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Stories To Read From FNArena

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Contents

Bunnings Expansion Not Without Risk

Wesfarmers intends to expand categories and online offerings at Bunnings although brokers point out the opportunities are not without risk.

-Will Bunnings' home improvement base prove resilient in housing/consumer downturn? -Management to trial a transaction website in Tasmania for consumers -Categories flagged for expansion are more competitive with higher cost to serve

By Eva Brocklehurst

Wesfarmers ((WES)) is targeting a multi-pronged expansion for Bunnings, its chief earner amongst its divisions. The company's investor briefing highlighted expanded categories, services and online offerings and provided commentary on industry drivers.

Yet some brokers are rather dubious about the extent of any upside. Morgan Stanley is concerned about reduced financial disclosure - no trading update on the financial information was provided at the briefing - and a lack of meaningful commentary about Bunnings at a time when the housing market is turning and online investments are to be made.

Citi observes management is looking to position for growth, given the extended slowdown in the housing market, and while the strategic initiatives make sense the opportunities are long-dated. The stock, meanwhile, is sustaining an elevated multiple, in the broker's view, given this stage of the housing cycle.

Management has indicated that sales-per-square-metre growth since FY13 has been around 4% versus like-for-like sales growth over the same period of 7.5%. The difference is attributable to higher rates of new store cannibalisation and the opening of bigger, less productive stores.

Still, management has indicated that the recent slow down in sales-per-square-metre growth was an anomaly and the previous trajectory should resume. Citi forecasts like-for-like-sales growth to trend lower, to 3.6% in FY19 and 3.0% in FY20, amid sales-per square-metre growth of around 2% per annum over the next three years.

Total sales growth has a very strong correlation with turnover of existing housing stock, Macquarie observes. DIY/hardware expenditure is elevated before a property sale by the vendors and after the transaction by the buyer. While Bunnings may not buck the housing slowdown as it did in 2010/11, the broker contends the chain continues to take market share and has proven resilient.

Morgans asserts that home improvement and building material expenditure are "necessities" and provide a base for earnings at Bunnings. In addition, population growth underscores the need for new housing and this provides a growing customer base. The broker also believes the focus on service makes Bunnings more than just a retailer, helping create stickier customers.

It is clear to Macquarie that Bunnings is evolving its offer to become more of a home lifestyle business as opposed to a hardware chain and there are many opportunities. Bunnings believes it has a $50m addressable market in this area.

Regardless of the opportunities the company outlined, UBS envisages risks to earnings in the near term and assesses these have not been priced in. The broker points to slowing consumer expenditure, with around 78% of Wesfarmers' FY20 earnings (EBIT) directly exposed to discretionary consumer expenditure.

Bunnings aspires to having its commercial/trade business rivalling consumer based business in size. Morgan Stanley understands it represents around 30% of sales currently and has been growing faster than the overall business. Citi suspects this would require significant investment in ranges, the store network and staff training.

Ticketing has been highlighted as a key component of store labour costs, such that rolling out digital ticketing has potential to generate substantial savings. Management is also not expecting a sizeable step up in labour costs, while electricity costs are being offset by solar panels.

Ord Minnett considers the external environment challenging but concludes that Wesfarmers has a strong balance sheet and ongoing cash generation. While it is uncertain whether the company has regained its "licence" for acquisitions, following the ill-fated UK & Ireland venture, the broker suspects there is capital management potential and modest long-term growth.

Online

Bunnings offers 20,000 special items on its online platform and the vast majority of purchases are from trade customers. Morgan Stanley calculates this is less than 1% of total sales. Now, management will start a trial in Tasmania of a transaction website for consumers, to be expanded nationally in 18 months time.

The broker senses a reluctance to invest in a transaction website, as it could be expensive and dilutive to margins. The company has noted higher delivery costs and a lack of customer demand for online, particularly in categories that are unable to be shipped.

Citi suspects the online channel will be dilutive to margins, as sales are not incremental and additional labour is required to pick and pack orders. Inventory levels are also likely to rise as Bunnings localises its range, while also fulfilling online orders.

Categories

Bunnings intends to expand its market share in kitchens, bathrooms, vendor furnishings and flooring. The company has low market share in these categories and is intent on improving its ranges as well as investing more in services such as in-home design consultants and on-site project management.

Yet UBS points out these categories are more competitive and there is a higher cost to serve. Moreover, Morgan Stanley notes these categories are relatively space and labour intensive and this signals potential for margin dilution.

FNArena's database shows two Buy ratings, two Hold and four Sell. The consensus target is $32.42, signalling -6.9% downside to the last share price. Targets range from $29.00 (Citi, Morgan Stanley) to $37.13 (Macquarie). The dividend yield on FY19 and FY20 forecasts is 7.9% and 4.5% respectively.

Gwalia Setback Unlikely To Hamper St Barbara

St Barbara has encountered a setback in its feasibility study for the mass extraction project at Gwalia, resulting in a reduction to production guidance amid higher costs.

-St Barbara could eventually meet the same gold production rates ascribed to hydraulic hoisting -Outlook boosted in the short term by the removal of expenditure on the expansion project -Simberi sulphide increasingly likely to go ahead

By Eva Brocklehurst

The mature Gwalia gold mine in Western Australia is facing constraints, as St Barbara ((SBM)) has reverted to trucking its ore after technological obstacles were encountered in a mass extraction feasibility study.

The study returned some negative aspects as the company found limits to its technology. The project has already been rolled back several times and the technical risks were understood so Citi finds the news disappointing. The expansion has been delayed further, to June quarter 2020, amid ongoing ventilation constraints.

Credit Suisse believes, the decline of -30% in the share price shows the risk inherent in all gold stocks when a generous premium is being attributed. However, the broker defends St Barbara's management, who did not over-promote the potential of hydraulic hoisting and did not tell the market to assume this would be the outcome. Hence, the broker attributes the sell-off to excessive market exuberance.

The stock was already trading at a premium to valuation, elevated by prior guidance for higher production at lower costs. The broker, as a result, upgrades to Neutral from Underperform.

The feasibility study has shown trucking of ore to be the preferred option to hydraulic extraction. The company will continue to employ trucking in life-of-mine production, to continue to 2031. The technically-challenged concept of hydraulic hoisting, it appears, could cost double the $100m expenditure that was anticipated in the pre-feasibility study. Moreover, the 1.4mtpa rate has proved to be unfeasible, given the shape of the orebody at depth and ventilation constraints.

Yet, Macquarie points out the trucking base case will still require an additional $100m in capital while St Barbara could eventually meet the same production rates as was previously planned with hydraulic hoisting, although the timeframe is unclear.

Displacement of higher grade ore by development material results in a reduction to guidance for FY19, to 235-240,000 ounces at all-in sustainable costs (AISC) of $980-1000/oz. This compares with the prior guidance of 240-255,000 ounces at AISC of $930-970/oz.

Macquarie still expects a reduction in AISC from FY20 because of the freeing up of ventilation constraints. The low point in AISC is expected in FY23 before increasing depth escalates costs. The broker reduces estimates for earnings per share in FY19 by -7%. Reducing the trucking rate at Gwalia while lifting operating costs means earnings estimates are lowered by -19-39% going forward.

The main revision for Canaccord Genuity is to production forecasts, with around -20% lower output expected from FY22 amid higher costs. The broker still believes Gwalia provides the company with consistent, long-life production and meaningful free cash flow.

While the market has reacted "savagely" to the release of the feasibility study, the broker highlights a very healthy outlook which has been boosted in the short term by the removal of expenditure on the expansion project.

Canaccord Genuity, not one of the eight stockbrokers monitored daily on the FNArena database, maintains a Hold rating with a $3.30 target. The database has five Hold ratings and the consensus target is $3.88, suggesting 13.8% upside to the last share price.

Macquarie describes the outlook for Gwalia as now less ambitious. Trucking should come with lower risk despite a more modest production outlook. The broker agrees Gwalia is a quality long-life asset.

Credit Suisse considers the company's record of conservative guidance and delivering projects on schedule and budget has, until now, been unblemished and this may have provided excess confidence that the value of a leap in technology could be fully captured.

Simberi

One aspect that did not disappoint was the outlook for Simberi sulphide in PNG. FY19 guidance is lifted to 130-135,000 ounces at AISC of $1245-1300/oz. Credit Suisse suspects the positive news on this expansion may offset the value lost by the downgrade to the Gwalia outlook.

The sulphide project increasingly appears likely to go ahead. Macquarie, too, expects Simberi should augment the longer term. Nevertheless, the broker suggests the company needs to add another asset and, in this respect, is well-positioned to act on any opportunity that may arise.

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Westpac Leads Charge In Further Remediation

Westpac Banking Corp has recognised more salaried adviser remediation and brokers suspect this may just be the start of further provisions across the banking sector.

-In addition to wealth advice, 50% of the refunds relate to consumer and business loans -Not yet able to finalise reliable estimates of refunds for aligned advisers operating under BT Financial licences -Westpac's methodology highlights disparities with other wealth managers

By Eva Brocklehurst

Further customer remediation provisions have been flagged by Westpac Banking Corp ((WBC)) for FY19 and brokers suspect there is more negative news to come.

Credit Suisse is disappointed, having expected that Westpac had moved through the majority of its banking-related remediation, while the potential for more aligned dealer group remediation - for fees-for-no-service - is greater than first thought. Morgan Stanley agrees there is a risk that remediation could be higher and drag on for longer than expected.

The bank will take additional provisions of around -$260m with its first half result for customer remediation for banking and salaried financial planners. In addition, Westpac is expected to take further provisions for aligned planners, confirming that $966m of fees have been collected over the period in question.

The bank has stated that salaried planner customer remediation provisions now represent 28% of fees generated by these planners since 2008. Westpac is finding it difficult to estimate the potential remediation requirements, particularly as many planners no longer work under BT Financial licences and may have left the industry.

Westpac has advised that remediation provisions in consumer and business banking comprise a large proportion of customers with interest-only loans, where the bank failed to switch back to principal & interest at the end of the term.

UBS is alarmed by this, as interest-only loans peaked at 50% of Westpac's mortgage book in FY17. UBS holds dividend forecasts flat at present but remains concerned about the rise in the dividend pay-out ratio. The broker is keeping an eye on the rapid deterioration in the housing market, which is around 68% of the bank's loan book.

Macquarie increases its remediation forecasts for all major banks over the next four years, resulting in FY19 estimates being downgraded -3-5% across the board. The broker agrees, given the near-term pressures, that Westpac's pay-out ratio of 88% is elevated and there may be a need for dilutive dividend reinvestment plans or a reduction to the dividend.

Sector Indications

Citi suggests Westpac is not alone, but appears to be moving ahead of its peers. While FY19 is shaping up as disruptive year the broker believes the bank continues to deliver core earnings growth of 2% and is managing costs.

Macquarie considers remediation charges low-quality expenses and does not incorporate them directly into fundamental valuations. However, recognising the capital implications, the scope for capital returns by the banks is considered to be diminished.

Westpac's disclosure has provided a useful benchmark for the potential remediation relating to aligned networks across the sector. The bank has indicated that obtaining the required documentation for the cohort of advisers that are known in this part of its platform is challenging.

Macquarie finds it difficult to have a more constructive view on the sector until external conditions begin to improve. The broker recognises that benchmarking to Westpac carries the risk of using overly conservative estimates from one operator, but with a lack of additional information, at this point this appears to be the most reliable way to go.

Wealth Management Disparity

Following Westpac's update Macquarie has reviewed the current remediation landscape for wealth managers and has unearthed a disparity between the amounts estimated/provided for by AMP ((AMP)) and IOOF ((IFL)) with Westpac's methodology. The broker continues to envisage a risk that additional provisions will be raised by both AMP and IOOF.

Extrapolating per-adviser remediation across the wealth manager adviser base implies a material shortfall compared with current and expected provisions made by these two listed operators. With respect to timing, Macquarie expects provisions are more likely to be raised in the second half of 2019.

To apply its remediation calculation to fee revenue the broker concedes AMP is solely calculating for advice and this may explain some of the variance. There may also be an element of conservatism in Westpac's numbers, or a higher proportion of inappropriate advice remediation.

FNArena's database shows two Buy ratings, three Hold and three Sell for Westpac. The consensus target is $27.09, signalling 4.2% upside to the last share price. Targets range from $22 (Deutsche Bank) to $33 (Morgans, yet to comment on the update). The dividend yield on FY19 and FY20 forecasts is 7.2% and 7.4% respectively.

Disclaimer: the writer has shares in the company.

Wholesale, Online Growth Slated For Smiggle

Premier Investments is accelerating its emphasis on the Smiggle brand as it expands an online and wholesale business globally, although sales growth for established Smiggle markets eased back in the first half.

-Online-only markets will require greater investment in Smiggle brand -No concession partnerships yet but negotiations continue -Apparel brands to cycle tough comparables in the second half

By Eva Brocklehurst

Smiggle continues to underpin the outlook for Premier Investments ((PMV)), although the company's apparel brands provided much-needed strength in the first half. The company's strategy for its children's stationery and related accessory business Smiggle is moving to a focus on online and wholesale, which means there is more emphasis on the brand and less on the ownership of the physical assets.

The first half result was in line under difficult market conditions, Credit Suisse points out, and in several respects the result puts a spotlight on the changes occurring in international retailing. Online sales were up 35.2% and 12.9% of total sales in the half.

The broker believes the market is yet to fully appreciate the long-term growth platform being created by Smiggle in the move towards online and wholesale distribution. The intention is to leverage someone else's investment in established store-based trading and online distribution. The broker calculates the current strategy provides for a sevenfold increase in the available consumer base versus the current distribution.

Yet Citi points out this is yet another change in strategy for Smiggle, and remains sceptical about whether the level of sales growth can be considered sustainable. Hence, Smiggle warrants a lower multiple and remains the reason why Citi has a Sell rating in place for the stock.

Smiggle's sales trajectory has slowed, admittedly, which requires apparel to step up to the plate, yet Credit Suisse finds nothing materially wrong with a slower rate of growth - 5% in the first half - other than difficult trading conditions in Australia and the UK. Australian toy brand closures, discounting in department stores in toys and stationery and UK's Brexit ordeal provided a soft background.

The logic in the company's strategy appears sound, amid lower entry/lease risk and higher earnings (EBIT) margins and returns, Macquarie asserts. Credit Suisse also finds the deferral of an aspirational revenue target of $450m to 2021 or 2022 is simply reflecting the lead time for implementation of the company's strategy. Materially, the broker believes the market is yet to factor in the more favourable economics that the strategy entails.

Smiggle Strategy

First wholesale and online arrangements are expected to start in July 2019. Over 100 wholesale stores are expected to be trading from July in Korea, Thailand, Indonesia, the Philippines and the Middle East (UAE), with the launch in Canada of a wholesale channel in mid to late 2019.

In continental Europe Smiggle will launch with Amazon in France, Italy, Germany and Spain. Bell Potter notes no concession partnerships have been announced, although negotiations continue. Online-only markets will require greater investment in brand, Macquarie points out, as a strong store presence has undoubtedly contributed to online success in other markets.

Smiggle sales in the first half were -16% below Bell Potter's estimates, as trading in the UK was significantly affected by Brexit. Australasia was weighed down by challenging retail conditions and tough comparables while strength in Asia continued.

Bell Potter, not one of the eight stockbrokers monitored daily on the FNArena database, eases back medium-term growth forecasts for Smiggle and reduces the target to $17.65 from $19.60. The broker maintains a Hold rating based on the Brexit uncertainty and domestic headwinds.

UBS still expects Smiggle to launch European concession stores and enter the US in the future. The broker now forecasts around 585 standalone stores, 90 concession and 110 wholesale Smiggle stores within a decade. At that point, Smiggle is expected to make up around 62% of retail earnings versus 45% in FY19 estimates.

Apparel Brands

Meanwhile, the company's apparel brands performed well, with sales growing 7% in the first half. This appears to have been significantly supported by Just Jeans and Jay Jays. Deutsche Bank describes the apparel result as exceptional, as it defies the general trend in the market.

Citi expects the acceleration in the core brands during the first half will moderate in the second half as the company cycles tough comparables, increased volatility from the NSW and federal elections and increased cannibalisation from online business.

While apparel brands may be structurally challenged, UBS observes momentum is still improving as the company closes unprofitable stores, achieves rent reductions and increases direct sourcing.

Morgan Stanley flags the fact that the results were in line with its forecasts in every aspect, while was no specific outlook provided. The company has closed 16 stores in total, including a Just Jeans flagship store, which Morgan Stanley believes sends a strong message to landlords.

The broker values Smiggle on 14x multiple, Peter Alexander on a 9x multiple and Portmans and Jacqui E on a 7x multiple, slightly below the average multiple for retailers. The broker considers Dotti, Jeans West and Jay Jays are more mature businesses and face the greatest pressure from international retailers.

Cost management was a feature of the results and Macquarie notes gross margin was solid in the context of the tough market conditions, declining just -14 basis points to 63.0%. Margins also benefit from key FX hedging policies, which facilitated merchandise planning. Sourcing initiatives also provided impetus.

FNArena's database has three Buy ratings, two Hold and one Sell (Citi) for Premier Investments. The consensus target is $18.03, signalling 14.1% upside to the last share price. Targets range from $15.60 to $19.80 (UBS). The dividend yield on FY19 estimates is 4.3% and on FY20, 4.8%.

Mixed Responses To Challenger's New Deal

Challenger is meeting the pressures on domestic demand by expanding its arrangements to include US-dollar denominated annuities in Japan.

-The deal puts a floor under Japanese annuity sales -Amid rising risk to domestic demand from lower interest rates -But has there been too much focus on the 10-year government bond rate?

By Eva Brocklehurst

Diversified financial services provider, Challenger ((CGF)), will expand its relationship with Japan's MS&AD Insurance, via subsidiary MS Primary, to provide guaranteed investment returns on US-dollar denominated annuities.

The new deal is simply extending the arrangement for Australian dollar guarantees to the US dollar. MS Primary will guarantee a base level of reinsurance of $640m for five years across both Australian and US-dollar denominated annuities.

As a result, MS&AD will seek to increase its stake in Challenger to more than 15%. The target start date for the arrangement is July 1, 2019, when Challenger will commence a quota sharing reinsurance of these annuities issued in the Japanese market by MS Primary.

Morgans considers the deal a good outcome, although remains cautious about near-term earnings pressures. At the very least the deal puts a floor under Japanese annuity sales.

Demand for Australian dollar annuities in Japan has softened as the gap to US yields has widened. As a global macro environment becomes more dovish, Morgans finds it hard to envisage some of the pressures unwinding any time soon, although Challenger has a good long-term growth story.

The expanded sales relationship provides increased conviction in Challenger's ability to deliver double-digit medium-term life asset growth, UBS suggests. This is particularly so with rising risk to domestic demand from lower interest rates.

Reflecting the long duration of the sales, UBS lifts its growth estimates for life average investment assets to 11% compound over the next 3-5 years. Renewed growth support from Japan is considered timely, as the lower interest-rate outlook in Australia could weigh on domestic demand as annuity rates fall.

Nevertheless, the issue for equity investors, Ord Minnett believes, should be whether Challenger's high guaranteed rates to wholesale investors leave enough on the plate for shareholders. In particular, the broker questions whether it makes economic sense for an Australian manager to be providing hedged US dollar returns.

The company's annuity sales of slowed recently, affected by the Hayne Royal Commission and the disruption it has caused a financial planners, as well as the higher US dollar yields in Japan. Now, Credit Suisse assesses this annuity agreement offers an opportunity worth $640m to over $3bn per annum, providing Challenger with base annuity book growth of 10-15%.

Hence, the broker considers the risk is skewed to the upside if domestic and/or Japanese annuity sales exceed expectations and capital restraint is unlikely to be an issue for the company initially. Ord Minnett agrees the book growth should never be an issue for Challenger.

Future Buy-out?

Morgan Stanley questions whether MS&AD's decision to seek increased ownership of Challenger may raise longer-term buy-out prospects for Challenger. On the other hand, Ord Minnett suspects it reflects a desire to watch the decisions that Challenger makes in order to provide its investment guarantees for 20 years, rather than indicating real takeover potential.

The broker ascertains MS&AD would not be comfortable with Challenger's 30%-plus exposure to risk assets. Challenger, therefore, offers an excellent deal, with 1.8% guaranteed returns, above what is offered to policy holders.

Ord Minnett asserts the risk for shareholders is too high and out of step with annuity writers globally and continues to believe Challenger will struggle to make its cost of capital after adjusting for historical levels of underperformance. The broker concedes markets have been strong and capital levels are likely to be replenished, while there is scope for further risking up of the book at a later date.

Bell Potter, not one of the eight stockbrokers monitored daily on the FNArena database, retains a Buy rating with a $14.07 target. The broker believes there is a clear message to the broader market that the recent volatility in asset prices is not of concern to the Japanese firm, which appears interested in long-term quality assets that are well run.

Too much of the recent commentary on Challenger has been preoccupied with one negative asset price movement, in the broker's view, namely the 10-year government bond rate, to the exclusion of other assets which are improving. Bell Potter calculates Challenger is on track to achieve its FY19 guidance of pre-tax profit of $545-565m.

FNArena's database shows one Buy (Macquarie, yet to comment on the update), five Hold and two Sell. The consensus target is $8.09, signalling -3.1% downside to the last share price. Targets range from $7.00 (Ord Minnett, Deutsche Bank) to $9.60 (Macquarie).

Benefits Of Coles Online Move Uncertain

Coles Group is implementing the Ocado online fulfilment platform over the next four years but brokers are unsure about the extent of the benefits.

-A technology deal that is four years in the making comes with some risk -Lack of transparency around economics likely to mean investors discount the returns -Capital expenditure is rising, signalling upside potential for the dividend is limited

By Eva Brocklehurst

Coles Group ((COL)) is transforming its online proposition, an initiative expected to double home delivery capacity and improve online profit margins. The company will implement the Ocado platform whereby efficiency gains are expected and wastage reduced.

The main issue brokers have is with the economics of the deal, with uncertainty surrounding whether the benefits offset ongoing fees. Coles has said the deal will be accretive to margins versus its current break-even position online. It will also be important to unlocking additional sales growth in metropolitan Melbourne and Sydney.

Morgans assesses that Ocado will be able to provide valuable expertise, given its sole focus is in the online area, and Coles will obtain greater range, improved product availability, freshness and more regular delivery windows.

Nevertheless, the broker acknowledges one of the main challenges with online sales is a higher cost to serve. Increasing network efficiency via larger truckloads and minimising the amount of driving will be key, in the broker's opinion.

Coles will gain access to Ocado's technology with respect to online ordering and fulfillment. Two automated customer fulfillment centres will open in Sydney and Melbourne by FY23 with $500-750m of sales capacity each. Coles will spend $130-150m over the four years to fit out the fulfillment centres.

Access to the online platform and last-mile technology will incur an ongoing fee, which UBS estimates at 3-4% of sales. The partnership echoes similar deals globally and the broker assesses it will de-risk Coles' longer-term online strategy.

Still, UBS has mixed views on the partnership. Locking in technology deals that are four years away in what is an ever-changing market comes with some risk. The broker remains positive about the grocery sector but believes Coles faces company-specific pressures and these will take time to address. It will also cost money.

Online Outlook

Consumers are demanding more convenience and this trend is likely to continue, so Morgans believes this is the right move for Coles. Given the fulfillment centres are not expected to be operational until the end of FY23, the broker maintains near-term estimates and increases outer year forecasts.

Macquarie welcomes the partnership because of changing shopping habits, although the competitive edge remains to be seen. The broker notes figures show the gap between intent to buy and the 4% of Australians that actually buy online is significant. Nevertheless, the rolling out of Amazon Fresh and the arrival of Kaufland and Costco's online offerings could spark further interest in online shopping for Australian consumers.

Citi expects Coles to generate a marginally profitable outcome on its delivered online orders with Ocado. Still, the lack of transparency around the economics of the partnership is likely to result in investors discounting the returns from this agreement. This is even if conservative assumptions place a return on investment well above the cost of capital.

Morgan Stanley points out profit margins for Coles online are currently zero. The company generates $1bn in online food sales, 70% delivered, which the broker foresees could increase to $2bn by FY23 and thereby represent an increase in penetration to around 6% from 3.2%.

Woolworths To Follow?

Coles has lagged Woolworths ((WOW)) in online business but four years is a long time, Deutsche Bank asserts. A number of service providers already have alternative technologies available and the broker would be surprised if

Woolworths does not go down the automated fulfillment path at a similar pace to Coles.

The broker also points out that the importance of click & collect, increasing consumer appetite for on-demand delivery and a dispersed population outside of urban centres cannot be ignored. Deutsche Bank retains a preference for Woolworths given its strong sales momentum.

Credit Suisse points out the independent grocery sector will lose from this development. The broker's previous analysis has indicated that a -30% reduction in fulfillment centre costs at Ocado's UK facilities might be achievable with additional automation. Subsequent generations of the Ocado system have resulted in significant improvements in productivity.

Regardless, Ord Minnett comes back to the issue of the initiative being long-dated, which suggests that market share losses and a sub-optimal margin performance versus Woolworths will continue. The incremental sales target of $1bn, post the partnership, is not expected to be incremental. The broker suspects, rather, online will cannibalise existing store sales.

The broker also believes, as capital expenditure is rising, this signals that the upside potential for the dividend pay-out is limited. While the company has confirmed that there is no impact on the 80-90% pay-out ratio from capital expenditure this year, Macquarie agrees the market remains concerned about the prospect of a reduction to the pay-out ratio next year.

FNArena's database shows one Buy (Citi) rating, four Hold and three Sell for Coles. The consensus target is $11.93, indicating 0.9% upside to the last share price. The dividend yield on FY19 and FY20 forecasts is 3.2% and 4.7% respectively.

See also, Coles Unloads Risk With Pub Deal on March 6 2019.

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

Material Matters: Lithium, Iron Ore, Oil & LNG

A glance through the latest expert views and predictions about commodities. Lithium; Chinese commodity demand; iron ore; oil; and LNG.

-China subsidy reduction may pull forward demand for lithium to first half of 2019 -UBS observes confidence in Chinese infrastructure activity offsetting weakness in other areas -Vale will find it hard to procure iron ore pellet from third parties -OPEC appears strongly determined to support oil prices -November's fall in oil prices likely to start showing up in LNG contracts

By Eva Brocklehurst

Lithium

China has provided its final 2019 new energy vehicle subsidy policy. A reduction in total subsidies amounts to -65-70% with central government subsidies reduced by -40-60% depending on type. Local government subsidies will be completely removed after a transition period.

Citi suspects this may pull forward the demand for electric vehicle batteries and lithium to the first half and, subsequently, it is possible there will be a decline in the second half. This does not change Citi's long-term forecasts for 11% penetration of battery electric vehicles and plug-in hybrid electric vehicles by 2025. However, the trajectory may be different.

The policy has a transition period from March to June 2019 which could buffer the negative impact over the full year, as incentives are increased for front-loading sales during this time frame. Nevertheless, the broker acknowledges these reductions in subsidies are the most significant there has been over the past few years so the impact on demand in the second half remains uncertain.

From the detail, Citi ascertains the subsidy for pure battery electric cars driving over 400km will be reduced by -50% to around US$3700 per vehicle. Battery electric vehicles with a range of less than 250km will no longer receive any subsidy, which is in line with expectations.

Plug-in electric vehicles subsidies are reduced by -55%. Meanwhile the battery density multiplier is capped at 1.0x for all batteries with density over 160Wh/kilogram. Citi suspects this will slow the industry's rush towards 811 batteries.

Morgan Stanley considers the reduction in subsidies negative for both lithium prices and related equities and suggests consensus expectations of EV penetration rates for China could be overly optimistic. The broker expects the production surplus of lithium over 2019 to begin to incorporate the price normalisation process, including a convergence of spot and contractual prices.

Morgan Stanley retains an Underweight rating on both Albemarle (Citi is Neutral) and Sociedad Quimica y Minera de Chile with Equal-weight ratings on Orocobre ((ORE)) and Galaxy Resources ((GXY)). The broker's preferred exposure at this point is Mineral Resources ((MIN)), as this shows significant value at current levels.

Chinese Commodity Demand

UBS has visited three major Chinese cities to gauge commodity demand and supply. The overall sentiment is more optimistic than the broker expected. Infrastructure activity is believed to be underway, offsetting weakness in steel demand from property, appliances and automobiles. Fiscal stimulus is also supportive as cuts of -3% to VAT are boosting confidence downstream.

Credit tightness appears less of an issue now than it was in 2018. Most steel mills believe demand will be flat to up 3%. EAF production and scrap use has fallen because of higher prices and low availability. Hence, iron ore demand is likely to be higher.

The broker found no consensus on the amount of iron ore supply lost from Brazil while domestic iron ore supply growth is seen limited by approvals. Most mills expect more supply from Southeast Asia, India and Africa.

Meanwhile there has been a three-year hiatus in new nuclear reactor approvals that has now ended. Existing approvals were being worked on but unapproved projects have stalled. Most power companies UBS met with suggested it would be difficult to lift the percentage of nuclear generation to the 10% target by 2030 from the current 4%.

Coal import restrictions remain opaque as customs officials have slowed imports of Australian coal to 40 days from 20 days. The broker received no clear indication of any change in policy.

Iron Ore

Of the 93mt in iron ore currently affected by production shutdowns, Vale expects around 53mt is likely to come back on board over 2019, while the 40mt impacted by de-commissioning of dams will be out for 2-3 years. The company's northern system and other commodities felt no impact as a result of the tragedy on January 25, 2019.

Vale's production tonnage is contracted, and any production lost outside of mines where force majeure has been declared will need to be procured from third-party tonnage. Importantly, as Vale produces around 60% of the pellet market it will be difficult to source this from third parties.

Latent capacity in China is also considered to be limited as the move to quality iron ore is expected to be a long-term structural change in the industry. Morgan Stanley finds it hard, given the uncertain situation, to extrapolate the medium-term supply/demand balance for iron ore.

Oil

Citi believes most of the macro concerns about crude demand have been eased, despite some economic growth concerns across the G7. Russia is reported to have produced 11.3m b/d for March, approaching its production target.

Given nearby market tightness Citi revises up its 2019 annual average price for Brent to US$70/bbl, with prices expected to peak at the end of the northern summer and declining to 2020. The broker's medium-term price outlook remains around US$60/bbl, with risks to the downside.

US crude stocks, meanwhile, reversed a dramatic drawdown in the prior week with a 2.8m bbl build to 442.3m b/d. US net crude imports were roughly unchanged week on week as a temporary closure of the Houston ship channel hindered waterborne trade flows.

Morgan Stanley notes a recent rise in oil prices has been accompanied by robust refining margins and improving time spreads. The broker envisages the market will be under-supplied by around -0.8m b/d by the September quarter, supporting a rally in Brent to US$75/bbl. Inventory built up in January but was well below historical norms.

Moreover, comments from OPEC suggest a stronger determination to support oil prices. Also, production rates in Venezuela and Iran appear fragile.

Morgan Stanley is also constructive on global economic growth, arguing that a combination of China's stimulus, a more dovish US Federal Reserve and a resolution of trade conflicts will drive global GDP growth back to trend by the end of the year.

LNG

Shaw and Partners expects LNG prices will fall over coming months. The majority of LNG sold by Woodside Petroleum ((WPL)), Santos ((STO)) and Oil Search ((OSH)) is to utilities in Asia and volumes are largely fixed, sold as base-load to industrial and utility consumers under contract as long as 25 years.

The majority of contract prices are linked to oil by linear formula, with a lag of 3-6 months. Hence, the linkage, and delays in pricing, means that the collapse in global oil prices which occurred last November is yet to show up in delivered LNG prices and this is likely to happen in coming months.

The broker expects a drop in contract LNG prices to US$7-8/MMBtu. Average LNG prices reached a peak in February in Japan this year, at US$12/MMBtu, reflecting an earlier peak in Brent crude of US$85/bbl in October 2018.

Meanwhile, spot trading in LNG is rising globally and pricing reflects short-term imbalances. However, spot trade for Australian exporters is a low proportion of all traded volume, thus, LNG spot prices are not so important for Australian producers.

ESG Focus: Coke; You Can't Beat The Real Thing (Part Two)

This second part concludes FNArena's deep dive into threats and outlook for coking coal in a more carbon sensitive world.

-Most substitutes for steel still circa five years away -Electric arc furnaces are on the rise -Increasing availability of scrap to impact on demand for iron ore, coking coal -Forecasters see floor under coking coal prices until 2025

By Sarah Mills

Substitutes in steel production

Another direct threat to coking coal is the use of substitutes in steel production. Most of these will not be in place for at least five years but they are worth examining.

One substitute is Hydrogen (H), H2, and H2O using electrolysis, which is said to require 10-20 years of development before full commercialisation (matching the coal phase-out timeline).

Using electrolysis has several advantages. It results in purer metals and lower energy consumption – the process is up to 30% more efficient.

There is also a process called direct reduced iron, which uses natural gas to concentrate iron ore into pellets within a furnace that requires less or in some cases no coke; has much lower CO2 emissions; and would be substantially less expensive.

Within five to 10 years they are predicted to replace blast furnaces. This process is already being used in small operations in countries where coal must be shipped in.

The US National Renewable Energy Laboratory's wind to hydrogen project has been operating for five years. It uses iron ore pellets for reduction. Austrian steelmaker Voestalpine has a hydrogen project in the pipeline and Sweden is going full tilt at developing a 100% carbon-free production method using hydrogen – the holy grail of steel production.

Water is the byproduct. Called HYBRIT, and using hydrogen produced from renewable electricity, the project is in a study phase until 2024 and the Swedish steel firm SSAB expects to have a demonstration plant ready in 2025.

Coking coal substitutes can also be used in existing blast furnaces in combination with coke using polymer injection technology. Waste plastics, for example, the majority of which are landfilled or incinerated), are far more energy efficient.

This technology is being used mainly in Japan and Europe. The main obstacle to its widespread adoption is the cost of collection and treatment of plastics, but the rollout of ESG investing and a carbon tax could shift that balance.

Tyres can also be used as a coke substitute in electric arc furnaces, which constitute 31% of total global steel production. The University of NSW in collaboration with Onesteel, has developed polymer injection technology in which carbon and energy are sourced from used tyres rather than coking coal in electric arc furnaces.

One million tyres equates to 15,000 tonnes of coal (which compares with world coking coal consumption of roughly 1bn tonnes a year). Given nearly 3bn tyres are produced each year globally, supply is practically guaranteed.

The process also produces a more stable foamy slag, which further improves efficiency. The byproducts are hydrogen and carbon monoxide. The UNSW polymer injection technology has been patented internationally and is being commercialised.

Monash University has been working on a technology using Victorian Brown coke, which is a cheaper substitute and contains less carbon than coke. These are just a sample of coal-substitute projects on the global drawing board.

Growing Indirect Challenges To Coking Coal

Then there are the indirect challenges to coking coal. The first is the rise of recycled steel.

Steel can be practically 100% recycled indefinitely without significant loss of mass or quality, and does not require a new injection of carbon from coal.

Electric arc furnaces produce about 31% of the world's steel using scrap metal, and the world plans to increase this to 80%. The World Coal Association says the average blast furnace uses 600kg of coking coal to produce a tonne of steel while the average electric arc furnace (using mainly recycled steel) needs just 16kg.

With renewable energy inputs, the footprint falls dramatically. Electric arc furnaces are cheap to build, flexible and have short cycle times (less than 60 minutes) and can make steel of specific character in small batches.

Advances in arc furnace technology also allow direct reduced iron to be used to supplement recycled steel. Boston Consulting Group expects between 50% and 70% of global steel will be constructed from scrap produced in electric arc furnaces by 2050.

The West has large reserves of scrap metal and is already restructuring in that direction. In the United States, which has huge scrap metal reserves, recycled steel constitutes 65% of new steel. Goldman Sachs estimates that China may reach 20% recycled steel by 2020 and by 2030-2040 it could approach 30% to 39%.

The rate at which this trend accelerates will be a significant factor in setting demand for coking coal within the decade.

Another factor affecting coking coal is steel demand. Pundits are forecasting a decline in construction-led demand, competition from alternative materials, and the affects of carbon penalties.

Goldman Sachs expects a dramatic scaling back of iron-ore demand due to slowing in construction demand and growing steel recycling. The construction threat is likely to hit the market past 2023, given steel demand is expected to remain fairly firm in the near term.

Then there is the rise of alternative materials. Manufacturing a car requires as much carbon as driving one. The body and chassis constitute more than half the weight of an average vehicle. As the carbon tax looms and ESG tracking is cemented, incentives will be strong for auto companies to seek lighter replacements with a lower carbon footprint.

Aluminium & Alternatives

The Centre for Automotive Research in the US forecasts high-strength steel use will peak at 15% of total vehicle weight composition by 2020 before gradually falling to roughly 5% by 2040 as other lightweight materials gain ground.

Already, aluminium has replaced steel in parts of cars for practical and safety purposes. Aluminium is half as dense as iron and is a material of choice in electric cars given the translation of weight savings to the battery or payload capacity.

But aluminium is two to three times more expensive than steel. It is also more costly to recycle.

New technologies are being developed. Given the respective properties and costs of the metals, steel is most likely to be used in small cars, and aluminium in large cars.

Carbon fibre has also been mooted as a steel substitute, particularly because it is lightweight, reducing fuel costs. But, at present, it is too expensive. A carbon tax combined with advances in technology could change that.

Pre-stressed laminated timbers (which has issues of its own) could replace steel in construction.

The aviation industry is expected to adopt nano-materials within 20 years. These lattice-like materials are super strong and super light and would be used in the new generation of "flying taxis" and other aircraft.

Indeed, the global market for composite materials is forecast to grow at an average compound annual rate of 7% a year across diverse sectors ranging from aerospace to automotive and construction.

Other substitutes include much cheaper chromium alloys from electric arc furnaces.

But the steel industry isn't taking these affronts lying down. Steel is four times stronger than aluminium and advanced high-strength steel can be made thinner. It is the most recycled material in the world and is cheaper to recycle. Add to the fact that many of its markets are expected to expand, then it should remain well supported even if its share of a likely expanded market declines.

China & Rest Of Asia

No discussion on coal would be complete without the inclusion of Asia.

China is the biggest manufacturer of steel in the world – producing around half of total global production. When China sneezes, coking coal catches cold.

In 2015, President Xi announced a series of steel industry reforms, one of which was a plan to remove 150Mtpa of capacity by 2020, which included the removal 120Mtpa of induction furnace capacity almost overnight.

This sparked a recovery in the steel price (which is being used to fund upgrades to mills) but a sharp fall in the coking coal price. Steel mills across China have been upgrading production facilities to include larger and more efficient blast furnaces and cookeries, further pressuring coal prices in recent years.

According to Reuters, roughly half of China's steelmaking capacity will have to comply with new emissions targets by 2020 and ultra-low emissions standards by 2025.

China has committed to cutting CO2 emissions per unit of gross domestic product by 60-65% from 2005 levels. After charging ahead, they collapsed towards the end of 2018, spurring a recovery in the coking coal price. China also recently banned coal imports at one port, again causing market angst and demonstrating how China's vagaries are likely to continue to drive volatility in the coking coal price.

Overall, most pundits agree that China's megatrend of declining steel production will hold – particularly as scrap metal reserves rise, the rate of urbanisation rises and its population ages.

Miners are pinning their hopes on India, which is tipped to overtake Japan and move from third to second-largest coking coal consumer after China. India does not face the constraining ageing demographics of China and the West, it has very low levels of scrap-metal, and it is in the very early stages of industrialising and urbanising. Less than 10% of India's middle class owns a refrigerator.

But, as highlighted earlier, the gap between China's and India's present consumption is huge. It is therefore unlikely gains in India will be able to offset China's reductions.

Indian steel consumption is forecast to rise to 158kg from 61kg per capita and coking coal demand is expected to rise 25% by 2020. Steel Guru says Indian demand is forecast to grow at 8.8% per year out to 2023. Europe meanwhile is accelerating its exit, as is the United States.

Coal Prices Forecasts

That brings us to the coal price forecast out to 2023 and beyond. Most pundits expect steady demand for coking coal out to 2023 and believe this should put a solid floor beneath prices.

Given the product's price sensitivity to steel demand, volatility may trigger a spike as low as US$100 a tonne but by and large the price of coking coal is expected to hold around the US$150 a tonne mark.

Coking coal's average price was US$187 a tonne as at September 18. Peabody Energy expects the price will fall to US$157 in 2019 and US$145 a tonne in 2020, but expects demand will grow between 2% and 4% to sit near 1bn tonnes a year.

Wood Mackenzie predicts coking coal will stay on average above US$US150 a tonne until 2023. In its February 2019 quarterly coking coal report, KPMG's compilation of market forecasts show the market expects the hard coking coal price will average US$179.10 in 2019; US$159.20 in 2020; US$154.40 in 2021; US$150.80 in 2022; and US$151.50 in 2023.

Price transitions are expected to feature between 2024 and 2030 as prices flirt with the marginal cost of supply. Peabody suggests investors will be targeting companies that display operational excellence; financial strength; sound portfolio management; high-quality assets; strong demand centres; focused lobbying on "licence to operate"; advocates for favourable energy policy; and adoption of technological advances that cut costs, carbon emissions and water use.

The outlook for coking coal is not as harsh as that for thermal coal but it too could suffer a dramatic reversal of fortune given the intense pace of change and disruption marking the shift to a carbon-free world.

Coking coal is facing challenges on six fronts: more efficient coking-coal blast-furnace technology; coking coal substitutes; alternatives to blast furnaces; the rise of scrap metal recycling; competition to steel from new materials; a likely carbon tax; and ESG penalties.

Consumption in the West, which has large reserves of scrap metal, is waning. China is committed to reducing its carbon footprint and its megatrend of declining coal demand is expected to prevail.

Russia's consumption is expected to rise. India is the main wildcard, but as it represents only 7% of the world's CO2 emission, any downward movement in China's demand is likely to outpace growth in India.

While most pundits expect coking coal prices will be fairly steady for at least five years, the above pressures will come to bear post 2025. In the meantime, the coking coal price is expected to be subject to volatility but remain on a downward arc with steady to slightly firmer demand providing a floor.

For now, at least.

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 March 18 to Friday March 22, 2019 Total Upgrades: 7 Total Downgrades: 11 Net Ratings Breakdown: Buy 42.15%; Hold 42.89%; Sell 14.96%

Most of the action among securities analysts, so it seems, is about deciding which share price movement triggers a downgrade or upgrade in rating. The share market itself has been hesitating about which direction next, but underneath some of the volatility that has risen to the surface lately might be explained by some of the analysts' decisions.

For the week ending Friday, 22nd March 2019 FNArena registered seven upgrades for individual ASX-listed entities, and eleven downgrades.

Worth pointing out: many of the upgrades have a whiff of "surely this share price cannot stay this low (or lower) forever" to it. Car leasing has two representatives through SG Fleet and EclipX Group among the week's upgrades. Only two upgrades did not move past Hold/Neutral.

On the negative side (downgrades), Sigma Healthcare stands out with two downgrades, but there are otherwise plenty of companies that released financial results after the February reporting season. More bad news means Wagners Holding is in there too, as is Sydney Airport, and Cochlear.

Probably not a surprise there is not much going on in the table for positive amendments to valuations and price targets. New Hope Corp (+3.8%) is the only one worth mentioning. On the flipside, EclipX Group and Sigma Healthcare suffer from the fall-out from their disappointing market update.

A little more colour is visible in the table for positive revisions to earnings estimates with Automotive Holdings leading the pack (after months of downgrades), followed by oOh!media, Megaport, TPG Telecom, and New Hope Corp. Negative revisions fell upon NextDC, Sigma Healthcare, ExclipX Group, Nufarm, and Caltex Australia.

Bond markets and other macro-economic events have investors' attention as the end of March/Q1 approaches. This also implies local banks' results are drawing nearer too.

Upgrade

ECLIPX GROUP LIMITED ((ECX)) Upgrade to Buy from Neutral by Citi .B/H/S: 2/2/0

The company has retracted prior guidance for net profit to be broadly in line with FY18 and disclosed that, for the five months to February, net profit was down -42%. Notwithstanding the headwinds, Citi believes EclipX is oversold and upgrades to Buy/High Risk from Neutral.

The broker expects an improvement in the second half, amid some of the commercial contract extensions ceasing, cost savings being realised and the company's normal skew to the second half.

Divestment of Grays and Right2Drive has been flagged. Meanwhile, McMillan Shakespeare ((MMS)) refused a request to extend the merger negotiations deadline.

Citi does not believe this will be an end to consolidation, although it may result in other interested parties entering the fray. The broker reduces the target to $1.29 from $2.38.

ELDERS LIMITED ((ELD)) Upgrade to Hold from Reduce by Morgans .B/H/S: 0/1/0

The impact of the prolonged drought, low wool volumes and increased costs have meant a weak first half result is likely and Elders has downgraded FY19 guidance to underlying EBIT of $72-75m.

This is not a surprise to Morgans, given the severity of the drought and the impact of Queensland's floods, and a steep fall in cattle prices has been noted.

In light of the adverse conditions, if guidance is achieved, this will be a reasonable outcome, in the broker's view. Tough trading conditions are somewhat factored into the stock and the broker upgrades to Hold from Reduce. Target is reduced to $6.30 from $7.80.

Should the Nutrien takeover bid for Ruralco ((RHL)) proceed, Elders will be competing with a much larger peer group and this, potentially, removes the corporate appeal that was previously attached to the valuation, in the broker's view.

Morgans reduces FY19 and FY20 forecasts by -12.2% and -11.9% respectively.

HEALIUS LIMITED ((HLS)) Upgrade to Buy from Hold by Deutsche Bank .B/H/S: 3/2/1

Deutsche Bank notes market conditions have become more challenging and this has led to a downgrade to FY19 guidance. Still, the company is making some progress in its transformation, in the broker's view.

There is a high number of GP additions as well as margin expansion in imaging. Given the 16% total shareholder return implied by forecasts the broker upgrades to Buy from Hold.

Deutsche Bank also expects the share price will be supported if another takeover proposal is announced. Target is $3.01.

NUFARM LIMITED ((NUF)) Upgrade to Add from Hold by Morgans .B/H/S: 6/1/0

Cash flow in the first half was significantly worse than Morgans expected and the company's balance-sheet position remains of concern. The extent of the revision to guidance was also worse than the broker expected.

European acquisitions are now not expected to achieve their original earnings guidance until FY20. Yet, following severe weakness in the share price the broker upgrades to Add from Hold.

Another tough half-year is anticipated and Morgans acknowledges short-term catalysts are limited. Target is reduced to $6.30 from $6.85.

The broker believes the current share price undervalues the existing business and provides no value for the Omega-3 seeds project.

See also NUF downgrade.

NOVONIX LIMITED ((NVX)) Upgrade to Speculative Buy from Add by Morgans .B/H/S: 1/0/0

Morgans has introduced a new rating category, Speculative Buy, for companies where there is potential for significant opportunity but that also carry significant risk.

The broker believes the upside potential for Novonix is compelling, but it has not yet sold its anode material or produced in large scale.

There are a number of issues the company will need to overcome in order to realise its potential.

The broker upgrades to Speculative Buy from Add and raises the target to $0.75 from $0.54.

RESMED INC ((RMD)) Upgrade to Buy from Hold by Deutsche Bank .B/H/S: 4/2/1

The second quarter result was weaker than Deutsche Bank expected, although the core US sleep & respiratory care market continues to grow at solid rate of 9%.

The broker notes sales weakness can be attributed to rest-of-world devices because of a high comparable period, and slower upgrades to tele-monitored devices in France and Japan.

The broker believes the business has a large opportunity to grow from the increased awareness and further penetration of the sleep apnoea market. The broker upgrades to Buy from Hold. Target is US$125.

SG FLEET GROUP LIMITED ((SGF)) Upgrade to Equal-weight from Underweight by Morgan Stanley .B/H/S: 2/1/0

Morgan Stanley observes the stock has sold off substantially since its AGM in October. The broker believes the business has sufficient levers to meet earnings expectations and a cost reduction strategy into the second half and FY20 should alleviate some of the top-line and margin pressure.

Positive catalysts, nevertheless, are some way off and the broker's upgrade to Equal-weight from Underweight is centred on valuation. New vehicle sales continue to be disappointing, particularly in NSW and Victoria. Target is $2.60. Industry view is In-Line.

Downgrade

BRICKWORKS LIMITED ((BKW)) Downgrade to Hold from Buy by Deutsche Bank .B/H/S: 0/4/0

First half earnings (EBIT) were ahead of Deutsche Bank's expectations, largely from better-than-expected property earnings.

While remaining positive on the medium-term outlook for property development, Deutsche Bank believes there is unlikely to be significant revaluations from FY20 onwards.

Investment in building products in North America is likely to support earnings in the long-term, although the broker also considers significant upside is unlikely in that space in the next three years.

Deutsche Bank downgrades to Hold from Buy. Target is $18.60.

COMMONWEALTH BANK OF AUSTRALIA ((CBA)) Downgrade to Underperform from Neutral by Macquarie .B/H/S: 2/3/3

Following a broader market re-rating, Macquarie finds the bank sector looking increasingly attractive on a relative basis. The sector is offering healthy dividend yields and supportive relative valuations.

Nevertheless, the broker continues to find the current fundamental outlook challenging and retains forecasts that are below consensus.

Macquarie finds it difficult to have a more constructive view until external conditions improve. The broker downgrades Commonwealth Bank to Underperform from Neutral on a relative valuation basis. Target is $69.

COCHLEAR LIMITED ((COH)) Downgrade to Sell from Hold by Deutsche Bank .B/H/S: 1/2/4

While services revenue growth remains strong, Deutsche Bank expects growth will slow in the second half as N7 upgrades move through the typical product cycle.

The broker also forecasts lower expense ratios will be needed if the company is to achieve the lower end of its FY19 guidance range.

A patent dispute with a competitor also looms, which may lead to a large payment of damages. Rating is downgraded to Sell from Hold. Target is $157.

ERM POWER LIMITED ((EPW)) Downgrade to Hold from Add by Morgans .B/H/S: 2/1/0

Since the company announced its first half result, it has outperformed the broader market index. Morgans believes share price strength has been principally driven by the re-start of the share buyback and increase in the dividend outlook.

The broker downgrades to Hold from Add, as a result of share price strength. The company has reserved $60m for investment in its energy solutions business in addition to the $18m paid for Greensense, Lumaled and Out Performers.

However, while the segment contributes $0.11 to valuation, Morgans points out it is yet to develop a track record of earnings growth.

The company also highlights that the Oakey power station will have increasing value by providing firming capacity to offset the increasing penetration of renewables into the Queensland generation mix. Target is raised to $1.90 from $1.81.

NEW HOPE CORPORATION LIMITED ((NHC)) Downgrade to Neutral from Outperform by Credit Suisse .B/H/S: 1/2/0

First half results missed expectations because of costs. Credit Suisse suspects investors are concerned that the syndicated loan the company has acquired is a signal for lower capital returns going forward.

The company has entered into a $600m secured loan facility to fund future growth projects. The broker was disappointed with the operating performance as unit costs increased in Queensland because of reduced feed available to wash plant and decreased yields.

New South Wales operations were also disappointing in terms of costs, affected by elevated fuel costs and increased repair & maintenance.

Credit Suisse downgrades to Neutral from Outperform, given the strong rally in the share price. Target is $4.

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

Ord Minnett notes, while first half operating earnings were in line with expectations, the underlying net loss of -$11.5m was below forecasts. The interim dividend is suspended temporarily in order to manage cash flow.

A poor weather outlook in Australasia and supply issues in Europe continue to dog the stock. Glyphosate is also of concern, because of the recent Bayer court case progressing to the second phase.

Ord Minnett reduces estimates for earnings by -30% for FY19 and by -26% for FY20. This leads to a downgrade to Hold from Buy and a reduced target, cut to $4.50 from $7.25.

See also NUF upgrade.

RURALCO HOLDINGS LIMITED ((RHL)) Downgrade to Hold from Add by Morgans .B/H/S: 0/1/0

In light of the Nutrien takeover bid for Ruralco, Morgans downgrades to Hold from Add and raises the target in line with the offer price of $4.40, from $3.60.

Ruralco has entered into a scheme of arrangement with Nutrien, a global agribusiness, the parent company of Landmark and the largest player in Australia's rural services industry.

Based on Morgans' forecasts the offer price implies an FY19 enterprise value/EBITDA multiple of around 8.8x. Ruralco will report its first half result on May 14 and has guided to a flat outcome.

SIGMA HEALTHCARE LIMITED ((SIG)) Downgrade to Sell from Neutral by UBS and Downgrade to Sell from Neutral by Citi .B/H/S: 0/0/4

Underlying earnings (EBIT) were ahead of guidance in FY19, although UBS notes earnings quality was affected by restructuring costs and weak cash conversion. The company has indicated FY20 underlying operating earnings (EBITDA) will be $55-60m.

UBS makes material upgrades to FY21-22 estimates, reflecting the incorporation of Project Pivot. Project Pivot is the company's $100m cost reduction program, of which around $60m is expected to come from the transition of Chemist Warehouse and the remaining $40m from operating efficiencies.

The company is a quality operator but UBS does not believe the stock warrants a premium to market. Rating is downgraded to Sell from Neutral and the target reduced to $0.45 from $0.58.

Post the release of FY19 financials, Citi has downgraded to Sell/High Risk from Neutral/High Risk. Price target falls to $0.52. The company's guidance towards more capex has led to reduced forecasts.

The analysts see the biggest risk to their Sell rating in the potential of a higher bid to shareholders. Otherwise, execution risks are seen as high, with management aiming to take out $100m in costs out of the business.

The reported financials were labeled as largely in-line. On adjusted basis, the operational performance as actually a smidgen better than expected, admit the analysts. Cash conversion, however, was weak.

SYDNEY AIRPORT HOLDINGS LIMITED ((SYD)) Downgrade to Hold from Buy by Deutsche Bank .B/H/S: 3/2/3

The share price is up over 16% since January, supported by long bond yields, strong passenger growth in January and a positive draft report from the Productivity Commission.

Deutsche Bank expects the stock to underperform, as the airport cycles last year's strong international passenger growth, downgrading to Hold from Buy. Target is reduced to $7.50 from $7.75.

WAGNERS HOLDING COMPANY LIMITED ((WGN)) Downgrade to Hold from Add by Morgans .B/H/S: 1/1/1

The company has advised that its largest cement customer, Boral ((BLD)), has issued a pricing notice. Morgans observes this is significant, given the take-or-pay contract is a cornerstone of Wagner's earnings profile in a volatile south-east Queensland construction market.

The broker notes the south-east Queensland cement market is highly concentrated and assumes the third-party providing the lower quote to Boral might be Cement Australia.

If so, this will support the view that demand conditions are weaker than expected, in the absence of major infrastructure projects and a slowdown in residential activity.

The company has suspended cement deliveries to Boral for six months as the dispute is addressed. Morgans downgrades to Hold from Add and reduces the target to $3.04 from $3.38.

Total Recommendations Recommendation Changes

Broker Recommendation Breakup

Broker Rating Order Company New Rating Old Rating Broker Upgrade 1 ECLIPX GROUP LIMITED Buy Neutral Citi 2 ELDERS LIMITED Neutral Sell Morgans 3 HEALIUS LIMITED Buy Neutral Deutsche Bank 4 NOVONIX LIMITED Buy Buy Morgans 5 NUFARM LIMITED Buy Neutral Morgans 6 RESMED INC Buy Neutral Deutsche Bank 7 SG FLEET GROUP LIMITED Neutral Sell Morgan Stanley Downgrade 8 BRICKWORKS LIMITED Neutral Buy Deutsche Bank 9 COCHLEAR LIMITED Sell Neutral Deutsche Bank 10 COMMONWEALTH BANK OF AUSTRALIA Sell Neutral Macquarie 11 ERM POWER LIMITED Neutral Buy Morgans 12 NEW HOPE CORPORATION LIMITED Neutral Buy Credit Suisse 13 NUFARM LIMITED Neutral Buy Ord Minnett 14 RURALCO HOLDINGS LIMITED Neutral Buy Morgans 15 SIGMA HEALTHCARE LIMITED Sell Neutral Citi 16 SIGMA HEALTHCARE LIMITED Sell Neutral UBS 17 SYDNEY AIRPORT HOLDINGS LIMITED Neutral Buy Deutsche Bank 18 WAGNERS HOLDING COMPANY LIMITED Neutral Buy Morgans Recommendation Positive Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 SGF SG FLEET GROUP LIMITED 67.0% 33.0% 34.0% 3 2 ECX ECLIPX GROUP LIMITED 50.0% 25.0% 25.0% 4 3 HLS HEALIUS LIMITED 25.0% 8.0% 17.0% 6 4 QAN QANTAS AIRWAYS LIMITED 29.0% 17.0% 12.0% 7 5 RMD RESMED INC 31.0% 19.0% 12.0% 8 6 MYO MYOB GROUP LIMITED -25.0% -33.0% 8.0% 4 7 NUF NUFARM LIMITED 86.0% 83.0% 3.0% 7 8 OML OOH!MEDIA LIMITED 90.0% 88.0% 2.0% 5 Negative Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 SIG SIGMA HEALTHCARE LIMITED -100.0% -50.0% -50.0% 4 2 NHC NEW HOPE CORPORATION LIMITED 33.0% 67.0% -34.0% 3 3 EPW ERM POWER LIMITED 50.0% 83.0% -33.0% 3 4 HPI HOTEL PROPERTY INVESTMENTS 33.0% 50.0% -17.0% 3 5 COH COCHLEAR LIMITED -44.0% -31.0% -13.0% 8 6 ANZ AUSTRALIA & NEW ZEALAND BANKING GROUP 6.0% 19.0% -13.0% 8 7 MPL MEDIBANK PRIVATE LIMITED -31.0% -19.0% -12.0% 8 8 ORG ORIGIN ENERGY LIMITED 63.0% 75.0% -12.0% 8 Target Price Positive Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 NHC NEW HOPE CORPORATION LIMITED 3.933 3.787 3.86% 3 2 EPW ERM POWER LIMITED 1.917 1.887 1.59% 3 3 MYO MYOB GROUP LIMITED 3.250 3.200 1.56% 4 4 HLS HEALIUS LIMITED 2.943 2.920 0.79% 6 5 QAN QANTAS AIRWAYS LIMITED 6.079 6.050 0.48% 7 Negative Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 ECX ECLIPX GROUP LIMITED 1.058 2.433 -56.51% 4 2 SIG SIGMA HEALTHCARE LIMITED 0.483 0.518 -6.76% 4 3 COH COCHLEAR LIMITED 167.738 169.113 -0.81% 8 4 ORG ORIGIN ENERGY LIMITED 8.233 8.294 -0.74% 8 5 ANZ AUSTRALIA & NEW ZEALAND BANKING GROUP 28.225 28.413 -0.66% 8 Earning Forecast Positive Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 AHG AUTOMOTIVE HOLDINGS GROUP LIMITED 3.045 0.534 470.22% 7 2 OML OOH!MEDIA LIMITED 27.626 25.533 8.20% 5 3 MP1 MEGAPORT LIMITED -27.150 -29.000 6.38% 3 4 TPM TPG TELECOM LIMITED 36.656 35.257 3.97% 6 5 NHC NEW HOPE CORPORATION LIMITED 50.333 48.967 2.79% 3 6 FMG FORTESCUE METALS GROUP LTD 84.587 82.491 2.54% 8 7 MYO MYOB GROUP LIMITED 15.633 15.280 2.31% 4 8 SGF SG FLEET GROUP LIMITED 26.500 26.050 1.73% 3 9 EPW ERM POWER LIMITED 24.300 23.967 1.39% 3 10 SUN SUNCORP GROUP LIMITED 74.729 73.900 1.12% 8 Negative Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 NXT NEXTDC LIMITED -0.117 -0.033 -254.55% 7 2 SIG SIGMA HEALTHCARE LIMITED 2.030 4.113 -50.64% 4 3 ECX ECLIPX GROUP LIMITED 16.800 23.900 -29.71% 4 4 NUF NUFARM LIMITED 28.623 39.934 -28.32% 7 5 CTX CALTEX AUSTRALIA LIMITED 193.683 202.683 -4.44% 7 6 WBC WESTPAC BANKING CORPORATION 222.686 228.843 -2.69% 8 7 WES WESFARMERS LIMITED 217.357 218.071 -0.33% 8 8 SYR SYRAH RESOURCES LIMITED -6.757 -6.746 -0.16% 5 9 ANZ AUSTRALIA & NEW ZEALAND BANKING GROUP 227.886 228.171 -0.12% 8 10 ORG ORIGIN ENERGY LIMITED 61.789 61.846 -0.09% 8 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: Sellers Becoming Urgent

The spot uranium price continues to slide as sellers are met with stalled demand.

-U3O8 spot price continues to fall -Honeymoon may not be over -Upheaval in Kazakhstan

By Greg Peel

The US Department of Commerce is due to submit its section 232 recommendations to the president on April 14. The president then has months to consider a response. All things being equal, it appears utility demand in the uranium market could remain stalled for some time.

Sellers became more aggressive in their offers last week as the spot uranium price continues to pull back from a near unbroken run up from late 2017 depths. They did manage to provoke some buying, but only after offers dropped to below US$26.50/lb, industry consultant TradeTech reports.

Seven transactions were concluded in the week totalling 700,000lbs U3O8 equivalent but by week's end TradeTech's spot price indicator had fallen a full -US$1.00 to US$26.00/lb, following on from the prior week's -US$1.10 fall. The spot price has fallen -10% in 2019 but remains 20% higher year on year.

TradeTech's term price indicators are steady at US$30.00/lb (mid) and US$32.00/lb (long).

Supply Side

The Honeymoon uranium mine in South Australia commenced production in 2011 and became the fourth of four Australian mines permitted under federal government restrictions. The other three are Olympic Dam in South Australia, owned by BHP Group ((BHP)), Ranger in the Northern Territory, owned by Energy Resources of Australia ((ERA)), which is two-thirds owned by Rio Tinto ((RIO)), and Beverley in South Australia, which is privately owned by US interests.

Currently Ranger is not mining any new ore, and Honeymoon was placed into care & maintenance in 2014 due to low uranium prices. But new owner Boss Resources ((BOE)) has begun a three-phase assessment as to whether restarting the mine is viable, or whether Honeymoon is over. Phase one has commenced, with phase three expected to be reached in 2020.

On the other side of the world, the president of Kazakhstan, Nursultan Nazarbayev, surprised by announcing his resignation last week despite his current term not ending until 2020. The 78 year-old, who has reigned since Kazakhstan became an independent state post the fall of the Soviet Union, has decided it's time for some new blood.

While Nazarbayev has handed over the reins to a "loyal ally" to see out the term, the resignation has provided uncertainty in uranium markets as Kazakhstan is the global "swing" producer. State-owned Kazatomprom has for the past two years set production limits in order to prop up uranium prices, much in the same vein as OPEC/Russia in oil markets. The market will be hoping a new president is similarly inclined.

Demand Side

The US Department of Energy last week finalized up to US$3.7bn in loan guarantees to finance construction of units 3 and 4 of the Vogtle nuclear generation project in Georgia, completion of which is now years behind schedule. The Vogtle units were the first new plants to be licensed in the US in thirty years.

"The Vogtle project is critically important to supporting the Administration's direction to revitalize and expand the US nuclear industry," said Energy Secretary Rick Perry during a visit to the site. "A strong nuclear industry supports a reliable and resilient grid, and strengthens our energy and national security".

We are reminded that the section 232 investigation centres around forcing US nuclear power generators to purchase a portion of their uranium requirements from (more expensive) US production as a matter of "national security".

Over in Spain, the government has agreed to consider a conditional extension of the operating lives of the Almaraz plant units 1 and 2 until 2027-28. The country's oldest nuclear plants were to be the first to close down under the government's nuclear phase-out policy that would see seven rectors shut by 2035. Nuclear currently supplies 20% of Spain's electricity.

Spain nevertheless holds a general election next month.

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

The Short Report

Guide:

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

Please take note of the Important Information provided at the end of this report. Percentage 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 March 21, 2019

Last week saw the ASX200 grafting back to 6200 before rolling back over again.

The table below shows a lot more red than green, suggesting the shorters are building positions once again as the "slowing global growth" story gains traction. Two big moves in shorts stand out from last week, but they are so big as to bring into question whether they are real or simply ASIC data blips.

Nufarm ((NUF)) shorts rose to 11.8% from 7.6% and Perpetual ((PPT)) shorts rose to 10.1% from 5.5%.

Other than to note wealth management peer IOOF Holdings ((IFL)) is sitting at 9.1% shorted, no news out of Perpetual recently suggests that move is questionable. The share price of Perpetual recently spiked on buying by a global dividend oriented ETF and the AFR reported Regal Funds Management has used the event to go short its fellow fund manager.

Nufarm's move is justifiable, but I have added it to Movers & Shakers below with a grain of salt. We might also note popular fruit & veggie grower Costa Group ((CGC)) has appeared at the bottom end of the table, so "agri" is a target in the current (literal) climate.

Last week I highlighted CSR ((CSR)) shorts had risen to 7.6% from 5.9%. Now they're at 9.4%. It would seem the announced intention to sell its glass business has provided the impetus, when selling the underperformer should actually be positive. The company is also undertaking a buyback, which should deter shorters. No obvious reason here.

Weekly short positions as a percentage of market cap:

10%+ ING 17.5 SYR 17.5 GXY 16.3 JBH 15.9 NXT 12.7 ORE 12.3 NUF 11.8 MTS 11.6 BWX 11.5 BAL 10.7 SDA 10.7 PPT 10.1 MYR 10.1

In: NUF, PPT

9.0-9.9

IVC, DMP, SUL, CSR, IFL, PLS

In: SUL, CSR 8.0-8.9%

HVN, HUB, BKL, BOQ, LYC, AMC

In: HUB, AMC

7.0-7.9%

SGM, RWC, AMP, KGN

In: KGN Out: NUF, CSR, HUB, AMC , MSB

6.0-6.9%

BIN, BEN, MSB, DHG, BGA

In: MSB, BGA Out: KGN, CCP, CGF

5.0-5.9%

CCP, RSG, APT, KDR, CGF, WSA, HT1, GMA, RIO, CGC, CAR

In: CCP, CGF, RIO, CGC Out: PPT, BGA, MLX, NSR, ARB Movers & Shakers

Shares in agricultural chemicals company Nufarm have lost half their value since May last year as drought has lingered in the east of Australia and offshore assets have not provided the offset. Adding to uncertainty is a US lawsuit against weed-killer glyphosate, which is a primary Nufarm product.

That fall in share price led brokers to believe risks were priced in, until last week when the company issued its earnings result that was broadly as expected but also downgraded guidance and suspended its dividend. The share price fell -24% on the day.

Seven FNArena database brokers cover the stock and of those, six have Buy ratings, believing the sell-off to be an overreaction. A jump to 11.8% shorted from 7.6% might suggest the shorters are tipping that a suspension of the dividend, as the drought lingers on, is a step towards an inevitable capital raising.

Except that Nufarm only recently raised capital. Or it could be an ASIC data blip. We'll revisit next week.?

ASX20 Short Positions (%)

Code Last Week Week Before Code Last Week Week Before AMC 8.0 7.6 RIO 5.2 4.8 ANZ 1.5 1.6 S32 1.0 0.9 BHP 4.0 4.0 SCP 1.0 0.8 BXB 0.5 0.4 SUN 0.6 0.8 CBA 2.3 2.2 TCL 1.9 1.5 COL 2.2 2.2 TLS 0.8 0.9 CSL 0.3 0.3 WBC 2.0 2.0 IAG 0.6 0.6 WES 2.1 1.9 MQG 0.4 0.5 WOW 2.7 2.8 NAB 0.9 1.7 WPL 0.7 0.6 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: US Homes, Oz Migrants & Platforms

Weekly Broker Wrap: US housing; Australian immigration; discretionary retailers; and platforms.

-Mismatch in housing supply and demand developing, as US population becomes younger -Australian migration levels need to be monitored, as reduced migration may impact demand -Slowing fund flows across platforms heightens competition -Specialist fund platforms continue to gain market share

By Eva Brocklehurst

US Housing

The percentage of youth in the US population is increasing rapidly and by 2034 those born between 1997 and 2012 will become the country's largest cohort, at around 78m. To Morgan Stanley this implies a brighter long-term outlook for the US versus other G10 economies and is likely to shape housing consumption trends.

The broker's analysis of census data shows labour force growth will trend upwards from the 2020s and trend consumption growth should rise to 2.5% in the 2030s, from around 1.7% in 2018. Housing demand, which the broker suggests should remain healthy, is likely to sustain rises in house prices and rents, although the younger generations are more likely to rent than the baby boomers of the past.

While expecting these young generations will fuel a 7% increase in demand, this is insufficient to overcome the 43% increase in housing supply expected as ageing baby boomers return existing stock to the market. The vast majority of this supply of housing is from owner-occupiers, who will use home equity as a primary source of value to fund seniors housing.

However, new generation demand is being more skewed towards apartments. The broker envisages net demand of 6.7m for rental units over the next 10 years in the US, 22% above the long-term average.

Another trend Morgan Stanley notes is online "iBuying" businesses being built by companies such as Zillow, aiming to acquire, fix and re-sell homes quickly and take advantage of changing consumer behaviour in the US housing market.

US online real estate penetration remains the second lowest category, only ahead of grocery, because of the size, infrequency and complexity of home buying and the high value placed on real estate agents' local knowledge and expertise.

Morgan Stanley expects the iBuying model will gain traction but online adoption will stay relatively low. Still the size of the US residential real estate market means that even a low 3% penetration implies iBuyers would purchase around 175,000 homes in 2030.

Australian Immigration

Immigration to Australia and the growth it engenders has become a hot policy topic, Morgan Stanley asserts. The government has announced a reduction in the permanent migration visa quota to 160,000 annually, from 190,000, over the next four years.

Morgan Stanley does not expect a short-term impact but believes net migration still needs to be managed, given the strong support for growth and employment the channel provides. That said, the drop in permanent migration has masked a substantial acceleration in the number of temporary visas being issued, which will keep annual net migration elevated.

A slowdown of 50,000 in net migration would reduce GDP by -0.2 percentage points, the broker calculates, all else being equal. It is also important for housing demand and, on Morgan Stanley's estimates, the excess supply of new houses will narrow in 2020. If migration slows this will put further pressure on house prices. Moreover, given the infrastructure activity, the emergence of skill shortages with any decline in migration will need to be monitored.

Discretionary Retailers

Macquarie highlights stocks that could benefit if some pre-election assistance to households was provided in the 2019 Commonwealth budget. Historically, a boost in household income has meant an uplift in sales for discretionary retailers. Australian consumers are currently experiencing falling house prices, anaemic wage growth and pressures on cost of living.

Macquarie believes any fiscal assistance would be good news for the PE multiples of stocks such as JB Hi-Fi ((JBH)), Harvey Norman ((HVN)) and Domino's Pizza ((DMP)). While not expecting the hand-out provided in the 2009 budget, the broker believes this gave an indication of how consumers may spend a small increase in income.

Clothing, footwear, department stores and recreational goods saw a noticeable boost after the stimulus. This indicates obvious upside for Myer ((MYR)), Kmart and Target ((WES)), Big W ((WOW)) and potentially Bunnings (WES) and JB Hi-Fi. In 2004 there was a more modest example of household assistance, and footwear and recreational goods stood out as beneficiaries. Home goods and liquor stores also showed a noticeable uplift.

Platforms

Following several years of strong growth, funds under management on platforms declined -1% in 2018. Annual net inflows in 2018 were down around -80%. Flows into superannuation products were also weaker than flows into investment products.

Citi assesses continued weakness in platform flows is a function of the Hayne Royal Commission and the weakness in capital markets in the December quarter. There is potential for flows to improve now that the Royal Commission has been completed.

Credit Suisse observes large institutional platforms are facing competition on two fronts: industry funds are winning share from retail funds in corporate and default super, while specialist platforms are taking share within the advised market.

The slowing fund flows across the industry will make winning business from competitors even more important. Credit Suisse retains a preference for high-growth platforms such as HUB24 ((HUB)) and Netwealth ((NWL)).

UBS is also cautious about the earnings outlook for traditional platform operators as the cuts to fees echo across the industry. The broker notes, despite a second consecutive quarter of net outflows in December, specialist platform providers were able to capture inflows at the expense of the majors.

The broker points out IOOF ((IFL)), with market share of 6.7%, was the only major provider to grow adviser numbers over the year to date. This indicates a limited impact on the business to date from APRA's (Australian Prudential Regulatory Authority) December regulatory actions.

Citi was also impressed by superannuation flows for IOOF versus the rest of the industry in the December quarter. Retail industry net flows in the second half of 2018 was the worst in more than six years, the broker assesses, likely reflecting the disruption to the advice industry following the Royal Commission.

Yet IOOF defied industry to achieve superannuation net flows of $93m. Meanwhile ANZ Wealth retail net flows were down -$166m in the December quarter. Of the established operators, BT experienced a solid $1.1bn in total retail net flows, including $460m of superannuation flows, with the price reductions in 2018 likely to have helped.

Citi also notes specialists continue to gain share with Praemium ((PPS)) moving to number four in terms of the highest net flows for the December quarter. The broker expects the structural shift will continue and that Netwealth and HUB24 will more than double market share over the next five years.

Citi retains Neutral ratings on the latter two stocks because, although there is upside in market share, there is also downside envisaged for margins. The broker points out the top 10 players obtained $5.6bn of net inflows despite total industry net outflows, showing the extent of the churn of funds within the industry.

Treasure Chest: Class Actions Entice Shine Corporate

FNArena's Treasure Chest reports on money making ideas from stockbrokers and other experts. Acquisitions are key to the growth plans of Shine Corporate, providing more diverse earnings for the lawyer group. Moelis Australia initiates coverage of the stock.

-Share price remains depressed despite improved operating performance -Class actions an increasing component of the business -Johnson & Johnson class action potentially a near-term catalyst

By Eva Brocklehurst

Shine Corporate ((SHJ)) is expanding its legal practice areas to obtain exposure to fast-growing segments such as class actions and family law, which also provide diversity in earnings. Acquisitions form a key part of the company's growth plans.

The stock has sparked interest from Moelis Australia, which initiates coverage with a Buy rating and $0.89 target. The broker notes the company's operating performance has improved since FY16, despite the share price remaining depressed, as management has been intent on stabilising core business.

Class actions, in particular, have increased strongly as a result of royal commissions into such areas as institutional abuse, financial services and aged care. The growth in class actions has been helped by increased adoption of third-party litigation funding.

The legal services industry is fragmented and Moelis believes there will be ample opportunity for Shine Corporate to make accretive acquisitions. The three largest operators are Slater & Gordon ((SGH)) and Maurice Blackburn with Shine Corporate coming in third.

The company has a defensive business in personal injury legals, which has limited exposure to the domestic economy and is characterised by stable growth and lower volatility. This appeals to the broker in the current market environment.

Management has stabilised its core business and delivered two consecutive years of earnings growth, enhancing fee productivity and recoveries from work-in-progress. The broker considers there is further opportunity for improvement. The stock trades at a 6.0x ratio to the broker's FY19 estimates for earnings per share. Moelis believes the Johnson & Johnson class action could be a key short-term catalyst for the stock.

Morgans suspects this particular class action, regarding mesh product liability, will keep investors on the sidelines until it is resolved. The company has not disclosed the work-in-progress build associated with this matter and mediation continues.

Morgans has an Add rating and $1.14 target for Shine and also expects the company will continue to build out a national family law business. Since the first half result, Shine has acquired a majority interest in Carr & Co, a Perth-based family law practice. During the first half the company acquired ACA Lawyers which operates in the class actions segment in NSW. This business is focused on commercial litigation and dispute resolution.

Shine provides legal services in Australasia with a focus on damages-based personal injury litigation, comprising 68% of FY18 revenue. The company has over 50 offices and was founded in 1976 in Toowoomba, Queensland. The stock was listed in 2013 at an IPO of $1.00 a share.

Key class actions currently being undertaken include Johnson & Johnson (mesh product liability), Department of Defence (land contamination), WorleyParsons ((WOR)) (shareholder misconduct) and Westpac Banking Corp ((WBC)) (overcharging on life insurance).

Bonds Are Crying Wolf

In this week's Weekly Insights:

-Bonds Are Crying Wolf -Conviction Calls -CSL Challenge: The Real Challenge Is Inside Us -Have Your Say - The CSL Challenge -Rudi On TV -Rudi On Tour

By Rudi Filapek-Vandyck, Editor FNArena

Bonds Are Crying Wolf

At risk of quoting the wrong investment legend, which is why I am sticking with anonymous, a smart cookie once observed that only after the infamous stock market crash of 1987 did investors the world around start worrying about the potential for a crash.

In similar vein, I'd like to put forward that selling risk assets because you might be worried about the world and the US economy sinking into recession looks well behind the curve at this stage. It is for this reason that commodities and equities sold off in the final four months of calendar 2018.

The world has seen a few dramatic changes since, and this has allowed for a quick V-shaped recovery. The first one is a significant policy change at the Federal Reserve, which not only has abandoned its intention for two more rate hikes medium term, Powell & Co have also decided that balance sheet reduction is no longer of the highest priority.

On top of this, the ECB is essentially back to being ready to re-start Quantitative Easing, while central bankers in New Zealand and Australia are watching further developments very closely in case domestic interest rates might need to be reduced. China already is stimulating its economy. The Japanese have shown no sign of ever quitting their perpetual QE policy.

The chart below has featured prominently in my on-stage presentations to investors this year. It shows why financial markets lost their nerve in the final quarter of calendar 2018; leading indicators for the US and for the global economy kept on weakening, and by the end of the year they were accelerating into negative territory.

The chart above shows one leading indicator for the US economy, but the situation was similar for the global economy as a whole.

There is an important similarity with two prior periods when leading indicators fell below the zero/neutral line. In early 2016 an imminent crisis was averted after the Federal Reserve, back then chaired by Janet Yellen, communicated to the market it would take a much more patient approach in normalising the cash rate back to neutral.

Back in 2011-2012 the crisis was all about Greece, and debt, and potential disintegration of the eurozone and it wasn't until Mario Draghi, president of the ECB, declared on July 26, 2012 he would do "whatever it takes" that worst case scenarios got buried and forgotten about.

Most importantly, and as shown on the graphic above, in each case economies recovered and so did risk assets. Until central bankers started "normalising" again, which in modern times means they reduced the virtual printing of money and even dared to start shrinking their bloated balance sheets.

Nobody really knows for how long this process can continue without creating the next financial crisis, if that is the inevitable end result of all this central banking Houdini-magic. But the impartial observation is that it has worked on both prior occasions, and it is likely to exert its magic again this time around.

The leading indicator that is shown on the graph above as falling steeply has already tentatively reversed course, posting a small rise in January. This, all else remaining equal, should in a while from now show up via improving economic data and indicators, feeding into market confidence that, yet again, worst case scenarios have been averted.

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It is generally accepted that bond markets represent more wisdom and gravitas than equity markets where daily sentiment and other factors of lower quality and sustainability can more easily grab the upper hand, certainly in the short term.

There is therefore a general acceptance that if ever a conflicting message is provided by movements in bonds and equities, wise investors take guidance from the former over the latter.

I would fully back up that view. But no market is infallible. And bonds do at times interpret the world incorrectly. This time might be one such example.

Or maybe the bond markets are not wrong, but the humans trying to interpret their message and its consequences are too much relying on the past?

What if bond markets are anticipating more Quantitative Easing from central banks, starting with the ECB in Europe? In that case, bond yields need to go lower, and investors believing a recession is on the horizon might panic out of equities and commodities. But if central bankers succeed in their quest, that will prove to be the wrong decision.

A recent study of bond market behaviour by analysts at Macquarie supports this view. Bond markets, reports Macquarie, in 2011 and 2016 troughed some 3 months later than equity markets, whereas further back into the past, bonds used to lead risk assets, not lag.

The problem post 2011-2012 is, of course, that central banks are very much engaged and actively intervening. It is well possible that, for the time being, bonds have lost their accuracy and their leading role, not to mention their predictive powers. This time around, suggests Macquarie, the observed lag might get even longer as some investors anticipate not only rate cuts but also the return of QE in response to slowing economic growth.

With other indicators such as copper, iron ore, and, yes, global equity markets themselves suggesting things have actually started improving for the global economy, Macquarie analysts firmly suggest this time around investors should back those indicators instead of bonds.

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None of the above means equity markets can never ever experience another sell off or meltdown. The last near abyss experience only ended less than four months ago. But it does appear that fears for the next recession are both late and premature.

The one scenario I am most worried about is that central bankers' race to the bottom might somehow feed into a much stronger US dollar, and this almost by definition will trigger money outflows for commodities, emerging markets and likely US equities as well.

Central bankers might feel like they're acting as the proverbial cavalry storming over the hill whenever things get hairy in the real world, but they do not meticulously control everything under all circumstances.

And yes, QE really has put those central bankers in a situation from which there simply is no easy escape. But that's a narrative for another time.

P.S. buy gold if you are really worried the end of this monetary experiment is nigh, and it won't be pretty.

P.P.S. Yield is in, not out. (But be wary of shopping mall owning REITs - see Premier Investments last week).

Conviction Calls

Morgan Stanley strategists have reiterated their view the Australian economy is due for a much longer slowdown than currently is being forecast by market consensus and the Reserve Bank of Australia.

With the Federal election and government budget upcoming, including hand-outs from a government keen to use all options to possibly avoid getting voted out, the RBA is likely to wait and see, and therefore poised to come to the stimulus party too late later in the year and in 2020.

The result is that earnings growth for corporate Australia will remain under pressure for longer. Morgan Stanley's modeling suggests investors should prepare for continued downward pressure as far out as late 2020, with possibility of a true blue earnings recession along the way.

The strategists have pulled back their year-end target for the ASX200 to 5800 from 6000. Industrials ex-financials with a domestic focus in particular have been singled out as the most likely victims on the Australian share market.

Morgan Stanley advises investors should remain focused on owning defensive industrials, preferably with an offshore bias, and resources stocks. The latter because the strategists continue to put their faith in the effectiveness of more China stimulus. Most preferred defensive industrials include healthcare stocks and insurers.

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Stockbroker Baillieu (it's not clear what their exact name is these days) has used the February reporting season to put forward a number of Top Stock Picks in the small and mid-cap segment of the Australian share market.

Among the suggestions made are Village Roadshow ((VRL)) and Galaxy Resources ((GXY)), both essentially being selected on the basis of "the future can only look better", but also EML Payments ((EML)) and MNF Group ((MNF)).

Amongst all the excitement regarding Afterpay Touch ((APT)), Zip Co ((Z1P)) and Splitit ((SPT)), investors might have missed the new contract wins at online loyalty programs and payments facilitator EML Payments, which should translate into hefty growth numbers for the years ahead.

EML Payments mainly serves customers in the wagering and salary packaging industries, with locally William Hill using its infrastructure to facilitate bets and payments by and to Australian punters. Baillieu thinks the onus is to the upside in terms of growth. It rates the stock Buy with a price target of $2.40.

MNF Group already enjoys a small army of loyal shareholders among small cap specialists, including formerly Contango now Naos Asset Management, so Baillieu analyst Luke Macnab is certainly not alone with his lofty expectations.

Describing MNF as "effectively the fifth telco of Australia", Baillieu finds MNF is best aligned with the rapid digitisation of telco services both domestically and abroad. MNF predominantly provides wholesale services to other telcos and to businesses across Australia with its cloud based virtual switchboard a cheaper and more efficient solution for many.

The company bought its nearest competitor last year (wholesale operations from Inabox Group ((IAB)) and the synergies to be achieved should underpin the tech-telco's strong growth profile in the years ahead. Recurring revenues are increasinly becoming a dominant feature.

Baillieu has a Buy rating for MNF, with a price target of $5.43.

CSL Challenge: The Real Challenge Is Inside Us

Two weeks ago, for my regular appearance on the free-to-air Finance TV channel now known as Your Money (formerly Sky News Business), I got teamed up with Mark Moreland from Team Invest.

Mark and I usually engage in friendly and sarcastic banter, both knowing we agree on many things about investing and the share market, but there is lots we will disagree on into eternity.

At one point during the broadcast Mark confessed he once upon a time owned shares in CSL ((CSL)), but then he sold out when the share price had reached $55, and subsequently never managed to get back on board.

I am not having a go specifically at Mark (I am sure he has many more profitable examples of investments made) but I instantly understood this is a prime example as to why investing in the share market is so much of a personal journey.

I have little doubt Mark believed at that time CSL shares had become too expensive, and they were poised for a fall too big to continue holding them in his portfolio. Instead, as we know now, CSL shares multiplied by a factor 4x over the subsequent five years.

The point I think is worth highlighting here is how our human mind works, creating barriers that become mountains we are unable to overcome. Having sold at $55, Mark could have bought back in at $70, or at $92. He could have re-joined at $140, or even at $178. But he never did, and two weeks ago he blamed himself for it.

Selling CSL shares at $55 was a bad decision, even though Mark had made a profit. Never getting back in was even worse a decision.

For investors, Mark's story serves as a reminder of how we build pivot points in our mind, which become barriers, and we get sucked into the short term myopia, telling ourselves we should be focusing on the long term, but we are obsessed with the here and now, which impacts on our vision and the investment decisions we make.

The other point to make is that short term Price Earnings (PE) multiples, or other forms of valuation measurements, can be quite deceiving for the simple fact they are short term. I note similar dynamics have kept investors at bay for high quality, robust growth stories including Altium ((ALU)), TechnologyOne ((TNE)), NextDC ((NXT)), Xero ((XRO)), and Aristocrat Leisure ((ALL)), to name but a few names on my own radar.

It's worth pointing out that while most research and analysis focuses on macro, trends, valuations, forecasts, et cetera the real enemy is hiding mostly inside us, not inside day to day share market volatility. It's there that the real challenge lies.

Have Your Say - The CSL Challenge

It's probably one of my key achievements since starting FNArena in 2002; to get investors interested in owning shares in CSL ((CSL)) and similar robust, high quality, sustainable growth stories, in defiance of general perception that stocks trading on a high PE multiple can never be owned but for a short term momentum play.

Over the years I have received many supportive emails and vocal encouragement from FNArena subscribers and investors elsewhere. At the end of last week's presentation to ASA members in Sydney, one elderly investor approached me with the words "CSL is such a wonderful company, why would you ever sell it?"

I think time has arrived we started sharing some of those stories with investors who are new to the CSL Challenge. From investors to investors. I am hereby asking those who own CSL shares to write down their motivation, memories, experiences, et cetera in order to share them with other investors.

Make it as detailed/generalised and as long/short as you like. Send it to info@fnarena.com, preferably with reference "CSL Challenge".

You don't have to do it completely pro bono. An innocent hand at the FNArena office will pick at random three contributions that will receive one bottle of wine each. To be eligible, make sure you also indicate whether you prefer red, white or rose. We'll pick one winner for each choice.

I'd say we close this invitation by April 15th, but let's not procrastinate too long. Get onto it right away! We take care of the wine selection.

Rudi On TV

My weekly appearance on Your Money is now on Mondays, midday-2pm.

Rudi On Tour In 2019

-ASA Melbourne, May 1 -ASA Toowoomba, Qld, May 20 -U3A Investor Group Toowoomba, Qld, May 22 -AIA Adelaide, SA, June 11 -AIA National Conference, Gold Coast, Qld, 28-31 July -AIA and ASA, Perth, WA, October 1

(This story was written on Tuesday 26th March 2019. It was published on the day in the form of an email to paying subscribers, and will be again on Thursday as a story on the website).

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