

Week
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Stories To Read From FNArena

Friday, 11 May 2018

FNArena
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Analysis

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Stemming Cost Growth Critical For NAB

National Australia Bank's weighting towards business banking, versus retail, is expected to remain supportive going forward but brokers note elevated expenditure leaves the bank vulnerable.

-Could be difficult to achieve profit growth in FY18 -Reduced confidence in ability to stem costs growth - Performance of business & private bank critical to growth outlook

By Eva Brocklehurst

Revenue trends are expected to deteriorate for National Australia Bank ((NAB)) in the second half, unless mortgages are re-priced, which Macquarie suggests could be a likely outcome if funding pressures persist.

Management has noted that whilst re-pricing mortgages has been the main driver of higher margins, a shift in mix towards higher-margin, smaller SME customers should mean upside is sustained in the future.

Brokers suspect expenses growth will pick up in the second half and agree, in the short term, this leaves the bank exposed to declining earnings. Nevertheless, business banking operations demonstrated strong growth and a solid outlook in the first half.

Macquarie notes the dividend reinvestment plan discount will be dropped for the first half dividend, suggesting participation is likely to fall to around 10%. The broker also notes asset quality trends remain sound as the credit impairment charge was better-than-expected in the first half, achieved despite improved collective provisions coverage.

Citi was disappointed with the result because revenue growth was lower than expected, and also suggests the restructuring plan has removed the flexibility to adjust costs when revenue growth is lower.

The largest division, around 45% of cash earnings, is business & private banking which offers genuine potential for outperformance, and the broker believes this puts NAB in a better position than its peers.

Citi maintains a Buy rating, even though the relative outperformance makes the stock less compelling than previously. The broker believes lower exposure to retail and institutional banking outweighs the challenges of a large multi-year restructuring plan.

Credit Suisse continues to support the strategy and the bank's willingness to address its cost base over the medium term but has become more cautious on the revenue side.

The broker suspects the inflexible cost base in the short term will mean that near-term earnings are affected before the full benefits of the current strategy are likely to be realised.

UBS also suggests the benefits of the large restructuring plan may be less than the bank anticipates, given the underlying revenue trends.

Expenditure

Ord Minnett shares some investor concerns about the wide target range of 5-8% on underlying costs growth in FY18 yet points out the bank has less exposure to retail banking, which is only around 25% of group profit, and there is potential for margin upside in business banking as well as upside from the divestment of the wealth business.

Macquarie acknowledges the level of the bank's current expenditure is highly elevated, partly as a result of underinvestment, historically, and partly because of a desire to better position for the future. In the short term, brokers agree, this leaves the bank exposed to declining earnings.

Ultimately, Macquarie expects success will be evident beyond 2020 if costs can be contained or improved on in subsequent years. Although there is execution risk, the broker continues to envisage longer-term value in NAB.

Taking a counter stance, Morgan Stanley finds the trading multiple hard to justify and has reduced confidence in the three-year cost guidance. The broker asserts the reinvestment burden, capital position and elevated pay-out ratio leave the bank vulnerable to operating and regulatory challenges.

Cost savings will need to increase and growth in underlying expenses slow for the bank to achieve its guidance for "flat" cost growth in FY19, in the broker's view.

Brokers note the CET1 ratio is at the lower end of the range for the major banks. The CET1 ratio of 10.2% was slightly below Ord Minnett forecasts but NAB is observed to have a path to 10.5% and will be less affected than its peers by the changes by APRA to the capital framework.

The broker envisages the dividend is safe, unless there is a significant change in industry fortunes, while a 7% yield is attractive.

The CET1 ratio also missed Morgan Stanley's forecasts, with the broker believing the optimisation of non-housing risk weightings has come to an end. Meanwhile, future capital generation appears modest given the elevated pay-out ratio.

Admittedly, Morgan Stanley understands there is over \$3bn, or over 75 basis points of capital, in the wealth management business.

MLC

The bank has announced plans to divest its MLC wealth management business (this does not include JB Were or the private bank), either via a de-merger, IPO or trade sale. This is expected to be carried out by the end of 2019. Return on equity is expected to increase subsequently.

However, Citi suggests a de-merger as opposed to a trade sale, is likely to put pressure on the dividend as the bank shrinks its capital and earnings base, again.

FNArena's database shows six Buy ratings and two Sell (Morgan Stanley, UBS). The consensus target is \$31.04, suggesting 7.1% upside to the last share price. Targets range from \$27.10 (Morgan Stanley) to \$33.50 (Morgans, yet to update on the result). The dividend yield on FY18 and FY19 forecasts is 6.8% and 6.7% respectively.

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Diversity Propels Macquarie Group Higher

In FY18 Macquarie Group performed well, again, and brokers agree the business has many levers to engage despite an increasingly challenged environment.

-Business supported by diverse earnings base and expertise in global asset & risk management -Other income and charges remain a significant driver of the current performance -Concerns increased by a large reliance on volatile capital market-facing business

By Eva Brocklehurst

Macquarie Group ((MQG)) surpassed its own guidance in FY18, for the sixth year in a row, as brokers suggest the diversified financial business continues a long-held practice of under-promising and over-delivering.

UBS considers Macquarie as a leveraged play, based on growth in assets under management and higher performance fees, market movements and activity, operating leverage and the Australian dollar.

The broker believes the market will continue to be attracted to the infrastructure management business as well as the operating leverage, and this provides upside that is not considered fully reflected in the share price.

Morgan Stanley envisages more upside than downside risk to FY19 earnings and this is expected to support the share price in the near term. Nevertheless, a P/E ratio of around 14x at this point in the cycle means an Equal-weight rating is the go.

Growth in the net profit contribution from the operating businesses is calculated at around 6% per annum over the past three years but management has not provided guidance for FY19. Morgan Stanley forecasts an ongoing improvement in the contribution from capital markets but a modest decline in annuity-style earnings for the first time since the financial crisis.

Main upside risks include performance fees, infrastructure, gains on sales, the group's compensation ratio and a weaker Australian dollar. Risks on the downside are commodities and global market trading income, and impairments.

Bell Potter, too, remains comfortable with the business, supported by the unmatched expertise in global asset and risk management, as well as the ability to adapt to changing market conditions. The broker not one of the eight stockbrokers monitored daily on the FNArena database, retains a Hold rating with a \$116.50 target.

While there can be some debate about the quality of the earnings, Ord Minnett concedes the group continues to perform well and demonstrate resilience as well as a balance between annuity and market-facing businesses. Nevertheless, the stock appears fair value.

Notwithstanding some compositional weakness, Credit Suisse believes the results should be positively received, given the solid headline, and raises its target to \$115 from \$110, maintaining an Outperform rating. The main risks include a downturn in capital market activities and the emergence of a risk-off environment.

Morgan Stanley suggests lumpy items will remain elevated and gains on sale will be the main cause. An increase in equity investments to around \$6.8bn should provide a healthy pipeline for gains on sales.

If the operating environment remains supportive and company-specific tailwinds continue to drive an upgrade cycle, then Morgan Stanley suggests Macquarie Group could trade towards its bull case of \$125 per share.

Performance Fees

FY18 results benefitted from very strong performance fees, at \$595m, primarily in the first half. Performance fees during FY19 are likely to be sharply lower, hence growth may be more marginal than FY18 levels, but from FY20 onwards UBS expects a bounce, as many of the listed funds reach maturity.

CLSA points out the balance sheet carries significant principle infrastructure investments to seed new funds and this aspect of Macquarie's business is 80% unlisted, while the accounting treatment involves recognition of performance fees back-ended a decade after funds were established. This creates a tail of performance fees which will emerge in coming years.

Infrastructure & Energy Markets

While investors have traditionally viewed Macquarie Group as an investment bank, Morgan Stanley estimates that less than 40% of revenue is sourced from traditional investment banking, funds management and wealth management activities that are exposed to equity and fixed income markets.

Meanwhile, Macquarie Group has established a track record in global expertise in infrastructure and energy markets, including renewables, and is positioned to benefit from structural growth, particularly in Asia.

UBS envisages upside in this area in coming years, provided market conditions remain buoyant. Many of the infrastructure funds were established in the years following the financial crisis with assets that were purchased at attractive levels.

With a dearth of investment opportunities across Australian financials, the broker expects the market to continue supporting Macquarie Group despite its price performance.

Ord Minnett had been hesitant about the outlook for recurring growth as the first half results showed no net flows in investment management, a flat asset finance portfolio and a declining principal finance portfolio.

While these trends have continued, the elevated level of activity in infrastructure and real assets and the mortgage growth in banking and financial services have overshadowed.

Morgans agrees the result highlights the strength of the diversified model, although other income and charges remain a significant driver of the current performance, and also lifts its target to \$115.

While the broker expects the market will accept other income and charges as being a normal part of the business, the sustainability of these items in future is still questionable. Concerns are arguably increased by a larger reliance on capital market-facing businesses in the current result, as all these operations can be volatile.

Other positives include a strong underlying momentum in banking and financial services driven by the growth in Australian mortgages and funds on platform, which both rose 14% over the year.

CLSA notes scope for additional capital management which could continue as infrastructure seed assets and principal investments are realised. The broker, not one of the eight monitored daily on the database, retains a Buy rating and raises its target to \$130 from \$117.

FNArena's database shows three Buy ratings, three Hold and one Sell (Citi, yet to comment fully on the result). The consensus target is \$105.26, suggesting -4.7% downside to the last share price. Targets range from \$79.50 (Citi) to \$117 (UBS). The dividend yield on FY19 and FY20 forecasts is 4.9% and 5.2% respectively.

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Revenue Headwinds Confront Westpac

Westpac's first half results benefited from re-pricing of mortgages, steady provisioning and improved treasury & markets income. Yet the uncertainty emanating from the Royal Commission looms large.

-Challenges exist in the cost base from a lower-growth environment -Potential for further positive contributions from the treasury & market segment -No changes to pay-out ratio or dividends expected until end FY19

By Eva Brocklehurst

Westpac ((WBC)) may have provided a robust first half result compared with its peers but brokers envisage the near-term operating environment will be tough for all banks. Citi described the result as "old school", driven, as it was, by re-pricing benefits from mortgages which led to superior margin management.

Unlike ANZ Bank ((ANZ)) and National Bank ((NAB)) the rhetoric from management was not about transforming the current business structure and operations. Still, Citi believes Westpac faces numerous longer-term challenges, in particular its cost base in a lower-growth environment, as well as managing the decline of retail banking profitability.

The sound first half result prevented Morgan Stanley downgrading FY18 estimates but given the uncertain operating and regulatory environment, the outlook for 2019 is considered clouded because of the end of the mortgage bull market, increasing capital intensity for retail banking and growing scrutiny of conduct.

Morgan Stanley retains an Equal-weight rating given the bank's settled strategy, cost consistency and some relative valuation support and believes Westpac can achieve underlying revenue growth of 4% in FY18, based on the first half margin and better than forecast markets & treasury income.

The impact of higher bank bill rates may be adding to revenue headwinds from front book competition and slowing loan growth. Hence, Morgan Stanley forecasts revenue growth to fall to around 2% in FY19.

Home loan re-pricing may be a source of upside but it could be difficult for the major banks to contemplate this in the near term, given the Royal Commission and other inquiries into the banking sector.

Going forward, CLSA observes Westpac's cost guidance is now the top of the 2-3% range and net interest margin pressures are building. With the Royal Commission likely crimping Australian bank pricing power, the broker suspects offsets from house re-pricing are unlikely.

Macquarie agrees the bank will not be immune from challenging revenue settings across the industry but also envisages scope for mortgage re-pricing. The bank's share of interest-only loans has reduced materially, dropping -6% in the first half to around 40%. Still, this remains 7-14% above peers.

UBS remains concerned about the bank's mortgage serviceability assessment from APRA. The broker believes the bank has further to go in tightening underwriting standards before the concerns of the Royal Commission are addressed.

This is especially the case given concerns about gross household income being overstated across the industry, while the total debt position of customers is not yet fully visible.

Morgans was pleased with the results, particularly as Westpac has not had to top up the \$169m provision for customer remediation that it raised in FY17, and believes this bodes well for the outlook of customer remediation costs. While the sector is subdued the broker expects Westpac to continue to deliver positive "jaws" as a result of its strong focus on cost management.

Net Interest Margin

UBS agrees that, while Westpac has successfully re-priced for higher funding costs in the past, it may be more challenging to justify this in the near term. As a result, the broker expects net interest margins to begin contracting from current levels.

UBS maintains a Sell rating and cautious view and expects housing credit growth to slow, as banks tighten underwriting standards and loans roll forward to principal & interest from interest only.

The highlight for Ord Minnett was the net interest margin, which rose to 2.05%. The broker expects the environment will become tougher because of the pressure on retail margins from loan switching and competition.

While management did a reasonable job defending mortgage standards, the broker doubts this will change the mind of its critics. One of the criticisms is that Westpac lacks cost flexibility, and expenses growth is likely to be stuck in the 2-3% range for some time.

While agreeing Westpac lacks the self-help capability of ANZ the broker envisages upside potential from cost savings once the customer services hub is rolled out, although this is a future story. Ord Minnett considers the share price weakness has more than priced pressures and maintains an Accumulate rating.

Treasury & Markets

Morgans suggests the treasury & markets contribution in the half is not super-normal, rather it is a reversion to more normal levels because the contribution in the second half of FY17 was unusually low.

While the elevated 90-day BBSW-OIS* spread is a concern from a margin perspective, a potential positive is that it may result in improved income from this segment in the second half, as a result of increased customer demand for interest-rate hedging and, potentially, greater trading opportunities.

*Australian bank bill swap rate to the global overnight indexed swap rate

Dividends

Despite the bank carrying \$1.3bn of surplus franking credits, CLSA does not believe Westpac will resume dividend growth before the FY19 final, while special dividends and buybacks are considered unlikely. The broker, not one of the eight stockbrokers monitored daily on the FNArena database, maintains an Underperform rating and reduces the target to \$28.40 from \$32.53.

While the bank could potentially increase pay-out ratios and pay special dividends, UBS also considers this likely only if the tightening of mortgage underwriting standards and the slowdown in credit growth are benign.

Macquarie envisages scope for Westpac to pay a special dividend in FY19, should credit conditions remain benign. The broker has removed the likelihood of a special dividend in the current year but notes that Westpac's approach to capital now appears to be closer aligned to peers, and the impact from the implementation of APRA's final capital rules is likely to be diminished.

FNArena's database shows four Buy ratings, three Hold and one Sell (UBS). The consensus target is \$31.95, signalling 8.6% upside to the last share price. Targets range from \$26.50 (UBS) to \$35.00 (Morgans). The dividend yield on FY18 and FY19 forecasts is 6.4% and 6.6% respectively.

Disclaimer: The writer has shares in the company.

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Work To Do At Orica

Orica sustained a poor performance in the first half, amid production problems at several of its plants. Brokers require progress on the issues into FY19 before becoming more positive.

-Needs to overcome manufacturing challenges before benefiting from improving commodity markets -Reliability of Burrup remains an issue for FY19 -FY19 could be an inflection point, amid a tightening east coast market in Australia

By Eva Brocklehurst

Orica ((ORI)) may have guided to a weak result for the first half but it was worse than many brokers expected. The company sustained a poor manufacturing performance amid production problems at several plants.

The reduction in earnings, operating earnings (EBIT) fell 20% and underlying net profit -37%, reflected unplanned plant maintenance, challenges in the cyanide market, technical issues at Burrup and ongoing losses from Minova.

The company expects to take 2-3 years to sustainably improve manufacturing performance across its global ammonium nitrate network. The focus is on standardising production and more consistent maintenance.

This highlights the challenges Orica needs to overcome before it can benefit from improving commodity markets and the operating conditions its customers are enjoying, Morgans suggests. While volumes are rising, prices have fallen and pressure is not expected to completely dissipate until FY20.

The broker suspects this situation reduces the company's leverage to a recovery compared with past cycles and the results would have been materially weaker had Orica not deferred some of its contract re-negotiations until FY19.

Credit Suisse acknowledges there is not much objective evidence to support expectations of improved execution but, in the near term, additional sustaining capital and a slower rate of cost reductions should relieve some of the pressures on manufacturing.

The broker suggests manufacturing issues over the past several years have likely pushed the cost base and sustaining capital expenditure too low. The company has indicated that the manufacturing aspects of cost reductions will be less as it focuses on improving plant performance.

Ord Minnett also believes there are significant risks surrounding the growth prospects, along with uncertainty about the profit profile of Burrup and the future for Bontang once Burrup ramps up.

Burrup

The performance of Burrup remains uncertain until the heat exchanger equipment is replaced in FY19. Macquarie points out the ownership and operating structure of the joint venture is unwieldy, which does not help.

As recently as the November AGM, Burrup was expected to run at 30-40% utilisation in FY18 before ramping up towards 60-70% by FY19. The March update revealed the heat exchangers were faulty and would result in little output in FY18. Now management expects further delays and guides to low availability in FY19.

Morgan Stanley also assumes that reliability at Burrup remains in question throughout FY19. Regardless, ongoing robust volume growth, and absence of one-off issues indicate earnings should still improve significantly in FY19.

Citi suggests the domestic market will be pushed into oversupply once the Burrup plant is fully operational and the Yarwun operations re-start trains 2 and 3. The broker asserts the stock is trading well above historical levels and remains overbought.

Macquarie agrees the multiples are relatively full and the stock requires delivery of earnings expectations, or upgrades, to substantially re-rate. Reliability of plant remains key to the second half along with an assumption of improved pricing outcomes in Latin America and Europe Middle East Africa (EMEA).

The company delivered \$35m in net savings from its business improvement program and a similar run rate is expected in the second half. Macquarie points out this is less than the previous guidance of \$100m for FY18.

Pricing

The pricing environment in Australia is firming but Macquarie suggests this is occurring mainly in the eastern states, as there was surplus tonnage in Western Australia.

The company believes there should be opportunities to increase Australian ammonium nitrate prices over the next 1-2 years as contracts come up for renewal. Orica also expects lower negative ammonium nitrate price variance this year, the bulk of which relates to Latin America and EMEA, where competition continues.

CLSA is not distracted by the issues with the operations and remains of the view that the outlook is improving, as volumes are starting to rise domestically, while margins should improve in FY19 when production issues are worked through in Western Australia.

The broker believes real leverage for the business will come when prices start to rise on tighter supply/demand. CLSA, not one of the brokers monitored daily on the FNArena database, acknowledges the business has not performed well but believes the cycle has turned. The broker has an Outperform rating and \$20.70 target.

Morgan Stanley is also more optimistic, although requires evidence of improvement in order to realise valuation upside. The broker's positive stance is predicated on the FY19 outlook, expecting this will be an inflection point, and forecasts 26% growth in earnings per share for the year.

Setting aside the previous production issues, Credit Suisse also expects earnings in the second half to be significantly stronger. A tightening market on the east coast of Australia should mean the company grows into the capacity at Yarwun, while Burrup appears to be fully loaded from FY20.

The broker suggests the outlook for North America and Europe is neutral while there is still some downside risk likely in Latin America.

FNArena's database shows one Buy (Morgan Stanley) rating, five Hold and one Sell (Citi). The consensus target is \$18.29, signalling -3.4% downside to the last share price. Targets range from \$16.50 (Citi) to \$20.10 (Morgan Stanley).

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A-REITs Score High On Yield, Certainty

A-REITs outperformed the broader equity market in April and sector earnings growth is expected to accelerate.

-Earnings predictability and attractive yields underpin A-REIT sector
-Stockland and Vicinity Centres seen scoring best on yield and earnings certainty
-Federal budget positive for infrastructure-linked A-REITs

By Eva Brocklehurst

Australian real estate investment trusts (A-REITs) performed well in April and several A-REITs have re-affirmed FY18 guidance, while Vicinity Centres tightened guidance to the top end of its previously stated range.

A-REITs outperformed the broader equity market by 56 basis points during the month, with the index generating a 4.5% total return. Shaw and Partners calculates the sector's forecast total return is now 10.8%, including a yield of 5.1% on an average 82.4% pay-out ratio.

Credit Suisse notes, in its analysis, all stocks advanced in April and Westfield ((WFD)) was the top performer, while Vicinity Centres ((VCX)) lagged slightly. The broker expects sector earnings growth will accelerate in FY18.

Shaw and Partners understands the sector is still underperforming on both a financial and calendar year basis, despite US 10-year bond yields breaking through 3% for the first time since 2014 and an upward shift in the Australian yield curve during the month.

The broker agrees there were no surprises on individual guidance during the March quarter updates. Residential settlement targets have been reconfirmed by both Mirvac ((MGR)) and Stockland ((SGP)) and retail centre disposals achieved premiums to book value. Meanwhile, retail sales growth, while remaining modest, showed signs of improvement from a landlord perspective.

With risks around higher bond yields, Macquarie's core holdings are centred on growth and include Lend Lease ((LLC)), Goodman Group ((GMG)), Charter Hall ((CHC)), and Mirvac. The broker would supplement this with value in retail such as GPT ((GPT)), Scentre Group ((SCG)) and Aventus Retail Property ((AVN)), given the improvement in retail sales in the March quarter.

Shaw and Partners retains Buy ratings on Vicinity Centres, Centuria Capital ((CNI)), Stockland, Centuria Metropolitan REIT ((CMA)), Scentre Group, Mirvac and Lend Lease, although the latter two are looking less compelling as they trade nearer to the target.

The broker has no Sell ratings but concedes Goodman, BWP Group ((BWP)) and National Storage REIT ((NSR)) screen relatively expensive.

Morgan Stanley suggests improving sales growth and premiums on asset sales could support sentiment against a backdrop of negative earnings revisions in the broader market. Stockland's comparable specialty sales growth has improved by the greatest amount and is now second to Mirvac, the broker notes.

Morgan Stanley observes sales are cycling below contracted 4-5% per annum rent increases and this signals ongoing negative re-leasing spreads and moderating comparable net operating income growth, which has, historically, limited the scope for multiple re-rating.

The broker is concerned about the quantum of capital expenditure the retailers and landlords may require to continue driving residual sales at shopping malls.

As several stocks have already downgraded FY18 guidance, Morgan Stanley suggests this could drive a rotation into those A-REITs that have the highest distribution yields and greatest certainty on earnings and balance sheet.

Stockland and Vicinity Centres score best on these metrics. The broker acknowledges defensive rotation could support the sector and create risk to its more cautious view but prefers to own A-REITs which can participate in the upside.

Among large cap retail A-REITs Credit Suisse has an Outperform rating for Stockland, Scentre Group and GPT, which are trading at a discount to net tangible assets.

Although Vicinity Centres offers valuation support at current levels the broker is concerned about slowing asset sales and underperforming assets. Retail sales growth improved in the March quarter and sector turnover rose to 2.4%. In absolute terms Mirvac recorded the strongest growth of 3.5%, although the broker notes it was the only company to decelerate from December to March.

Supermarkets and specialty stores are observed to be growing at a modest pace while discount department stores are showing a turnaround in sales. The decline in growth for department stores appears to be slowing. Vicinity Centres, Stockland and GPT reported higher sales per square metre as of March 2018.

CEO Remuneration

Citi has analysed the CEO remuneration of 12 listed A-REITs within the ASX 200. Incentive structures need to be controlled in terms of remuneration, the broker suggests, given the sensitivity of the sector to the property cycle.

Lengthening the required performance periods is one measure which may improve incentives to successfully navigate the cycle. However, setting hurdles too high could encourage companies to ride out the cycle rather than ensure resilience in the business.

The broker notes Goodman, Mirvac, Charter Hall, GPT and Lend Lease have all re-positioned portfolios in recent years, placing them in a better position relative to A-REITs which have been less active.

2018 Budget

The federal government has maintained its infrastructure focus in the 2018 budget with an infrastructure funding package of \$75bn that includes national strategic roads expenditure of \$3.5bn, as well as state-based projects such as the \$5bn Melbourne Airport rail link.

Macquarie considers this a boost for Lend Lease, which expects an addressable pipeline of around \$35bn per annum in engineering works, of which it could win \$4bn per annum over the medium term. Each additional \$1bn of Australian construction revenue is around 3-4% of group earnings, Macquarie calculates.

The \$20,000 instant asset write off for small business has been extended for a further 12 months and should be a positive for electrical, hardware and office product retailers.

A further 14,000 high-level homecare packages will be delivered for the elderly, which Macquarie suggests is unlikely to address housing affordability issues and may be a net negative for retirement village demand. The flattening of income tax brackets is considered positive for the retail sector.

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Oil Lift Boosts Outlook For WorleyParsons

WorleyParsons has indicated the resources industry has started to recover and expects a fair share of the work as customers reinvest in projects.

-Positive indicators emerging for O&G and resources projects -2018 capital expenditure intentions still more than -40% below 2013 levels -Strong growth in the backlog of work for the sector

By Eva Brocklehurst

The presentation from WorleyParsons ((WOR)) on the work flowing from its major oil & gas and resources customers was upbeat. The company is confident of winning a fair share of the work as the industry recovers.

Global oil & gas capital expenditure budgets were reported to be up 8% in 2018, although the flow to work and actual expenditure will lag. The company is witnessing increased front-end engineering & design (FEED) activity across a broad base and Macquarie suggests this is a positive leading indicator for future expenditure.

The broker believes the market will continue to back the company's recovery prospects, notwithstanding the uncertainty regarding timing. The main news, in Citi's view, was that staff utilisation and employment were up slightly across February-March.

Strategic priorities are now on onshore and offshore O&G and resources infrastructure. Chemicals, minerals & metals, refining and LNG are second order, while there is an increased focus on new energy and digital initiatives.

Citi found the annual investor briefing very useful, with management updating on the dynamics of the resources industry and the capital expenditure trends. WorleyParsons expects increases in global O&G capital expenditure in 2018-19 on the back of modest growth in oil demand.

Credit Suisse, on the other hand, would have preferred more financial data in order to get a better look at how the business is tracking and to underpin the qualitative outlook. The broker acknowledges the message is better than 2017 and higher oil prices are reinforcing capital expenditure plans, although budgets appear largely unchanged.

The company does expect more final investment decisions in FY19-20 to alleviate the expected supply gap in FY21-22. Nevertheless, Credit Suisse points out 2018 capital expenditure intentions are still more than -40% below 2013 levels.

Ord Minnett found increased justification for its positive view as capital expenditure forecasts suggest a marked improvement in the business cycle. The longer-term outlook may be even more positive once exploration & production companies commit to larger-scale growth projects.

Current E&P capital expenditure only reflects increased sustaining expenditure on projects to offset production declines, the broker points out. Management has highlighted that project development of more than 40mbpd will be required by 2040 to offset field decline and LNG demand is expected to catch up with supply by 2020.

Valuation

Macquarie notes the business, as well as its peers, traded at forward PE ratios of around 25-30x during 2007-08, reflecting the last peak in the share market and oil price. This also coincided with very strong growth in the backlog of work for the sector. The broker emphasises the link between PE multiples and growth in the backlog.

WorleyParsons does have a high level of debt amid a generally lower risk profile versus global peers and Macquarie envisages both financial and operating leverage via de-gearing and revenue-driven earnings upside.

Credit Suisse was disappointed that there was no quantification of net debt or gross margin and observes mining appears to be lagging O&G, despite an uptick in feasibility studies and a broad improvement across commodities.

In other news, Macquarie notes there is no material progress on the collection of \$150m in outstanding receivables from state-owned into prices and, as an aside, the corporate backdrop continues to feature Dar Group, which has increased its stake over the last 12 months to 19.9%.

FNArena's database shows five Buy ratings and one Sell (Credit Suisse). The consensus target is \$16.03, suggesting -5.4% in downside to the last share price. Targets range from \$10.50 (Credit Suisse) to \$18.50 (Citi).

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Hard Grind Ahead For AMP

Brokers are finding it hard to incorporate the fallout from the Royal Commission's interrogation of AMP executives, including potential for net outflows, margin squeeze and higher corporate costs.

-AMP Bank the only division reporting growth in the March quarter -Significant downside risks make valuations hard to determine -Margin erosion, fee pressure likely as AMP attempts to retain assets

By Eva Brocklehurst

The way ahead will be long and rough for AMP ((AMP)) as it seeks to restore confidence in its brand. This is the view brokers have taken after the Hayne Royal Commission exposed poor governance and treatment of customers.

Brokers are finding it hard to incorporate the fallout from the RC's interrogation of executives, including potential for net outflows, margin squeeze and higher corporate costs.

As Deutsche Bank asserts, given myriad uncertainties on the regulatory landscape, as well as both strategic and operational uncertainties, caution must prevail despite a compelling fundamental valuation.

Three directors, up for re-election at the recently-held AGM, have stepped down, while David Murray has been appointed chairman on the departure of the previous chairman. The CEO and head counsel have also departed and the company still seeks a new CEO. Brokers expect the portfolio review is unlikely to progress much in the current circumstances.

March quarter

AMP reported a soft first quarter, but brokers consider this largely irrelevant, given the trading relates to the period before the Royal Commission proceedings. AMP has flagged potential for higher customer remediation costs and related expenses plus enhancements to its control and governance systems.

Australian wealth management sustained -\$200m in net outflows with AMP attributing the weakness to reduced activity in superannuation following the changes to contribution caps from July 1, 2017.

AMP Capital net overflows were -\$127m, driven by flows into real estate and infrastructure. The AMP Bank loan book growth of 2% is considered likely to have been above-system growth.

The first quarter update reveals insight into the pre-RC era and, while in theory this should show a healthier organisation, UBS finds little evidence in the cash flows. The broker, the only one with a Sell rating on the FNArena database, points to the outflows in wealth management, with little growth elsewhere. AMP Bank was the only division that reported growth.

Macquarie expects the impact on reputation and the damage to flows stemming from the RC will materialise from the June quarter onwards, and expects little upside for the shares in the near term, downgrading to Neutral.

While recognising the difficulty in quantifying the impact from the RC, the broker increases the expected rate of outflows from the wealth management division. In aggregate, Macquarie forecasts around -\$35m of net outflows between FY18 and FY22.

Bell Potter remains very concerned about the implications and envisages a mass exodus from the company's wealth business. Adviser numbers have declined -30% since the numbers peaked in the first half of 2014.

The decline, in the broker's view, illustrates that the vertically integrated advice model is unattractive to advisers, who have begun to favour greater freedom of product choice and a more independent model.

Bell Potter, not one of the eight monitored daily on the FNArena database, asserts that AMP is an ex-growth company and reiterates a Sell rating and target of \$3.39.

Division Implications

The broker remains particularly concerned about the four divisions which represent over 80% of FY17 earnings. Many of the advisers are likely to leave wealth management and take the business with them, before there is even a chance for AMP to make changes.

The funds management division, AMP Capital, is likely to suffer outflows as the new norm, as some investors look to extract money from all things branded AMP, particularly if advisers leave. In wealth protection, the broker's concerns centre on the ongoing viability of the company's life insurance book.

One client, VicSuper, is already heading for the departure lounge and this will reduce the book by over -20%. The legacy products division is likely to have accelerating outflows, following the 2018 federal budget intent on making it easier to exit without penalty.

Valuation

Morgans is not surprised by expectations customer remediation costs will increase, or the several class actions being filed against AMP. Higher customer remediation costs are not included in its numbers just yet, given the items are difficult to quantify and will go below the line anyway.

The business remains a long-term turnaround story but the broker assesses, on an FY18 PE of 11x, some value can be found.

The main downside risks to its Add rating, Morgans envisages, are unexpected volatility in equity markets, any further downturn in the Australian life insurance market, fee pressure on wealth management and unfavourable regulatory changes affecting superannuation or life insurance.

Credit Suisse agrees the uncertainty and slowing of growth elsewhere makes it hard to quantify the impact on forecasts. On recently lowered forecasts for earnings, the broker calculates AMP is currently trading at a -30% PE discount to the market.

While it is hard to argue this is not justified in the current circumstances, in the longer term, Credit Suisse finds the valuation appealing and maintains an Outperform rating.

Citi considers the issues to be wide ranging and the implications potentially so significant that value is hard to determine. Still, the broker would have to lower assumptions materially to believe the current share price does not represent value.

Therefore, to account for the uncertainty, its target price is set at a significant discount to valuation, which is now calculated on a slightly more conservative basis.

Macquarie expects margin erosion in the near term as fee pressure is likely to intensify when AMP attempts to retain assets under management, and changes are legislated, such as the 3% cap on passive superannuation announced in the federal budget.

While asset sales and the potential for capital returns underpinned Macquarie's previous investment thesis the recent issues have decreased the likelihood of this occurring in the near term.

Ord Minnett anticipates trust will return, in time, as occurred post the problems in 2003. The broker lowers earnings estimates to reflect weak markets, the impact on flows from adverse publicity stemming from the RC and the increased cost of regulation, as well as some further client remediation.

This has led to a -7% decline in FY19 estimates. The broker reduces its target to \$4.84 from \$5.90, factoring in a -15% discount to account for the risk that vertical integration is abolished.

FNArena's database shows three Buy ratings, four Hold and one Sell (UBS). The consensus target is \$4.53, suggesting 16.0% upside to the last share price. This compares with \$5.62 at the start of April, before the RC hearings were underway. Targets range from \$3.80 (UBS) to \$5.75 (Morgan Stanley). The dividend yield on FY18 and FY19 forecasts is 7.2% and 7.4% respectively.

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Material Matters: Batteries, Energy & Zinc

A glance through the latest expert views and predictions about commodities. Battery materials; energy; zinc; and iron ore.

-Supply and demand outlook for both cobalt and lithium remain positive -Geopolitical risks, reduced supply likely to tighten oil market -Domestic LNG prices reverse declining trend -Potential for a rebound in zinc demand in September quarter -Balanced market envisaged for iron ore in 2018

By Eva Brocklehurst

Battery Materials

Elon Musk has indicated that Tesla is reducing the amount of cobalt within its battery chemistry. Canaccord Genuity suggests this comment was an attempt by the company to distance itself from market concerns regarding cobalt supply. Cobalt is predominantly mined in the Democratic Republic of Congo.

The broker notes the market, in some quarters, received this as hard news and decided to reduce exposure to cobalt equities. In reality, while there are several battery formats that have different mixtures of metals, each has its own advantages and disadvantages. Nevertheless, there is a trend towards reduced lithium-cobalt-oxide and increased use of nickel-manganese-cobalt mixtures.

A higher nickel content increases energy density but also has a propensity towards combustion. The broker suggests the supply and demand outlook for both cobalt and lithium remain positive, based on increasing demand for electric vehicles and energy storage systems. Consequently, the current correction is considered an excellent entry point for exposure to battery materials.

Energy

Geopolitical risks have been raised in the oil market following the threat from US President Donald Trump to pull out of the Iran nuclear deal. ANZ analysts note the extent of oil's rally this year would have been significantly weaker if it had not been for recent tightness in the market. This is expected to grow in the second half of 2018 on the back of supply constraints and strong demand.

The analysts subsequently raise forecasts, with a 12-month target of US\$80/bbl for Brent crude. If the US pulls out of the Iran nuclear deal and re-imposes sanctions, ANZ analysts believe it will ultimately disrupt 200-300,000b/d of crude oil exports. The market appears ill-equipped to deal with such disruptions as OPEC has been steadfast in constraining supply.

Saudi Arabia is also suggesting that oil prices are too low. Iran's oil production has grown by more than 1m barrels since sanctions were waived in January 2016. Asia remains the dominant buyer of Iran crude and the analysts expect China to remain an active buyer, as it was prior to the nuclear deal.

This is not the only supply-side risk. The US has called for sanctions on the Venezuelan oil industry, attempting to pressure President Maduro to restore his country's constitution. Venezuela relies heavily on US refinery supply that is needed to push heavy crude through pipelines or tankers.

Meanwhile, production from Algeria has dropped in March because of maintenance of key oilfields, while the decline in output from Angola is increasing. Demand is also playing a part, and the analysts expect a large deficit for the remainder of 2018. Hence, should the sanctions be reimposed, the market is expected to tighten even further in the first half of 2019.

Citi notes spot LNG prices have stabilised on the back of the strength in oil. As Brent prices have risen nearly 10% in April LNG prices have reversed the declining trend in the middle of the month to end at US\$8/mmbtu. A further boost to prices could come emerging demand in South American markets as well as reduced supply on a single train shutdown at Gorgon.

Australian gas prices continue to decline, except in Queensland. Gas prices fell by -13% across the southern states because of lower demand during the shoulder months and increased supply as Longford resumed production. Prices in Queensland were higher by 6% in line with rising LNG export prices.

Citi notes Woodside Petroleum ((WPL)) and Oil Search ((OSH)) are the most exposed to spot LNG prices and this suggests potential for positive sentiment to soften over coming months.

Citi downgrades Woodside to Sell from Neutral, envisaging the stock fully priced at its long-term oil price forecast of US\$55/bbl. On current numbers the share price infers a US\$66/bbl price. The broker continues to believe the stock is the most defensive name in the sector given its strong balance sheet. Citi maintains a Sell rating for Oil Search, believing it too early to pay full value for the growth assets.

Zinc

Morgan Stanley suggests the market's increasingly bearish mood regarding zinc may prove premature and there is a potential for a rebound in the September quarter as demand picks up and new mine supply takes time to come on board. Zinc demand is then expected to strengthen into the peak summer period, lending support to prices in the September quarter.

Morgan Stanley notes Chinese smelters remain short of raw materials and domestic concentrate output fell -58% year-on-year in January to February. While the majority re-started by April smaller operations are reported to be still suspended. China's restrictions on imports of EAF (electric arc furnace) dust has also contributed to sourcing difficulties at the smelters.

As the concentrate market re-balances, downward pressure on prices is likely to resume and intensify through the December quarter and into 2019, in the broker's view. Together with recovering mine output in China, Morgan Stanley subsequently expects world zinc mine production to top 13mt for the first time in 2018 and this should return the concentrate market to balance by the end of the year.

Iron Ore

Demand has improved for iron ore, as Ord Minnett notes global purchasing manager indices ticked up in April and there was record global steel production through March. Meanwhile, volumes from the major miners were lacklustre and FY18 output guidance appears stretched for both Fortescue Metals ((FMG)) and BHP Billiton ((BHP)).

The broker notes, after falling about -20% in March the benchmark 62% iron ore price has steadied through April, ending the month near US\$65/t. Ord Minnett upgrades 2018 Chinese steel production estimates to 866mt and reduces estimates for the rest of the world output slightly.

This has tightened the supply/demand model and shows a broadly balanced market. This compares with previous expectations of a 45mt surplus. The broker maintains a 2018 forecast for the iron ore benchmark price of US\$66/t, close to current spot levels.

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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 April 30 to Friday May 4, 2018 Total Upgrades: 5 Total Downgrades: 10 Net Ratings Breakdown: Buy 45.19%; Hold 40.08%; Sell 14.73%

The direct correlation between share price movements and stockbroker ratings for ASX-listed stocks remained alive and well last week. As share market indices swung higher, the number of stocks receiving downgrades multiplied.

For the week ending Friday, 4th May 2018, FNArena registered ten downgrades and five upgrades. Equally noteworthy: only two up the upgrades moved ratings to Buy, while four of the downgrades moved to Sell.

The two stocks receiving upgrades to Buy during the week are New Hope (coal) and Nine Entertainment (media). Stocks downgraded to Sell are APN Outdoor, ASX Ltd, Regis Resources, and Sandfire Resources. The latter was the only one to receive two downgrades for the week.

Resources companies continue to play a prominent role in the Australian share market's resurgence, as well as in stockbroking analysts making amendments, but the week's overview for positive revisions to valuations/price targets nevertheless has three industrials stocks on top: ResMed, Aristocrat Leisure, and Nine Entertainment.

The negative side only has three names lined up, and all changes are benign, with Link Administration (capital raising) "beating" APN Outdoor and MYOB Group.

The week's table for positive revisions to earnings forecasts is more of a resources affair, with Senex Energy proudly on top, followed by Alacer Gold, Beach Energy, OceanaGold, and Fairfax Media. On the flipside, we find Syrah Resources taking a huge blow, or at least the graphite producer's estimates, followed by Independence Group, Link Administration, National Australia, and InvoCare.

The banking reporting season is proving yet another sad affair with estimates and price targets in general taking another step backwards post results. Share prices have not followed suit, however, as share price weakness had preceded results reports. Macquarie, not a real "bank", once again proved that trading on a sector premium does not mean the shares are "expensive" by any means.

Domestic reporting season continues throughout the remainder of the month, with numerous High PE stocks complementing banks, wealth managers and cyclical. FNArena's Corporate Results Monitor is keeping track of all releases post February, including a calendar for companies scheduled to report.

Upgrade

INVOCARE LIMITED ((IVC)) Upgrade to Neutral from Sell by UBS .B/H/S: 0/4/2

The broker believes InvoCare's Protect & Grow strategy offer long term opportunities but in the short term, the negative impact of closures is greater than expected. Market share losses, a slow domestic death rate and the temporary closure of Singapore all contributed, UBS notes.

The strategy is a good one but the new growth profile is yet to be proven and will require more capital. The broker is thus cautious but given share price weakness upgrades to Neutral. Target falls to \$12.65 from \$13.65.

See also IVC downgrade.

NINE ENTERTAINMENT CO. HOLDINGS LIMITED ((NEC)) Upgrade to Outperform from Neutral by Credit Suisse .B/H/S: 3/2/1

Credit Suisse raises long-term forecasts to reflect a more efficient allocation of programming resources following the company's capture of the Australian Open tennis rights and the relinquishing of its long-held domestic cricket rights.

The broker increases FY18 TV advertising market growth forecasts to 2.0% from 1.2%.

Rating is upgraded back to Outperform from Neutral as the broker now believes the business remains in an upgrade cycle. Target is raised to \$2.60 from \$2.35.

NEW HOPE CORPORATION LIMITED ((NHC)) Upgrade to Add from Hold by Morgans .B/H/S: 2/1/0

The Queensland Supreme Court has set aside the Land Court decision on Acland stage 3 and referred it back for further consideration. Morgans considers this a significant win for the company in what has been a 10-year approvals process.

Despite this news the broker notes the market ascribes no value to Acland 3, implying a free option on a potential positive outcome for investors. Rating is upgraded to Add from Hold and the target to \$2.36 from \$2.23.

WOOLWORTHS LIMITED ((WOW)) Upgrade to Hold from Reduce by Morgans .B/H/S: 4/2/2

March quarter sales were slightly better than Morgans expected. Big W was relatively weak, affected by the timing of New Year's Day and the shift of the school holidays in NSW.

Morgans rolls forward its model for FY19 and increases the target to \$25.87 from \$22.62. Given a forecast 12-month total shareholder return of -4% the broker upgrades the rating to Hold from Reduce. Morgans retains a preference for Wesfarmers ((WES)).

XERO LIMITED ((XRO)) Upgrade to Neutral from Sell by UBS .B/H/S: 1/2/2

UBS has transferred coverage to a new analyst, resulting in an upgrade to Neutral for Xero and a target increase (and currency switch) to A\$42.50 from NZ\$26.50.

Xero is towards the end of its transition from loss-making start-up to self-funding business, the new analyst notes, and offers a proven business model and significant structural growth opportunities. FY19 has the potential to be an industry-changing year in the UK due to new regulatory requirements.

Downgrade

APN OUTDOOR GROUP LIMITED ((APO)) Downgrade to Sell from Neutral by Citi .B/H/S: 2/2/1

We hadn't noticed anything from Citi on the company since initiating coverage in December last year. Now the broker has used a sector update to pull back its rating to Sell from Neutral.

The analysts remain confident strong growth for the outdoor media space is set to continue, but for APN Outdoor in particular they are concerned about costs and margin compression. As every shareholder knows, these are not the ideal combination.

Target price tumbles to \$4.50. Citi prefers oOh!media ((OML)) in the sector. Management at APN Outdoor already admitted it will have to make additional investments to catch up with the competition. The analysts suggest more needs to be done.

ASX LIMITED ((ASX)) Downgrade to Sell from Hold by Deutsche Bank .B/H/S: 0/3/5

The March quarter trading update points to a strong FY18 result, although the company does expect fourth quarter expenses will step higher.

Driven by strong results so far this year the stock has reached record levels and Deutsche Bank believes the valuation is stretched. Rating is downgraded to Sell from Hold. Target is \$55.90.

GRAINCORP LIMITED ((GNC)) Downgrade to Neutral from Outperform by Credit Suisse .B/H/S: 2/3/0

The outlook for rainfall is signalling low soil moisture entering the 2018 season and any further reduction in rainfall from this point would result in downside to the crop.

Outside of crop conditions, Credit Suisse notes upside rests on the company pursuing a more aggressive restructuring of its storage and logistics business. The broker expects oils and malt will be in focus at the first half result on May

11.

Credit Suisse downgrades to Neutral from Outperform. Target is steady at \$9.06.

INVOCARE LIMITED ((IVC)) Downgrade to Equal-weight from Overweight by Morgan Stanley .B/H/S: 0/4/2

The disruption to the business from the capital expenditure program has been greater than expected and Morgan Stanley reduces forecasts for earnings per share by -6% for 2018-20.

The broker's main concern is that 43% of the volume decline in the March quarter could not be attributed to intentional one-off closures. Market share loss appears to have accelerated, excluding the impact of refurbishing initiatives.

Target is reduced to \$12.60 from \$15.70. Rating is downgraded to Equal-weight from Overweight. In-Line industry view.

See also IVC upgrade.

NAMOI COTTON CO-OPERATIVE LIMITED ((NAM)) Downgrade to Hold from Add by Morgans .B/H/S: 0/1/0

FY18 results were strong and supported by a large cotton crop, Morgans notes. However, dry conditions and reduced dam levels will likely reduce the size of the 2019 crop. Morgans makes material downgrades to forecasts as a result.

Given the initial outlook for FY20 is challenging, the broker downgrades to Hold from Add. Target is reduced to \$0.51 from \$0.54.

QANTAS AIRWAYS LIMITED ((QAN)) Downgrade to Neutral from Buy by UBS .B/H/S: 3/2/1

Qantas' March quarter revenue performance beat expectations and management expects momentum to continue into the June Q, albeit at a more moderate pace. UBS has lifted earnings forecasts.

The increase is offset by factoring in higher oil prices, although Qantas' 70% hedge tempers the impact. A greater impact is nevertheless priced into latter years. UBS has lifted its target to \$6.50 from \$6.35 but with the share price already strong, the broker pulls back to Neutral.

REGIS RESOURCES LIMITED ((RRL)) Downgrade to Lighten from Hold by Ord Minnett .B/H/S: 1/1/4

Ord Minnett struggles to justify the valuation as, despite Regis Resources being a strong dividend-paying gold company, 20% of valuation is attributed to McPhillamys and preliminary environmental assessment submissions have recently been delayed.

The broker downgrades to Lighten from Hold. Target is raised to \$4.20 from \$4.10.

ST BARBARA LIMITED ((SBM)) Downgrade to Hold from Accumulate by Ord Minnett .B/H/S: 1/3/1

Ord Minnett notes the gold sector continues to re-rate after the March quarter update and downgrades to Hold from Accumulate on valuation.

St Barbara has been one of the broker's preferences but, after a recent strong performance, more details are awaited from the Gwalia GMX project before becoming more positive. Target is raised to \$4.50 from \$4.30.

SANDFIRE RESOURCES NL ((SFR)) Downgrade to Reduce from Hold by Morgans and Downgrade to Hold from Buy by Deutsche Bank .B/H/S: 0/3/4

Gold output was better than Morgans expected in the March quarter, slightly offset by marginally weaker copper production versus forecasts. The company has added 1.3mt to the DeGrussa ore reserve from an upgrade to C5 resources and conversion to reserves of resources within barrier pillars at the extremities of the ore body.

The broker believes the upgrade buys some time for the company, although more is required to alleviate medium-term risk attached to mine depletion.

While the current cash accumulation is impressive, the broker points out the outlook is increasingly reliant on exploration success and development at Black Butte. Rating is downgraded to Reduce from Hold. Target is raised to \$7.02 from \$6.80.

Sandfire's -5% lower copper production in the quarter beat Deutsche Bank's estimate by 2%. Plant maintenance impacted and the miner was cycling a strong Dec Q but grades improved, the broker notes, and FY guidance is maintained.

Target rises to \$8.40 from \$8.10 but rating downgraded to Hold on valuation.

Total Recommendations Recommendation Changes

Broker Recommendation Breakup

Broker Rating Order Company New Rating Old Rating Broker Upgrade 1 INVOCARE LIMITED Neutral Sell UBS 2 NEW HOPE CORPORATION LIMITED Buy Neutral Morgans 3 NINE ENTERTAINMENT CO. HOLDINGS LIMITED Buy Neutral Credit Suisse 4 WOOLWORTHS LIMITED Neutral Sell Morgans 5 XERO LIMITED Neutral Sell UBS Downgrade 6 APN OUTDOOR GROUP LIMITED Sell Neutral Citi 7 ASX LIMITED Sell Neutral Deutsche Bank 8 GRAINCORP LIMITED Neutral Buy Credit Suisse 9 INVOCARE LIMITED Neutral Buy Morgan Stanley 10 NAMOI COTTON CO-OPERATIVE LIMITED Neutral Buy Morgans 11 QANTAS AIRWAYS LIMITED Neutral Buy UBS 12 REGIS RESOURCES LIMITED Sell Neutral Ord Minnett 13 SANDFIRE RESOURCES NL Sell Neutral Morgans 14 SANDFIRE RESOURCES NL Neutral Buy Deutsche Bank 15 ST BARBARA LIMITED Neutral Buy Ord Minnett Recommendation Positive Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 NHC NEW HOPE CORPORATION LIMITED 67.0% 33.0% 34.0% 3 2 XRO XERO LIMITED -20.0% -40.0% 20.0% 5 3 NEC NINE ENTERTAINMENT CO. HOLDINGS LIMITED 33.0% 17.0% 16.0% 6 4 IGO INDEPENDENCE GROUP NL -17.0% -33.0% 16.0% 6 5 FMG FORTESCUE METALS GROUP LTD 64.0% 50.0% 14.0% 7 6 WOW WOOLWORTHS LIMITED 19.0% 6.0% 13.0% 8 7 NCM NEWCREST MINING LIMITED -6.0% -19.0% 13.0% 8 8 SHL SONIC HEALTHCARE LIMITED 25.0% 14.0% 11.0% 8 9 RMD RESMED INC 25.0% 14.0% 11.0% 8 10 ALL ARISTOCRAT LEISURE LIMITED 69.0% 64.0% 5.0% 8 Negative Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 SVW SEVEN GROUP HOLDINGS LIMITED 67.0% 100.0% -33.0% 3 2 APO APN OUTDOOR GROUP LIMITED 20.0% 50.0% -30.0% 5 3 SFR SANDFIRE RESOURCES NL -57.0% -29.0% -28.0% 7 4 QAN QANTAS AIRWAYS LIMITED 33.0% 60.0% -27.0% 6 5 GNC GRAINCORP LIMITED 40.0% 60.0% -20.0% 5 6 ASX ASX LIMITED -63.0% -50.0% -13.0% 8 7 MYO MYOB GROUP LIMITED 67.0% 80.0% -13.0% 6 8 LNK LINK ADMINISTRATION HOLDINGS LIMITED 50.0% 60.0% -10.0% 6 9 CSL CSL LIMITED 56.0% 64.0% -8.0% 8 10 RRL REGIS RESOURCES LIMITED -50.0% -43.0% -7.0% 7 Target Price Positive Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 RMD RESMED INC 13.302 12.352 7.69% 8 2 ALL ARISTOCRAT LEISURE LIMITED 29.458 28.079 4.91% 8 3 NEC NINE ENTERTAINMENT CO. HOLDINGS LIMITED 1.983 1.892 4.81% 6 4 SFR SANDFIRE RESOURCES NL 7.384 7.120 3.71% 7 5 NCM NEWCREST MINING LIMITED 21.068 20.411 3.22% 8 6 WOW WOOLWORTHS LIMITED 27.786 26.929 3.18% 8 7 RRL REGIS RESOURCES LIMITED 4.130 4.030 2.48% 7 8 SVW SEVEN GROUP HOLDINGS LIMITED 19.293 18.900 2.08% 3 9 QAN QANTAS AIRWAYS LIMITED 6.720 6.584 2.07% 6 10 NHC NEW HOPE CORPORATION LIMITED 2.470 2.427 1.77% 3 Negative Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 LNK LINK ADMINISTRATION HOLDINGS LIMITED 9.087 9.270 -1.97% 6 2 APO APN OUTDOOR GROUP LIMITED 4.762 4.828 -1.37% 5 3 MYO MYOB GROUP LIMITED 3.948 3.950 -0.05% 6 Earning Forecast Positive Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 SXY SENEX ENERGY LIMITED -0.786 -2.086 62.32% 7 2 AQG ALACER GOLD CORP 6.052 5.637 7.36% 4 3 BPT BEACH ENERGY LIMITED 13.950 13.000 7.31% 6 4 OGC OCEANAGOLD CORPORATION 24.695 23.043 7.17% 5 5 FXJ FAIRFAX MEDIA LIMITED 5.820 5.530 5.24% 6 6 SVW SEVEN GROUP HOLDINGS LIMITED 99.533 94.800 4.99% 3 7 QAN QANTAS AIRWAYS LIMITED 62.020 59.570 4.11% 6 8 WSA WESTERN AREAS NL 7.548 7.258 4.00% 6 9 OSH OIL SEARCH LIMITED 29.794 29.137 2.25% 8 10 RRL REGIS RESOURCES LIMITED 32.460 32.180 0.87% 7 Negative Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 SYR SYRAH RESOURCES LIMITED -0.012 4.578 -100.26% 5 2 IGO INDEPENDENCE GROUP NL 13.804 16.780 -17.74% 6 3 LNK LINK ADMINISTRATION HOLDINGS LIMITED 38.267 40.520 -5.56% 6 4 NAB NATIONAL AUSTRALIA BANK LIMITED 215.786 225.825 -4.45% 8 5 IVC INVOCARE LIMITED 56.483 58.671 -3.73% 7 6 BLD BORAL LIMITED 38.987 40.353 -3.39% 6 7 NST NORTHERN STAR RESOURCES LTD 32.308 33.417 -3.32% 7 8 JBH JB HI-FI LIMITED 201.657 208.113 -3.10% 8 9 SFR SANDFIRE RESOURCES NL 79.177 81.497 -2.85% 7 10 FMG FORTESCUE METALS GROUP LTD 46.652 47.733 -2.26% 7 Technical limitations

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Uranium Week: Hitting The Ceiling

Demand picked up in the spot uranium market last week but every time the sellers back off the buyers lose interest once more.

-Uranium market activity reasonable in April -Spot price rises in May -Australian sales to India getting closer

By Greg Peel

Activity in the uranium market in the month of April did not match that of March but was brisk nonetheless, as fuel loading began in several locations (new reactors preparing for start-up, or in the case of Japan, restart-up). Loading began for two Chinese reactors, one in Finland, and one in Japan.

This meant utilities were active on the buy-side during the month, although traders and producers still dominated. In the case of producers, it is currently cheaper for some to simply buy uranium in the market to satisfy long term delivery contracts than it is to produce it themselves.

Industry consultant TradeTech reports 29 transactions were completed in the spot market in April totalling 5mlbs U3O8 equivalent. The last week saw 2m of those 5mlbs change hands as buying stepped up.

TradeTech's spot price indicator nevertheless closed the month at US\$21.00/lb, unchanged from end-March. Only four of the last twelve months have seen an increase in price, and the spot price is down -4.3% year on year.

The consultant's term market indicators were similarly unchanged at US\$25.50/lb (mid) and US\$28.00/lb (long).

There was a lull after month's end before activity picked up again towards the end of last week. Five transactions were reported in the first week of May, totalling 760,000lbs U3O8 equivalent, and prices rose with each successive transaction.

By week's end the sellers had backed off far enough that the buyers were no longer interested. TradeTech's weekly spot price indicator is up US50c at US\$21.50/lb.

Production & Sales

Rio Tinto ((RIO)) produced 1.5mlbs U3O8 in the March quarter, down -17% from the December quarter and -4% from the previous March quarter. Rio's two-thirds owned Energy Resources of Australia ((ERA)) produced 667,000lbs at its Ranger mine in Australia's Northern Territory and its two-thirds owned Rossing mine in Namibia produced 848,000lbs.

ERA's production, representing the processing of stockpiles, was down -26% on last March as stockpile grades diminish. Rossing's production, on the other hand, represents a 26% increase.

Paladin Energy ((PDN)) is preparing to move its Langer Heinrich mine in Namibia into care & maintenance while BHP ((BHP)) increased production at its Olympic Dam mine in South Australia but recorded lower sales. In Canada, Cameco's strategy of cutting production to reduce costs in the low-price environment is paying off, as the company increased earnings in the quarter compared to last year.

It was back in 2014 when then Australian prime minister Tony Abbott announced the government would allow uranium sales to India, despite India being nuclear weapons capable and not a signatory to the global nuclear non-proliferation agreement. It was July last year when Australia finally sent its first shipment to India - a test sample.

BHP and US-based Heathgate Resources, operator of the Beverley mines in South Australia, are currently in negotiations with the Indian Department of Atomic Energy to come to an actual agreement to supply uranium for power generation purposes. Four other countries are already supplying India.

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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 May 3, 2018

Last week saw the rally in the ASX200 “turn parabolic” as yet another momentum-driven hundred points were added to take the index to 6100.

In terms of stocks shorted 5% or more, no stocks dropped out of the table last week as a result of the rally while four stocks entered, suggesting short-covering is not a market driver. Those were data centre operator NextDC ((NXT)), gold miner Resolute Mining ((RSG)), copper miner Sandfire Resources ((SFR)) and market data and management provider Iress Market Technology ((IRE)).

Amongst all the red and green below, there were only four moves in short position of one percentage point or more, and two of those were in the 10% plus table.

Domino's Pizza ((DMP)) dropped to 16.4% from 17.4% and Nanosonics ((NAN)) dropped to 13.1% from 14.1%.

Shorts in funeral director InvoCare ((IVC)) rose to 10.4% from 8.4%.

See below.

I noted in last week's report that Healthscope ((HSO)) shorts had fallen to 9.9% from 13.3% following a takeover bid, as might be expected. Last week the shorters continued to bail, leaving the stock only 6.2% shorted.

Weekly short positions as a percentage of market cap:

10%+

SYR 21.2 JBH 16.7 DMP 16.4 GXY 14.8 NAN 13.1 VOC 12.2 MYR 11.5 ORE 11.4 RFG 11.2 HT1 11.2 AAC 11.0 BWX 10.7
NWS 10.7 APO 10.5 IVC 10.4 IGO 10.0

In: IVC Out: MYX

9.0-9.9

MYX, APT, FLT, AAD

In: MYX, FLT, AAD Out: HSO

8.0-8.9%

PLS, HVN, MLX, WEB, IPH

In: MLX, WEB, IPH Out: IVC, AAD, FLT, MTS

7.0-7.9%

BIN, BGA, GMA, TPM, MTS, GEM, TGR, CSR

In: MTS, BIN, CSR Out: WEB, IPH, MLX, BAP

6.0-6.9%

IFL, QUB, GXL, ING, BAP, BKL, HSO, NSR, PRY, SEK, KAR

In: HSO, BAP Out: CSR, BIN, SUL

5.0-5.9%

BEN, MOC, NXT, BOQ, SUL, JHC, IMF, RSG, CCP, AHG, SFR, NUF, MQA, MYO, IRE

In: SUL, NXT, RSG, SFR, IRE

Movers & Shakers

Medical device maker Nanosonics has been moving sharply up the most shorted table in past weeks but last week saw a drop to 13.1% from 14.1%. Shorters were caught out when the company received US FDA approval for its next generation Trophon disinfectant. The share price jumped as much as 18% following the news.

The share price in once can-do-no-wrong Domino's Pizza had all but halved from August 2016 when the company did wrong by its workforce and became somewhat of a market pariah. Last week Domino's popped 12% on the back of a very strong quarterly earnings result from its US counterpart. Domino's shorts fell to 16.4% from 17.4%.

People just aren't popping off at the rate they should be, but that's not funeral director InvoCare's main problem. InvoCare shares dropped off the perch by -13% following a profit warning last week.

The company is undertaking, you might say, a series of site closures for the purpose of refurbishment in line with a longer term growth strategy, and this is impacting on short term earnings. Analysts are confident the strategy will eventually pay dividends but point out that closures only account for around half of the reduction in earnings management warned of in the short term. A lower death rate may be impacting on the industry but analysts conclude the numbers imply a loss of market share.

InvoCare joined the elite 10% plus shorted club last week with an increase to 10.4% from 8.4%.

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: Health, Financials & Wealth

Weekly Broker Wrap: strategy; health care; health insurance; diversified financials; and wealth managers.

-Commonwealth 2018 budget relatively benign for corporate profits -Unlikely to be substantial improvements in health industry dynamics post budget -Private health insurance emerging as a key election issue -Budget seen slightly negative for super and life insurance industry -Structural separation considered a risk for wealth management industry

By Eva Brocklehurst

Strategy

In the wake of the Australian government's 2018 budget, Credit Suisse observes the economy is set to continue with its dual speed nature, reflecting a sluggish and leveraged consumer and confident corporate sector.

The forecast surplus in FY20, a year earlier than expected at the last budget, should be positive for the Australian dollar and bond market all else being equal. However, the broker suggests considerable changes in the demand/supply backdrop in global government bonds will push local yields higher.

Compared with previous years the budget appears relatively benign for corporate profits. The broker suggests the Australian earnings expansion is likely to continue and targets an ASX200 level of 6500 by the end of the year.

Credit Suisse expects a budget to be modestly positive for consumer stocks that sell to low-middle income employees as well as Challenger ((CGF)) and, potentially, Transurban ((TCL)). The budget is expected to be negative for hospitals, life insurers and Link Administration ((LNK)).

Health Care

The budget fully funds a new five-year public hospital agreement with the states and territories. Credit Suisse suggests the increase in public hospital funding, and lack of discussion on the decline in the private health participation rate, means private hospital reforms are unlikely in the near term. Therefore there are unlikely to be substantial improvements in industry dynamics.

Meanwhile the review into the Medicare Benefits Schedule is ongoing, with the government aiming to reduce spending on inappropriate or obsolete diagnostic tests and reform outlays to GP attendance. Credit Suisse suspects funding cuts could emerge in the medium term.

This segment is relevant for Primary Health Care ((PRY)) and Sonic Healthcare ((SHL)). The Pharmaceutical Benefits Scheme, relevant for Sigma ((SIG)) and Australian Pharmaceutical Industries ((API)), will sustain a reduction in revenue rebates and expenses associated with improved payment administration that will offset outlays for new drug listings.

UBS also observes a limited impact for listed health providers from the budget both in the MBS, PBS and public hospital measures and in the supply of home care for the aged. The aged care budget was largely focused on improving sector quality, transparency and mental health outcomes and there was no mention of basic daily care fee deregulation.

Ord Minnett was disappointed that basic daily living fees have not been uncapped in residential aged care, as this may have provided some relief for providers in the light of recent funding reforms.

Despite the benign nature of the budget the broker continues to believe the pre-election period is positive for domestically-focused healthcare companies, with the exception of private hospitals in the light of Labor's plan to cap premiums if it wins the election.

Health Insurance

With falling participation rates and elevated margins the affordability debate in private health insurance is emerging as a key election issue. Labor's promise to cap premium hikes at 2% for two years sets the tone, Morgan Stanley believes, and elevates earnings risks to health insurers and private hospitals.

The broker believes insurers have the capacity to navigate the squeeze on margins but shifting the claims curve will not be easy. The the best lever is better contracted outcomes with private hospitals and shifts to home care.

Morgan Stanley's bear case assumes collective action to attack claims inflation will recover around 50% of the margin headwinds and lifts its bear case weighting to 30% from 20%. In this scenario the broker prefers nib Holdings ((NHF)) over Medibank Private ((MPL)).

The broker notes, unlike Healthscope ((HSO)), Ramsay Health Care ((RHC)) is not underpinned by M&A or the consortium offer and is vulnerable to disruptive rehab models. Healthscope is the broker's preferred hospital exposure.

Diversified Financials

The Australian government's 2018 budget package includes reforms geared to the minimisation of fees and insurance premiums on low super account balances. The government is capping fees to superannuation accounts with balances of less than \$6000 at 3% of the account balance and banning exit fees from all superannuation accounts.

UBS considers this a modest negative for super and life insurance. Social Security changes to lifetime income products were slightly less negative than initially proposed and implementation is also delayed to FY20.

UBS notes the automatic transfer of loss in inactive accounts to the ATO of factors that are negative at the margin for super administration providers. Life insurance, a relatively small contributor for AMP ((AMP)) and Suncorp ((SUN)), will become an opt-in for people aged under 25 or those with low balances.

Ord Minnett suggests the measure on small account balances could be negative for Link, in particular, as millions of accounts are consolidated, and for AMP, which manages some accounts in this regard. The government is reducing audit requirements for self managed super funds and this could increase the appeal of such funds at the expense of retail funds.

Wealth Managers

UBS observes the Royal Commission has shaken the wealth management industry and led to a period of considerable change. The risk is the changes could be considerably worse for AMP relative to others. The broker has recently downgraded AMP to Neutral from Sell and IOOF ((IFL)) to Neutral from Buy.

A step-change in the cost base associated with a range reforms aimed at adviser misconduct appears inevitable. The broker does not anticipate any material winding back of 2013 reforms or overall system changes but expects AMP to experience a protracted period of outflows, while the flows to IFL could moderate and Netwealth ((NWL)) emerge a beneficiary.

Vertical integration has been the elephant in the room at the Royal Commission and, while not a base case, the broker suggests that should structural separation proceed, it would be cumbersome and erode value for the vertically integrated major operators.

Benefits to specialty platform providers would be constrained as the wealth managers reinvest in technology and product pricing to retain assets under management.

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Ainsworth Profit Outlook Falls Short

Ainsworth Game Technology has significantly downgraded guidance, made worse by the fact the revision includes a recent order from Churchill Downs.

-Soft new game performance, regulatory delays account for second half slump -Second half performance includes new 600-unit order from Churchill Downs -No evidence yet of a recovery in product performance

By Eva Brocklehurst

Ainsworth Game Technology ((AGI)) has provided a significant downgrade to its FY18 guidance. Second half pre-tax profit is expected to be around \$20m, versus previous guidance to be modestly ahead of the \$42.2m posted in the prior corresponding half.

Regulatory delays are affecting product releases in Australia but North America was also weaker amid lower class III participation units and higher royalty costs associated with Pacman.

Deterioration occurred across all divisions. What is making matters worse, CLSA believes, is that the revised guidance includes a recent order from Churchill Downs for 600 units, which suggests significant weakness elsewhere.

The broker makes cuts to estimates for operating earnings (EBIT) of -41-47% over FY18-20 and has an Underperform rating and \$1.23 target.

For Macquarie the downgrade illustrates the volatility and low visibility in the sales business, which is 75% of revenue. The company is suggesting earnings will improve in FY19 but the broker believes this has to be underpinned by game performance.

Macquarie also notes that Ainsworth has corporate appeal as Novomatic holds 52% of the stock. The broker sticks with a Neutral rating and lowers the target to \$1.05.

Guidance assumes Churchill Downs sales are completed in the second half, although regulatory approvals are pending. Macquarie is confident the sale will be completed and estimates it accounts for around 33% of the second half pre-tax profit guidance. Otherwise, pre-tax profit, excluding the Churchill Downs sales, would be \$30m, down -48% year-on-year.

UBS believes the bulk of the decline in sales came through lower customer demand and subsequent lower ship share. As FY18 is supported by the sale to Churchill Downs and ongoing sales to Novomatic, the underlying trend could be worse than the headline suggests, and the broker believes it prudent to re-base earnings for future years.

UBS downgrades estimates by -38% for FY18 and -41% for FY19. The brokers lack of confidence going forward is based around the ongoing one-off sales and the negative momentum for ship share in the US.

Revenue is also set to decline in Latin America in the second half for the first time since 2014, and there is for high R&D expenditure to improve the game library.

UBS concedes the class III outright sales segment, in which Ainsworth is concentrated, is inherently volatile and manufacturers can experience long peaks and troughs in the product cycle. UBS currently forecasts ship share of 10% and 4% in Australia and the US respectively, with a marginal improvement in participation.

As yet, there is no evidence of a firm recovery in product performance, that should lead to a multi-year earnings growth outcome if it were the case. The next catalyst the broker expects are surveys on the US market in July.

UBS also does not believe the collaborative agreement with Novomatic will achieve the expected synergies over FY18 and would also need to see an improvement in Ainsworth's new game performance before it can be confident Australian earnings have stabilised.

Until Ainsworth achieves diversification in earnings and improves game performance the broker expects uncertainty to prevail, maintaining a Sell rating with a \$1.09 target.

Canaccord Genuity, too, has now downgraded to Sell from Hold, reducing its price target to \$1.00 from \$2.32. Contrary to management commentary, Canaccord Genuity believes what we are witnessing is a re-basing of profit

margins for the company. The stockbroker notes the operational margin (EBIT) has now fallen in three of the past four half-yearly results.

Until more clarity is achieved around this matter, Canaccord Genuity suggests investors should simply avoid the stock.

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Treasure Chest: Finding Value In The Gold Sector

Australia's mid-tier gold miners have had a strong FY18 but are they too well priced, and is there opportunity elsewhere?

-Oz mid-tier miners outperform gold price -Relative value apparent in smaller developer/explorers -Valuations stretched for producers

By Greg Peel

Last week's Macquarie Security Australia Conference included a day of presentations from leading ASX-listed gold producers, developers and explorers. What particularly impressed Macquarie's analysts was the breadth of growth options being generated and delivered by the sector.

Backing this up is a big increase in exploration, which has already delivered new discoveries, and a drive to embrace new technology. Companies now have the balance sheet strength to facilitate change and grow their businesses, Macquarie notes. The analysts believe the local sector will continue to outperform on the global stage.

This outperformance has been evident in a 17% rise, FY18 to date, in the ASX gold index, led by mid-tier stocks. Emerging gold plays have also fared well, note the researchers at Argonaut, helping to drive the ASX small resources index up 48%. Over the period, the AUD gold price has risen 10% and the USD price 7%.

Argonaut believes this outperformance has been driven by North American investment in Australian gold miners when US gold miners have underperformed.

By Argonaut's calculation, US miners have returned around -3% in value in FY18 while the average of Australian returns is +5%. But within that average, a core group of mid-tier miners has returned 30-80%.

Too Much?

Ord Minnett has long held the view that the ASX gold sector looked inexpensive versus its global peers, and this recent breakout in valuation versus the gold price is supported by the value creation occurring within these companies via operating efficiencies, strong cash generation and reserve replacement.

But have the mid-tier producers now run too far?

Argonaut believes so, suggesting further significant upside is hard to identify from current valuations. But Argonaut notes that over the same period, emerging developers have recorded only incremental gains. The analysts argue that in the near term, investors will look to come "down the curve" into the developer space for value.

Here, Argonaut's key picks are Dacian Gold ((DCN)), Gascoyne Resources ((GCY)) and Gold Road ((GOR)).

Dacian poured its first gold at its Mt Morgans development at the end of March, having completed the project on time and on budget. Macquarie also has Dacian among its key producer picks (Macquarie now identifies Dacian as a producer), along with St Barbara ((SBM)), Saracen Mineral Holdings ((SAR)) and Regis Resources ((RRL)).

Among the developers/explorers, Macquarie likes Gold Road and West African Resources ((WAF)).

St Barbara and Regis Resources are also favoured by Ord Minnett, but the broker believes they have now run too far, hence a downgrade for St Barbara to Hold from Accumulate and to Lighten from Hold for Regis.

Ords also has Evolution Mining ((EVN)) and Northern Star Resources ((NST)) on Hold ratings, leaving OceanaGold ((OGC)) as the only mid-tier producer retaining an Accumulate rating.

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Conviction Calls, And Middle Class Poverty

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

-Quality Is Not In A Bubble -Conviction Calls -Middle Class Poverty? Blame The Banks -Rudi On TV -Rudi On Tour

[Note the non-highlighted items appear in part two on the website on Thursday]

Conviction Calls

By Rudi Filapek-Vandyck, Editor FNArena

Contrary to usual practice, the main story of this week's Weekly Insights has been relegated to Part Two, which shall be published on the website on Thursday morning (Make sure you don't miss it).

On Monday, CLSA banking analyst Brian Johnson experienced the sweet taste of having stuck one's neck out for a particular investment opportunity, and then witnessing how the Conviction Call, amidst many critics and doubters, turns into a gift that simply keeps on giving.

Johnson is a long time groupie of the Millionaires Factory at Macquarie Group ((MQG)). When the share price approached the \$100 level the first time around, pre-GFC, Johnson was employed by JP Morgan at the time and remained steadfast in his conviction the price should be well above that level. Alas, that call got buried inside the turmoil that followed globally and which left Macquarie soul-searching for a new business model.

Fast forward to 2018 and this time around the share price merely sighed when the \$100 price tag came into focus, and then simply rallied past it. Friday's results release revealed the usual scenario of investors and (some) analysts getting a little bit antsy as the share price kept on trending upwards, but once the numbers were out, everybody once again was left in awe.

In simplistic terms, FNArena's consensus price target (which does not include CLSA) further increased to \$104.50 from \$101.20 prior to the release. But, of course, the share price is already beyond that... Maybe investors can take guidance from the three brokers that have a price target still a few percentages above the current share price?

CLSA analyst Brian Johnson has now raised his price target to \$130 from \$117.

Or maybe the real message here is that when it comes to high quality performers, which Macquarie undoubtedly is, investors shouldn't fret so much about short term, minor issues like "how much has the share price gone up?" and "what exactly is the PE, and how high the sector premium?"

If the past four to five years have provided one clear message it is that quality trumps price and value, and investors who do not understand the message are missing out badly. What goes for Macquarie obviously also applies to high quality, high PE stocks like CSL ((CSL)), REA Group ((REA)), and others.

To date I have been reluctant to add Macquarie to my selective list of All-Weather Performers in the Australian share market. I still haven't. But for those who have access to the section dedicated to my research on the website (that would be: only paying subscribers), you'll find Macquarie under the heading of Prime Growth Stories, alongside the likes of a2 Milk ((A2M)) and Aristocrat Leisure ((ALL)).

Elsewhere, Citi analysts provided the fuel for shares in shoe-retailer Accent Group ((AX1)), formerly known as RCG Corp, to recoup some of recent losses by bumping up their valuation/price target for the small retailer by 22% to \$1.40. Investors might be familiar with this company through well-known brands including The Athlete's Foot, Timberland, Vans, Skechers, and Saucony.

After sinking as low as 67c in May last year, shares in the retailer have gone on an extended run (pun intended) and are now approaching \$1.30, also helped by the talk about tax cuts in the upcoming federal budget. Looking at the sector from a top down angle, however, I remain of the view discretionary retailers are a minefield for investors, and will be for years to follow.

For every single Champion stock that comes out the other end a winner, there will probably be four or five disaster stories that have only started to crumble just yet. Not the kind of risk I like to include in my strategy or portfolio.

Accent Group remains Citi's top choice among small cap retailers in Australia (and has been for a while).

Stockbroker Morgans updated its selection of High Conviction Stocks last week and I hope it's not just my imagination but the selection seems to contain fewer names after each update. This shouldn't surprise, as local equities have been on a tear over the past weeks and anybody's conviction shrinks in the face of robust share price rallies.

Morgans' present selection consists of five ASX100 members plus two smaller cap names; Cleanaway Waste Management ((CWY)), Suncorp ((SUN)), BHP ((BHP)), Link Administration ((LNK)), and Westpac ((WBC)), plus CML Group ((CGR)) and PWR Holdings ((PWR)).

Interestingly, Morgans also calculated High PE stocks have outperformed the broader index by 13% per annum since April 2013. Note: that is five times 13%, on average, not 13% over the period. Strategists Andrew Tang and Tom Sartor acknowledge the years ahead might not be as accommodative for high growth stocks with interest rates on the rise, but they are quick to add "most of the outperformance and higher valuations of Growth vs Value can be explained by higher margins, earnings and ROE" [Return on Equity].

In other words: see Macquarie above. Morgans' strategists do highlight that, while backing genuine Growth companies still makes sense, it is nevertheless a time to be more selective now.

Strategists at Credit Suisse also updated their Top Picks in Australia, which saw the inclusion of Domain Holdings Australia ((DHG)), James Hardie ((JHX)), Suncorp ((SUN)) and Wesfarmers ((WES)), alongside the removal of Southern Cross Media ((SXL)) and of IDP Education ((IEL)).

Other names on the short list are: AGL Energy ((AGL)), Coca-Cola Amatil ((CCL)), CSL, Caltex Australia ((CTX)), IOOF Holdings ((IFL)), National Australia Bank ((NAB)), Qantas ((QAN)), and Speedcast International ((SDA)) - these are all positive positions ("long"). The sole name with a negative stance ("short") on the list is WiseTech Global ((WTC)).

Judging by WiseTech's share price performance over the week past, however, and with analysts at Citi upgrading to Buy and lifting their price target to \$14.12, I think the odds have turned in favour of Credit Suisse eating humble pie at some stage. Credit Suisse analysts certainly won't be the only ones; Bell Potter analyst Chris Savage stuck with his Sell rating for WiseTech Global on May 2nd, refusing to lift his twelve month price target above \$9.25. At least it's not the \$7.10 suggested by Credit Suisse.

Analysts at Morgan Stanley have been making the extra effort in recent weeks, trying to convince their clientele data centres operator NextDC ((NXT)) is entering a new phase in its development, and there should be a whole lot more value for shareholders as the outside world comes to grips with how strong demand really is for data storage.

And as management at the company based in Sydney's Macquarie Park grabs the bull by the horns via more capacity, paid for by the recent cap raising, on top of the already expanding suite of world class assets.

No coincidence thus, Morgan Stanley has the highest price target in the FNArena universe when it comes to NextDC - at \$9.20 that target suggests both investors and analysts elsewhere are still too cautious, with the share price still more than -27% below the targeted level.

Another remarkable new development was the announcement by UBS that a new analyst is now in charge of covering accountancy software provider Xero ((XRO)). The new guy definitely broke loose from the old shackles. The price target moved from a miserable NZ\$26.50, well below the share price, to A\$42.50 which was at that time (May 2) well above the share price.

As you probably guessed, the Xero share price has been closing the gap steadily ever since. Equally important, in my view, and in line with my comments about Macquarie, CSL, and the likes earlier, the new guy in charge at UBS does not believe Xero's share price crossing the \$100 mark in less than five years from now is such an outrageous proposition.

In fact, he thinks this is do-able, not even accounting for everything in good news that can potentially pop up between now and then. The sentence that says it all from the May 2 UBS report:

"Xero is towards the end of a transition from a loss-making start-up to a self-funding business with a proven business model and significant structural growth opportunities".

By 2022, UBS projects, Xero shareholders should expect their first dividend payout (27c). The change in currency for UBS's price target is due to the fact Xero is abandoning its NZ-listing in favour of entering key share market indices in Australia.

Small cap specialists at Ord Minnett equally reviewed their Top and Bottom Picks in Australia. The new Top Pick is Webjet ((WEB)), of which the in-house analyst (no copying JP Morgan on this stock) has been a long term fan. Webjet has been in and out of investors favour over the year past because of numerous accountancy adjustments, which can be quite unsettling at times.

Ord Minnett, however, remains comfortable the company continues to grow "multiple times faster than the underlying markets in which it operates". Added scale in the B2B hotel segment should drive further earnings and margin growth.

The new Bottom Pick (negative view) is salmon producer Tassal Group ((TGR)) with the extra observation JP Morgan is one of very few who genuinely keeps a close eye on international and domestic dynamics affecting salmon producers in Australia. Ord Minnett white labels JP Morgan research while both IOOF Holdings, majority shareholder in Ord Minnett, and JP Morgan are reportedly in negotiations for the sale of JP Morgan equity in Ord Minnett.

Warmer waters and cost of production increases will be the main catalysts that will cause Tassal to disappoint investors, predict the analysts.

Finally, here is something that is worth contemplating, and for multiple reasons. Analysts at Credit Suisse have been a long time supporter of iSelect ((ISU)), no doubt thanks to the fact Credit Suisse was joint lead-manager of the float back in June 2013. On Monday they finally threw in the towel, having rated the stock Outperform alongside a price target of \$1.95 when yet another profit warning was released to the stock exchange.

The new rating is Neutral and the new target price is \$0.58. If this seems like overly harsh treatment, consider the share price was last trading at 53c. Yes, I know, it was above \$2 in mid last year, but that's how it goes with "cheap" looking stocks that simply cannot get the sustainable turnaround happening.

Monday's research update by the clearly unsettled duo of Paul Buys and Andrew Dodds stands out because it questions whether iSelect can have a future going forward. Both analysts question whether sustainable profits are actually possible with what seems to be a less than dependable business model?

It is here and now that we are all being reminded that at the time of the IPO, iSelect's largest shareholder pre-float, Spectrum Equity Investors, sold the bulk of its equity holding without any forewarning or obvious justification within weeks after the bourse listing. That certainly didn't look "supportive" at the time, and iSelect never really recovered from the bad start as a publicly listed internet portal.

In hindsight, Spectrum Equity Investors selling so soon after the successful listing should have been enough of a warning that iSelect is not a steady and reliable fee generator in the way management kept selling the corporate story to investors and stockbroking analysts. In the lead up to the IPO, I had the pleasure to talk about iSelect with an experienced source from within the industry. His view was short, but clear: don't go near it.

Apart from all this, this company in particular has given investors plenty of reasons to be disappointed since listing. Those who are still on board, holding out for that elusive miracle, or simply because the stock looks "cheap", should blame themselves for not paying attention.

One of the conclusions I have drawn from the years past, is too often investors, and their advisors, pay too much attention to "price" and "valuation" ("it looks cheap"), and not enough to "quality" of management and the business model.

This is one of the fundamental reasons as to why All-Weather Stocks such as CSL, Cochlear ((COH)), REA Group, et cetera are trading on much higher Price-Earnings (PE) multiples than the broader market. These companies are still exposed to the global economy out there, but there is a very slim chance they will ever do an iSelect, no matter what the circumstances.

Last week I was again reminded about this as Ainsworth Game Technology ((AGI)) issued yet another serious profit warning, and as management at Gateway Lifestyle Group ((GTY)) yet again disappointed by admitting the company won't achieve guidance for the year. These stocks might look "cheap", but that in itself won't prevent them from missing expectations, or disappointing otherwise.

The notion there's a price for everything, and share prices for perennial disappointers are likely to fall too deeply, only has value for a certain type of investor, with a specific strategy. Hint: it does not include Buy and Hold for the long term.

Alert subscribers would have picked up a large number of the stocks mentioned above are also included on the dedicated All-Weather Stocks section of the FNArena website. This section contains my research into this specific theme, as well as regular updates for all companies included. This section is exclusive for paying subscribers at FNArena (6 and 12 months).

Middle Class Poverty? Blame The Banks

An interesting angle regarding consumers and the outlook for consumer budgets in Australia was put forward by Dick Bryan, emeritus professor of political economy at the University of Sydney, on the Opinion page of the Sydney Morning Herald, 27th April 2018.

On Bryan's assessment, Australian society is now encountering a fully new concept: middle class poverty. And he finds Australian banks are to blame for it.

The general idea, and I am now translating a few dozen paragraphs into one sentence, is that banks have systematically allowed Australian households to over-borrow for property post GFC and today these households are living hand-to-mouth in order to continue paying off the burdensome mortgage, while costs are rising and property prices are falling.

Share prices in discretionary retailers are rallying on the prospect of a reversal in consumer spending on the back of tax cuts offered by an anxious Turnbull government in Canberra. If Bryan's assessment is even remotely correct, how long do you think any stimulus period might last?

RBA rate hikes anyone?

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Rudi's View: Quality Is Not In A Bubble

In this week's Weekly Insights (this is Part Two):

-Quality Is Not In A Bubble -Conviction Calls -Middle Class Poverty? Blame The Banks -Rudi On TV -Rudi On Tour

[Note the non-highlighted items appeared in part one on the website on Wednesday]

Quality Is Not In A Bubble

By Rudi Filapek-Vandyck, Editor FNArena

What if I told you you have the chance to buy into an investment that generates on average a return of circa 25% per annum, significantly above the market in Australia, while also high returning during periods of share market turmoil; say high single digit when European banks and Greece are in trouble (2011-mid-2012) and mid-teen percentage return between May 2015 and March 2016 when very little seemed to work in equity markets worldwide?

Even back in 2008-2009, when the world came to a dangerous stand still and equities lost half, or more, of their value, there was no loss for shareholders.

You'd probably smile and say "Thank You, I'll take it. What's the catch?"

That is, if you believe me. (Trust me, you can).

Now what if I offered you an alternative, say, an investment that, at best, tracks the index in Australia and that sinks like a stone, along with the broader market, every time uncertainty and turmoil hits? Average return over the past four-five years: not much, mostly paid out in dividends, which compensates for the slight erosion in capital. Would you be equally enthusiastic?

Now you say: No, why would I? (Am I stupid, or what?)

But you see, here is where things get interesting. Because, in real life, you are most likely to choose option number two.

Because option number one is CSL ((CSL)), trading at a significant premium towards most other ASX-listed shares, and most professional investors, commentators and other kinds of share market experts won't stop warning we should all be careful about buying stocks that trade at a premium. We might lose a lot of money.

These warnings are nothing new since CSL's premium has been around for more than two decades, but as everyone can see on a simple price chart going back far, far into the past, these constant warnings are in sharp contrast to what actually transpires in real life, and that is that CSL's share price very rarely pulls back significantly, and every time it does it recovers and then moves onwards to a new high.

The error most people make is to put all stocks in one basket and then try to distinguish on price. A low Price-Earnings (PE) multiple is "good", because you'd want to purchase at a low price. A high PE multiple thus is "bad" because the asset in case has now become "expensive".

This approach is in contrast to standard practice in just about every other sector that exists in the modern day economy. Does a Lamborghini cost the same as a Skoda? Is a Gucci dress more expensive than clothes bought at Target? Why do Ronaldo and Messi cost so much more than Tim Cahill? You can have a cheap holiday in Bali but you cannot replicate that on Capri.

The reason why stocks like CSL trade on a premium is because, simply put, they are of a higher quality. And the difference in quality shows up through much greater, sustainable rewards for shareholders in the long run.

This, by the way, has always been the case. But amid the hectic news reporting on day to day events and the smorgasbord of conflicting predictions for financial markets, this is not something that easily attracts a lot of attention (if any). However, as far as the past five years are concerned, the outperformance of "quality" over every other segment in the local share market has been brutal, as shown in the graph below from stockbroker Morgans.

What Morgans' analysis shows is that consistent high growth achievers have outperformed the ASX200 by 13% per annum since April 2013. All the while, investors rummaging around in "cheap" looking stocks are likely licking their wounds today, while those in the middle where growth is not more than average, with stocks trading on average PE multiples, those stocks have generated rather mediocre investment returns, as did the index.

Wait a minute, I hear you thinking, there have been plenty of examples of High PE stocks that have come crashing back to earth, try Domino's Pizza ((DMP)), for example, and Blackmores ((BKL)). True, but the same can be said about stocks trading on much lower multiples. Shareholders in AMP ((AMP)) just lost one quarter in only a few weeks time. Telstra ((TLS)) shares have more than halved since February 2015. Not to mention what happened to the stoic and faithful in IPH Ltd ((IPH)), iSentia ((ISD)), Retail Food Group ((RFG)), Myer ((MYR)), or Village Roadshow ((VRL)), to name but a handful out of an excruciatingly long list.

The conclusion here is not that High PE stocks represent higher risk (which is incorrect - see Morgans' research), rather it is that not every High PE stock is equal. Just like some stocks that fall in price can prove an unexpected bargain, while others are a value trap and nothing less.

So how does one distinguish a High Quality stock that deserves to trade at a premium from others that won't be able to sustain it?

Years of research into this matter have taught me that non-cyclical plays a major role. A true Aristocrat, or Champion Stock, or All-Weather Performer, whatever name we choose for these companies of exceptional qualities, operates above the vagaries of the typical economic cycle. They are the best in their field, which often acts as a moat around their operations and market share. They also have great management running the company with the added notion it is much easier to successfully run a great business than it is a not so great one.

In the words of Warren Buffett: It is smart to invest in a good company, one that, say, your idiot nephew could run. Because if you have a really good business, it doesn't make a difference.

Great businesses run by quality management display consistency, as well as dependability. You won't see CSL issuing a statement that next year's profits might be -30% below previous guidance. They might have debt on the balance sheet, but never in excessive quantities. You want to see consistency and dependability in action? Open a spreadsheet with CSL's annual sales, profits, margins and dividends over the past two decades.

One key characteristic that is often overlooked is these businesses continue to invest for the future. It is no coincidence CSL is one of the most generous spenders on R&D in the Australian share market. Investments effectively keep the business weather-proof through new product development, new markets, improved practices, higher efficiency, new applications, share buybacks, and the occasional acquisition.

Irrespective, after nearly three decades of strong growth, CSL might find the going a tad tougher if only because it has grown so much in size. In fact, this is one reason as to why some critics are warning there is a Bubble in Quality, with a strong suggestion share prices for companies including CSL are about to repeat the boom-bust experience of Bitcoin and other virtual coins.

Their argument is based upon two observations: firstly, the premium that quality growth stocks are trading at versus the rest of the market has never been this large, plus premium valuations today are also well above long term averages for the individual companies involved. Secondly; growth in many cases, including for CSL, has slowed down a notch which sits at odds with an even higher valuation premium.

What is missing in these Bubble Must Burst predictions is these premium valuations are not simply a multiple of next year's profit per share; there is an unquantifiable part that relates to the consistency in delivery and to the high degree of trust investors can place onto management's guidance, targets, and execution.

Equally important, while absolute growth might be slower today, on a sustainable basis, it is not that difficult to make the argument that on a relative comparison, companies like CSL today actually stand out even more from the pack because an increasing number of lesser quality peers finds consistent growth even harder to achieve than, say, five years ago.

Such is the contemporary environment for many an Australian company in which regulatory scrutiny, tight household budgets, rising bond yields, higher energy prices, a peak in the housing cycle, digital disruption and slowing economic momentum outside the USA are creating more headwinds and operational challenges than otherwise might have been the case.

Investors need not look any further than the latest company reports with all major banks bar Westpac ((WBC)) underwhelming on already reduced expectations (all consensus price targets have fallen post financial results releases), and with share prices facing selling pressure post trading updates and financial results releases from Orica

((ORI)), Incitec Pivot ((IPL)), Nufarm ((NUF)), Eclix ((ECX)), iSelect ((ISU)), Greencross ((GXL)), Australian Pharmaceutical Industries ((API)), Perpetual ((PPT)), Fleetwood ((FWD)), Village Roadshow ((VRL)), Catapult Group ((CAT)), Gateway Lifestyle ((GTY)), and others.

Management at JB Hi-Fi ((JBH)) recently tried to bury their profit warning for the running year inside a presentation to institutional investors (for which it was suitably embarrassed by the stock exchange). Similar to trying to get away with bad news via releasing it after the market's close on a Friday, this too is something you won't see happening from a true quality company. The same goes for accounting shenanigans (no room for "aggressive accounting").

Incidentally, the one result that proved truly awe-inspiring so far this month came from Macquarie Group ((MQG)) which, you probably guessed it, is also a member of the High Quality few enjoying a premium valuation.

There is one danger though, and that is that true Champions like CSL and Macquarie stand out too much for too long, which in share market terms means too many participants jump on board while the times are good and momentum is positive. Few ever doubt the quality and merits of an investment when the price is trending upwards.

During a presentation to investors two years ago, I was asked how long before stocks like CSL might fall out of favour? My answer was this is not a matter of time, but of circumstances. Everything needs context. It seems like a distant memory today, but CSL's share price did not perform between 2009 and mid-2012. Apart from some minor company specific issues, and the headwind from a rampant Aussie dollar, those were the years investors focused on the global recovery post the Grand Recession of 2008-2009. Having plenty of choice among beaten down share prices, and with profits surging after heavy falls, there was no need to value consistency, reliability, quality, sustainability or even growth in itself.

Who needs quality when one can make 40% return from beaten down cyclical?

Another time of heavy investor selling happened in the second half of 2016. Financial markets started pricing out emergency low bond yields, and every fund manager in the country sat overweight defensive growth and Champion stocks. The portfolio switching proved violent and swift, with every stock on a High PE sold down in exchange for "value" among banks and resources stocks.

It didn't last long.

Champion stocks have rallied to new highs and their relative premium versus low growth strugglers (let's call them for what they are) is again near an all-time high. At least, that was the case after the February reporting season during which many a High PE, High Growth company delivered more evidence of why their stock deserved to trade at a significant market premium.

Next came general market weakness during which those stocks on premium valuations displayed better resilience. Oops. That meant the relative premium was now even larger!

The correction since is taking place through relatively stronger performances from energy stocks, miners and various other laggards since the beginning of April. Tellingly, there has been no en masse abandoning of Premium High Quality Growth Stocks, despite higher bond yields in the US and "experts" warning about The Next Bubble.

It is possible this relative underperformance versus cheaper "value" has further to run, as I suspect funds managers have again found themselves with too high levels of cash and not enough risk to warrant a sell-off in markets. I very much doubt, however, we are going to see a repeat of late 2016 anytime soon.

Beyond the short term, I remain of the view High Quality, High Growth will continue to deliver, and continue to perform. Because such is the general corporate and economic context.

The FNArena-Vested Equities All-Weather Model Portfolio invests in accordance with the principles outlined above, and in-line with my ongoing research into All-Weather Performers in the Australian share market. Paying subscribers at FNArena have access to my past publications (including eBooks), updates and writings, as well as a dedicated section on the website.

The Portfolio's performance couldn't keep up with the broader market's 3.9% surge in April, but then there were no negative performances in the three preceding months. For the financial year to date, the performance as at April 30th, is 12.21% (10 months). If we go back to April 30 last year, the performance has been 15% (12 months). For the first four months of the calendar year, the return stands at 2.84%.

All these numbers are (well) above the performance of the ASX200 Accumulation index which at the end of April was still slightly negative year-to-date (-0.11%), with the twelve months total return not reaching beyond 5.46%. The market's return for the financial year ending June 30th thus far is 8.26%. Many a balanced fund in Australia has found it hard to beat the index over the longer periods, or even over the past five years. Why do you think this has been the case?

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