small gain but spot uranium has managed to trade above resistance at US$20/lb.

By Greg Peel

After four weeks of incremental gains, the weekly spot uranium price has managed to break through the US$20/lb barrier that had appeared to be a line in the sand for opportunistic buyers. Industry consultant TradeTech's weekly spot price indicator rose US20c last week to US$20.15/lb.

Prices gradually rose throughout the week with traders active on both sides, but utilities were amongst the buyers in six transactions totalling 700,000lbs U3O8 equivalent. For the prior three weeks, buyers had backed off every time sellers tried to lift offers above the US$20/lb mark.

In supply-side new last week, the government of the state of Western Australia announced it would reinstate a ban on uranium mining, as had been promised ahead of the election of the new Labor government. The prior conservative government had lifted the state's long standing ban and in its tenure granted approval for production at four uranium projects.

The new government has exempted those approved projects from the ban, hence Cameco's Kintyre and Yeelirrie projects will be allowed to proceed along with Vimy Resources' ((VMY)) Mulga Rock and Toro Energy's ((TOE)) Wiluna.

In demand-side news, South Korea's new president announced he would halt plans to build new nuclear reactors and will not extend the lifespan of existing reactors in his policy to phase out nuclear power.

President Moon Jae-in also plans to phase out coal-fired power and steer the country's energy consumption towards renewables and LNG. South Korea currently has 25 nuclear reactors supplying around a third of the country's power needs. Eight more had been in the planning process. Moon would like to see 20% of power provided by renewables by 2030.

The US Energy Information Agency released its Uranium Marketing Annual Report for 2016 last week. The report noted US nuclear power plants purchased 50.6mlbs U3O8 over the year, -10% down on 2015, at an average price of US$42.43/lb, -4% down on 2015.

The Short Report

Guide:

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

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

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

Summary:

Week ending June 22, 2017

Those of a certain age may remember the first ever video game, Pong, which offered arguably less excitement than the latest version of Grand Theft Auto. But if we call one Pong paddle an ASX200 level of around 5680, and the other around 5800, no better analogy describes the current fluctuations of the Australian stock market.

Last week was the turn of the index to go down again, ahead of this week's rally back to, as I write, 5800. We might evoke another game analogy and say "Return to Go".

While the table below exhibits a lot of red and green, a lot of it is bracket creep. But there were some sizeable moves in short positions as well last week, with capital raisings playing their part.

Bellay's Australia ((BAL)) raised capital to acquire a canning factory, its share price took off, and shorts dropped to 5.5% from 10.4%. In the same space, Bega Cheese ((BGA)) raised capital to pay down debt, including that accrued from buying Vegemite, and its shorts have jumped to 8.7% from 6.5%. Why one down, one up? See below.

Qube Holdings' ((QUB)) raising, required to further fund its Moorebank intermodal terminal, is now concluded and the stock has fallen out of the 5% plus shorted table. Heading that way is Vocus Communications ((VOC)), not because of a raising but because of a bid from private equity. Vocus has dropped down another bracket to 7.8% shorted.

Brokers believe the sell-off in lithium miner Galaxy Resources ((GXY)) has been overdone, and ratings upgrades have followed. But Galaxy shorts rose to 9.2% from 7.6% last week. Peer Pilbara Minerals ((PLS)) also jumped into the 6% bracket from the 5%.

It was an interesting week last week in the gold space. Shorts in Saracen Minerals ((SAR)) fell to 7.4% from 9.4%, shorts in Perseus Mining ((PRU)) fell to 6.7% from 8.5%, and Beadell Resources ((BDR)) dropped out of the 5% plus table.

But it was replaced by Dacian Gold ((DCN)).

Finally we note shorts in Sirtex Medical ((SRX)) rose to 6.6% last week from 5.2%. A tad unfortunate given following an announcement the company was downsizing, Sirtex shares leapt 17% yesterday.

Weekly short positions as a percentage of market cap:

10%+

ORE 20.1 SYR 19.6 WSA 16.0 IGO 15.6 MYR 15.4 ACX 13.2 MTS 13.2 MYX 13.0 ISD 12.4 RFG 12.0 FLT 11.9 JBH 11.9 DMP 11.9 AAD 11.4 SHV 10.8

Out: BAL

9.0-9.9%

HVN, GXY, NEC In: GXY Out: SAR

8.0-8.9%

BGA, JHC, EHE, QIN, CTD, BKL

In: BGA, CTD, BKL Out: VOC, PRU

7.0-7.9%

GTY, HSO, MND, VOC, OFX, AHG, NWS, SAR, TPM, IPD

In: SAR, VOC Out: GXY, CTD, BKL, BEN

6.0-6.9%

MYO, BAP, BEN, PRU, SRX, PLS, IFL, GXL, RWC, RIO, NXT, SEK

In: PRU, BEN, SRX, PLS, GXL, NXT, SEK Out: BGA, CSV

5.0-5.9%

CSV, MSB, KAR, BAL, AWC, AAC, VRT, OSH, AWE, RCG, HT1, CCP, DCN, WGX, BDR, MTR, QUB

In: BAL, CSV, AWE, RCG, HT1, DCN

Out: SRX, GXL, SEK, PLS, NXT, WGX, BDR, MTR, QUB

Movers and Shakers

Under normal circumstances, if a company raises capital through a rights issue it's typical to see hedge funds go in and short the stock, looking to take up the discounted rights for an arbitrage profit. That's why for example, we saw shorts in Qube Holdings jump recently before falling back again.

It would also explain why shorts in Bega Cheese jumped to 8.7% last week from 6.7%. Last week Bega announced a capital raising to pay down the debt it took on board to purchase the grocery business of Mondelez International in January, thus cementing Australia's favourite sandwich combination of cheese and Vegemite.

Interestingly, Bega's raising was way oversubscribed and the share price has run up since, suggesting shorters looking for the arbitrage may have made the wrong call.

It certainly would have been the wrong call to try to arbitrage Bellamy's raising, as the stock price has soared. Mathematically, a capital raising dilutes the earnings per share of a stock and thus, ceteris paribus, should prompt a share price fall, but then it all depends on why the company is raising capital.

Bellamy's will use the capital to acquire the factory that does its canning and to pay Fonterra to reset its supply agreement. The bottom line is this is all a step towards the dairy company securing Chinese Food & Drug Administration registration, allowing Bellamy's to more securely tap into surging Chinese demand for infant formula and other products.

The stock price has surged as a result, and rather than play the short arbitrage, existing short positions have bailed in a hurry (assuming ASIC data is accurate). Bellamy's shorts have crashed to 5.5% from 10.4%.

One of the most volatile stocks on the market of late has been that of Galaxy Resources, proving lithium mining is at once a glowing opportunity in today's electric world and a very difficult proposition. Galaxy shares took a bath two weeks ago.

But this prompted both Macquarie and Citi to upgrade to Buy (or equivalent). Galaxy's share price has since stabilised rather than recovered, but Galaxy shorts rose to 9.2% last week from 7.6%. It's still a long way to go to meet producing peer Orocobre ((ORE)), which still sits a-top the table on 20.1% shorted, followed by graphite producer and battery-related peer Syrah Resources ((SYR)) on 19.6%, followed by daylight.

Lithium hopeful Pilbara Minerals saw its shorts rise to 6.6% from 5.4% last week.

The US dollar gold price has had some volatile moments of late, balancing out Fed rate hikes, a weaker US dollar, a low inflation world, and hints at possible ECB tightening. If we then translate through the currency to Aussie dollar gold, the picture becomes even more complicated.

Aussie gold stocks have been up and down and maybe this has prompted activity on the short side, or scared frustrated shorters off. Either way, shorts in Saracen Minerals fell to 7.4% last week from 9.4%, shorts in Perseus Mining fell to 6.7% from 8.5% and Beadell Resources dropped out of the 5% plus table, but Dacian Gold popped in at 5.0%.

ASX20 Short Positions (%)

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

IMPORTANT INFORMATION ABOUT THIS REPORT

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

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

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

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

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

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

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

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

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The Wrap: Property, Health Insurers & Gaming

Weekly Broker Wrap: Residential developers; health insurers; strategies; gambling sector; and Class.

-Residential cycle turning less favourable, Citi expects dwelling price growth to moderate -Morgan Stanley challenges view that government cannot afford to allow private health insurance participation to decline -Economic growth and modest inflation helps ASX-listed equities linked to offshore markets -Morgan Stanley cautious on gambling sector amid high valuations and declining returns on investment

By Eva Brocklehurst

Australian Residential Developers

Citi is increasingly of the view that the residential cycle is turning to less favourable and dwelling price growth will moderate. All major apartment markets have recorded reductions in prices over the past three months and Sydney's auction clearance rates, a leading indicator of price growth, have declined for four consecutive months.

Lending conditions are tightening in response to increased regulatory scrutiny and apartment settlement times and conversion times are extended, a sign, the broker believes, that conditions are affecting demand.

Given the changing residential landscape Citi prefers residential projects that are longer dated, and have embedded price gains to support margins, as well as product that is at relatively affordable prices to support volumes, with buyer profiles tilted to owner occupiers and domestic purchases. This supports a preference for Stockland ((SGP)) over Mirvac ((MGR)). Citi has a Buy rating for the former and a Sell rating for the latter.

Health Insurers

The perception that population growth and policy enticements are driving 2-3% volume growth per annum for health insurers is not the reality, Morgan Stanley contends. After a decade of around 3% annual growth, the broker forecasts participation in hospital insurance will be falling in FY18.

Lives under 60 years of age that are insured have turned negative in FY16 and are likely to continue to deteriorate. Worsening affordability, a squeeze on household cash flows and competition from public hospitals are underpinning this trend, while regulatory sticks are losing their sting.

Therefore, restoring the Medibank Private ((MPL)) franchise gets tougher, in the broker's opinion, and revenue growth of less than 2% is expected in FY17-19. For nib Holdings ((NHF)) Morgan Stanley suspects sustaining above-market growth will be more challenging, although expanding distribution is helping.

The broker also challenges the view that the government cannot afford to allow private health insurance participation to decline. Meaningful changes to the system carry large political risk and appear unlikely in the medium term.

Strategy

Global growth is around trend, Morgans observes, and increasingly positive for Europe and the US. Employment, corporate profits, consumer sentiment, industrial production and inflation all support an improved outlook. The broker notes economic growth and moderate inflation have helped the performance of ASX-listed equities that are linked to offshore markets.

Companies in the ASX200 currently source 66.3%, or 78% ex resources and healthcare, of their revenue from Australia. While this number indicates a large bias to the domestic market, around 29% have significant revenue streams outside of Australia.

The broker highlights ten stocks which it believes will benefit from offshore growth. They include Corporate Travel Management ((CTD)), Incitec Pivot ((IPL)), Domino's Pizza ((DMP)), Orora ((ORA)), Amcor ((AMC)), Macquarie Group ((MQG)), SpeedCast ((SDA)), BT Investment Management ((BTT)), ALS Ltd ((ALQ)) and Macquarie Atlas Roads ((MQA)).

A falling Australian dollar against a stronger US dollar and euro will benefit companies with US and European exposure and exporters linked to foreign earnings. A persistent lack of demand from the domestic economy is expected to weigh on growth and, in the short to medium term, without further rate reductions, Morgans expects the Australian dollar to drift lower.

Deutsche Bank observes demand for Australian commodities appears solid and Chinese growth continues to move forward. The broker's preferred lead indicator, Asian company earnings revisions, points to ongoing strength.

While resource share prices have been tied to commodities since 2004, historically, miner earnings and share prices do better than commodities, as value is created through volume growth and developing new assets. The broker envisages scope for this to happen again as capital expenditure has dropped sharply and, historically, this has been good for share prices. Rio Tinto ((RIO)) is the top pick in miners and Oil Search ((OSH)) in energy.

Gaming

High valuations and a declining return on investment capital suggest caution in the gambling sector and require greater selectivity, Morgan Stanley asserts. The environment has changed since FY16, when VIP revenues were driving solid growth at Australasian casinos. Now, the broker expects lower industry growth, slow recovery in VIP, and domestic pressures from increased competition, fewer concessions and weaker macro conditions.

Historically, changes in returns for gambling stocks have tended to correlate with share price performance. Thus, with returns trending lower amid high valuations and optimistic forecasts, the broker has a Cautious industry view.

Star Entertainment ((SGR)) is positioned for relative strength, as the broker expects higher utilisation as refurbishments are completed. Morgan Stanley has an Overweight rating on Star and believes the stock offers above-peer growth. Crown Resorts ((CWN)), on the other hand, is considered fairly valued and the broker has an Equal-weight rating.

Morgan Stanley considers the prospects for New Zealand's SkyCity Entertainment signal low growth earnings, driven by fading tailwinds in Auckland, as benefits from new concessions roll off and the disruption from capital works continues, while challenges in the company's Australian business continue.

Class

Class Ltd ((CL1)) provides cloud-based administration software for self-managed super funds in Australia and has an FY17 market share of 23%, via its flagship product Class Super. UBS observes consistent growth has been a feature of the business, with compound growth in a 2015-17 of 39% for sales and 54% for operating earnings (EBITDA).

The company continues to benefit from the growth in self managed super funds in Australia and the structural shift of administrators to the cloud from desktop and non-specialised software. The broker's forecasts imply FY18-21 compound growth in sales of 20% and operating earnings of 24%, highlighting the operating leverage in the business as it scales up. UBS initiates coverage with a Buy rating and $3.40 target.

Collins Foods Bites Off More KFC

Brokers are encouraged by the additional scale that the latest acquisitions bring to the Collins Foods KFC network in Australia.

-FY17 results beat expectations and sales at KFC continue to improve into FY18 -Acquisition means a KFC footprint across all states bar ACT -Acquisition expected to improve the quality and stability of earnings

By Eva Brocklehurst

Brokers are encouraged by the additional scale that the latest acquisitions bring to the Collins Foods ((CKF)) KFC Australia network. The additional restaurants raise the total store count to 223.

The FY17 result also beat expectations, as operating earnings (EBITDA) were up 9% and ahead of guidance issued in March. Normalised net profit was up 40%. UBS observes the beat to expectations was largely because of a strong performance from KFC Australia and lower depreciation.

Like-for-like sales in Australia for KFC have improved in FY17 and this has continued into FY18, as the company's same-store sales for the first eight weeks suggest. Australian operating earnings margins increased 10 basis points to 16.4%.

Meanwhile the company's Sizzler chain operating earnings were down -14% and slightly weaker than UBS estimated, as six of the restaurants were closed in Australia. Canaccord Genuity forecasts no earnings contribution from the domestic Sizzler business in future periods. The broker also expects Sizzler Asia will be divested in the future when the Australian operations are sorted.

In FY18 the company expects to open 8-9 new KFC Australia restaurants and re-model 20 major and 20 minor stores. In Europe, the company plans to open 4-5 new restaurants in Germany for KFC and 4-5 in the Netherlands. Six new franchise restaurants for Sizzler Asia will open.

UBS considers the stock good value and upgrades to Buy from Neutral, increasing forecasts for earnings per share by 2% for FY18 and 8% for both FY19 and FY20. UBS is confident the company will achieve free cash flow, net of store capital expenditure, on a combination of incremental earnings from rolling out new stores and the recent acquisitions.

Nevertheless, the broker considers it unlikely the company will make an acquisition that will materially contribute to FY19 earnings and is likely to focus on integrating recent acquisitions in the near term. Management has guided to mid single digit accretion to earnings per share in FY19 and UBS includes estimates of 4%.

Canaccord Genuity notes the business generates strong cash flow with a large proportion re-invested into expansion. Given the long-dated nature of cash flow, the broker estimates valuation is heavily skewed to terminal value with a high degree of sensitivity to the cost of capital.

The broker, not one of the eight monitored daily on the FNArena database, uses a blended methodology and arrives at a price target of $6.22. Given a discount to valuation, Canaccord Genuity upgrades to Buy from Hold.

Acquisition

The company has acquired 28 KFC restaurants located across Tasmania, South Australia and Western Australia from Yum! Brands for $110m. This will be funded through a $44m non-renounceable, 1-for-11 entitlement offer at $4.55/share and $69m in debt. The acquisition is to be completed in stages later this year.

UBS estimates around 4% accretion to earnings per share in FY19. The company now has a footprint across all states except the ACT. Adjusted for non-operating stores and acquisition costs, Canaccord Genuity believes this latest acquisition improves the quality and stability of group earnings.

Deutsche Bank suggests the acquisition multiple is attractive versus the company's trading multiple of seven times FY18 operating earnings, considering the quality of the stores, which have an implied margin of 16.8%, 41 basis points higher than the company's existing portfolio.

Deutsche Bank believes these stores are a good addition to the network as they add two new states and enhance scale nationally. The broker retains a Hold rating on valuation grounds, noting the stock is currently in a critical phase of execution as it implements offshore expansions.

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Upside For Ramsay

By Michael Gable

In today's report, we have a few companies that have proven to be topical of late. We take a close look at Ramsay Health Care ((RHC)) which has recently underperformed the other big Aussie healthcare stock - CSL. The overall healthcare index has had a good run in the last several weeks so is it time for RHC to catch up?

We looked at RHC in the ASX newsletter in February and mentioned risk of a fall towards the low $60's. After doing that in March, the stock then rallied up towards $74. It then eased off and is now retesting that area. This $74 seems to be a strong level of resistance so we could see RHC come back here in the short term, to at least $72. A push through $74 would be a positive on the chart and should lead to further upside.

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Michael is RG146 Accredited and holds the following formal qualifications:

• Bachelor of Engineering, Hons. (University of Sydney) • Bachelor of Commerce (University of Sydney) • Diploma of Mortgage Lending (Finsia) • Diploma of Financial Services [Financial Planning] (Finsia) • Completion of ASX Accredited Derivatives Adviser Levels 1 & 2

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Not Time To Buy Woolies

Bottom Line 27/06/17

Daily Trend: Down Weekly Trend: Down Monthly Trend: Up Support levels: $24.00 / $23.13 / $22.23 / $20.50 - $19.76 Resistance levels: $27.71 - $28.03 / $29.22

Technical Discussion

Woolworths ((WOW)) has interests in food, liquor, petrol, hotels and New Zealand supermarkets. The latter is engaged in the procurement of food and liquor for resale to customers in New Zealand. The hotel section is engaged in the provision of leisure and hospitality services which includes food, alcohol and accommodation as well as entertainment and gaming. For the 27 weeks ending the 01st of January 2017 revenues increased 3% to A$29.16B. Net income before extraordinary items decreased 61% to A$806.7M. Revenues highlight the Australian Food section increase of 3% to A$18.71B and the New Zealand Supermarkets section increase of 6% to A$3.07B. Broker/analyst consensus is “Hold”. The Dividend yield at today’s price sits at 3.0%. Reasons to be cautious: → The risk of a price war has subsided. → Recent results show that sales were up and margin shrinkage improving. → Balance sheet pressure is easing due to the petrol divestment. → Big W CEO has resigned after less than a year in charge. → There is still downside risk to earnings. → More changes in the business strategy are on the cards. → The speed of the recovery in profits is looking more questionable.

Over the past few weeks half of Woolworths board have bought stock which comes following the March trading update. In fact, four board members have doubled their holdings on average. This is a vote of confidence although one thing is for sure, you shouldn’t buy solely on the back of directors Holdings. Despite having inside information management can, and do get it wrong - especially in terms of time. Be this as it may, we’ll continue to concentrate on the patterns. We looked at the monthly chart last time which showed that there was still upside potential, even regarding a bounce only. This is still our expectation although over the short-term the risk is to the downside, albeit a shot bounce could unfold from current levels.

From the July 2016 lows, a corrective pattern higher has been unfolding which culminated in locking in wave-(a) just short of the annotated wave equality projection. The depth of the subsequent retracement opens the door to head down toward the typical retracement zone just beneath $24.00 over the coming weeks although this shouldn’t be a straight-line decline. It needs to unfold in 3 clearly defined waves, or at least a series of corrective patterns. Should this unfold then another good buying opportunity could present itself at those slightly lower levels, albeit it’s going to be several weeks down the track. On the divergence front, the bullish variety is evident on this daily timeframe which has also triggered.

A large increase in volume was also evident on the run-up to the recent lows made a week ago which once again opens the door for a rally to unfold from here. This could continue up toward $26.60 but it would take a push above that level before thinking in terms of avoiding the deeper retracement further down the line. On the weekly chart (not shown) bearish divergence is still apparent although our oscillator is now within touching distance of the oversold position meaning it shouldn’t be a headwind for too much longer.

Trading Strategy

Should a lacklustre bounce unfold from current levels as expected, a shorting opportunity could be around the corner although any subsequent weakness should be limited to the typical retracement zone between $24.00 - $23.13. We’d prefer to be buyers at those aforementioned lower levels further down the track meaning patience is going to be required before another buying opportunity presents itself. Bigger picture, it’s still difficult to get overly enthusiastic at this stage.

Risk Disclosure Statement

Treasure Chest: Value Returning To Fortescue

Two brokers have upgraded Fortescue metals to Buy from Sell, seeing value now apparent in the iron ore miner.

- Iron ore price stabilising? - Fortescue share price fallen sharply - Low cost production supports cash flow and dividends

By Greg Peel

Shaw & Partners notes Fortescue Metals' ((FMG)) earnings trajectory has now rolled over to the downside following "a flurry of recent iron ore price adjustments". Bell Potter has cut forecast earnings by -16% and -19% in FY17-18 and cut dividend forecasts by -10% and -9% respectively.

Both have upgraded the stock to Buy.

Neither are FNArena database brokers. The most recent update from a database broker came from Citi a week ago, who downgraded to Sell based on a bearish outlook for the iron ore price. The broker noted Chinese port inventories have been building and more low-cost supply is coming on to the market. The broker also estimates a price below US$50/t is required to close down high-cost Chinese domestic production.

Fortescue produces lower grade ore than BHP Billiton ((BHP)), Rio Tinto ((RIO)), Roy Hill and Vale. Price discounts for lower grade ore have widened in recent times and while this is more cyclical than structural, Citi believes wider discounts could yet remain in place for some time.

Credit Suisse agrees with Citi's thesis. But CS sees Fortescue's realised prices for its ore rising back to normal levels. The broker retains Outperform. Morgans agrees with CS on the realised price argument, and suggests the factors driving wider discounts for lower grade ore are beginning to reverse. Morgans upgraded to Add mid-June.

Shaw's analysis suggests to the broker the iron ore price may be forming a base and Fortescue's earnings trajectory should follow suit. After a -40% drop in share price, mimicking the drop in the iron ore price from earlier in the year, Shaw believes Fortescue is now offering value.

Not only has Shaw upgraded to Buy, but it has "double-upgraded" straight from Sell.

Bell Potter remains "wary" of the iron ore price and agrees concerns over the ramp-up of high grade production at Roy Hill in the Pilbara and Vale's S11D in Brazil is causing concern. Elevated Chinese stockpiles are also a concern, but Bells believes this reflects an increase in Chinese exports as high-cost domestic production is indeed cut back.

On the demand side, steel prices and production remain robust, with manufacturing PMIs across key global economies remaining in expansion territory. The broker also notes the removal of 100mt of the most expensive production, keeping the high end of the cost curve well above US$50/t.

The cost curve is the important element. Fortescue may be looking at lower iron ore prices translating into lower earnings and dividends but the miner's low cost of production supports ongoing strong free cash flows through the cycle and a robust balance sheet backs up dividends. Even after forecast cuts, Fortescue is offering a 6% yield (9% after franking) on Bell Potter's numbers. The fall in share price has brought valuation back to an attractive level.

Bells has cut its target to $5.55 from $5.75, which is still well above the current share price. Hence the broker has also "double-upgraded" to Buy from Sell.

Shaw has set a target of $5.50.

When Citi downgraded to Sell last week the broker cut its target to $3.90 from $5.80. Citi is alone in its Sell rating, with the database otherwise showing four Buy and three Hold (or equivalent) ratings. The consensus target is $5.67 despite Citi's sharp downgrade, but high marker UBS ($7.00) has not updated since April.

With the quarter coming to a close, brokers are currently readdressing their commodity prices forecasts and miners, Fortescue included, will shortly be releasing quarterly production and sales reports.

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Treasure Chest: Flight Centre Too Lofty

The share price run for Flight Centre looks overdone given the outlook, brokers believe.

-Shares are up 42% since March -Multiple above historic levels -Weak consumer suggests slowing growth

By Greg Peel

Travel agent Flight Centre ((FLT)) has been slow to adapt from its bricks & mortar incumbency into the modern world of online travel bookings. But more recently the company has addressed the issue and has managed to gain market share as Australian departures remain healthy despite a lower currency.

Airline competition has nevertheless led to ticket price deflation over the year but investors have taken heart that Flight Centre's cost reduction measures are sufficient to offset weaker margins. Subsequently, the share price has run up 25% year to date, UBS observes. In fact, having dipped earlier in the year, Flight Centre shares have run up 42% since March.

By May, brokers were already beginning to question the stock price run. Morgan Stanley (Underweight) suggested cost reductions would need to be pretty significant to achieve FY18 consensus expectations. Deutsche Bank (Hold) acknowledged healthy departure rates but believed these were only a reflection of lower air fares, which imply weaker margins and growth.

Morgan Stanley reiterated its Underweight rating in June, in recognition of weakening consumer environment.

UBS this morning has also pointed to a "more sombre" outlook for the Australian discretionary retail environment, noting that Australian leisure travel accounts for around half of Flight Centre's profit. The good news is air fare price deflation has begun to moderate. While this may support margins, a weak consumer is not going to provide any revenue boost if air fares stop getting cheaper.

Rising fuel and electricity costs, out of cycle mortgage rate increases and a softening housing market all bode poorly for discretionary spending in FY18, UBS suggests. As the RBA keeps warning us, Australians are up to their necks in debt. Spending does not get much more discretionary than an overseas holiday.

UBS cannot see the potential for earnings growth ahead that would support the stock's current valuation. Flight Centre historically trades at a -14% discount to the ASX Industrials ex-Financials and is currently trading at a -5% discount.

The broker has raised its target price to $37.60 from $36.10 but this is still short of the current price, hence a downgrade to Hold.

Morgan Stanley's target is a far more pessimistic $25.00. The UBS downgrade means the only broker left with a Buy (or equivalent) rating for Flight Centre out of the eight FNArena database brokers covering the stock is Credit Suisse, who hasn't updated since the February result.

Indeed, only four brokers have updated since February and only two in the past three months. We currently have one Buy, five Holds and two Sells on the database for a consensus target of $30.93.

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