Week
# 29

# Stories To Read From FNArena
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# Whitehaven Poised To Leverage Coal Price

Despite the complexities in coal pricing most brokers believe Whitehaven Coal is well-placed to leverage the price tension.

-Both challenges and catalysts ahead in FY18 -Whitehaven switching some coking coal to thermal to optimise margins -Cash to asset ratio could improve in the next 12 months

By Eva Brocklehurst

Whitehaven Coal's ((WHC)) June quarter production update highlighted several important considerations for FY18. Firstly, another change out of the Narrabri longwall is expected in the third and fourth quarters and, Macquarie notes, given the challenges in installing the first 400m longwall, there is a further risk for production numbers.

The company slightly missed its FY17 production target of 21-22mt, delivering 20.8mt. FY17 unit costs were $2/t above FY16. Another challenge is that the company signalled Maules Creek would not have its next production increase until FY19, forecasting 10.5mt run-of-mine for FY18.

Regardless, the primary drivers of Morgan Stanley's positive view remain intact. The cost profile is adjusted and the broker carries some higher costs into the forward years, with the impact being a -5% reduction in forecasts for earnings per share.

Having made the adjustments, Morgan Stanley believes it is important not to lose focus on the volume growth, product mix and the price realisation the company has achieved.

The broker expects $340m to be added to the cash position in FY17, taking net debt down to $290m and gearing to 8%. Morgan Stanley forecasts 22% production growth from FY17-19, which stands out in an industry that is largely ex growth.

Volume will be complemented by the ratio of metallurgical coal rising to 33% from 23%, the broker calculates and, combined with an gradual increase in realised prices for thermal coal, Whitehaven should generate strong free cash flow even as coal prices fall.

Metallurgical Versus Thermal

The metallurgical coal mix improved to 25% in the June quarter, from 22%, despite some tonnage being sold as thermal to optimise margins. The realised thermal coal price improved again, to 4% over the index price.

Macquarie asserts pricing is more complex than it first appears. The result highlighted an important consideration in the semi-soft market: that the company is switching some Maules Creek production to thermal from semi-soft. This signals broader concerns for FY18 and beyond.

The company sold metallurgical coal for around US$106/t, continuing the discount at around -14% for the quarter and close to the FY17 average discount of around -17%.

Commentary regarding switching to thermal coal at Maules Creek, which even with a 9% premium still receives a lower realised price than the company's metallurgical coal price, implies for Macquarie that semi-soft sales may not achieve the pricing and volume expectations in the future.

Sales fell short of Morgans expectations but high inventories suggest the slippage can be recovered. The broker also points to the complications in the realisation of semi-soft prices, which came in around -US$7-8/t below forecasts.

Morgans expects the variance between benchmark and index-linked/spot sales for metallurgical coal should narrow, making price realisation less volatile, and the increasing volume of Maules Creek semi-soft being directed to contract pricing should also help.

All up, brokers conclude that the changing environment for metallurgical coal makes it difficult for producers and investors alike to read the signs.

Following the update, Morgans trims FY18 production assumptions and downgrades FY17-19 forecasts. The impact on valuation is offset by a lift in the long-term assumptions for metallurgical coal to US$110/t.

Morgans also expects a reduction in net debt following the substantial free cash flow being generated over the last 18 months and highlights the fact the company is one of the few listed pure coal players that is able to leverage ongoing price tension.

Size, high cash margins and the potential to pay dividends should drive interest from investors looking for default resources exposure in a market that lacks quality mid cap stocks, Morgans believes. As the stock is trading close to valuation, the broker maintains a Hold rating.

Shaw and Partners had been concerned for some time that the FY17 consensus expectations were too high and further trims its estimates by -2%.

Vickery

The Vickery project's environmental impact statement should be submitted in the September quarter and this should allow talks on a joint venture to proceed.

Shaw and Partners notes the “healthy” level of inbound interest in the project and would be pleased if the company surprised with a large joint venture divestment payment, such as a 30% sell-down.

The broker, not one of the eight monitored daily on the FNArena database, acknowledges the coal price has caught a tailwind recently but considers the dynamic is more one-off and cyclical rather than medium-term and structural. Shaw retains a Sell rating and $2.40 target.

The Vickery mine will not start up before Maules Creek is running at 13mtpa, in FY20 on Morgan Stanley's estimates, but a joint venture could be established in 2018. Morgan Stanley only attributes $150m in value to Vickery but suspects it could be worth over $1bn once it is operational.

Morgan Stanley assumes the company will not pay a dividend until FY19. The broker acknowledges the stock screens poorly on dividend yield and the total cash to assets ratio in quantitative models but suggests both these could improve in the next 12 months.

There are four Buy, three Hold and one Sell (Macquarie) on FNArena's database. The consensus target is $3.09, suggesting 8.3% upside to the last share price. Targets range from $2.70 (Macquarie) to $3.60 (Morgan Stanley).

See also, Can Whitehaven Sustain Higher Prices? on April 19, 2017.

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# Opportunity Knocks In Retail A-REITs

Several factors are behind the underperformance of A-REITs but brokers are discounting many of them and suggest the sector presents some opportunities.

-Retail A-REITs may offer better value amid limited downside -Vicinity Centres and Scentre Group considered oversold -Australian landlords seen well positioned to cope with increasing online sales

By Eva Brocklehurst

On a macro level the recent sell-off has created some opportunities in the A-REIT sector. Macquarie reinstates an outperform stance, observing A-REITs sold off materially as global increases in bond yields were factored in.

The broker observes the distribution yield spread to bonds remains attractive at 270 basis points and, assuming this spread normalises to the long-term average of 195 basis points by keeping the bond yield static, this will equate to around a 20% top-down total shareholder return.

Macquarie cannot envisage how the US Federal Reserve will continue to tighten rates without dislocating financial markets and at the same time maintain a 2.3% long-term US bond yield forecast. The broker expects the sector's performance will remain correlated with changes in the 10-year bond.

Retail

The perceived structural and cyclical factors which have caused the retail A-REITs to underperform in the year to date include the pending arrival of Amazon, slowing retail sales and the high household leverage that affects discretionary expenditure.

CLSA argues that, while the pull-back across the the sector makes office names more attractive, the retail A-REITs offer much better value amid limited downside. While office will have stronger reversionary rental growth than retail over the next three years this appears to be priced in, in the broker's view.

There is less volatility in earnings from the likes of retail A-REITs such as Scentre Group ((SCG)) and Vicinity Centres ((VCX)) and distribution yields are also more sustainable. CLSA's preferred exposure is Scentre Group, suggesting it remains the highest quality retail A-REIT, offering a maintainable 5.3% distribution yield and growth rate of 4.2% over two years for earnings per share.

Meanwhile, Vicinity Centres has done a good job in the broker's opinion in realising around $50m of synergies and divesting around $1.5bn in assets post its merger. Vicinity Centres trades on a -5.5% discount to its December 2016 net tangible assets and, with gearing of 24%, CLSA expects a buy-back will be announced.

The broker is also of the view that the company should consider selling off around $1bn in lower quality assets that could be used for capital management. CLSA, not one of the eight stockbrokers monitored daily on the FNArena database, has a Buy rating on Scentre Group with a $4.92 target and an Outperform rating on Vicinity Centres with a $2.82 target.

UBS upgrades Scentre Group, GPT ((GPT)) and Vicinity Centres to Buy from Neutral on valuation grounds, after considering the Amazon threat in more detail and believing this is now priced into the stocks.

The broker considers Scentre Group and Vicinity Centres oversold on the Amazon threat and now present strong value. At the same time the market has become too negative on GPT's retail portfolio and the company's premium Sydney/Melbourne office portfolio is considered the best way to gain exposure.

UBS believes the concerns over the online threats are overplayed for the retail A-REITs after taking into account the shopping centre landscape in Australia. Australian landlords are envisaged well-positioned to compete, considering retail space per capita, favourable demographics population densities and the mix of tenants/sales.

With the introduction of Amazon the broker anticipates online sales penetration to increase to 19% from 11% (ex food) by FY23. The broker estimates the retail A-REITs are trading on a 6.0% cap rate, which compares with the December

2016 stated weighted average rate of 5.3%.

On an annual rolling basis retail A-REITs have underperformed the sector by around -26% and valuation metrics suggests the risks are now priced in. Those A-REITs UBS suggests are most exposed if Amazon takes share from bricks & mortar retailers include Scentre Group, while GPT and Stockland ((SGP)) rank lowest.

Another retail tenant is added to Macquarie's watch list for retail A-REITs, food. These tenants appear to operate on very low margins and increased competition from the continued rolling out of food tenancies into malls is eroding returns, leading to lower rents.

When the food category is added to Macquarie's prior analysis of shopping centre tenants, around 44% of a shopping centre income is at risk. For example, a -10% reduction in income from these categories over time would result in up to a -4% headwind for those under coverage. Macquarie emphasises that this is material, as most retail A-REITs are growing income at around 2%.

Furthermore, the top five shopping centres for each A-REIT are generally 37-73% of the retail portfolio value and this warrants ongoing attention. These particular centres are typically higher growth and/or in more affluent catchments.

Macquarie also observes that retail A-REITs will keep pushing for higher densities. Vicinity Centres, in particular, has excess car space versus other A-REITs, equating to around $0.14 per share of potential value.

Macquarie concludes that, while retail has been a problematic segment this year, as sales have slowed over the past 12 months and stress levels on the tenant base are increasing, a lot has now been factored in.

Residential

Macquarie also updates the outlook for residential A-REITs and shifts to a more cautious stance, factoring in a greater cost of credit and the relative difficulty in accessing credit, particularly for the investor segment of the market. Macquarie prefers Queensland and Victoria going forward because of positive interstate migration.

On in individual basis, reflecting the recent sell-off to levels suggesting a more attractive total shareholder return, Macquarie has upgraded Dexus Property ((DXS)), GPT and Vicinity to Outperform from Neutral and Scentre Group and Westfield ((WFD)) to Outperform from Underperform.

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# NextDC Entangled In Push On Data Centre

Brokers are concerned that data centre operator NextDC may be distracted by the recent corporate activity that is besetting data centre owner, Asia-Pacific Data Centre.

-Strategic stake to be used to vote against 360 Capital resolution to install its own nominee -360 Capital wants to pursue other avenues in the data centre space and distribute additional capital, raising debt levels -Demand for data centre services seen dominated by large cloud-computing providers with substantial bargaining power

By Eva Brocklehurst

What is happening with Asia Pacific Data Centre ((AJD))? Brokers suspect the management of NextDC ((NXT)) may now be distracted by recent corporate activity involving AJD and 360 Capital ((TGP)).

NextDC has made a strategic investment in Asia Pacific Data Centre, to be used to vote against a resolution by 360 Capital to remove the responsible entity and install its own nominee.

NextDC believes retaining the existing structure and an independent board is in the best interests of security holders. The company acquired a 14.1% stake in Asia-Pacific Data Centre for $29m and has stated it does not intend to control the data centre, or acquire the underlying assets, but will review its strategy if required.

360 Capital requires 50.1% of the vote at the extraordinary general meeting next week to successfully remove the current responsible entity. Macquarie notes proxy advisory group ISS has told AJD investors to reject the 360 Capital proposal, citing corporate governance concerns.

Asia-Pacific Data Centre is NextDC's landlord for three data centres, Sydney, Melbourne and Perth, and 360 Capital acquired a 19.8% stake on May 2 for $36m, requesting a seat on the board which was rejected.

NextDC's reasoning regarding the acquisition will be crucial to its ability to win over the remaining eligible shareholders at the vote, Moelis contends. Should NextDC be unable to block 360 Capital's change of management and responsible entity, the next move to protect its strategic interest will be anxiously awaited, as NextDC is the sole tenant of the data centres.

In Deutsche Bank's view the strategic investment is an attempt to preserve the current landlord/tenant relationship and prevent a more aggressive entrant into the Australian data centre industry, which may compete for assets in the future.

The investment underscores a potential risk to the company's longer-dated returns profile, the broker believes, given the capital that is looking to enter the industry. Deutsche Bank envisages limited financial risk with the strategic stake and an aggressive response to a potentially less rational competitor could reduce the threat of new data centre entrants going forward.

Citi suspects the reasons behind the acquisition are to ensure that the landlord of the company's three assets is aligned with NextDC's best interests. The broker envisages limited upside from deploying this capital to acquire a non-blocking stake and does not rule out a move to acquire the underlying assets of Asia-Pacific Data Centre.

An activist external manager, were 360 Capital to be successful, raises corporate governance issues, in Macquarie's opinion. This is underscored by the stated intention of 360 Capital to distribute additional capital to security holders by increasing debt levels and pursuing other opportunities in the data centre space.

Macquarie envisages the latter could reduce the quality of the asset portfolio but believes the risk to the leases is relatively low, and any share price weakness in NextDC is a buying opportunity.

UBS notes Asia-Pacific Data Centre's board has had confidential approaches from third parties expressing interest. The board is progressing the discussions to determine whether a proposal will be put to shareholders. The broker points out that NextDC has right of first refusal over the data centres.

The initial lease agreement between NextDC and Asia Pacific Data Centre was 15 years, starting in December 2012, with two 10-year option periods followed by 15-year option period. Rent is adjusted annually for CPI and a market rent

review is conducted every five years determined in agreement between the two parties.

Asia-Pacific Data Centre assets was spun out of NextDC in 2013, with the group's sole assets being the first Melbourne Sydney and Perth data centres in which NextDC is the single tenant.

FY18 Outlook

CLSA suspects, if NextDC decides to acquire the assets, that it will likely be funded by an equity raising. At present, the company has minimal debt capacity and the broker believes it unlikely it will tap the debt markets again. CLSA, not one of the eight stockbrokers monitored daily on the database, has a price target of $4.25 and downgrades the stock to Underperform from Buy.

Moelis reduces its rating to Hold with a $4.85 target. The broker, also not one of the eight, is cautious about FY18 estimates and the uncertainty regarding the acquisition of the stake.

The caution around FY18 consensus estimates stems from the potential for negative operating earnings (EBITDA) contributions from the three new centres that are ramping up, as well as higher electricity prices affecting the second half of FY18.

Moelis believes in the NextDC investment proposition over the medium term and considers the business on track to becoming a materially larger company, with excellent data centre locations and generating attractive returns on capital.

Demand for data centre services remain strong but CLSA suspects it will be dominated by hyper-scale cloud computing providers that have substantial bargaining power. The company is building three new data centres in Brisbane, Melbourne and Sydney and the broker believes these second-generation centres will now be ready later than previously anticipated.

The broker was quite discouraged by a recent visit to the Melbourne site, given the progress. Annualised revenue per megawatt is reduced by -1-2% per annum relative to the broker's previous forecasts.

While demand is not considered an issue the average revenue per megawatt of capacity is likely to come down, CLSA believes. In addition, competition is increasing with AirTrunk coming online in August/September and Equinix and Metronode both expanding existing facilities.

There are six Buy ratings on the FNArena database. The consensus target is $4.83, suggesting 15.0% upside to the last share price.

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# Strong Balance Sheet Underpins South32

South32 missed expectations on several fronts in its June quarter but continues to screen well for brokers on current multiples, underpinned by a strong balance sheet.

-Downgrades to production guidance considered likely in FY18 -Main challenges at Illawarra and Cannington -Free cash flow remains healthy and prospects exist for further returns

By Eva Brocklehurst

South32 ((S32)) missed expectations on several fronts in its June quarter but continues to screen well for most brokers on current multiples, underpinned by a strong balance sheet.

Only two assets out of seven hit full year guidance. Full year production misses occurred versus Credit Suisse estimates at Worsley, South African thermal coal, Illawarra, Australian manganese and Cannington. Meanwhile, the Cerro Matoso and Brazil alumina beat expectations.

The broker suspects there is a risk to current FY18 guidance for both South African thermal coal and Cannington, but awaits the August results for more visibility.

Cannington, GEMCO (manganese), South African coal and Worsley missed Deutsche Bank's expectations and further downgrades to guidance are considered likely in FY18, as Illawarra, Cannington and South African coal are still experiencing problems with operations.

Production Challenges

The most challenged operation is considered to be Illawarra metallurgical coal where a longwall move has been extended by four days and ramp up is slower because of challenging roof conditions.

Deutsche Bank notes the company has a tendency to guide towards stretch targets and expects that production will still fall short of revised guidance at Appin (Illawarra coal).

The broker expects the current outage at Appin will continue for at least another six weeks. Revised FY18 guidance is expected at the August results.

Macquarie was disappointed by the production miss at Cannington and downgrades silver, lead and zinc production forecasts for FY18 by -20-35% to account for the lost crusher availability.

The broker notes FY18 has become an increasingly important year of transition for Cannington, which represents around 25% of group net present value.

Earnings Outlook

Meanwhile, realised pricing for manganese and metallurgical (coking) coal was better-than-expected and this leads Deutsche Bank to upgrade FY17 earnings estimates by 7%, despite the weaker production.

FY18 earnings estimates are reduced by -16% on the expected lower production and higher costs emanating from Cannington and Illawarra.

Citi downgrades to Neutral from Buy, driven by downgrades to FY18 earnings forecasts, given lower production and revisions to its commodity and FX estimates.

The broker observes the operational challenges that affected the company in FY17 have continued into FY18. Coupled with a bearish outlook for coal, this means Citi prefers Rio Tinto ((RIO)) as its diversified miner pick.

Citi has downgraded coal, nickel and silver prices but upgraded aluminium prices and incorporates a stronger Australian dollar and South African rand in its forecasts. Nevertheless, the broker still envisages the company will generate healthy free cash flow.

Credit Suisse retains an Outperform rating but concedes it difficult to find a near-term positive catalyst. In lieu of material M&A there is more capacity to return capital to shareholders and the broker understands there may be a reasonable floor under the share price.

UBS also notes, with a targeted net cash ceiling of US$500m, further returns could be contemplated. UBS forecasts a final dividend of US5.3c per share based on a 40% pay-out ratio. There is a possibility this could be partly franked but the broker would prefer to see franking returned as it is generated.

Macquarie estimates the company has ample balance-sheet capacity to either double the size of the current share buy-back or upgrade its dividend. The broker estimates net cash increased by around US$65m in the quarter. During the quarter the company completed US$211m of its US$500m buy-back.

In the absence of in FY18 guidance up date, Ord Minnett believes Illawarra and Cannington asset to have a difficult year and, as a result, lowers earnings forecasts. The broker acknowledges the concerns regarding operations that overhang the stock but continues to believe these are non-structural.

Ord Minnett maintains a Buy rating and $3.00 target based on solid valuation metrics, a strong balance sheet and the exposure to Chinese aluminium supply reforms.

There are five Buy ratings on FNArena's database and three Hold. The consensus target is $2.98, suggesting 9.0% upside to the last share price. Targets range from $2.60 (Deutsche Bank) to $3.40 (Morgan Stanley, yet to comment on the update).

See also, Appin To Drag On South32 on July 11 2017.

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# Material Matters: Iron Ore, Aluminium & Coal

A glance through the latest expert views and predictions about commodities. Iron ore; aluminium; nickel; and thermal coal.

-Iron ore prices expected to go higher to incentivise more mine re-starts -Capacity reductions in aluminium in China an unknown quantity -Earnings upgrade potential for major aluminium players could be significant -Macquarie expects modest price recovery for nickel beyond the September quarter -China seen limiting imports of thermal coal

By Eva Brocklehurst

Iron Ore

Citi observes most of China's small domestic iron ore mines have not executed proper mine planning during the boom years, while development expenditure has declined significantly for iron ore over the last couple of years. As a result, the broker suspects it will take some time for iron ore mine operating rates to go back to the levels of previous years.

The current mine operating rate of 66% was last sustained when iron ore prices were close to US$70/t. Hence, Citi believes, even after a rebound to US$65/t, iron ore should go higher to incentivise more re-starts from current levels.

The broker also notes that while China is one of the top three iron ore producing countries in the world, its production is fragmented and there is no visibility on the cost structure of the mines as few of them are publicly-listed entities.

As a result, the broker uses mine operating levels at different price points to get a sense of the supply elasticity. Overlaying China's domestic mine operating rates on the seaborne iron ore price, it is evident to Citi that Chinese domestic production has followed seaborne iron ore prices with 1-2 month lag.

Aluminium

Capacity reductions for aluminium in China are starting to increase. So far, Macquarie notes 340,000tpa of capacity reductions among smelters located in Shandong and Xinjiang, with another 2.58mtpa under the risk of closure. The broker suspects more than 65% of identified illegal capacity in the two provinces may be closed over the next couple of months.

For the fourth quarter, after assessing the overlap with the winter curtailment policy, Macquarie believes production rates may come down further, to 33-34mtpa, leaving full year Chinese production at around 35mt.

In Morgan Stanley's opinion, a large part of the confusion for aluminium-focused investors regarding smelter capacity reforms is that the story keeps changing. Much of the targeted capacity has only been recently identified and the Chinese government is still negotiating with industry on a reform strategy.

The broker is reluctant to simply include capacity reductions that were unidentified in the first place. If all illegal capacity is closed it has no impact on the broker's forecasts since it is not included in the outlook. For now, Morgan Stanley adopts government estimates that suggest 9.7% of China's 44mtpa capacity is "illegal". The Ministry of Industry and Information Technology estimates total permitted smelting capacity in China is 39.5mtpa.

Separately, Morgan Stanley still expects China to enforce at least a 1mtpa reduction to output in the northern winter. In 2017-18 the broker does not expect Chinese output will decline significantly. The bull case for aluminium is not based on whether China can substantially cut output, in the broker's opinion, but rather whether medium-term production growth can be eased back at the same time as demand growth of over 4% is maintained.

A potential upgrade to consensus aluminium prices remains a key driver behind Macquarie's positive view on Rio Tinto ((RIO)), South32 ((S32)) and Alumina Ltd ((AWC)). The broker believes the earnings upgrade potential for the three businesses is significant, should the market start to turn more positive and based on the speed of the capacity reductions.

Under a US$1/lb scenario Macquarie's 2018 earnings forecasts for both Rio Tinto and Alumina Ltd would rise 25% and 28% respectively. South32 earnings forecasts would rise 31%. Spot aluminium prices have traded in a range of US85-

90c/lb over the past five months but Macquarie is more bearish. The broker forecasts 2017 and 2018 prices at US87c/lb and US82c/lb respectively.

Nickel

Macquarie observes, for most of the past 18 months, the nickel market has been in deficit, initially supported by booming demand in the stainless steel industry and for nickel in batteries. More recently, the deficit has been based on weakening supply. The main drivers of price since early 2016 have centred on speculation regarding government policy decisions on exports in both the Philippines and Indonesia.

The broker notes second quarter de-stocking appears to have run its course and a massive surge in Chinese stainless steel exports has also cleared inventory. Moreover, rising chrome and stainless prices in July are signalling a strong rebound in Chinese production of stainless steel.

Macquarie expects, because of seasonal weakness and the lagged de-stocking effect, that US and European markets will remain weak until at least September. The resumption of Indonesian exports and fewer mine closures in the Philippines are likely to mean increased supply enters China this year versus last year.

Macquarie's supply/demand outlook signals a 50,000 tonnes deficit in 2017 and a smaller one in 2018, assuming no more mine closures. Non-nickel pig iron production has been very weak so far this year and the broker does not rule out further closures, noting at current prices around 40% of global output is still loss-making.

A number of operations could close in the second half if prices stay at current levels and the broker expects a modest price recovery is likely. Probably beyond the September quarter when ore supply growth could re-accelerate.

Thermal Coal

Credit Suisse observes thermal coal inventory is soft, as China did not stockpile in the spring and instead focused on ensuring mines did not exceed production quotas. Major miners have ceased selling on spot in order to meet contracts, and spot prices have climbed because of the tightness of supply. China remains the driver of seaborne coal prices as it is further price maker and the marginal buyer.

The broker notes traders only buy imports when they are cheap relative to domestic prices. Given the tightness in China's coal supply the broker now expects the Newcastle price will remain above US$80/t for the second half of the year and above US$75/t in the first half of 2018.

Rising spot prices have triggered several reactions from Chinese authorities, Credit Suisse observes. Contracts have been forbidden to be written above RMB570/t and large suppliers are been called on to speed up the release of coal. China's customs authorities have also restricted terminals that can accept coal imports.

Slowing imports is an unusual way to unwind tightness, Credit Suisse asserts, and this suggests authorities may be intent on keeping spot prices out of the power stations, as well as hoping that domestic output will ramp up. Credit Suisse believes hindering imports is likely to extend the duration of higher prices across the second half of this year.

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# Conflicting Signals For Gold

Analysts are modestly upbeat about the price of gold as the world continues to be anxious about growth and geopolitical conflicts.

-Gold price not expected to bounce as another US rate hike expected in 2017 -Yet geopolitical concerns provide support -If US Fed persists with "looking through" low inflation this could add further downside risk

By Eva Brocklehurst

Analysts are mulling the state of play in gold, noting the price has struggled recently and a tight range of US$1200-1300/oz has been traded in 2017 so far. That said, the gold price is up almost 8% in the first half.

A sharp rise in gold imports from India and China in the first half of the year provided some support for the yellow metal, although the World Gold Council predicts some easing in Indian demand because of the launch of a GST in July.

In the midst of this, demand for gold from central banks has been subdued, analysts at National Australia Bank suggest, although Russia's central bank has been steadily increasing its purchases of gold. On the supply side, gold production is expected to ease back in 2017.

In sum, the NAB analysts are mildly optimistic about gold, despite the near-term weakness, believing that the safe-haven status of gold and possible re-emergence of financial market volatility should underpin demand.

They forecast the price of gold to be around US$1235/oz by the end of the year and rise to US$1300/oz by the end of 2018. In order for the gold price to descend to around US$1100/oz and below, the analysts suggest a period of geopolitical and financial calm needs to settle on the globe.

Conversely, a financial shock or geopolitical upset could mean the price surges above US$1400/oz but this, they emphasise, is not the central forecast.

Morgan Stanley has a stable call on gold, which assumes the world remains anxious about global growth, but acknowledges a more hawkish US Federal Reserve could weigh on the short-term price outlook.

The current trend in gold appears to be threatening the floor of this year's trading range. Moreover, the broker does not believe the gold price will bounce, convinced that the US Fed will impose another rate rise this year. Admittedly, this requires the Fed to look through a persistent softening in the US inflation rate.

Morgan Stanley remains a modest bull on gold and acknowledges, compared with the rest of its metal coverage, this is enough to make gold one of its top picks for 2017-18. This outlook is largely based on the view that global growth is unsettled by geopolitical conflicts.

If the US Fed ignores soft inflation and pushes ahead with another rate hike, as well as three more next year (which is Morgan Stanley's house view), then investors may soon regard this as the dominant price driver for gold and not the state of global politics. Hence, the broker incorporates this aspect as the new downside risk for its gold price outlook.

Morgan Stanley also points out that, despite the popular view that US rate hikes weigh on gold prices, the rule does not work in the first 12-18 months of a rate hike cycle. Instead, the gold price typically lifts 10-20%.

Morgan Stanley forecasts a gold price of US$1250/oz in 2017-18, with a flat or benign outlook beyond this time frame. The bearish signals for gold, which the broker advises should be tracked by investors, include a persistent lift in real rates and a decline in non-commercial net positions in the commodity.

Macquarie also suggests the gold price is being affected by the market's belief that central banks are keen to normalise monetary policy. The next event is the European Central Bank meeting and only small changes are expected.

The broker agrees that, while chairman Janet Yellen has hinted that low inflation is becoming more of a worry, the US Fed still appears fairly committed to raising rates again this year.

Among the broker's top picks in Australian gold miners is junior producer Saracen Minerals ((SAR)), which has reaffirmed its potential for meaningful upgrades to mine life and cash flow.

Macquarie notes drilling results at Thunderbox indicate consistent grades with depth that could be conducive to a bulk mining operation below the currently producing open pit.

The broker's top picks among the major producers include Evolution Mining ((EVN)) and OceanaGold ((OGC)). As well as Saracen Minerals in the juniors, Macquarie also includes St Barbara ((SBM)) and Resolute Mining ((RSG)) in its top picks.

Among the developers and explorers the broker highlights Dacian Gold ((DCN)) and Gold Road Resources ((GOR)).

Meanwhile, Macquarie flags Northern Star's ((NST)) underwhelming FY18 guidance. Increased production at Jundee and Kalgoorlie are not covering the notional deferral of production at Tanami and what Macquarie assumes will be a cessation of production at Paulsens in mid FY18.

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# 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 July 10 to Friday July 14, 2017 Total Upgrades: 11 Total Downgrades: 8 Net Ratings Breakdown: Buy 42.36%; Hold 41.42%; Sell 16.22%

The week ending Friday, 14th July 2017 saw stockbrokers issuing more upgrades than downgrades for investment recommendations on individual ASX-listed entities; finally!

FNArena registered 11 upgrades versus eight downgrades. Most downgrades stopped at Neutral. Receiving upgrades were a mix of regional banks, bond proxies, industrials and one gold miner. Downgrades were predominantly issued on appreciating share prices.

Total Buy and equivalent ratings for the eight stockbrokers monitored daily still exceeds total Hold/Neutral ratings; 42.36% versus 41.42%. Historically, this tends to signal a tougher time for the local share market. The one exception was in late 2016 when the Trump-inspired reflation trade lifted banks and resources stocks, but most of that has come unstuck since and reflation 2.0 isn't genuinely taking off in 2017, at least not thus far.

Positive amendments to valuations and price targets remain low, with rising phoenix Flight Centre taking the crown for the week enjoying a 5% increase, but there's little else with Seven West Media coming second with a gain of 1.6%.

Again, the numbers look larger on the negative side with Michael Hill's consensus target suffering -6.6%, followed by Platinum Asset Management taking a hit of -3.29%, while Incitec Pivot's hit stopped at -1.33%.

Origin Energy enjoyed the largest increase to profit forecasts (+12%), beating Perseus Mining (+5.9%) and Nine Entertainment (+2.86%). On the negative side, Mount Gibson's consensus forecasts fell -58%, followed by Michael Hill (-11.6%) and Whitehaven Coal (-6.22%).

Analysts are now starting to look forward towards the upcoming local reporting season. Thus far, earnings estimates have been declining but otherwise the confession season has remained remarkably silent.

Upgrade

THE A2 MILK COMPANY LIMITED ((A2M)) Upgrade to Buy from Hold by Deutsche Bank .B/H/S: 2/2/0

Deutsche Bank analysts have dug deep into what makes a2 Milk tick, and what should potentially still lay ahead. The end result is they have "materially" increased their revenue growth outlook. This has pushed up the price target to NZ$5 (up 52% from prior target).

The broker's optimism is partially based upon the observation that brand interest in key end market China remains strong and the fact it remains materially higher than key brand peers Wyeth and FrieslandCampina.

In addition, states the broker, there's ongoing support from macro factors such as the relaxation of China's single child policy. Upgrade to Buy from Hold.

AGL ENERGY LIMITED ((AGL)) Upgrade to Neutral from Underperform by Macquarie .B/H/S: 3/3/1

The recent fall in AGL's share price, following underlying electricity forward pricing, has taken the stock back to meet Macquarie's valuation. Hence the broker has upgraded to Neutral.

Macquarie notes a lack of wind has impacted on AGL's renewable generation and forced the company to source higher priced gas energy. While this will drag on earnings, the offset is better pricing outcomes from electricity generation on normalised volumes.

Target rises to $24.50 from $24.30.

ASTRO JAPAN PROPERTY TRUST ((AJA)) Upgrade to Buy from Hold by Ord Minnett .B/H/S: 1/0/0

It's a two-step upgrade from Ord Minnett on the back of the broker's observation the transaction market has strengthened in Japan, resulting in yields firming marginally over the past six months for the type of assets Astra Japan Property Group owns.

Ord Minnett has pushed up FY18 realisable NTA estimate to $7.20 (up 7% from $6.75 prior). FY18 DPS forecast moves higher by 2% to $0.47. The latter is linked to AJA’s recent shopping centre acquisitions, explains the broker.

BENDIGO AND ADELAIDE BANK LIMITED ((BEN)) Upgrade to Neutral from Underperform by Macquarie .B/H/S: 0/3/3

Given regional banks have a greater proportional exposure to mortgages in their lending than the majors and are not subject to the government levy, Macquarie calculates the belated move to reprice investor/interest-only mortgages will provide a significant near term earnings tailwind.

To that end the broker upgrades Bendelaide to Neutral. Target rises to $11.50 from $11.00.

BANK OF QUEENSLAND LIMITED ((BOQ)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 2/5/1

Given regional banks have a greater proportional exposure to mortgages in their lending than the majors and are not subject to the government levy, Macquarie calculates the belated move to reprice investor/interest-only mortgages will provide a significant near term earnings tailwind.

To that end the broker upgrades Bank of Qld to Outperform. Target unchanged at $12.50.

BT INVESTMENT MANAGEMENT LIMITED ((BTT)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 2/3/1

BT saw 3.1% funds inflows in June for 9.4% year on year, exceeding Macquarie's 5% plus performance benchmark. The manager's new strategies are approaching a three-year track record and funds are attracting new flows and generating performance fees.

BT's share price is nevertheless down -16% since the May numbers with the index down only -3%, making the fund manager attractively priced in Macquarie's view. Upgrade to Outperform. Target rises to $12.05 from $11.70.

CHARTER HALL RETAIL REIT ((CQR)) Upgrade to Neutral from Underperform by Credit Suisse .B/H/S: 0/5/1

Charter Hall Retail is scheduled to report FY17 numbers on August 15. Credit Suisse is anticipating funds from operations (FFO) of $124.2m (30.6cps), 0.6% above guidance of 30.4cps and 0.6% higher than FY16.

The analysts do highlight they continue to view earnings guidance for zero growth as conservative in the context of the quantum of asset sales executed to date. For FY18, the broker has penciled in 31.9c while suggesting a buy-back at current levels looks attractive.

Combining all of the above, and recent share price weakness, the decision was made to upgrade to Neutral from Underperform. Rolling forward the modeling has resulted in the target price increasing to $4.13 from $4.00.

FLIGHT CENTRE LIMITED ((FLT)) Upgrade to Buy from Hold by Ord Minnett .B/H/S: 1/3/4

Ord Minnett has changed its Flight Centre analyst, resulting in an upgrade to Buy and a target price increase to $48.17 from $31.06.

Flight Centre has benefitted from the growth in outbound travel over the last ten years but suffered more recently from falling international air fares, the new analyst notes.

Fares are now stabilising and a management review should lead to cost reductions. An improved earnings outlook drives the upgrade, with the company now expecting a result towards the top end of the guidance range.

INCITEC PIVOT LIMITED ((IPL)) Upgrade to Buy from Neutral by UBS .B/H/S: 4/2/2

Incitec Pivot has spent some $2bn since 2010 on its Moranbah and Louisiana ammonia plants and the cash flow from these investments is expected to flow from FY18, UBS notes. But fertiliser prices have been weak as new supply has entered the market.

The market has adjusted for low prices but the broker expects a through-the-cycle recovery from FY18. A bottoming in prices and the market's under-appreciation of Incitec's planned cost controls leads UBS to upgrade to Buy on an unchanged $4.00 target.

NORTHERN STAR RESOURCES LTD ((NST)) Upgrade to Hold from Sell by Deutsche Bank .B/H/S: 0/4/2

Northern Star's June Q production came in 25% ahead of Deutsche Bank thanks to an excellent quarter at Jundee featuring a 50% grade increase. The FY17 result will come in at the top end of guidance.

The broker believes a more muted FY18 guidance range is conservative given a number of short term catalysts ahead, such as the Kalgoorlie plant extension study and reserve upgrade. The company's August strategy day awaits. A target increase to $4.40 from $4.30 prompts an upgrade to Hold.

See also NST downgrade.

SHOPPING CENTRES AUSTRALASIA PROPERTY GROUP ((SCP)) Upgrade to Neutral from Underperform by Credit Suisse .B/H/S: 0/3/3

Shopping Centres has a track record of outperforming guidance and Credit Suisse believes FY17 might prove another case, given recent transactional activity and the later than expected launch of the second SURF fund. Solid growth in Woolworths ((WOW)) sales augur well for the landlord but specialty sales growth may prove a drag.

Ahead of the result next month, the broker has lifted forecasts to above consensus and raised its target to $2.18 from $2.04, prompting an upgrade to Neutral.

Downgrade

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

The company's market update revealed operating dynamics have improved significantly towards the end of FY17, with Morgans pointing out operational profit (EBIT) is now expected to come in at the top-end of guidance range, adding [this is] "an outcome that looked highly unlikely six months ago".

New price target of $1.35 compares with $1.20 prior but given the share price has moved significantly higher already, the rating has been pulled back to Hold from Add.

The analysts do expect gross margin to be pressured towards the bottom of management's guidance, with the added observation the company will now be cycling a period of poor execution last year. Management's focus is now seen shifting towards further cost productivity tailwinds.

BELLAMY'S AUSTRALIA LIMITED ((BAL)) Downgrade to Sell from Neutral by Citi .B/H/S: 0/1/2

Fresh upon the announcement of the $28.5m acquisition of the Camperdown cannery, the company received news from Chinese authorities the Camperdown license had been suspended. The cockroach theory remains in full force.

Citi analysts state it appears Bellamy's cannot catch a break these days. They see alternatives and options for management, but in the short term the mood is expected to turn sour. Downgrade to Sell from Neutral. Target falls to $5.63 from $5.75.

Other challenges that yet need to be dealt with include escalating organic supply costs, excess inventory and reliance on the daigou, state the analysts. They observe the share price has rallied 64% since late March. Small adjustments have been made to forecasts.

MAGELLAN FINANCIAL GROUP LIMITED ((MFG)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 0/6/0

Fund underperformance in June has led to lower funds under management and lower performance fees for Magellan than Macquarie had expected. The broker has subsequently cut earnings forecasts by -8% and -3% in FY17-18 and cut its target to $26.37 from $26.63.

Given Magellan shares have substantially outperformed the index since May, Macquarie downgrades to Neutral.

MICHAEL HILL INTERNATIONAL LIMITED ((MHJ)) Downgrade to Hold from Add by Morgans .B/H/S: 2/1/0

Michael Hill's FY17 sales grew 6% thanks to an improvement in the June quarter, led by A&NZ and Canada. The US and Emma & Roe continue to provide a meaningful earnings drag, Morgans notes.

Because of material losses in these businesses, the broker needs to see a change in management strategy before it can recommend the stock to investors. As the stock is trading in line with the sector average PE, Morgans pulls back to Hold. Target falls to $1.32 from $1.53.

NORTHERN STAR RESOURCES LTD ((NST)) Downgrade to Neutral from Buy by Citi .B/H/S: 0/4/2

Northern Star's June Q production beat Citi's forecast by 19% and costs by 4%, with Jundee driving outperformance. FY18 guidance is in line with expectation as Kalgoorlie and Jundee grow while the focus at Paulsens shifts to exploration.

Citi expects positive news and a reserve upgrade at the August strategy update but believes the good news is priced in for now. Downgrade to Neutral. Target rises to $5.10 from $4.85.

See also NST upgrade.

NAVITAS LIMITED ((NVT)) Downgrade to Neutral from Buy by UBS .B/H/S: 1/3/1

UBS continues to like the longer term structural thematic that supports the outlook for a company like Navitas; it's all about increasing wealth in developing countries driving demand for education services within developed countries.

Plus the risk for Navitas losing another contract like Macquarie or Curtin within the Australian operations is lower than the analysts thought previously. Nevertheless, UBS sees headwinds on the horizon for FY18, and that's why the rating has been pulled back to Neutral from Buy.

Estimates have been lifted, but even so the forecast remains for a minor -3% EPS decline in FY18. This makes the current share price less attractive after recent appreciation. Target lifts to $5 from $4.50.

PLATINUM ASSET MANAGEMENT LIMITED ((PTM)) Downgrade to Underperform from Neutral by Macquarie .B/H/S: 0/0/4

Platinum's international fund has outperformed over 12 months and represents 43% of funds under management. Macquarie notes, while the Asia fund (18%) continues to underperform. Despite international outperformance, Platinum saw net FUM outflows of -7% in June.

Given the drag of outflows, the broker has cut forecast earnings and its target to $3.88 from $4.43, and downgraded to Underperform.

ROYAL WOLF HOLDINGS LIMITED ((RWH)) Downgrade to Hold from Accumulate by Ord Minnett .B/H/S: 0/4/0

Royal Wolf's major shareholder, GFN Asia Pacific, has launched a full takeover at $1.83 which the board has recommended. GFN is already on that board given 51% ownership.

For that reason, and given there is no domestic competitor with enough scale to acquire the company, Ords does not see another bid emerging. Target raised to $1.80 from $1.70 and as the market has already caught up, rating dropped to Hold.

Total Recommendations Recommendation Changes

Broker Recommendation Breakup

Broker Rating Order Company New Rating Old Rating Broker Upgrade 1 AGL ENERGY LIMITED Neutral Sell Macquarie 2 ASTRO JAPAN PROPERTY TRUST Buy Neutral Ord Minnett 3 BANK OF QUEENSLAND LIMITED Buy Neutral Macquarie 4 BENDIGO AND ADELAIDE BANK LIMITED Neutral Sell Macquarie 5 BT INVESTMENT MANAGEMENT LIMITED Buy Neutral Macquarie 6 CHARTER HALL RETAIL REIT Neutral Sell Credit Suisse 7 FLIGHT CENTRE LIMITED Buy Neutral Ord Minnett 8

INCITEC PIVOT LIMITED Buy Neutral UBS 9 NORTHERN STAR RESOURCES LTD Neutral Sell Deutsche Bank 10 SHOPPING CENTRES AUSTRALASIA PROPERTY GROUP Neutral Sell Credit Suisse 11 THE A2 MILK COMPANY LIMITED Buy Neutral Deutsche Bank Downgrade 12 ADAIRS LIMITED Neutral Buy Morgans 13 BELLAMY'S AUSTRALIA LIMITED Sell Neutral Citi 14 MAGELLAN FINANCIAL GROUP LIMITED Neutral Buy Macquarie 15 MICHAEL HILL INTERNATIONAL LIMITED Neutral Buy Morgans 16 NAVITAS LIMITED Neutral Buy UBS 17 NORTHERN STAR RESOURCES LTD Neutral Buy Citi 18 PLATINUM ASSET MANAGEMENT LIMITED Sell Neutral Macquarie 19 ROYAL WOLF HOLDINGS LIMITED Neutral Buy Ord Minnett Recommendation Positive Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 A2M THE A2 MILK COMPANY LIMITED 50.0% 25.0% 25.0% 4 2 SCP SHOPPING CENTRES AUSTRALASIA PROPERTY GROUP -50.0% -67.0% 17.0% 6 3 AGL AGL ENERGY LIMITED 21.0% 7.0% 14.0% 7 4 BEN BENDIGO AND ADELAIDE BANK LIMITED -50.0% -64.0% 14.0% 7 5 FLT FLIGHT CENTRE LIMITED -38.0% -50.0% 12.0% 8 6 IPL INCITEC PIVOT LIMITED 25.0% 13.0% 12.0% 8 7 SWM SEVEN WEST MEDIA LIMITED -20.0% -25.0% 5.0% 5 8 CQR CHARTER HALL RETAIL REIT -17.0% -20.0% 3.0% 6 Negative Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 BAL BELLAMY'S AUSTRALIA LIMITED -67.0% -33.0% -34.0% 3 2 MHJ MICHAEL HILL INTERNATIONAL LIMITED 67.0% 100.0% -33.0% 3 3 PTM PLATINUM ASSET MANAGEMENT LIMITED -100.0% -75.0% -25.0% 4 4 NUF NUFARM LIMITED 14.0% 17.0% -3.0% 7 Target Price Positive Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 FLT FLIGHT CENTRE LIMITED 38.160 36.021 5.94% 8 2 SWM SEVEN WEST MEDIA LIMITED 0.762 0.750 1.60% 5 3 SCP SHOPPING CENTRES AUSTRALASIA PROPERTY GROUP 2.207 2.183 1.10% 6 4 BEN BENDIGO AND ADELAIDE BANK LIMITED 11.121 11.007 1.04% 7 Negative Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 MHJ MICHAEL HILL INTERNATIONAL LIMITED 1.480 1.585 -6.62% 3 2 PTM PLATINUM ASSET MANAGEMENT LIMITED 4.060 4.198 -3.29% 4 3 IPL INCITEC PIVOT LIMITED 3.699 3.749 -1.33% 8 4 BAL BELLAMY'S AUSTRALIA LIMITED 5.117 5.157 -0.78% 3 5 AGL AGL ENERGY LIMITED 27.044 27.230 -0.68% 7 Earning Forecast Positive Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 ORG ORIGIN ENERGY LIMITED 17.573 15.583 12.77% 7 2 PRU PERSEUS MINING LIMITED -3.047 -3.238 5.90% 5 3 NEC NINE ENTERTAINMENT CO. HOLDINGS LIMITED 13.437 13.063 2.86% 5 4 NST NORTHERN STAR RESOURCES LTD 33.300 32.386 2.82% 6 5 APE AP EAGERS LIMITED 49.595 48.720 1.80% 4 6 FLT FLIGHT CENTRE LIMITED 225.888 223.113 1.24% 8 7 SRX SIRTEX MEDICAL LIMITED 82.000 81.000 1.23% 3 8 RSG RESOLUTE MINING LIMITED 23.000 22.733 1.17% 3 9 SCP SHOPPING CENTRES AUSTRALASIA PROPERTY GROUP 14.817 14.650 1.14% 6 10 IGO INDEPENDENCE GROUP NL 7.868 7.785 1.07% 6 Negative Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 MGX MOUNT GIBSON IRON LIMITED 1.700 4.100 -58.54% 3 2 MHJ MICHAEL HILL INTERNATIONAL LIMITED 7.913 8.951 -11.60% 3 3 WHC WHITEHAVEN COAL LIMITED 38.638 41.200 -6.22% 8 4 OZL OZ MINERALS LIMITED 50.496 53.246 -5.16% 8 5 TLS TELSTRA CORPORATION LIMITED 30.879 31.616 -2.33% 8 6 RIO RIO TINTO LIMITED 643.577 658.901 -2.33% 8 7 FMG FORTESCUE METALS GROUP LTD 98.648 100.991 -2.32% 8 8 IPL INCITEC PIVOT LIMITED 19.035 19.460 -2.18% 8 9 SFR SANDFIRE RESOURCES NL 54.224 55.349 -2.03% 8 10 BHP BHP BILLITON LIMITED 191.725 195.257 -1.81% 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: Up By The Stairs

The spot uranium price rose for a seventh consecutive week last week but again only incrementally.

By Greg Peel

Industry consultant TradeTech's weekly spot price indicator rose US10c to US$20.35/lb last week to mark the seventh consecutive weekly gain. It all sounds very exciting until one considers the seven week rally amounts to only a 4.3% increase in price. Last Friday night nickel rose 4% in the session.

The spot price did trade as high as US$20.50/lb during the week before buyers again became reluctant to pay up. Five transactions totalling 800,000lbs U3O8 equivalent were concluded. Utilities did feature on the buy side, along with traders.

Late last year the spot uranium market appeared to have reawakened as prices rose quickly from a multi-year low to US$26.50/lb by mid-February. Despite seven weeks of uninterrupted rally, US$26.50/lb seems a very long way off.

The Demand Side

Uncertainty reigns on the demand side of the market at present. The new South Korean president's administrative order that nuclear reactor construction be halted as part of a plan to phase out nuclear power altogether is causing confusion. The suspension period will run for three months in order that a public debate may be held.

Last week Korea Hydro & Nuclear power decided to suspend the construction of two new plants but not to abandon the projects altogether. Rather, the time will be used to conduct inspections, service equipment and so forth, at an estimated cost of US$88m. If a public debate is not held within the three months, KHNP will reconsider its position.

Meanwhile the new French government has set a target of reducing nuclear power in France's energy mix to 50% by 2025. France's state-owned generator operates 58 reactors in the country and may have to close as many as 17. However the exact number is not clear as the government is yet to develop a full climate plan.

Politics has become a major issue for the global nuclear industry, both negatively and positively. The construction of nuclear reactors and the development of uranium mines takes longer than the average democratic government term. Will presidents Moon Jae-in and Macron be ousted at the next election and replaced by a party with pro-nuclear policies?

The issue has arisen recently in Australia, where the conservative party won government in the state of Western Australia and overturned the longstanding ban on uranium mining that had been supported by the prior Labor government, only to see a Labor government reinstated at the next election and the subsequent reinstatement of the ban. The new government did, nevertheless, exempt four mining projects under development as a result of the previous government's policy.

The Trump Administration is supportive of the US nuclear industry and has pledged funds for technology development and so forth, but power policy lies with the individual states and there uncertainty reigns as to whether legacy reactors will need to be shut down on an economic basis or not. It will come down to the relevant state's energy policy.

And will Trump see another term? Will he see out this one?

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# 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 July 13, 2017

Last week the ASX200 only managed to get as high as 5742 before it again rolled back down to below 5680.

It was another week when very little of note happened in Short Land, and no new themes emerged among movers & shakers.

Last week I noted short positions in Australia's two prominent nickel miners, Western Areas ((WSA)) and Independence Group ((IGO)) typically go up and down with the nickel price – shorts are increased as share prices rise in response and reduced as share prices fall – and last week was a positive one for nickel prices.

Western Areas shorts rose to 16.6% last week from 14.7% although Independence shorts stayed put on 14.9%.

Last week I noted Myer ((MYR)) shorts were on the rise once more. Myer has been in the 10% plus shorted club for eons on the simple theme of department stores being dinosaurs in the face of growth in online shopping, and recent short increases reflect Amazon's coming as further underscoring that theme. But rival David Jones also posted its first full-year sales slump last week since its South African takeover.

The Amazon theme is the same for JB Hi-Fi ((JBH)), which having slowly fallen to the bottom of the table over time is now now back in familiar 10% plus territory. JB's rival is Harvey Norman ((HVN)), which last week saw its shorts jump to 10.5% from 8.7% on no new news.

And that's about it for the week. No Movers & Shakers. We might otherwise note that having snuck into the 5% plus table at the bottom the week before, telco amaysim ((ATS)) last week shifted into the 6% bracket.

And we also acknowledge a new member, in at 5.4% shorted, being National Storage REIT ((NSR)). REITs are not typically a class of stock shorters are interested in.

Weekly short positions as a percentage of market cap:

10%+

SYR 18.1 ORE 17.5 WSA 16.6 MYR 16.0 IGO 15.9 RFG 12.7 ISD 12.2 MTS 12.1 JBH 12.1 AAD 12.0 ACX 11.9 MYX 10.9 DMP 10.9 FLT 10.6 HVN 10.5 SHV 10.2

In: HVN

9.0-9.9%

NEC, GXY No changes

8.0-8.9%

JHC, GTY, AHG, QIN, BKL, HSO, A2M, CTD

Out: HVN

7.0-7.9%

GXL, TPM, PRU, BAP, BEN, NWS

In: PRU, BEN Out: EHE

6.0-6.9%

IPD, RIO, SAR, VOC, NXT, OFX, RWC, BAL, SEK, MND, AYS, OSH

In: NXT, AYS, OSH Out: BEN, PRU, APO, BGA

5.0-5.9%

APO, CSV, VRT, AWC, AWE, AAC, IFL, KAR, NSR, MYO, BGA, DCN, GEM, PPT, RCG

In: APO, BGA, NSR, GEM Out: OSH, AYS, SRX, CCP

Movers and Shakers

See above.

ASX20 Short Positions (%)

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

IMPORTANT INFORMATION ABOUT THIS REPORT

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

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

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

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

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

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

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

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

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# The Wrap: Rates, A-REITs And PNG LNG

Weekly Broker Wrap: RBA cash rates; Amazon & CPI; A-REITs; PNG LNG; Bell Potter initiates on Cyclopharm

-PIMCO does not expect RBA to start hiking rates for at least 6-12 months -The main impact of Amazon likely to be on Australia's CPI -Brokers observe retail A-REIT rental growth turns negative, office on the rise -Goldman Sachs highlights PNG as a key area for cost-competitive LNG growth

By Eva Brocklehurst

Cash Rate

PIMCO stands by its belief that the new neutral in relation to Australia's cash rate is about 3%. Over four years ago (and again this week) the Reserve Bank of Australia explicitly referenced 3.5% as an estimate of the neutral nominal cash rate.

As a result PIMCO expects interest rates will be significantly lower than in other historical cycles. Moreover, Australian households have raised their debt levels since the GFC, taking advantage of lower mortgage rates, and borrowing rates have started to increase for certain cohorts because of regulatory changes.

PIMCO suspects an important inflection point may be approaching. Borrower confidence is dominated by the level of lending rates and recent changes in house prices. PIMCO believes this will limit the flexibility to increase official rates.

Hence, the start of any official rate hike cycle in Australia is not expected to be likely for at least 6-12 months. Global economic dynamics expected to be in place at the time suggest to PIMCO that there will be an increased probability of volatility in economic growth.

The level of the Australian dollar will be key in this scenario. The depreciation of the Australian dollar since 2013 has assisted the economic transition in Australia but PIMCO notes that it it has also appreciated by over 15% since early 2016.

Amazon And CPI

The arrival of Amazon in Australia late in 2018 is expected to challenge many retailers, and may be enough to impact the broader economy, UBS asserts. The main impact is expected to be retail price disinflation.

While there are concerns that this could lead to a slump in retail sales for incumbent retailers and hurt employment, UBS highlights the sector's share of consumption has already declined for decades to a record low. The main impact is expected to be on the CPI.

UBS estimates that each 0.5 percentage points slowing of Australian retail price growth will reduce the CPI by around 0.15 percentage points. Amazon should slow retail prices and online business subtract up to around 0.25 percentage points from the CPI over time.

Moreover, pressure on the retail sector is colliding with an unfolding correction in housing and record low household cash flow. This is expected to limit the Reserve Bank of Australia's willingness to join global central banks with a more hawkish outlook, and UBS suspects it raises the risk of a delay to current estimates for a normalising of rates from late 2018.

A-REITs

After considering the threat from Amazon in more detail, UBS believes the risks to Australian real estate investment trusts are priced in. As a result the broker upgrades Scentre Group ((SCG)), GPT ((GPT)) and Vicinity Centres ((VCX)) to Buy from Neutral on valuation grounds.

The broker believes Australian landlords are well-positioned to compete, considering the retail space per capita, favourable demographics and the evolution of retail assets in Australia.

The broker expects online sales penetration to increase to 19% by FY23 from the current 11%, ex food. Taking into account increased levels of online penetration in a 3% retail sales growth environment, around 1.75% per annum of specialty sales growth is anticipated over the next five years.

In this environment the broker forecasts 1.5-1.7% comparable net operating income growth, versus the current 3%, and suggests this indicates re-leasing spreads of -8-10% by FY20.

Morgan Stanley notes retail rental growth has turned negative, down -4% during the June quarter in regional malls across Sydney and Melbourne, as incentives remain stable at 13% and 5% respectively.

The broker acknowledges the dangers of extrapolating one quarter's data but believes the statistics do seem to support indications of downside risks to landlord income from softening expenditure growth and rising online penetration, which in turn is putting downward pressure on retailer margins and rents.

Reports have suggested that retailers are successfully negotiating lower rents with landlords and this provides evidence for the broker that the balance of power is shifting towards the tenant. Meanwhile, office rents are rising and Melbourne has overtaken Sydney for the strongest rental growth, confirming the broker's preference for office over retail.

Retail A-REITs are becoming increasingly attractive on a relative basis but Morgan Stanley suspects that retail book values understate real capital expenditure, and transactions could become even more limited as potential purchasers reassess post capex returns.

The backdrop is also driving demand for logistics facilities, as retailers try to improve efficiencies, and signals to the broker that underlying retail asset returns could lag both the office and industrial segments for some time.

Goldman Sachs calculates cash yields on premium Sydney and Melbourne CBD assets are in the 3-4% range at current valuations. This is considered precariously close to the cost of new debt, leaving little accretion from acquisitions.

The broker has reviewed the capital growth of office assets against the number of years held and finds the long-term compound growth rate is typically very low, attributed to the fact that large capital expenditure is required to maintain competitive assets over time, and this is typically a sunk cost which maintains rents rather than being valuation accretive.

Goldman Sachs believes the window to capture growth is limited and prefers Mirvac's ((MGR)) developments to create value, versus direct asset purchases and/or waiting for leasing activity to derive better earnings and distribution growth.

PNG LNG

PNG is one of the few areas globally where Goldman Sachs believes LNG exports will be cost competitive with the Henry Hub-linked US LNG price. The broker believes the next phase in PNG may be relatively lower in terms of costs because of brownfield economics.

Moreover, highlands gas tends to be liquids-rich and the government is intent on supporting the gas industry as the economic impact is transforming a largely undeveloped country.

Oil Search ((OSH)) remains a cornerstone player in any PNG expansion, with meaningful stakes in all major provinces. The PNG government is a major shareholder in the company which the broker believes is also key to fast-tracking LNG.

If the market does not recognise this value, Goldman Sachs highlights that the stock ranks the highest in its Asia-Pacific upstream coverage as attractive for merger & acquisition potential. PNG is also the highest quality asset location for Santos ((STO)) and one of two key growth options for the company, the broker notes.

Cyclopharm

Cyclopharm ((CYC)) owns the intellectual property and is the exclusive supplier of a system for functional lung imaging. The technology is primarily used for diagnosis of pulmonary embolism (blood clots) in the lung.

This potentially fatal condition is difficult to diagnose without imaging and the technology, Technegas, meets the need, particularly in patients that are contra-indicated for CT scans.

Bell Potter initiates coverage with a Buy recommendation and valuation of $1.13. Despite consistent revenue and growth in underlying profitability, the company is expected to report an operating loss from FY17-19, after including

the cost of the clinical trial.

The broker notes the company is not a biotechnology stock or drug developer and its status as a medical device company has been well established.

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# Sturdy Lithium Price Bodes Well For Galaxy

Galaxy Resources has fulfilled its legacy 2016 contracts and is set to take advantage of robust lithium prices.

-All volumes going forward to be based on 2017 pricing -Mt Cattlin will need to perform well in second half to achieve guidance -Activities ramping up at Sal de Vida and James Bay

By Eva Brocklehurst

Galaxy Resources ((GXY)) enjoyed a strong finish to the June quarter which brokers believe bodes well for the second half, although overall, production at Mt Cattlin was softer and costs were higher than forecasts.

Citi expects operations to improve in the second half on the back of higher volumes and better prices. June operating performance suggests the second half run rate will be on target, with recovery rates of 61% exceeding 2017 guidance of 50-55% and mill throughput at an annualised 1.6mtpa. Going forward, all volumes are going to be price based on 2017 terms.

The company achieved an average realised price of US$724/dmt over the June quarter, and has announced that all subsequent shipments, having exhausted 2016 legacy contracts, will be based on 2017 pricing terms of US$830/t for 5.5% grade lithium concentrate and US$905/t for 6% grade product. Galaxy completed its 2016 shipment obligations in April, with sales contracted at US$600/t.

The changes in production, costs and realised prices mean Citi lowers 2017 earnings estimates by -20% and lifts 2018 and 2019 by 4% and 11% respectively. The broker also notes spot lithium markets remain robust, driven by strong Chinese demand and a pick up in electric vehicle volumes after a slow start to 2017.

Mt Cattlin will need to perform strongly in the second half to achieve on guidance, Canaccord Genuity suggests, and 2017 production guidance, maintained at 160,000t, now appears a stretch. The broker, not one of the eight monitored daily on the FNArena database, maintains a Buy rating and target of $3.50.

Catalysts

There are several catalysts occurring in the second half, including 2018 offtake agreements, a final investment decision on financing for Sal de Vida and a resource upgrade and feasibility study for James Bay.

Mt Cattlin produced 32,990t spodumene in the June quarter, and now that the first ramp up phase is complete the company will move to plant optimisation and expansion. Macquarie expects this will double production over the next 12-24 months.

Mt Cattlin contributed 11% of Australian spodumene exports in the quarter, and port data reveals exports of concentrate have effectively doubled since April. As a result, the broker expects 2018 earnings will be substantially larger, and a slightly more aggressive assumption for production rates results in an 8% increase to earnings estimates.

Macquarie, retaining an Outperform rating, believes that building on the successfully completed ramp up of Mt Cattlin will be critical to maintaining Galaxy's market share in what is expected to be a rapidly growing Australian supply base.

UBS remains Neutral on the stock. While acknowledging some strong results in the June quarter the broker awaits key catalysts. UBS wants to be more comfortable regarding whether the company can ramp up to full production at Mt Cattlin by 2019 and increase recoveries to 70-75%.

Sal De Vida, James Bay

Activities are ramping up at Sal de Vida and site infrastructure is being established. UBS is prepared to wait for progress on Sal de Vida, in regards to whether the company can secure a joint venture partner or debt funding.

The first two production wells have been completed and the company is refurbishing the test plant and commencing planning for a temporary construction camp. Canaccord Genuity also considers financing and a final investment decision at Sal de Vida a key catalyst for Galaxy.

At James Bay, resource drilling is progressing more rapidly than planned and results to date suggest the potential for a meaningful increase in the resource estimate through both depth and strike.

UBS also awaits the completion of the definitive feasibility study at James Bay to become more confident. Drilling has reached 65% of the target and results are expected in the September quarter.

There are two Buy ratings and one Hold (UBS) on FNArena's database. The consensus target is $2.25, suggesting 25.2% upside to the last share price.

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# Upside For Beach Energy

By Michael Gable

The Australian market continues to trade in a range, mainly pushed around by the banks. As mentioned in last Tuesday's report, and then again in Saturday's Fairfax newspapers where our views were quoted by a journalist, we need to be mindful of this triangular trading range. When the market breaks out of it, a large move normally follows. Beach Energy ((BPT)) looks particularly interesting here at the moment, so take a look at that chart.

We were also going to bring you some further analysis on Programmed Maintenance Services (PRG). After including the chart in last week's report, and noting how close it was to breaking higher, we decided to spend some more time looking at the fundamentals. Unfortunately, a couple of days later it received a takeover bid, at a price more than 60% above where it last traded. Hopefully someone grabbed it anyway off the back of last week's report but we have to admit to not buying it yet - and now its too late. You can't win them all, but you have to be in the game to have a chance. Better luck next time.

The chart for BPT is a textbook example of a stock finding a low and preparing to rally. Firstly, we can see that the stock rallied from about 50c to 90c during September to December last year. The stock needed 3 months to rally 40c, but then in twice that period of time (6 months), it could only dip back to the mid 50c region. So, from a timing point of view, the fact that the stock needed a longer period of time to retest the low and then hold it, is a positive sign. Then in the last couple of weeks, BPT has made a higher high and higher low, with yesterday's move looking particularly bullish. If BPT comes back a few cents here, then that would be a buying opportunity with an initial upside target near 70c.

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# Don't Chase CBA

Bottom Line 20/07/17

Daily Trend: Up Weekly Trend: Up Monthly Trend: Up Support levels: $77.65 - $76.29 / $69.22 Resistance levels: $87.74 / $96.16 / $105.00

Technical Discussion

Commonwealth Bank ((CBA)) is Australia's leading provider of integrated financial services including retail banking, premium banking, business banking, institutional banking, funds management, superannuation, insurance, investment and sharebroking products and services. The Group is one of the largest listed companies on the Australian Securities Exchange. It provides a full range of retail banking services including home loans, credit cards, personal loans, transaction accounts, and demand and term deposits through its Commonwealth Bank and Bankwest brands. The Group has leading domestic market shares in home loans, personal loans, retail deposits and discount stockbroking, and is one of Australia's largest credit card issuers. For the six months ending the 31st of December 2016 interest income decreased 1% to A$16.67B. Net interest income after loan loss provision increased 4% to A$8.14B. Net income applicable to shareholders increased 7% to A$4.9B. Net interest income after loan loss provision reflects the retail banking services section increase of 6% to A$4.23B. Broker/Analyst consensus is a comprehensive "Sell". The dividend yield is currently 5.1%. Reasons to be cautiously optimistic: → Yesterday's announcement by APRA was less severe than originally anticipated. → Major banks should be able to offset the negative impact from the government levy by around 50%. → Regulatory fears eased. → Sold Visa shares which should improve capital ratios. → Trading at around an 8% premium to its peers with 14% being the average. → The recent update showed reduced bad debt and stronger market trading profits. → Improved discipline on mortgage pricing is required. → Healthy dividend around 5%.

The banks got a big boost yesterday when APRA finalised its capital requirements which were better than both the banks and the market expected. Whether this can trigger a more significant rally is a big question although our stance remains firm. There is still upside potential within a bounce although we still can't get overly confident that this latest move higher is the start of a multi-month trend higher. As we've mentioned in recent reviews of the banks and the XXJ, it's the speed of the retracement off the April 28th high that is holding us back. A corrective pattern should not unfold as a straight leg movement, especially at this stage of the trend.

As such, we still must be sceptical regarding the recent rally. In fact, a push back up toward the recent pivot high at $87.74 is about the best we can expect although this would then open the door to see another decent leg down toward the early June lows circa $77.65. This would complete a much more symmetrical corrective pattern and set the stage for the next leg higher within wave-(iii). Taking a step back and looking at the weekly chart reminds us that Commonwealth Bank is the only one of the big four that can still produce a longer term 5-wave movement higher off the 2009 lows. However, having broken through the boundary of a large ascending triangle late last year, it's essential that impulsive price action remains the main theme. That said, this is still more than feasible even if price heads up to the April highs and then rejects - which is still our expectation.

Trading Strategy

We still believe it's best to remain sidelined and out of the banks. We certainly don't want to be chasing price higher on the back of the APRA announcement yesterday. It's obviously had a positive effect but it doesn't automatically mean that lower prices aren't around the corner. There are better trending companies out there at the moment with some of the small to mid-tier stocks breaking higher and getting on with the job. We'll continue to concentrate on those.

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