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Stories To Read From FNArena

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Wireless More Significant For Telstra, NBN

Telstra has downgraded revenue and earnings estimates for FY18 in view of the NBN decision to delay the roll out of HFC technology. Yet several brokers remain more concerned about the increasing influence of wireless.

-NBN delays not hugely significant for Telstra's valuation -But indicative of the sensitivity of reported earnings to one-off NBN payments -Wireless technologies a threat to the NBN model

By Eva Brocklehurst

In response to the NBN decision to delay the roll out of HFC technology for 6-9 months, Telstra ((TLS)) has reviewed its earnings outlook for FY18. If it were not for the NBN announcements guidance would be unchanged, as the company has indicated there is no change to the performance of operations.

Revenue estimates for FY18 are lowered by -$700m and operating earnings (EBITDA) by -$600m. This indicates a downgrade of around -2% and -5% at the mid point of guidance, respectively. Telstra suggests the delay will be modestly positive, financially, over the full rolling out of the NBN. In other words, one-off payments will be received just a little later, and the company would obtain the benefits from using its existing higher-margin infrastructure for longer.

There was nothing in Telstra's update to change Morgan Stanley's fundamental view and Underweight rating, noting, if nothing else, the situation is indicative of the sensitivity of reported earnings to the one-off payments from the NBN.

Macquarie also finds, on an underlying basis, there is little changed, as the majority of the impact is a timing difference. The broker calculates much of it will reverse in FY19, although acknowledges the timeframe over which the NBN plans to catch up is unclear.

Macquarie upgrades Telstra to Outperform as the dividend is underpinned by NBN payments over the medium term and the yield should provide support. The thesis of yield support holds on the basis that Telstra can hold, or grow, its dividend.

Morgans assumes the delays will have a knock-on effect in FY19, reducing FY18 forecasts for earnings per share by -10% and FY19 by -6%. The broker believes investors are not paying for any potential upside around competing technologies and downside is priced into the valuation. Telstra is considered to have a partial natural hedge on the NBN, so the delays are not drastic to valuation, and this is one of the key reasons Morgans has an Add rating.

Citi has a different take. The broker is surprised the downgrade to operating earnings is so large, which implies that either the natural hedge is less effective than previously expected or there has been further deterioration in the core business since original guidance was issued in August.

NBN delays are positive for core earnings, the broker admits, as Telstra retains its copper network earnings. Citi's estimates for earnings per share are reduced by -10% in FY18 and -4% in FY19, while FY20 is upgraded 13% on the assumption that the NBN will still hit its FY20 targets.

Wireless

While 80% of the revenue from the NBN roll out has been delayed, Citi estimates 20% of this is a permanent loss, given NBN has increased its allocation to wireless and will not pay Telstra for disconnecting the copper network in those areas.

Wireless technologies are a real threat to the NBN model, Morgans agrees. Australia may languish in respect of fixed-line speeds but it is in the top 10 for mobile speeds globally. Moreover, the introduction of 5G and other wireless last-mile technologies, which are not going to be regulated, are a real threat to the NBN, and Morgans suggests its financial model may fail. The broker asserts the NBN will have to lower the last-mile access price, which would ultimately be a positive for telco earnings.

This could happen in FY22, or even earlier, when the last customer is forced onto the NBN and numbers are solidified. Morgans considers the NBN a political hot potato and, if the government wrote off the $30m in equity invested and lowered last-mile access costs this would solve a significant part of the speed problems. As Telstra shares are trading -12% lower since the FY17 result, Ord Minnett also takes a look at what catalysts are required to lift the stock.

The broker agrees, given an impending new entrant on the mobile side, the catalyst will have to come from a change in the NBN business model and it would be in the best interests of the country if the government lowered its expected return on the investment in the NBN to allow a focus on service rather than profitability.

The government would have to write down some of its investment and the broker estimates 30-50% potential upside to Telstra share price if such an event occurred. The other catalyst could be a reduction in fees imposed on internet service providers to access the NBN network. The impact on Telstra would be similar, albeit on a smaller scale. In this scenario, Ord Minnett estimates 20-30% potential upside to the share price.

FNArena's database shows four Buy, two Hold and two Sell ratings. The consensus target is $3.78, suggesting 9.0% upside to the last share price. Targets range from $3.25 (Citi) to $4.11 (Morgans). The dividend yield on FY18 and FY19 forecasts is 6.3% and 6.4% respectively.

See also, NBN Delay Largely Neutral For Telstra on November 28 2017.

This stock is not covered in-house by Ord Minnett. Instead, the broker whitelabels research by JP Morgan.

Buying Opportunity Presents In G8 Education

A slump in occupancy and higher costs have driven G8 Education to downgrade earnings. Many brokers consider the drop in the share price presents an opportunity.

-Several contributing factors to the downgrade temporary in nature -Supply-driven risks likely to continue into the first half of 2018 -High sensitivity to changes in occupancy rates

By Eva Brocklehurst

A surprise downgrade by G8 Education ((GEM)) led to a sharp sell-off in share price yesterday but most brokers believe this was undeserved, and it is an opportune time to buy. The main reasons cited for the reduction in 2017 estimates included new childcare supply, higher costs relating to staff changes and an increase in training costs. The company has revised 2017 guidance for earnings to be around $160m, down from "mid $170m" previously.

Canaccord Genuity believes the fundamentals are positive, as childcare is a relatively defensive industry where supply is moderating and demand is likely to benefit from an increase in government funding.

The main problem areas for supply were western Sydney, Gold Coast, east Brisbane and inner Melbourne, which comprise 73% of the downgrade for 2017. Canaccord Genuity estimates the revised guidance, reflecting the past three months of trading, suggests a -1.5-2% decline in occupancy, beyond what was expected.

The other major contributing factor to the downgrade was a regulatory change that came into effect in NSW and Victoria on October 1, that ensured staffing ratios were met during staff breaks. This required agency labour to fill gaps but the issue is considered temporary. An additional $1m in staff development and training was also spent above what was factored into prior guidance, but is also expected to be a passing influence.

The share market reaction was overdone and this presents a buying opportunity, hence Canaccord Genuity, not one of the eight stockbrokers monitored daily on the FNArena database, has a Buy rating and $4.20 target. Going forward, strong double-digit growth in earnings per share is expected in 2018 and 2019. Moreover, a conservatively geared balance sheet means the company is able to grow via acquisition.

CLSA is on the same page, recommending buying on the weakness. A weak 2017 result was expected although the downgrade was larger than forecast. Timing suggests the company may have experienced a sharp deterioration in occupancy late in the year. Still, risk/reward remains to the upside, in the broker's opinion, amid changes in government funding and a strong development pipeline. CLSA, also not one of the eight, has a Buy rating and $5.40 target.

However, Deutsche Bank considers the downgrade reflects a notable loss of earnings momentum and retains a Hold rating on this basis, citing heightened uncertainty in the industry overall. On the positive side, the company has indicated its acquisition program is on track and the upcoming childcare funding package will be positive.

Ord Minnett does not believe the downgrade suggests any new systemic industry or company-specific issues. It could be argued guidance needs to be set more cautiously going forward but the broker does not believe this casts doubt over the investment thesis. Significant improvements in operating earnings and return on capital are expected over the medium term.

Given the reaction in the share price, down -23%, the broker agrees investors now have a second chance before earnings start to move higher, particularly from the second half. Ord Minnett estimates underlying operating earnings fell short of budget by around - $10-11m, or -5-6%.

Occupancy

Macquarie acknowledges valuation is undemanding but remains cautious, envisaging supply-driven earnings risks will continue into the first half. Industry dynamics are expected to improve after rebate changes from July 1 but the broker wants evidence of improved occupancy before becoming more comfortable with the outlook.

This is particularly so given the high sensitivity of the stock to occupancy changes. Macquarie estimates every 1% change in occupancy leads to a $10m change, annualised, in revenue. The broker assumes a similar level of occupancy in 2018 to 2017, with a weak first half and a stronger second half. The first half of the year is also seasonally weaker because children leave to start school in February.

The main driver going forward, Ord Minnett agrees, will be the absorption of the supply that has been added to the market over the next 18-24 months. The company expects average occupancy to now be around 77% in 2017, implying a -2.7% fall on 2016. Occupancy could be a challenge, but Ord Minnett does not believe the situation is any worse than previously communicated.

For Deutsche Bank, the downgrade also highlights the high leverage in fixed costs to occupancy movements and, given exit barriers for excess supply in the industry are high, the market assumption that occupancy will improve in the short to medium term heralds downside risk.

Rebate Changes

Childcare subsidies will be introduced on July 1 with activity and means testing. In the activity test the subsidy will be determined by the hours of activity. A childcare rebate of 50% that is currently not means tested will be replaced with a subsidy. The single subsidy will be 20-85% with no fee relief for families on incomes over $350,000 per annum.

The database shows two Buy and two Hold ratings. Consensus target is $4.13, suggesting 16.2% upside to the last share price. The dividend yield on 2017 and 2018 forecasts is 5.5% and 5.6% respectively.

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Capital Return On The Cards For Metcash

Metcash has ended its first half with a net cash position and will contemplate capital management by the end of the second half. Nevertheless, brokers have mixed views on the ability to turn around the supermarkets business.

-Grocery business structurally challenged in the longer term yet hardware provides a counterpoint -Upside risks to forecasts if the company can improve IGA retail sales, increase private-label and reduce units to support margins -Brokers expect either increased pay-out ratio and/or buyback

By Eva Brocklehurst

Metcash ((MTS)) expects further cost reductions in supermarkets and growth in its hardware business will provide modest growth in earnings in FY18. First half results suggest cash flow has improved, with the company moving to a net cash position.

A capital management review has been flagged for the second half. Definitive guidance was not provided and management expects difficult conditions in food & grocery will continue in the second half. Savings from the "working smarter" program are expected to provide an offset.

Morgan Stanley suggests the shares are cheap and, as the market comes to appreciate the longer-term hardware opportunity and a turnaround in food & grocery a re-rating could occur. Cost reduction initiatives, given the company is not even halfway to its target of $120m, means cost growth will likely be negative for the next 2-3 years in the food & grocery division and improvements in sales trends will help profitability.

The stock trades at a discount to intrinsic value as it continues to be viewed as a structurally challenged business yet, although part of the supermarkets business is challenged, this has always been the case, Morgan Stanley contends, and hardware is in line for structural growth from the exit of Masters and a fragmented home improvement market.

UBS upgrades FY18-20 estimates by 6-9%, with modest upgrades to hardware reflecting the upgraded synergy target of $20-25m. The broker believes the grocery business, which is 60% of operating earnings (EBIT), is structurally challenged in the long-term, yet concedes there are few catalysts for underperformance in the near-term as cost reductions and hardware synergies offset the top-line pressures for the moment.

The broker has placed the stock under review, looking at the probability that synergies from hardware and cost reductions in groceries could mean earnings growth is sustained for longer. At present UBS maintains a Sell rating.

The stock should be trading at a large discount to Woolworths ((WOW)) given the challenges and a recovery at Woolworths, in Deutsche Bank's opinion. Currently, the stock is trading at around -38% discount which compares with its long-run average of -40%.

The broker observes sales are still declining and margins would be narrowing if it were not for the cost reduction program. Conversely, there are still opportunities to grow the liquor business and hardware is benefiting from synergies. The broker expects the independent supermarkets will continue to lose share and when cost reductions come to an end operating de-leverage is likely to resume.

Macquarie is more positive. The cost reduction program is being used partially to stem cost inflation in the core business, and could be competed away, yet this is a good source of earnings in an otherwise challenging environment.

Upside risks to forecasts are envisaged should the company be able to execute on some of its strategies, such as improving IGA retail sales via Metcash to 80% from 70%, increased private-label penetration and a reduction in units to supplement margins.

Credit Suisse does not have a lot of enthusiasm for a business where sales revenue is declining by around -3-4% per annum, the issue stemming from IGA supermarkets and the wholesale business. Expansion of Aldi and cost reductions at Woolworths and Coles ((WES)) is likely to mean deflation continues over the medium term and this is negative for the company's high fixed cost model.

While the broker accepts there is a solid opportunity in the acquisition of Home Timber and Hardware (HTH) this only contributes 22% of group EBIT on a fully annualised basis.

CLSA, too, suggests a return to sustaining positive sales is eluding the business, with cost reductions required to maintain steady earnings and points out consumers continue to move away from the IGA brand and the number of Super IGA stores has fallen 23% in the last four years.

While hardware stands out with pro forma sales growth of 7% and synergies from combining Mitre 10 and HTH have been upgraded, CLSA worries that a return to growth will be hard to achieve. The broker, not one of the eight monitored daily on the FNArena database, downgrades to Sell from Underperform, with a target of $2.70.

Citi observes sales trends are weak and the food & grocery segment remains dependent on cost savings to stabilise earnings. The broker envisages several risks, particularly as the company faces revenue decline in grocery, amid potential contract losses in convenience stores or major retailer groups.

Capital Management

Capital management in the form of an off-market buyback or special dividend is likely, UBS believes, estimating a $100m buyback will be 2% accretive to earnings per share in FY19. Citi believes a higher dividend pay-out ratio is most likely but concedes a buyback could also be accretive, given the comparatively lower cost of debt. The broker forecasts a gradual lift in the pay-out ratio to 70% from 60%, subject to market conditions.

Credit Suisse agrees with the likelihood of a higher dividend pay-out, potentially 80-90% in the near-term, or a buyback at around 5% of issued equity in the absence of significant growth initiatives. The broker is not that confident that the free cash flow yield of 8% adequately compensates for medium-term earnings downside, and downgrades to Underperform from Neutral.

Given the stock is now in a net cash position, a buyback make sense to Macquarie at current multiples. A $300m buyback would take gearing to around 15% and be 7% accretive to earnings, factoring in the positive spread between the earnings yield and marginal cost of funding.

Liquor

The liquor business has been under pressure with a $1m provision for a bad debt in Western Australia and consumption trends suggesting a reduction in volumes. Moreover, operating expenditure associated with start of the new container deposit scheme in NSW affected the first half. Retailers located in northern NSW that were previously being serviced by a Queensland distribution centre have had to be re-routed to NSW given the new pricing structure.

The database has two Buy, two Hold and three Sell ratings. The consensus target is $2.82, signalling -9.9% downside to the last share price. Targets range from $1.90 (UBS) to $3.40 (Morgan Stanley). The dividend yield on FY18 and FY19 forecasts is 4.4% and 4.7% respectively.

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Housing Demand To Ease In Major Centres

Demand for new houses and land across the major centres of population in Australia is likely to start easing, BIS Oxford Economics suggests.

-Greater demand for medium and high-density dwellings at the expense of new houses -Land prices now catching up with house price growth -More difficult for developers to maintain margins as construction costs accelerate

By Eva Brocklehurst

Deteriorating housing and land affordability across Australia's major population centres is expected to quell demand for new houses and, consequently, limit the next round of housing lot production.

This is the finding from a report by BIS Oxford Economics, which signals demand for residential land in the major centres of the eastern states should ease into 2018. The research company's Outlook for Residential Land 2017 to 2022 report suggests residential lot production in Sydney, Melbourne and south-east Queensland has peaked. Demand for land in Adelaide and Perth has been weakening and will continue to soften.

Changing lifestyle choices and affordability preferences have also meant greater demand for medium and high-density dwellings at the expense of new houses. New supply in the eastern state population centres has been more pronounced in the units & apartments segment, amid a continued deficiency of detached housing, which is likely to underpin demand going forward.

A downturn in new dwelling supply should mean a deficiency in housing stock re-emerges in most markets eventually. Along with an expected acceleration in economic growth by the turn of the decade this should underpin rising demand for housing through the next cycle.

Meanwhile, new housing demand remains at high levels, with Sydney estimated to have recorded its highest level of residential land production over 2016/17. Lot production in Melbourne peaked in 2014/15 and has remained close to this peak in subsequent years. Brisbane, Gold Coast and Sunshine Coast also experienced a moderate upturn in 2013/14 after an extended period of weakness.

"Most markets saw house price growth outpace land price growth through the early stages of the upturn, which improved the value proposition for a new house," researcher Angie Zigomanis said. "That said, land prices have now largely caught up and this gap will have narrowed, making new housing less attractive."

There's been significant increases in land prices in Melbourne this year which has meant new house affordability has deteriorated. While lot production is likely to remain high into 2018, as recent pre-sales of residential lots are delivered, the resultant weaker demand will cause lot production to fall away from 2018/19, the report suggests.

Meanwhile, Brisbane had an undersupply that reached its nadir in 2012/13, which initiated an upturn that has been supplemented by strength in net interstate migration flows. A further rise is forecast in 2017/18 before significant oversupply in the apartment market in Brisbane plays through to demand for new housing.

The Sunshine Coast and Gold Coast markets have followed the lead of Brisbane. Lot production peaked in 2016/17 as both markets benefited from migration out of Brisbane, Sydney and, to a lesser extent, Melbourne, when affordability became increasingly constrained in those cities.

Lot production Adelaide has been more moderate than in the eastern states. Low interest rates and modest house price growth supported demand but slowing economic conditions and population growth are now weighing on that market.

In Perth the market is now falling after a peak in 2014/15. Western Australia's decline in mining-related investment has caused interstate migration to shift to an escalating outflow and overseas migration has fallen. Consequently, demand for new houses has slumped in Perth and this has affected the land market.

It appears to the writers of the report that median lot sizes have stabilised in most cities over the past 2-3 years. An expected softening in house price growth over 2017/18 and 2018/19 is expected to play through to land prices, which in turn will make it more difficult for developers to maintain margins as construction costs escalate. Affordability will become more challenging and most markets are expected to experience an easing of housing lot production in the next 2-3 years.

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ASX' Blockchain A Long Term Play

ASX has decided to replace its CHESS system with a distributed ledger technology. While this has potential to create new revenue opportunities, broker suggests it will be some time before these become evident.

-Costs should come down with less need for reconciliations -Near-term value seen reflected in the share price -Initial focus for DLT introduction will be on market stability and integrity

By Eva Brocklehurst

Australia's Securities Exchange, ASX ((ASX)), has leaped into the forefront of the digital revolution, deciding to replace its ageing systems for clearing and settlement of transactions with a new platform. The company will replace its CHESS equity clearing and settlement system with a distributed ledger technology (DLT).

At this stage, Citi considers this little more than a decision to replace one technology with another but suspects, in time, it could lead to significant changes in revenue streams. Some revenues will likely diminish but this should be substantial scope for new services.

Costs should come down, as there is less need for reconciliations when participants connect to a fully functioning DLT. In turn, this should make it cheaper to transact and potentially increase volumes.

ASX will give customers choice in accessing post-trade services, allowing them to continue to connect in a similar way using the current front-end, if preferred. Customers will also be able to connect directly with a distributed ledger.

Regulators, at this stage at least, are not expected to object to the implementation of DLT. Regulators will be a party to the architecture by being a node in the network.

Citi expects the introduction of DLT to clearing will have implications for a number of players such as share registrars, including Link Administration ((LNK)) and Computershare ((CPU)) as well as investment banks.

The broker believes the ASX is a perfect case for testing the technology given it is a private network and has only one small competitor. Further advantages include the fact that transactions committed to DLT can never be undone and represent a single source of fact.

Deutsche Bank agrees the impact will be limited in the near term, as the focus is expected to be on market stability and integrity, but DLT opens up significant opportunities for growth in the longer term.

The broker envisages the main risk depends on whether trading levels vary significantly from trend, while unexpected regulatory changes could also provide risk over the medium term. Deutsche Bank likes the company's strong market position and balance sheet, but as cost growth is currently running at double the revenue growth believes the stock is fairly valued.

Value Upside?

UBS believes the boost evident in the share price in the lead up to the decision is likely to fade. Moreover, with buoyant equity markets over the first half that have not translated into stronger revenues the valuation metrics appear increasingly stretched. Alongside the the bullish sentiment regarding technology the shares also appear to have outperformed on rising equity markets.

Yet equity revenue drivers have failed to follow suit, as turnover is down -2% in the year-to-date and higher margin on-market turnover is down -4%. Furthermore, dominant settlement messages, which are a key revenue driver, are down -7.5%. Within derivatives, SFE futures volumes have been robust, UBS acknowledges, although equity options are flat. All up, the broker opts to downgrade its rating to Sell from Neutral.

Blockchain

A blockchain is a distributed database, a decentralised list of transactions shared between computers instead of being stored on a central computer. The ASX DLT system, being built by US-based Digital Asset Holdings, will require permission be granted for access i.e. it is a “permissioned blockchain” as opposed to a public blockchain.

The DLT system means ASX will continue to control settlement and ownership data but will make it available without access barriers to market operators and other clearing facilities.

Ord Minnett considers the benefits provide a medium-term tailwind for ASX and expects the the legislated monopoly in CHESS will be replaced by a natural monopoly in providing IT and back-office infrastructure and data. Costs are likely to increase from FY19 but the company has suggested a lot of this could be covered under its existing capital expenditure plans.

Morgans guesses DLT will be relatively neutral to earnings, although new functionality may provide some earnings upside. The company has maintained FY18 capital expenditure guidance at $50m and the broker expects similar levels over the next few years, given the DLT development costs will likely offset some reductions in expenditure from completed projects.

The company has stated that DLT was selected as the technology because, in part, it can deliver additional revenue opportunities. Day one requirements of participants will ultimately affect the timing of capital expenditure, Morgans suspects.

Transition To DLT

The proposed timing for the transition will be provided by March 2018 but details and capital expenditure are unlikely to be available until August. Full roll-out is likely to take around 24 months. The clearing function is unlikely to completely disappear but over time there may be less need for it.

This should then reduce the capital ASX needs to support its clearing house. Nevertheless, Citi suggests it may be a while before the Reserve Bank of Australia allows significant capital to be released.

The main transition involves replacing the old clearing house electronic settlement system, which has not reached the response time that pre-trade order-queuing and electronic trading of financial assets has reached. This results in a settlement latency. Latency is expected to be maintained in the transition to DLT.

A testing phase will be started in March 2018 and settlement times will remain at T+2, despite the technology allowing faster settlement. A longer settlement period allows market participants to open and close positions in the same trading day without posting capital, and benefits ASX volumes. In particular, high-frequency traders use this feature.

FNArena's database shows three Hold and five Sell ratings. The consensus target is $52.24, signalling -6.8% downside to the last share price. Targets range from $49.09 (Morgans) to $54.90 (Citi).

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Material Matters: Oil, Coal And Oz Miners

A glance through the latest expert views and predictions about commodities. Oil; coal; commodity outlook and Oz miners.

-Will OPEC-led production cuts reduce global oil stockpiles next year? -Declining need for high cost, marginal coal supply perceived in 2018 -Chinese support expected to drive positive earnings revisions for miners

By Eva Brocklehurst

Oil

OPEC and allied oil producers have agreed to extend production cuts for a further nine months to the end of 2018. Production caps for Libya and Nigeria will also help reduce oversupply risks next year. Commonwealth Bank analysts note both countries account for around 2.8% of global oil supply and their inclusion in OPEC's decision is a surprise as both are producing below historical levels because of disruptions.

OPEC has also stated that production limits will be reviewed at the June meeting. The analysts suggest the inclusion of a review will appease Russian companies that are looking for an exit strategy. Saudi Arabia has suggested that when an exit is contemplated it will happen gradually to insulate the market from any shocks.

The CBA analysts maintain downside risks to estimates, amid concerns that OPEC-led production cuts may not reduce global oil stockpiles next year. Meanwhile, US supply growth looks more certain and there is increased hedging activity.

Morgan Stanley suggests, outside the US, there isn't much growth to be found. Moreover, despite impressive production numbers in September from US states where shale production dominates, growth to that extent is hard to sustain.

In aggregate, over the last 12 months, supply has fallen, outside of OPEC and associates, driven by Mexico and China in particular. Demand is growing and, with supply constrained, the broker suggests the burden on shale will increase. This should provide fundamental support to current oil prices.

Morgan Stanley believes the OPEC decision comes against a backdrop of a market that has already re-balanced. as inventories have been drawn down rapidly this year. US shale will need to contribute at least 1.1mb/d in 2018, a 20% increase, just to keep the oil market under supplied to the equivalent of 2017.

Coal

Macquarie finds some interesting trends amongst trade flows in coal. Demand from Asia is particularly evident in South African exports and the persistence of negative freight across the swap curves is considered a reflection of the strength of Pacific markets relative to the Atlantic.

South Korea has increased imports from South Africa, Canada, Colombia and the US. This is markedly different to Japan, which source most of the additional coal from its traditional Australian supply. For China, most of the additional imports come from Indonesia. India meanwhile has cut back on thermal coal imports in 2017 with the exception of the US.

Generally, Macquarie envisages a declining need for high-cost, marginal supply in 2018. Ex-China seaborne demand is still positive, driven by continuous growth in Asia that is only partly offset by a further decline in European imports. Additional supply from Australia and Colombia is expected to meet most of the demand in Asia.

The market in 2018 appears dependent on a further increase in Chinese imports and/or a rebound in Indian seaborne demand in order for prices to stay at their current elevated levels, in Macquarie's view.

Commodity Outlook And Oz Miners

Citi makes significant upgrades to commodity prices, ex-precious metals, with the largest upgrades being for bulks. A tight Chinese steel market is expected to support more sustainable steelmaking margins, in turn supporting demand for high-grade iron ore.

The broker upgrades forecasts for iron ore to US$64/t from US $53/t. Meanwhile, Newcastle thermal coal prices are expected to average US$78/t in 2018 and metallurgical (coking) coal is expected to average US$155/t.

Although there are near-term risks from seasonal and Chinese currency-related effects, that may be amplified by the shutting down of Chinese operations over the winter, the broker expects demand to recover and a re-stocking rally in the first quarter of 2018.

Chinese growth and supply-side reforms continue to provide support for the market, although Citi does not necessarily forecast significant gains in 2018. Consensus upgrades are expected to drive positive earnings revisions for the relevant companies as well as strong free cash flow. If companies remain disciplined, and there is a lack of viable acquisition targets or projects, this cash flow is expected to be distributed to shareholders.

The broker prefers the Australian diversified majors such as BHP Billiton ((BHP)), Rio Tinto ((RIO)) and South32 ((S32)), as they are expected to deliver cumulative free cash flow of US$56bn over the next three years on the broker's current commodity price forecasts. Citi upgrades BHP, Rio Tinto, South32, Fortescue Metals ((FMG)) and Alumina ((AWC)) to Buy from Neutral.

Citi has a positive outlook for copper and nickel in 2018/19, which drives upgrades to its targets for Independence Group ((IGO)), OZ Minerals ((OZL)) Sandfire Resources ((SFR)) and Western Areas ((WSA)). OZ Minerals remains the broker's preferred copper and base metal exposure.

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Robust Demand Pushes Oil, Gas Prices

The decision by OPEC and allies to continue limiting production until the end of 2018 has provoked a review of the outlook for oil and, by association, Australian gas prices.

-Oil market rapidly re-balancing despite OPEC decision amid little project expansion, except in US -A key factor in the outlook is the speed at which the US gears up for LNG exports -Recent easing of Oz gas prices likely to be temporary amid heightened appetite for gas

By Eva Brocklehurst

As widely expected, OPEC and allies have extended their current crude oil output agreement to the end of 2018. Morgan Stanley considers this a positive step forward as it reduces the risk of upside surprises to production, given the inclusion of both Libya and Nigeria in the quota.

The broker forecasts very little growth from OPEC next year with production in Venezuela, Angola and Algeria also likely to decline independent of OPEC policy. The decision comes against a backdrop where the oil market is already rebalancing and inventories have been drawn down rapidly.

With globally synchronous economic growth and oil prices well below historical highs, Morgan Stanley expects demand will continue to power ahead in 2018, and forecasts another year of 1.5mb/d growth. In the absence of an uptick in investment, the broker expects global production decline to continue, modelling a further contraction of 0.1mb/d in 2018.

This leaves an opportunity for the US to fill the gap but for this to happen, US shale will need to contribute at least 1.1mb/d of global growth in 2018, almost a 20% increase. Even so, this will leave the oil market under-supplied by an amount similar to 2017.

Oil prices have risen faster than National Australia Bank analysts expected, with Brent now above US$63/bbl. This should present upside to domestic prices, compounded by forecasts for a lower Australian dollar. Meanwhile, the performance of Queensland coal seam gas has been patchy and new development is likely to be relatively high cost.

The analysts suspect that even if the Commonwealth can create a surplus in the domestic market and keep prices lower than export benchmarks until 2019, it is likely that 2020 is will mean renewed international integration and gas prices will continue to equal export prices, minus transport costs. The key factor may well be the speed with which the US gears up for LNG exports.

The analysts suggest if east Asian prices move away from oil and towards Henry Hub, then there may be downward pressure on Australian export prices.

UBS presents a base case that OECD inventories will reach five-year averages by the September quarter of 2018 after which there will be have a tapering of producer quotas. The broker retains a longer-term view of Brent at US$70/bbl, a level which is estimated to incentivise new production.

The broker increases estimates for 2018 Brent by US$5/bbl to US$60/bbl, which has material implications for company earnings in that year. Higher oil prices also flow into higher contracted LNG pricing. Companies with higher-than-optimal debt levels such as Santos ((STO)), Origin Energy ((ORG)) and to a lesser degree Oil Search ((OSH)), should be able to accelerate a reduction in debt. No acceleration in growth activities is expected.

Shaw and Partners also revises oil estimates higher, in line with current moves in the market, and considers the recent easing of gas prices a temporary reprieve. Corporate activity is on the ascendancy which means industry appetite for gas is heightened. Oil markets, if OPEC adheres to its cuts, are expected to continue rebalancing through 2018 and gather momentum in 2019.

The broker also notes recent drawdowns in the US and OECD are counter-seasonal and, if sustained, would be quite bullish for oil prices in 2018. The broker revises earnings and valuations for oil stocks across the board and prefers the lower cost, lower-geared stocks which offer the least risk through the cycle.

Supply, rather than demand, is considered the key driver of the rebalancing story. Traders are keenly watching US supply and data shows the US rig count plateauing. US production is now at a record high and benefiting from the diversion of capital to short-cycle onshore US production.

Yet, despite rising domestic supply, US inventories are falling at greater than historical rates, which can only be explained by exports. This suggests that US volumes are displacing supply from other regions where depletion rates are rising.

The question Shaw and Partners asks is: when will debt and equity providers exhaust the funds for this negative investment in US production? A lot of onshore companies remain in negative cash flow and can only continue growing if there is capital to feed on.

LNG Outlook

UBS believes a new wave of supply will be difficult to absorb in the short term. Yet, underlying demand remains strong and a shortage of new projects being sanctioned is evidence the market will eventually rebalance. The broker also suggests LNG pricing cannot change in such a way as to dissuade new investment, which will need to be actioned in the next 2-3 years.

Australian large cap energy stocks are primarily LNG companies so a change in LNG demand growth, likely emanating from China, should mean a faster rebalancing and that this segment outperforms the market over the next 12 months.

While the intensity of reports on Australia's gas crisis have abated, longer-term supply issues have not been resolved, Shaw and Partners asserts, and higher prices are expected to return again in 2018. The broker suggests the industry is responding to gas price signals and the ongoing threat of Commonwealth intervention, with many raising equity capital and activity levels picking up in the Cooper Basin in Queensland.

While major pipelines have been proposed to connect the Northern Territory and Queensland's Bowen and Galilee basins to the east coast network, this will take time. Meanwhile, non-binding approaches to acquire AWE ((AWE)) and Santos suggest ongoing interest in companies which are active in gas exploration and production.

Macquarie envisages the global oversupply from projects that are operating, or under construction, could last until 2022. If advanced projects are included in this calculation the oversupply would extend to 2027. Moreover, two other factors may stretch this out even further, such as export plants running above nameplate and the rise of renewables.

The broker notes significant contributions to volatility in LNG prices have stemmed from the lack of storage capacity in China and start-up delays from new projects. This volatility is now diminishing as gas storage in China has been completed and many of the delayed projects are ramping up in the US and Australia.

In combination with a substantial volume of legacy contracts that are up for renewal, Macquarie has lowered long-term LNG price estimates to around US$7.50/mmbtu in real terms. The broker envisages new demand to 2030 coming through emerging countries in Asia.

The broker's top pick among LNG producers is Oil Search, which has upside from its recent Alaskan acquisition. For Woodside Petroleum ((WPL)) Macquarie believes falling oil volumes in 2018 and rising contract risk do not justify implied pricing.

Wholesale LNG Markets

National Australia Bank analysts observe that domestic gas suppliers are offering wholesale contracts at up to $10/GJ, amid expectations of a recovery in LNG export prices, which are currently hovering around $8-9/GJ. Contracts have become difficult to secure for more than 18 months or so, despite much longer-term contracts being available to overseas importers of Australian LNG.

Domestic spot prices may have trended lower since the June quarter to reflect the move towards more accurate netback prices - exports minus liquefaction and pipeline costs - as well as political pressure, but the summer remains a risk for Australian prices and possibly supply. The analysts expect, if export prices move higher following oil, domestic prices could again exceed $8/GJ and elevated electricity use could drive prices even higher than that.

While Australian LNG exports continue to ramp up, the analysts suspect that some terminals will run well below nameplate capacity. Australian Energy Market data shows that only APLNG is running close to capacity.

Gas used in electricity generation has fallen markedly in Queensland since early 2015 and the beginning of gas exports. In contrast, gas use has increased in Victoria and South Australia since 2016, reflecting the closure of coal generators.

The NAB analysts suggest the implications for energy markets are profound: higher wholesale gas prices will drive improved profitability for remaining coal-fired generators and keep them in service for longer while any new generators are likely to be renewable.

Find out why FNArena subscribers like the service so much: "Your Feedback (Thank You)" - Warning this story contains unashamedly positive feedback on the service provided.

Weekly Ratings, Targets, Forecast Changes

By Greg Peel, Acting 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 November 27 to Friday December 1, 2017 Total Upgrades: 7 Total Downgrades: 8 Net Ratings Breakdown: Buy 41.34%; Hold 42.54%; Sell 16.12%

Last week saw the ASX200 bouncing around the 6000 mark, failing to make a meaningful breakthrough. Stock analyst ratings changes were again evenly balanced over the week, with seven upgrades meeting eight downgrades. Of the upgrades, six were to Buy and of the downgrades, three were to Sell. At 42.5%, Hold ratings continue to edge out Buy ratings.

There was no overall theme to the week other than to note the bulk of the upgrades were to stocks that have underperformed of late and now look better value, according to analysts, and the downgrades similarly were to stocks that have outperformed and now look well priced or overvalued.

Coca-Cola Amatil, Motorcycle Holdings, Orica and the two IVF clinics, Monash and Virtus have all de-rated beyond what analysts consider reasonable. Aristocrat Leisure and Treasury Wines have run too hard. Ord Minnett believes the market has become too overweight the miners and expects a rotation in early 2018, hence downgrades to South32 and Western Areas. In the vehicle leasing/salary packaging space, Citi believes Smartgroup and McMillan Shakespeare are now stretched and recommends switching into EclipX ((ECX)) and SG Fleet ((SGF)).

Last week's target price moves were led by a 11% increase for Automotive Holdings ((AHG)) following the divestment of its cold logistics business. Domain ((DHG)) rose 8% when Morgan Stanley bucked the trend and initiated with an Overweight rating (the three other initiations have Sell ratings), while IOOF Holdings ((IFL)) rose 5% on the acquisition of ANZ's wealth management business.

On the downside, target reductions followed weak trading updates from Webjet ((WEB)), down -9%, and Class ((CL1)), down -6%, while poor box office sees Village Roadshow ((VRL)) down -4%.

A positive update from Aristocrat was met with a 30% increase in consensus earnings forecast while Auto Holdings aforementioned divestment was worth 9%.

Western Areas copped a -37% downgrade but such moves are not unusual among the miners, while Webjet's woes were worth -16%.

Upgrade

COCA-COLA AMATIL LIMITED ((CCL)) Upgrade to Buy from Neutral by Citi .B/H/S: 3/4/1

Citi's upgrade to Buy, with a reduced price target of $8.80 (from $9.10) is supported by two key pillars. The shares look cheap, with the analysts observing a -12% discount versus Coca-Cola European partners, described as Amatil's "nearest rival".

The second pillar is an anticipation that revenues in Australia will stabilise in H1 and this should act as a catalyst for the stock to recover. Citi thinks 5% EPS growth is possible beyond FY19.

DEXUS PROPERTY GROUP ((DXS)) Upgrade to Accumulate from Hold by Ord Minnett .B/H/S: 3/2/2

Sydney and Melbourne office assets have been re-priced considerably since June, Ord Minnett observes. A-REITs have a "once in a cycle" opportunity to trade the asset class, the broker asserts, as asset values exceed replacement cost at premiums not seen since 1987-88.

The broker upgrades to Accumulate from Hold, believing Dexus is best positioned in terms of opportunity because of a favourable cash flow outlook and strong valuation support. Target is raised to $10.50 from $9.50.

IOOF HOLDINGS LIMITED ((IFL)) Upgrade to Overweight from Equal-weight by Morgan Stanley .B/H/S: 2/3/0

The acquisition of the ANZ ((ANZ)) wealth business is a landmark deal in Morgan Stanley's view, with scope for substantial upside to targeted synergies. The deal takes out a major competitor and delivers substantial scale.

The broker notes IOOF and AMP ((AMP)) appear to be the only major players committed to advice, as banks are retreating. In the long run the broker considers this an attractive situation.

Rating is upgraded to Overweight from Equal-weight. Target is raised to $13.00 from $9.90. Industry view is In-Line.

MOTORCYCLE HOLDINGS LIMITED ((MTO)) Upgrade to Add from Hold by Morgans .B/H/S: 1/0/0

FY17 acquisitions, and the maiden contribution from Cassons, should mean the company is positioned to achieve growth in the first half despite tough industry conditions, Morgans asserts.

The company has pointed to weak conditions for new bike sales, down -5.4% in the year-to-date versus used bike volumes that are up 14.1%.

Morgans suggests that, given the contributions from the three acquisitions in the second half of FY17, the actual organic volume growth would have been lower.

Rating is upgraded to Add from Hold. Target is raised to $5.57 from $5.41.

MONASH IVF GROUP LIMITED ((MVF)) Upgrade to Add from Hold by Morgans .B/H/S: 2/0/0

Morgans observes the share price has been punished after the company downgraded first half expectations. Transition to a new CEO, the loss of a key doctor and competitive pressures are the main issues.

However, underlying IVF cycle numbers are returning to long-term growth rates, and despite downgrading FY18 net profit forecasts by -7.2%, the broker is encouraged by broader market developments.

Morgans upgrades to Add from Hold. Target is reduced to $1.52 from $1.58.

ORICA LIMITED ((ORI)) Upgrade to Equal-weight from Underweight by Morgan Stanley .B/H/S: 0/6/2

Disappointing FY18 guidance has triggered a material de-rating of the stock, Morgan Stanley observes. Since November 6 the share price has declined -18% and this is set against the backdrop of an -8% downgrade to Morgan Stanley's FY18 net profit forecasts.

Rating is upgraded to Equal-weight from Underweight. While becoming more positive, the broker concedes its move to upgrade may prove premature and acknowledges scope for things to get worse before they can get better.

Target is $16.50. Industry view is Cautious.

VIRTUS HEALTH LIMITED ((VRT)) Upgrade to Add from Hold by Morgans .B/H/S: 2/1/0

Morgans suspects the broader IVF market is stabilising, as recovery in NSW and Victoria offsets weakness in Queensland.

The weakness in the Virtus Health share price is considered an opportunity, seemingly affected by the unexpected downgrade by Monash IVF ((MVF)). The broker notes that the Monash issues are independent of the broader market.

Morgans upgrades to Add from Hold. Target is $5.46.

Downgrade

ARISTOCRAT LEISURE LIMITED ((ALL)) Downgrade to Accumulate from Buy by Ord Minnett .B/H/S: 5/2/0

FY17 net profit was ahead of board minutes forecasts. The company has also announced the acquisition of game developer Big Fish. Ord Minnett observes the company has significantly increased its digital exposure, with further opportunities available.

The broker considers the risk/reward attractive but, as there's been a strong run up in the share price since September, downgrades to Accumulate from Buy. Target is reduced to $24.20 from $24.60.

INVESTA OFFICE FUND ((IOF)) Downgrade to Hold from Accumulate by Ord Minnett .B/H/S: 2/2/2

Sydney and Melbourne office assets have been re-priced considerably since June, Ord Minnett observes. A-REITs have a "once in a cycle" opportunity to trade the asset class, the broker asserts, as asset values exceed replacement cost at premiums not seen since 1987-88.

Yet, the broker downgrades Investa to Hold from Accumulate, expecting lower cash flow and a higher level of refurbishment expenditure. Target is reduced to $4.85 from $5.00.

MCMILLAN SHAKESPEARE LIMITED ((MMS)) Downgrade to Neutral from Buy by Citi .B/H/S: 0/4/0

Citi has updated on the Australian automotive fleet industry recommending investors switch out of Smartgroup and McMillan Shakespeare and into EclipX (preferred) and SG Fleet.

The analysts anticipate ongoing consolidation of the sector with both SG Fleet and EclipX expected to lead the move. To support the shift in preference, and in reference to elevated valuations, both Smartgroup and McMillan Shakespeare have received downgrades to Neutral. Target $16.87.

SOUTH32 LIMITED ((S32)) Downgrade to Hold from Buy by Ord Minnett .B/H/S: 0/7/1

Ord Minnett believes the local market is now overweight the mining sector and share prices may be vulnerable to rotation heading into the next calendar year. While not being outright negative, the broker recommends reduced exposure.

South32 is downgraded to Hold from Buy following recent gains in the share price. $3.40 target maintained.

SMARTGROUP CORPORATION LTD ((SIQ)) Downgrade to Neutral from Buy by Citi .B/H/S: 4/2/0

Citi has updated on the Australian automotive fleet industry recommending investors switch out of Smartgroup and McMillan Shakespeare and into EclipX (preferred) and SG Fleet.

The analysts anticipate ongoing consolidation of the sector with both SG Fleet and EclipX expected to lead the move. To support the shift in preference, and in reference to elevated valuations, both Smartgroup and McMillan Shakespeare have received downgrades to Neutral. Target $10.11.

TREASURY WINE ESTATES LIMITED ((TWE)) Downgrade to Underperform from Neutral by Credit Suisse .B/H/S: 2/2/3

Credit Suisse believes the company affords above-market growth for investors but this is priced in for the time being and downgrades to Underperform from Neutral.

The recent share price rally has pushed the company's price/earnings ratio and operating earnings ratio ahead of peer comparables, in the broker's calculation. Target is $14.15.

VILLAGE ROADSHOW LIMITED ((VRL)) Downgrade to Underperform from Neutral by Macquarie .B/H/S: 0/2/2

A depressed industry box office and underperforming titles have resulted in the first four months of FY18 being significantly weaker than the previous corresponding period.

In theme parks, although the critical summer trading period is yet to commence, management expects a substantial improvement in segment earnings. Dividends are expected to return in FY18.

Macquarie observes downside risk to earnings and limited near-term catalysts for a re-rating and downgrades to Underperform from Neutral. Target is reduced to $3.50 from $4.10.

WESTERN AREAS NL ((WSA)) Downgrade to Sell from Hold by Ord Minnett .B/H/S: 1/1/5

Ord Minnett believes the local market is now overweight the mining sector and share prices may be vulnerable to rotation heading into the next calendar year. While not being outright negative, the broker recommends reduced exposure.

Western Areas is downgraded to Sell from Hold. Target is $2.50.

Total Recommendations Recommendation Changes

Broker Recommendation Breakup

Broker Rating Order Company New Rating Old Rating Broker Upgrade 1 COCA-COLA AMATIL LIMITED Buy Neutral Citi 2 DEXUS PROPERTY GROUP Buy Neutral Ord Minnett 3 IOOF HOLDINGS LIMITED Buy Neutral Morgan Stanley 4 MONASH IVF GROUP LIMITED Buy Neutral Morgans 5 MOTORCYCLE HOLDINGS LIMITED Buy Neutral Morgans 6 ORICA

LIMITED Neutral Sell Morgan Stanley 7 VIRTUS HEALTH LIMITED Buy Neutral Morgans Downgrade 8 ARISTOCRAT LEISURE LIMITED Buy Buy Ord Minnett 9 INVESTA OFFICE FUND Neutral Buy Ord Minnett 10 MCMILLAN SHAKESPEARE LIMITED Neutral Buy Citi 11 SMARTGROUP CORPORATION LTD Neutral Buy Citi 12 SOUTH32 LIMITED Neutral Buy Ord Minnett 13 TREASURY WINE ESTATES LIMITED Sell Neutral Credit Suisse 14 VILLAGE ROADSHOW LIMITED Sell Neutral Macquarie 15 WESTERN AREAS NL Sell Neutral Ord Minnett Recommendation Positive Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 DHG DOMAIN HOLDINGS AUSTRALIA LIMITED -50.0% -100.0% 50.0% 4 2 VRT VIRTUS HEALTH LIMITED 67.0% 33.0% 34.0% 3 3 AHG AUTOMOTIVE HOLDINGS GROUP LIMITED 79.0% 50.0% 29.0% 7 4 IFL IOOF HOLDINGS LIMITED 40.0% 20.0% 20.0% 5 5 ORI ORICA LIMITED -25.0% -38.0% 13.0% 8 6 CCL COCA-COLA AMATIL LIMITED 25.0% 13.0% 12.0% 8 7 CHC CHARTER HALL GROUP 42.0% 33.0% 9.0% 6 8 AMC AMCOR LIMITED 31.0% 25.0% 6.0% 8 9 PGH PACT GROUP HOLDINGS LTD 20.0% 17.0% 3.0% 5 Negative Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 CL1 CLASS LIMITED 67.0% 100.0% -33.0% 3 2 VRL VILLAGE ROADSHOW LIMITED -50.0% -25.0% -25.0% 4 3 WEB WEBJET LIMITED 20.0% 40.0% -20.0% 5 4 SIQ SMARTGROUP CORPORATION LTD 58.0% 75.0% -17.0% 6 5 TWE TREASURY WINE ESTATES LIMITED -21.0% -7.0% -14.0% 7 6 WSA WESTERN AREAS NL -57.0% -43.0% -14.0% 7 7 MTR MANTRA GROUP LIMITED 13.0% 25.0% -12.0% 8 8 ALL ARISTOCRAT LEISURE LIMITED 64.0% 71.0% -7.0% 7 9 COH COCHLEAR LIMITED -57.0% -50.0% -7.0% 7 Target Price Positive Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 AHG AUTOMOTIVE HOLDINGS GROUP LIMITED 3.891 3.506 10.98% 7 2 DHG DOMAIN HOLDINGS AUSTRALIA LIMITED 3.663 3.383 8.28% 4 3 IFL IOOF HOLDINGS LIMITED 12.140 11.520 5.38% 5 4 MTR MANTRA GROUP LIMITED 3.736 3.641 2.61% 8 5 ALL ARISTOCRAT LEISURE LIMITED 25.400 24.850 2.21% 7 6 COH COCHLEAR LIMITED 146.257 143.800 1.71% 7 7 CHC CHARTER HALL GROUP 5.893 5.835 0.99% 6 8 AMC AMCOR LIMITED 16.229 16.135 0.58% 8 Negative Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 WEB WEBJET LIMITED 11.930 13.080 -8.79% 5 2 CL1 CLASS LIMITED 3.333 3.550 -6.11% 3 3 VRL VILLAGE ROADSHOW LIMITED 3.690 3.840 -3.91% 4 4 CCL COCA-COLA AMATIL LIMITED 8.464 8.738 -3.14% 8 5 SIQ SMARTGROUP CORPORATION LTD 9.268 9.275 -0.08% 6 Earning Forecast Positive Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 ALL ARISTOCRAT LEISURE LIMITED 101.160 77.624 30.32% 7 2 AHG AUTOMOTIVE HOLDINGS GROUP LIMITED 29.110 26.739 8.87% 7 3 OZL OZ MINERALS LIMITED 60.381 56.709 6.48% 8 4 BSL BLUESCOPE STEEL LIMITED 99.680 95.102 4.81% 5 5 A2M THE A2 MILK COMPANY LIMITED 21.850 21.116 3.48% 5 6 BKW BRICKWORKS LIMITED 110.475 107.300 2.96% 4 7 ORG ORIGIN ENERGY LIMITED 52.949 51.933 1.96% 7 8 NVT NAVITAS LIMITED 21.323 20.953 1.77% 6 9 CCL COCA-COLA AMATIL LIMITED 55.350 54.738 1.12% 8 10 TTS TATTS GROUP LIMITED 17.167 16.980 1.10% 4 Negative Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 WSA WESTERN AREAS NL 3.958 6.298 -37.15% 7 2 WEB WEBJET LIMITED 43.560 51.722 -15.78% 5 3 NXT NEXTDC LIMITED 3.647 3.905 -6.61% 7 4 CL1 CLASS LIMITED 7.833 8.333 -6.00% 3 5 VRL VILLAGE ROADSHOW LIMITED 17.775 18.500 -3.92% 4 6 DOW DOWNER EDI LIMITED 41.134 42.078 -2.24% 5 7 FXJ FAIRFAX MEDIA LIMITED 5.495 5.578 -1.49% 7 8 GNC GRAINCORP LIMITED 40.544 41.144 -1.46% 5 9 MIN MINERAL RESOURCES LIMITED 131.400 133.333 -1.45% 3 10 ALQ ALS LIMITED 26.345 26.678 -1.25% 6 Technical limitations

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

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Uranium Week: Volatility

Having broken out of a long period in the doldrums, the spot uranium price is now experiencing heightened volatility.

By Greg Peel

Having finally broken out of a five month period of being unable to move away meaningfully from the US$20/lb mark, the spot uranium price rose to US$24.75/lb before falling back to US$23.60/lb in the Thanksgiving-interrupted week. Last week saw a further fall of -US35c to US$23.25/lb on industry consultant TradeTech's weekly spot price indicator.

Volatility reigned. The spot price fell as low as US$22.50/lb early in the week before rebounding sharply, and then running smack into a big sell order at November month-end. When the dust settled, 1.6mlbs of U3O8 equivalent had changed hands in 14 transactions, which is quite a busy week.

But the feature of the week was the complete absence of end-users in the market. Having curtailed uneconomic production, many producers are now choosing to buy in uranium at prices lower than their own cost of production to satisfy legacy delivery contracts. Hence producers appeared as both buyers and sellers last week, along with intermediaries and speculators. Utilities were not seen.

Which probably explains the volatility.

In demand-side news, Bangladesh became only the third new member of the nuclear power club in thirty years last week as the country commenced construction of its first reactor. Bangladesh follows Belarus in 2013 and the UAE in 2012.

Volume

If the spot price break-out last month has sparked volatility, it has done so on the greatest number of monthly transactions ever posted since records began in 1996. March 2011 – the month of Fukushima – saw 45 transactions reported, TradeTech notes. This November, 64 transactions were reported, totalling 7.4mlbs U3O8 equivalent.

November's volume represents 23% of total 2017 volume year to date.

In uranium term markets, seven transactions were reported in November totalling 4.1mlbs. After months of quietly sliding lower, TradeTech's term price indicators have finally seen a monthly increase on the spot market bounce.

The consultant's mid-term price indicator is up US$3.65 to US$28.00/lb and the long-term indicator is up US$1.00 to US$31.00/lb.

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 November 30, 2017

Last week saw the ASX200 saw-tooth its way up to over 6020 before crashing back to 5960 on the last day of the month – the day the government announced a Royal Commission into the banks.

If readers were looking forward to learning of an exciting and eventful week on the short side of the market then sorry, no luck. Yes there's red and green on the table below but nothing of any consequence.

Only one stock saw a change in short position of one percentage point or more. Nickel miner Independence Group ((IGO)) shorts fell to 18.7% from 19.7%. But as is so often noted in this Report, moves in week-on-week short positions in Independence and peer Western Areas are as volatile as the nickel price itself.

I could make a big deal out of the fact that for the first time in a very long time, Myer ((MYR)) has slipped out of the 10% plus shorted club. But as it's only to 9.7%, there's no point in looking for a trend at this stage.

I could also note that Woolworths ((WOW)) is back into the 5% plus table after a period of absence, to be the only other ASX Top 20 company alongside Rio Tinto to be shorted to such an extent, but as it's a move to 5.0% from 4.8% shorted, I won't.

No Movers & Shakers this week.

Weekly short positions as a percentage of market cap:

10%+

SYR 21.3 IGO 18.7 DMP 17.0 JBH 15.1 HSO 15.0 RFG 11.9 AAD 11.2 WSA 10.7 ACX 10.5 MTS 10.3 APO 10.0

Out: MYR

9.0-9.9

MYR, HT1, HVN, VOC, FLT, JHC In: MYR, FLT

8.0-8.9%

NWS, ORE, QIN

In: ORE Out: FLT, MYX, NXT

7.0-7.9%

MYX, NXT, GXL, GXY, TPM, NSR, RIO, AAC, SHV, GTY

In: MYX, NXT, AAC Out: ORE

6.0-6.9%

ISD, MYO, AHG, BAP, BEN, KAR

In: KAR Out: SEK, MND, ING, TAH, SUL

5.0-5.9%

CSR, TAH, SEK, IPD, ING, QUB, MND, PRU, GMA, SUL, ABC, WOW

In: SEK, TAH, ING, MND, SUL, WOW Out: KAR, MOC, BKL

Movers and Shakers

See above.

ASX20 Short Positions (%)

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

IMPORTANT INFORMATION ABOUT THIS REPORT

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

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

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

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

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

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

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

FNArena has offered this qualified explanation of the vagaries of short stock positions as a warning to subscribers not to jump to any conclusions or to make investment decisions based solely on these unqualified numbers. FNArena

Find out why FNArena subscribers like the service so much: "Your Feedback (Thank You)" - Warning this story contains unashamedly positive feedback on the service provided.

The Wrap: Salmon, Real Estate & Small Retail

Weekly Broker Wrap: salmon; technology; high conviction stocks; global real estate; small retailers; house prices; and salary packaging.

-Weaker international salmon prices impact outlook for Oz producers -Citadel Group debuts as number one in Bell Potter's key picks in technology -Morgans suggests solid returns still exist but should not come with excessive risk -Real estate portal adjacencies could be substantial -RBA may be on hold until 2019 -Consolidation potential in Australia's automotive fleet leasing sector

By Eva Brocklehurst

Salmon

Weaker international salmon prices have affected Ord Minnett's models for both Huon Aquaculture ((HUO)) and Tassal Group ((TGR)), and a -32% decline has been incorporated since May. The broker envisages an opportunity for Huon, as its valuation has de-rated more strongly than Tassal, and net profit forecasts are still 18% ahead of FY18 consensus estimates. A Buy rating is maintained while the target is trimmed to $5.81.

In contrast, Ord Minnett held less conservative prior estimates for Tassal so marking to market has more of an impact. Moreover, the broker finds the company's cost reduction outlook less compelling. Hence, the rating is downgraded to Lighten from Buy and the target lowered to $3.43 from $5.00.

Technology

Bell Potter updates its key stock picks in the technology sector following recent price movements. Citadel Group ((CGL)) debuts at number one with a strong growth outlook and potential to re-rate as a pure software company from a services and software company.

Technology One ((TNE)) remains a key pick as its expected to deliver a strong growth year in FY18 and trades at a PE discount to other high quality tech stocks. A solid earnings rebound is expected from Senetas ((SEN)) while Appen ((APX)) returns as a key stock following a transforming acquisition. There are no changes to the broker's Sell ratings on WiseTech Global ((WTC)) and Altium ((ALU)), which are based purely on valuation.

High Conviction Stocks

Morgans suggests stock markets are in a sweet spot, as global growth is becoming entrenched and there is little evidence of inflation. Nevertheless, geopolitical risks also indicate this environment is unlikely to continue. The broker advises that while solid returns are still achievable, this should not come with excessive levels of risk.

The broker identifies Senex Energy ((SXY)) as ideally position to make a material impact on the east coast gas market, with two projects expected to transform earnings over the next few years. Bapcor ((BAP)) is removed from the high conviction list, having locked in a 12% return over the last nine months . Still, Morgans remains attracted to the stock's defensive characteristics.

Global Real Estate

Macquarie observes digitisation is improving the efficiency of property-related processes and transactions. Established property portals are positioned to participate in growth because they have large audiences engaged at a critical time in the acquisitions cycle. They also have extensive data which allows increasing interaction and improved strategies.

The broker's analysis suggests adjacencies could be as much as 2.5-3.5 times the size of the total advertising market. Opportunities in financial services are generally the largest but the market for connections and home services is also substantial.

Just as Amazon, Uber and Netflix provided a better experience versus the old models they disrupted in retail, taxis and cable respectively, Macquarie's US analysts envisage iBuyers doing the same for US home sales.

This presents a threat to the real estate agent commission pool, which is ultimately the main source of revenue for US property portals. Against this material opportunity in adjacencies for real estate portals Macquarie takes a cautious view of Australian names because of valuation concerns. REA Group ((REA)) has been downgraded to Underperform while Domain ((DHG)) has been upgraded to Neutral.

Small Retailers

Citi places Michael Hill ((MHJ)) as its top pick in the small cap retail sector. The broker considers a PE multiple for FY18 of 13x is too cheap, given the options in the company's two loss-making areas - Emma & Roe and the US. Meanwhile, the broker considers the emergence of BB Capital on Accent's ((AX1)) register (formerly known as RCG) could be a game changer and lead to new earnings opportunities.

The broker expects Beacon Lighting ((BLX)) will enjoy favourable conditions for the next 12 months as it cycles the negative impact from the Masters shutdown. Citi is concerned that Nick Scali ((NCK)) may be affected in the medium term by a slowing housing cycle and increased execution risks from the largest one-year roll out in the company's history amid expansion into New Zealand.

The broker likes the Greencross ((GXL)) model but remains concerned about the impact on margins from a need to harmonise prices between Petbarn and online offerings. Baby Bunting ((BBN)) has a strong business model but could be hurt in the short term as inferior competitors are forced a shutdown, leading to sales loss and margin pressure.

House Prices

UBS observes growth in dwelling prices has dropped to the historical levels where a reduction in official interest rates could be anticipated. House prices have been almost flat over the last six months, dragging year-on-year growth to its lowest growth rate since 2016, at 5.2%. Nevertheless, the Reserve Bank appears less willing to react to weak house prices at this stage.

UBS has long held the view that a soft landing will occur, with growth of 0-3% in 2018, and the RBA will retain steady rates until the Dec quarter of 2018. Now, the broker envisages heightened risk that consumption will weaken and drag on inflation, a scenario that suggests the RBA may be on hold until 2019. However, for the RBA to consider actually cutting the rate, the strong global outlook would have to deteriorate.

Salary Packaging

Citi downgrades two novated leasing and salary packaging companies, Smartgroup ((SIQ)) and McMillan Shakespeare ((MMS)) to Neutral, because of elevated valuations relative to peers.

Given material synergies that could be realised from scale benefits the broker believes consolidation in the Australian automotive fleet leasing sector is probable, led by SG Fleet ((SGF)) and/or EclipX ((ECX)).

The broker estimates a merger of the two could potentially unlock synergies of $26-53m, primarily from purchasing economies and consolidation of operations.

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Bingo Forges Ahead In Waste Management

Waste management and recycling business Bingo Industries has picked up several acquisitions to further expand its services and brokers suggest it is well primed to stay ahead of the competition.

-Acquisitions considered sound, fitting well within existing strategies -Strong macroeconomic drivers in the company's markets -Shaw and Partners expects maiden dividend in first half of FY18

By Eva Brocklehurst

Waste management and recycling company Bingo Industries ((BIN)) is growing its presence in Victoria, having established a diverse, vertically integrated operation in NSW. The company has picked up several acquisitions including National Recycling for $51.1m and Patons Lane Recycling Centre & Landfill for $90m.

Guidance for $89m in operating earnings (EBITDA) is reaffirmed and contributions from the acquisitions should add an additional $4m. Brokers believe the acquisitions are sound and fit well within the existing strategy, while Macquarie expects the landfill solution is a longer-term positive. The main risk now lies in executing on the significant growth profile and bedding down the acquisitions.

The acquisition of National Recycling, centred in Victoria, includes two freehold properties with expected synergies of $6m to be realised within 12 months. Patons Lane is a significant greenfield expansion in western Sydney, in Macquarie's opinion, which would be paid for over three instalments of $30m between December 2017 and July 2019.

Patons Lane is expected to open in FY20 and already has a development approval. The site will require an additional $40m in capital expenditure to become operational. Vertical integration will capture margins associated with ongoing landfill expenses and Macquarie believes the company should be positioned well, should regulatory change occur in Queensland. Queensland is expected to implement a levy to encourage recycling and reduce the amount of waste going to landfill.

A $120m entitlement offer will fund the acquisitions as well as six redevelopments, four in NSW and two in Victoria, for total expenditure of $29.5m. This should add 50% to the network capacity by 2020. The raising will also repay the debt from the Has-a-bin acquisition ($6m).

Macquarie considers National Recycling was a logical takeover target, as Bingo Industries is intent on increasing its exposure to the Victorian market. Historically, this business appears to be primarily focused on waste collection with post-collection capacity expected to come on line in the March quarter next year. Macquarie has an Outperform rating and $2.66 target on the stock.

Ahead Of The Game

Shaw and Partners has initiated coverage with a Buy rating, medium risk rating and target of $2.90 and flags the fast growing, diversified business as an innovator in technology, with recovery rates that are second to none in the industry. Financial metrics are attractive and the broker forecasts FY18 operating earnings of $94m, slightly ahead of guidance. This represents growth of 47% on the prior year.

Strong and attractive returns of over 20% are calculated, which is considered a exceptional result for a capital-intensive business in a very competitive and highly commoditised industry. Shaw expects a maiden dividend in the first half of FY18.

There are strong macroeconomic drivers for the company's markets, the broker notes, in both NSW and Victoria, such as population growth and the investment in buildings and infrastructure. The company has a leading position in building & demolition waste collection and processing in Sydney and is expanding its presence in the commercial & industrial segment.

Also, regulation is increasing and this raises barriers to entry, Goldman Sachs observes, and landfill capacity is falling. Governments and customers are demanding higher recycling rates and stricter compliance on environmental standards.

The company has built strong systems and operations to stay ahead of competition, the broker notes, and waste collection volumes are expected to grow at a 5% compound rate over 10 years. Moreover, the company has exposure to large-scale infrastructure projects.

Goldman Sachs has a $3.40 target and initiates coverage with a Buy rating, conceding further contracts, particularly in building & demolition, could drive earnings above forecasts. Moreover, exposure to $143bn worth of NSW and Victoria's state budget infrastructure expenditure should outweigh any residential construction slowdown. The broker forecasts 100% operating cash flow/operating earnings conversion, as the company has minimal working capital requirements.

Total capital expenditure, excluding acquisitions, is forecast to average 138% of depreciation as capacity in post-collections is increased and the advanced automated recycling technology is implemented across the network. The post-collections network is 56% of FY18 estimated earnings, with facilities situated in strategic growth corridors and based around locations where waste is generated.

Monadelphous Looking Toppy

By Michael Gable

The ASX/S&P 200 Index continues to move above and below that 6000 level, and that is what everyone is focusing on. However, it has generally traded on top of the previous high this year which was formed on 1 May. That is the important level to watch. As the market establishes a baseline above a previous high, it will have the ability to launch higher.

This week's report covers Monadelphous Group ((MND)).

MND has had a great run in the last couple of years. We are seeing signs that it might just take a breather though. Last week was a negative week, forming a candlestick pattern known as a "dark cloud cover" (circled). Last week's volume on the sell-off was also twice the average for the last year. This leads us to believe that MND should weaken from here. There is some trendline support just under $18, which isn't too far away, hence the neutral stance. But if that breaks, then we are looking at a slide towards to low $16's.

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Michael is RG146 Accredited and holds the following formal qualifications:

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

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NAB: Avoid For Now

Bottom Line 05/12/17

Daily Trend: Down WeeklyTrend: Down Monthly Trend: Down Support levels: $29.00 / $27.79 / $25.14 Resistance levels: $32.98 - $34.09

Technical Discussion

National Australia Bank ((NAB)) is a financial services organization providing products, advice and services through its major Australian franchise and businesses in the United Kingdom, New Zealand, the United States and Asia. In New Zealand, it operates through Bank of New Zealand. In April 2014, JB HI FI Ltd announced that National Australia Bank Limited and its linked entities ceased being a shareholder of the Company. For the year ending the 30th of September 2017 interest income decreased 1% to A$27.4B. Net interest income after loan loss provision increased 2% to A$12.36B. Net income applicable to shareholders, excluding extraordinary items decreased 3% to A$6.08B. Net interest income after loan loss provision reflects an increase in interest earning assets and a decrease in interest bearing liabilities. The dividend yield is currently 6.3 %. Broker/Analyst consensus is “Hold”.

Reasons to be cautious medium term (longer term outlook still bullish): → Recent results not taken well by the market. → New bank levy has this market sector skittish → A strong capital base is beneficial for maintaining the dividend. → The risk of capital raisings has abated. → Good value based on earnings compared to its peers. → Costs appear under control yet being monitored → The company has sold GBP625m of underperforming UK assets. This releases GBP127m of capital. → Ongoing growth questionable.

It’s no secret that we haven’t been fans of the big banks over the past few months, irrespective of price climbing higher off the late June low. In fact, during our last review the typical retracement zone of the prior leg down had been overcome which under normal circumstances would be positive. However, in this instance we’ve been as confident as we can be that the leg higher was corrective in nature, keeping the door open for another swift leg South. Over the past few weeks that’s exactly what’s transpired with the Banking sector embarking on what should be the final probe down at this degree of trend.

On the back of price continuing up through the 61.8% retracement level, we have amended the wave equality projection which now sits at $27.89 and isn’t too far beneath current levels. There is confluence at those lower levels with the 61.8% retracement level of the prior uptrend sitting slightly lower at $27.79 providing an area of confluence. As always, the more confluence there is, the greater the chance it’s going to prove to be significant. One thing we have to be aware of though is the recent announcement regarding a Royal Commission into Australia’s Banking sector which obviously hasn’t helped sentiment. The big four banks have sold-off and many analysts are suggesting it’s only early days with further downside likely. This fits with the technical picture over the short-term although we aren’t suggesting Armageddon is about to hit. No doubt there will be further developments on the subject in due course although this doesn’t necessarily have to be bad news. Either way, we’ll keep abreast of the patterns and let those dictate the outlook.

Trading Strategy

I wouldn’t be tempted to try and trade the anticipated leg down, especially as the target only sits around $28.00 which isn’t significantly beneath current levels. In fact, signs of buyers around that target zone, by the way of some high closes and increasing volume would offer a buying opportunity, especially if you want exposure to the sector. We still believe it’s a sector to avoid for the moment although patterns and sentiment can change at the drop of a hat so we’ll keep taking a regular look at the banks for signs of improvement.

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