

Week  
**27**

# Stories To Read From FNArena

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FNArena  
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Analysis

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## Outdoor Advertising Continues To Eclipse TV

Outdoor advertising is eclipsing TV these days and, with the digitising of billboards, companies in this sector are increasingly attracting broker scrutiny.

-Significant efficiency benefits in digital billboards -Capital expenditure on digital may start to decline beyond 2017 -Brokers not overly concerned by slowing revenue growth trend

By Eva Brocklehurst

Outdoor advertising continues to take precedence over TV sets these days and with the digitising of billboards, those companies in this sector are increasingly attracting broker scrutiny.

Growth in the sector has recently been driven by digitisation. Digital revenues in Australian outdoor advertising increased rapidly to 40% of sector revenues in 2016 from just 8% in 2012. The current market generated \$790m in net revenue in 2016. The main benefits of digital billboards are flexibility and yield enhancement, as these are able to serve multiple advertisers on the same screen.

Deutsche Bank initiates coverage on the sector with Buy ratings on APN Outdoor ((APN)), oOh!Media ((OML)) and QMS Media ((QMS)), believing pure outdoor stocks should re-rate from current levels, given the underlying sector growth.

The broker is of the view that the high level of urbanisation in Australia relative to the rest of the world provides for a penetration rate that is higher than the global average of 6% for billboards. Population growth, growth in air travel and continued increases in the number of kilometres that are travelled all support the medium.

Risks Priced In?

Deutsche Bank believes the risks to these outdoor stocks are effectively priced in at current levels and multiples do not take into account underlying sector growth. OOh!Media provides exposure to a highly digitised portfolio and is the broker's top pick, with further scope to convert static billboards as only 54 of its 4,000 billboards were digitised at the end of 2016.

QMS has undertaken an aggressive expansion and increased its digital billboards to more than 68 as of June this year, from 12 just three years ago. APN Outdoor, which has the lowest proportion of digital revenues relative to the others, is still exposed to favourable dynamics and the recent sell-off represents an attractive entry point, and the broker's opinion.

Major players in the business are investing heavily in converting static panels into digital. Beyond this year, Deutsche Bank expects this capital expenditure will decline, amid forecasts for the number of digital screens being added to the system to progressively decline. This should in turn support free cash flow over the medium term.

HT&E ((HT1)), while not a pure player in outdoor media as it has a radio segment, has also shown significant improvement in its outdoor division. The company has a strong presence in street furniture, taxis and bus/tram advertising via its Adshel business. Adshel's performance improved significantly in March and forward bookings remains solid, Credit Suisse observes, and the rate of digitisation is expected to increase in Australia.

Now the merger between APN Outdoor and oOh!Media will not go ahead, the company should be a beneficiary in the broker's opinion, as that former deal had potential to erode Adshel's market position.

Deutsche Bank calculates that Adshel has around 16% market share and APN Outdoor and oOh!Media represent around 64% of the industry. APN Outdoor, oOh!Media and QMS are the main competitors in billboards, whereas the former two are also the main operators in airports. In New Zealand, QMS is the largest operator with around 39% market share.

Slowing Growth?

Brokers acknowledge that in the year-to-date advertising revenue growth in outdoor media has slowed to around 7% year-on-year, mainly driven by flat revenue in "roadside other" (street furniture, taxis/bus/tram) and transport (train stations, interchanges, airports) segments. UBS acknowledges the data suggests slower digital yield growth in recent

months versus history, but points out the outdoor advertising market is predominantly weighted to the September and December quarters.

The trend should be monitored but Deutsche Bank is not overly concerned, as billboards and the retail/lifestyle segments have continued to grow in double digits and both oOh!Media and QMS derive over 70% of their revenues from these areas. The broker concedes APN Outdoor has a relatively high level of exposure to the weaker segments such as roadside other and transport, yet expectations for growth still reflect the trend.

Importantly, outdoor advertising over the decade to 2016 has been one of the few traditional advertising segments to gain market share. The outdoor industry grew at a 7.6% compound growth rate versus the Australian advertising industry at 5%. UBS notes digital, as a proportion of total outdoor revenue, was 44.7% in May versus 36.8% a year earlier, implying digital revenue growth of 33% and a -4% decline in static revenue.

See also, Outdoor Media Growth Robust, But Slowing on June 6, 2017.

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## Domain The Main Game For Fairfax

Two indicative proposals from private equity have not resulted in a formal bid for Fairfax and the company is pursuing its agenda of de-merging Domain. Brokers explore the path forward.

-Main issue for bidders likely to be rapidly declining earnings profile -Has uncertainty created a buying opportunity? -Citi calculates negligible cash flow ex Domain

By Eva Brocklehurst

Fairfax Media ((FXJ)) has confirmed the two indicative proposals from private equity have not resulted in a formal bid, although did not provide a definitive reason as to why TPG decamped. Management suggests TPG did not want to proceed with buying the entire company. With respect to Hellman & Friedman, it was not able to form a bid by last Friday's deadline and Fairfax terminated discussions.

Citi believes the main issues for the bidders were a rapidly declining earnings profile and potential restructuring and redundancy charges needed to keep newspaper earnings in positive territory.

Morgan Stanley is disappointed, having expected at least one bid would prevail, but remains positive about the fundamentals of the business and the strategy that is in place to realise value. Fairfax is debt free and the Domain spin-off is on track for completion by the end 2017.

While expecting the shares may ease on the back of the failure to procure a definitive bid, the broker believes there is nothing to change the fundamental view and retains an Overweight rating.

Meanwhile, media ownership reforms are back in the Senate in the first week of August. The broker envisages no change to the rules but, if ownership rules are removed, this will provide Fairfax with more options.

In the past, the company has received informal offers for other assets, such as radio, and Morgan Stanley would like the company to promote this path. The broker believes exiting non-strategic assets for cash and reinvesting the proceeds through a buy-back would be a sensible way of creating additional value.

UBS believes the keys to hurdling price/earnings return targets involve aggressive gearing in an unlisted environment and organic earnings growth.

The company is expecting FY17 operating earnings (EBITDA) of \$262-266m and will provide an update on Domain at the FY17 results. Listings have returned to positive growth in the June quarter and Morgan Stanley observes comparables will get considerably easier in the September quarter.

### Domain Valuation

Morgan Stanley calls for an investor briefing on Domain to discuss the growth strategy, particularly around expanding into the broader digital/e-commerce opportunity.

UBS would also like further detail on what amounts will be paid away by the agent equity model in the de-merging of Domain, particularly as agent equity interests are apportioned over time and "Premium Plus" contributions grow.

The broker also has queries regarding the revenue and cost structure of the de-merged Domain. Without these items, UBS is hesitant to apply a similar operating earnings multiple to the Domain digital business to that which it applies to REA Group ((REA)).

Citi retains a positive view on Domain, as it is consistently growing faster than its rival and has high exposure to Sydney and Melbourne. Nevertheless, current earnings are likely to be below normal because of low listing volumes in those cities. When assessing a fair multiple for Domain, Citi uses REA as a starting point and believes there are two reasons for the Domain to trade at a premium and one reason to trade at a discount.

Reasons for a premium are growth and exposure to Sydney and Melbourne. The reason to trade at a discount is, size. Fundamentally, Citi envisages the smaller portal is deserving of a discount, as its development and marketing costs are

likely to be similar to its larger peer but there will be lower revenues to support those functions.

Credit Suisse reinstates coverage of Fairfax with an Outperform rating and \$1.10 target and considers the uncertainty created by the private equity negotiations has created a buying opportunity ahead of the de-merger of Domain. The broker envisages potential for Domain to grow value over time and narrow the gap to REA Group.

Credit Suisse's valuation implies a multiple of 17.8 times FY18 adjusted operating earnings, similar to REA Group on 17.5. The broker suspects investors will pay a premium for the strong growth opportunity in Domain, post the de-merger.

#### Fairfax Without Domain

The bulk of the company's value is comprised of Domain while the remainder faces structural pressures. The company has noted Domain revenue is up 10% in the second half, and there is been a pick up in digital revenue growth over the last few weeks. This is been offset by greater revenue decline in print.

On this basis Citi shifts its view back to a fundamental valuation, reducing its target by -12% to \$1.06 and retaining a Neutral rating. The broker forecasts operating earnings of \$31m for metro media in FY17, off revenue of \$517m. Cost savings in FY18 of \$30m should keep the division in positive territory despite double-digit revenue declines.

Nevertheless, after restructuring charges, net cash flow is negligible and Citi calculates Fairfax will need to repeat the same cost savings every year and is unlikely to stabilise revenue in the next few years.

There are two Buy ratings and three Hold on FNArena's database. The consensus target is \$1.14, suggesting 19.6% upside to the last share price. Targets range from \$1.00 (UBS) to \$1.50 (Morgan Stanley).

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## Flight Centre; The One That Flew Too High

Flight Centre delivered a welcome surprise, upwardly revising guidance for FY17 towards the top end of its prior range. Nevertheless, brokers consider the valuation is stretched.

-Recent share price rally considered excessive -Is risk still skewed to the downside? -Major efficiency initiative under way which could deliver value

By Eva Brocklehurst

Flight Centre ((FLT)) delivered a welcome surprise, upwardly revising guidance for FY17 after a string of downgrades in recent years. The company expects pre-tax profit between \$325-330m, up 2.5-4.9%, and signals a strong sequential improvement in trading in the second half. This is the first growth in earnings the company will have reported since the first half of FY16.

Morgans considers the upgrade a significant positive and believes the company is now through the worst of what has been a challenging period. The broker asserts the return of earnings growth in the second half is illustrative of cyclical issues rather than the structural threat that many feared.

Although there has been some moderation in airfare deflation, the company has delivered strong volume growth, which Deutsche Bank suggests is indicative of market share gains, given a weaker backdrop. The broker expects the increased focus on costs and productivity should assist margins going forward but acknowledges the stock is not cheap, although the outlook is considered better than it has been for quite some time.

### Share Rally Overdone?

Citi observes the supply-demand outlook for airfare pricing has clearly improved and implements double-digit upgrades to its earnings estimates for FY18 and FY19. Still, the broker believes the share price has factored in an optimistic growth profile and/or major cost reductions. Citi downgrades to Sell from Neutral.

Morgan Stanley agrees the recent movement in the share price is over the top. The broker suspects that the main drivers of the better-than-expected FY17 guidance are the recent improvement in Australia's consumer cycle and faster moderation of international deflation. The broker also notes volume growth continues to outpace the market.

Does this announcement justify the sharp upward movement in the share price since March? Morgan Stanley suspects not. Consensus earnings forecasts are likely to move up to the guidance mid point, so up around 6%, which implies that the shares, having risen 50%-plus, have re-rated considerably. The broker believes pressure on the company's model in Australia continues.

As an indication, the price/earnings multiple of 20x on FY17 estimates implies significant earnings growth and would be a considerable reversal of the last three years. Morgan Stanley forecasts earnings to decline in FY18 and retains an Underweight rating.

Growth in the second half was driven by better performances in several of the company's jurisdictions, notably North America and the UK. The company has guided to a record result from the US business and improvements in Canada and is also guiding to local currency growth in the UK business.

While Flight Centre did not provide specific reasons for the strong performance in the US and UK, Macquarie believes it was driven by the small-medium enterprise market which the company has been targeting over recent years. Despite indications the US and the UK are delivering "record results" this year, the broker suspects the weak GBP is a headwind.

Meanwhile, Australasian business improved during the second half because of increased prices for air tickets and robust turnover, despite soft discretionary spending conditions elsewhere, brokers observe. Credit Suisse highlights the resilience of travel volumes and the strong recent retail trade figures as a paradox in a low-wage growth environment.

Australia, the company's most important leisure business, is suffering from high levels of inbound capacity and, in this context, Macquarie considers the stock expensive on an absolute and relative basis, maintaining a view that continued

softness in airfares in FY18 and medium-term margin declines, coupled with valuation pressure, mean risk is skewed to the downside.

UBS upgrades its earnings per share estimates for FY17-20 by around 6%. While believing the company is in a strong position to grow earnings in FY18, the broker is cautious on the Australian consumer outlook and suspects this could limit further upside, given Australia makes up over 70% of Flight Centre earnings.

#### Transformation Program

Credit Suisse believes the share price has now overshot valuation and downgrades to Underperform from Outperform. Despite this, the broker notes there are several avenues to improve value. A major efficiency initiative is under way and the company has a potential for significant reduction to costs from further automation of back-office functions.

Sustainably reducing the cost structure of the store network is less obvious, in the broker's observation, although achieving a -5% reduction in cash costs would add around \$4 per share to valuation, all else being equal. The main challenges facing the company centre on gaining the benefits of vertical integration without over-committing on fixed costs, Credit Suisse suspects, and to manage the risks associated with concentration in any particular market.

Morgans is also encouraged by the decision to pursue internal improvements through the business transformation program, yet agrees the recent share price appreciation has largely factored in the benefits of transformation and subsequent earnings recovery.

Until management is able to quantify the level of earnings improvement stemming from its transformation program, the broker believes the stock is fairly valued and retains a Hold rating. The company is expected to provide further detail on the targeted benefits at its FY17 result.

FNArena's database has four Hold ratings and four Sell for Flight Centre. The consensus target is \$36.02, suggesting -14.7% downside to the last share price. This compares with \$30.93 ahead of the update. Targets range from \$28.70 (Macquarie) to \$40.00 (Morgans, Citi, Deutsche Bank).

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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 June 26 to Friday June 30, 2017 Total Upgrades: 12 Total Downgrades: 14 Net Ratings Breakdown: Buy 41.99%; Hold 41.58%; Sell 16.43%

It remains remarkable that during the weak May and June months for the Australian share market, stockbroking analysts continue to issue more downgrades than upgrades for individual ASX-listed stocks. Equally noteworthy is that the underlying trend for profit forecasts remains negative, albeit possibly skewed because of heavy bias towards reductions for miners, explorers and energy producers.

The positive stand-out is valuations and price targets where positive developments at companies including Metcash, Link Administration, Seven West Media, ALS Ltd and Corporate Travel keep the overall picture a positive one.

Steadfastly more downgrades than upgrades has now pushed total Buy (and equivalent) ratings for the eight stockbrokers monitored daily above total Neutral/Hold ratings. Traditionally, this is a signal for tougher times ahead for the local stock market, which certainly has been the case over the past two months.

This apparent contradiction can be explained by the fact that Sell ratings have become more popular recently with eight of the week's downgrades moving to Sell. Total Sell ratings have now climbed to 16.43% which, historically, is quite high.

The one exception to past observations was in late 2016 when more Buys than Neutrals translated into a narrow rally in which banks, resources and lowly valued cyclicals fully participated, but the rest of the market not. Is the cross-over signalling a repeat of late 2016?

Profit forecasts are being weighed down by heavy reductions for companies including Vicinity Centres, Tabcorp, Independence Group, Santos and Mineral Resources. Those enjoying positive amendments include Ardent Leisure, Metcash, Link Administration and Seven West Media.

The week's positive news stems from upgrades in target prices where upward revisions for Link Administration, Seven West Media, ALS Ltd and Corporate Travel (same names all over) outweigh negative adjustments to the likes of Myer, Class, Sandfire Resources and TPG Telecom.

Confession season hasn't been too busy and the corporate calendar remains thin for the week ahead. No doubt, analysts are now genuinely starting to prepare for the August reporting onslaught.

In terms of downgrades in ratings, there's no clear trend in the week's tally, which culminated in 12 versus 14 (upgrades/downgrades). ALS Ltd, Link Administration, Metcash, Seven West Media and Insurance Australia Group were among those receiving downgrades. Among the upgrades we find Insurance Australia Group (2x), Metcash, BT Investment, Flight Centre and Tabcorp.

Upgrade

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



Gold miners have re-capitalised and exploration budgets have troughed. Credit Suisse estimates the capital raised by juniors alone could underpin a 50% increase in exploration activity over the next 2-3 years.

Despite its optimism, the broker models a recovery to around 75% of the prior peak, which leaves room for upside. Moreover, global testing peers continue to expect trend revenue growth and expansion of margins and this provides a supportive backdrop to turnaround underperforming areas within the company's life sciences segment.

Rating is upgraded to Outperform from Neutral. Target is raised to \$7.80 from \$6.70.

AUSNET SERVICES ((AST)) Upgrade to Outperform from Neutral by Credit Suisse .B/H/S: 2/4/1

The company is now on a solid footing, having completed its metering restoration and resolving outstanding litigation, and Credit Suisse increases revenue expectations based on the anticipated acceptance of a higher rate of depreciation and lower forecast inflation.

A favourable outcome from the gas distribution determination should also be supportive. Credit Suisse upgrades to Outperform from Neutral and the target is increased to \$1.80 from \$1.70.

BEACH ENERGY LIMITED ((BPT)) Upgrade to Buy from Neutral by Citi .B/H/S: 2/3/1

Citi has upgraded to Buy/High Risk from Neutral/High Risk following a -20% underperformance for the shares over the past two months. The analysts point at greater than average leverage to a falling oil price, but also to market concerns about a potential capital raising to fund the next acquisition.

Citi analysts are sympathising with the capital raising risk, while contemplating a scenario whereby a commercial partner can be found to still purchase assets but with less dilution for shareholders.

Meanwhile, point out the analysts, Beach has substantial high-returning opportunity for capital allocation in Cooper. The analysts also suggest the outlook is likely to be stronger than consensus is giving the company credit for, but management needs to provide more details.

COLLINS FOODS LIMITED ((CKF)) Upgrade to Buy from Neutral by UBS .B/H/S: 1/1/0

The company has acquired 28 KFC restaurants from Yum! Brands for \$110m. The acquisition will be funded through a \$44m non-renounceable entitlement offer and \$66m in debt.

Meanwhile, the company reported a strong FY17 result, beating UBS expectations. This was predominantly driven by stronger-than-expected KFC Australia performance and lower depreciation.

Rating is upgraded to Buy from Neutral and the target is raised to \$6.00 from \$5.60.

DULUX GROUP LIMITED ((DLX)) Upgrade to Neutral from Underperform by Credit Suisse .B/H/S: 0/4/2

In the light of a recent wave of global consolidation in the industry, Credit Suisse weighs up whether Dulux might be predator or prey. On the prey side, the broker sees the core paint business as attractive but the home improvement businesses not so. Dulux could divest these to unlock value, but a solid share price rules out a private equity bid.

On the predator side, the broker believes the company is likely targeting a UK paint acquisition. Factoring in its analysis sees Credit Suisse lift its target to \$6.85 from \$6.05 and upgrade to Neutral.

GREENCROSS LIMITED ((GXL)) Upgrade to Buy from Neutral by UBS .B/H/S: 1/1/1

UBS notes feedback from the industry in pet retailing has signalled there is some trading down in food products and weaker gross margins.

The broker cuts its sales growth expectations for the Australasian retail division for the second half to 3.3% from 4.2%, and lowers divisional gross margins forecasts to a -50 basis points contraction.

Rating is upgraded to Buy from Neutral on the back of recent share price weakness. Target is reduced to \$7.10 from \$7.50.

INSURANCE AUSTRALIA GROUP LIMITED ((IAG)) Upgrade to Hold from Reduce by Morgans .B/H/S: 2/4/2

Insurance Australia Group expects reserve releases of around 5% of NEP in FY17 and has upgraded insurance margin guidance to 13.5-15.5%.

Morgans argues that elevated reserve releases are a lower-quality item and not sustainable. The broker finds the market's view on the stock peculiar, as recent weather downgrades were ignored while the elevated reserve releases appear to be rewarded.

The broker upgrades FY17 estimates by around 20% and FY18 by 2%. Target is lifted to \$6.27 from \$5.56. Rating is upgraded to Hold from Reduce.

See also IAG downgrade.

LINK ADMINISTRATION HOLDINGS LIMITED ((LNK)) Upgrade to Buy from Neutral by Citi .B/H/S: 3/2/0

Citi labels the acquisition of Capita Asset Services (CAS) "transformational", destined to facilitate "significant EPS accretion" from FY19 onwards. No double guessing as to why the broker has decided to upgrade to Buy from Neutral.

No doubt, an acquisition this size represents a challenge for management, acknowledge the analysts, while the price paid seems pretty full. But Citi seems firmly of the view the upside potential outweighs the potential negatives.

EPS estimates have been lifted by 3% this year, reduced by -3% for FY18 and lifted by 13% for FY19. The accompanying trading update is seen as slightly positive. Target jumps to \$9.20 from \$8.25.

MEDIBANK PRIVATE LIMITED ((MPL)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 1/2/4

Macquarie observes policy holder disputes are at the lowest level since 2000. This reduced level of disputes, amid expectations that IT system problems will diminish, increase the potential for improved customer retention and a more positive FY18, the broker believes.

Macquarie upgrades to Outperform from Neutral. Target is raised to \$3.07 from \$3.00.

METCASH LIMITED ((MTS)) Upgrade to Hold from Sell by Deutsche Bank .B/H/S: 2/4/1

FY17 results pleased Deutsche Bank. Food sales were not as bad as forecast, the balance sheet was better and cost reductions have lifted the margin.

While the outlook is tough and the second half revealed slowing market growth, intense discounting and the continuing spread of Aldi, sales did not come under as much pressure as the broker had feared.

Rating is upgraded to Hold from Sell. Target is raised to \$2.30 from \$1.60.

See also MTS downgrade.

SEVEN WEST MEDIA LIMITED ((SWM)) Upgrade to Hold from Sell by Deutsche Bank .B/H/S: 0/3/1

The federal government has effectively removed licence fees for free-to-air TV broadcasters in FY17. Deutsche Bank adjusts numbers to take into account the absence of licence fees and now expects the removal will be made permanent.

Offsetting this, the broker lowers advertising market forecasts for FY18 and FY19 to factor in the likely restrictions on gambling advertising.

While continuing to forecast Seven West operating earnings to fall by -12% in FY17, the broker's changes result in upgrades to forecasts for FY18 and beyond. Target is raised to \$0.80 from \$0.70 and the recommendation is upgraded to Hold from Sell.

WHITEHAVEN COAL LIMITED ((WHC)) Upgrade to Overweight from Equal-weight by Morgan Stanley .B/H/S: 4/3/1

Morgan Stanley remains positive on the mining industry but discussions with investors suggest they are cautious.

The broker finds the global outlook favourable, with a low risk of a slump in China, and commodity prices are beneficial, particularly as bulk commodities are finding support levels. While the broker acknowledges the setting is not "red-hot" it is constructive.

Morgan Stanley upgrades to Overweight from Equal-weight on the back of a more upbeat thermal coal outlook. Target is raised to \$3.55 from \$3.30. Industry view: Attractive.

Downgrade

BT INVESTMENT MANAGEMENT LIMITED ((BTT)) Downgrade to Sell from Neutral by UBS .B/H/S: 1/4/1

UBS does not believe the business can achieve near-term consensus expectations regarding performance fees. Over the last five years performance fees have contributed 16% of revenue and 20% to group pre-tax profit.

The broker notes the company's success over the last five years has been driven largely by the acquisition of JO Hambro and, with net flows remaining strong, recent underperformance across a range of funds has flown under the radar.

UBS downgrades to Sell from Neutral. Target is reduced to \$11.15 from \$12.00.

FLIGHT CENTRE LIMITED ((FLT)) Downgrade to Neutral from Buy by UBS .B/H/S: 1/5/2

The company's share price has risen 25% in the year to date and UBS observes it has outperformed the broader market. This, coupled with a more sombre outlook for the Australian discretionary retail environment, is the main driver of the broker's downgrade to Neutral from Buy.

The main issue for the company over FY17 has been airfare deflation which is offset strong volume growth and limited the business's ability to generate over-riders.

UBS believes a weaker consumer backdrop is the main risk to an earnings recovery, despite management suggesting the rate of deflation has started to ease. Target is raised to \$37.60 from \$36.10.

INSURANCE AUSTRALIA GROUP LIMITED ((IAG)) Downgrade to Underperform from Neutral by Macquarie and Downgrade to Sell from Neutral by Citi .B/H/S: 2/4/2

Insurance Australia Group has raised its FY17 insurance margin guidance range to 13.5-15.5% from 10.5-12.5%.

Despite price rises, Macquarie believes structural claim issues in motor vehicle insurance should mean the underlying margin contracts into FY18.

The broker believes the multiples are now stretched and downgrades to Underperform from Neutral. Target is raised to \$6.05 from \$5.95.

Factoring in higher reserve releases and other changes, Citi lifts forecasts for earnings per share in FY17 by 21% and FY18 by 5%. The broker now forecasts FY17 reported insurance margin of 15.3%, towards the top end of revised guidance.

The broker raises the target to \$6.30 from \$6.05 but downgrades to Sell from Neutral, as the stock appears too expensive.

Citi suspects the underlying margin may still be under some pressure from elevated claims inflation in motor vehicles and the earn-through of prior commercial insurance pricing.

See also IAG upgrade.

METCASH LIMITED ((MTS)) Downgrade to Neutral from Outperform by Credit Suisse .B/H/S: 2/4/1

FY17 results were better than Credit Suisse expected. The broker was surprised by the re-introduction of the final dividend at 4.5c.

The broker downgrades earnings forecasts to largely reflect a refining of a 52-week EBIT estimate. Target drops to \$2.38 from \$2.54. The share price appreciation leads Credit Suisse to downgrade to Neutral from Outperform.

See also MTS upgrade.

MYER HOLDINGS LIMITED ((MYR)) Downgrade to Sell from Neutral by UBS .B/H/S: 1/4/1

Myer's share price has fallen around 40% in the year to date but UBS believes further share price underperformance is likely because of a weakening consumer backdrop.

There is also the issue of rising competition, both from international entrants and through online. The broker's medium-term forecasts fall materially, driven by mid-single digit downgrades to top-line sales.

UBS now assumes like-for-like sales growth will be flat.. Rating is downgraded to Sell from Neutral. Target is reduced to \$0.75 from \$1.00.

NEWCREST MINING LIMITED ((NCM)) Downgrade to Underweight from Equal-weight by Morgan Stanley .B/H/S: 0/3/4

Morgan Stanley remains positive on the mining industry but discussions with investors suggest they are cautious.

The broker finds the global outlook favourable, with a low risk of a slump in China, and commodity prices are beneficial, particularly as bulk commodities are finding support levels. While the broker acknowledges the setting is not "red-hot" it is constructive.

Morgan Stanley downgrades to Underweight from Equal-weight, not because there are specific downside risks, but rather because value is captured in the share price and other miners screen better. Target is reduced to \$20.75 from \$21.50. Attractive industry view.

NINE ENTERTAINMENT CO. HOLDINGS LIMITED ((NEC)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 1/2/2

Macquarie believes the reduction to license fees from FY18 and the removal of fees for the FY17 year is a positive for the media industry.

The company has provided updated FY17 guidance of \$200-210m to incorporate the benefit of no license fee. Macquarie notes the government is still pushing for a broader reforms package but, if enacted, does not believe consolidation will create significant value for existing players.

Rating is downgraded to Neutral from Outperform on valuation grounds. Target is \$1.35.

NORTHERN STAR RESOURCES LTD ((NST)) Downgrade to Underweight from Overweight by Morgan Stanley .B/H/S: 1/2/3

Morgan Stanley remains positive on the mining industry but discussions with investors suggest they are cautious.

The broker finds the global outlook favourable, with low risk of a slump in China, and commodity prices are beneficial, particularly as bulk commodities are finding support levels. While the broker acknowledges the setting is not "red-hot" it is constructive.

Morgan Stanley downgrades to Underweight from Overweight, not because there are specific downside risks, but rather because value is captured in the share price and other miners screen better. Target is \$4.85. Industry view: Attractive.

SANDFIRE RESOURCES NL ((SFR)) Downgrade to Underweight from Equal-weight by Morgan Stanley .B/H/S: 4/2/2

Morgan Stanley remains positive on the mining industry but discussions with investors suggest they are cautious.

The broker finds the global outlook favourable with a low risk of a slump in China and commodity prices are beneficial, particularly as bulk commodities are finding support levels. While the broker acknowledges the setting is not "red-hot" it is constructive.

Morgan Stanley downgrades to Underweight from Equal-weight, not because there are specific downside risks, but rather because value is captured in the share price and other miners screen better. Target is reduced to \$5.90 from \$6.40. Industry view is Attractive.

SPARK INFRASTRUCTURE GROUP ((SKI)) Downgrade to Underperform from Neutral by Credit Suisse .B/H/S: 2/3/1

The stock is now trading at a three-year high relative to AusNet ((AST)), and at or above privatisation benchmarks.

Credit Suisse estimates that the value of synergies that may be achieved by combining the company's stake in Victorian assets with those of DUET are likely to be less than 1.4% of its discounted cash flow value.

Rating is downgraded to Underperform from Neutral. Target is \$2.40.

SEYMOUR WHYTE LIMITED ((SWL)) Downgrade to Hold from Add by Morgans .B/H/S: 0/1/0

The company has recommended the proposed acquisition by VINCI at \$1.285 cash per share. The company may decide to pay one or more dividends up to 44.5c and, if paid, the cash consideration as part of the scheme will be reduced by the cash amount of the dividends.

Morgans suspects the dividend payment is highly likely given the company's cash and franking credit balance. The broker downgrades to Hold from Add and sets the target at the offer price (\$1.29).

TABCORP HOLDINGS LIMITED ((TAH)) Downgrade to Neutral from Outperform by Credit Suisse .B/H/S: 1/1/1

Credit Suisse downgrades FY18-20 forecasts for earnings per share by around -4% because of growth in retail commissions, as the company introduces a geo-locating system to allow venues to participate in digital turnover. While knowing this initiative was underway, the broker did not anticipate the material cost involved.

Also contributing to the downgrade is a lower FY17 wagering revenue base. Rating is downgrade to Neutral from Outperform as previously the broker believed there was enough value for investors to take on the synergy growth option, and now the stock has to fall for the risk/reward to be attractive. Target is reduced to \$4.80 from \$5.00.

TPG TELECOM LIMITED ((TPM)) Downgrade to Neutral from Buy by UBS .B/H/S: 2/3/2

UBS has surveyed consumers and the majority of the survey is willing to pay more than \$25/month for the type of plan that the broker believes TPG may offer at a \$25 price point. Whether this translates into churn for the company is unclear, as proof of the network quality is required.

Nevertheless, UBS has increased confidence that the company can capture mobile market share and increases its long-term mobile share assumptions to 9.0% from 7.5%.

Rating is downgraded to Neutral from Buy as the near-term risks are skewed to the downside, and the increase to the broker's mobile capital expenditure forecasts is not enough to offset the increase to long-term market share assumptions. Target is reduced to \$6.00 from \$6.70.

Total Recommendations Recommendation Changes

Broker Recommendation Breakup

Broker Rating Order Company New Rating Old Rating Broker Upgrade 1 ALS LIMITED Buy Neutral Credit Suisse 2 AUSNET SERVICES Buy Neutral Credit Suisse 3 BEACH ENERGY LIMITED Buy Neutral Citi 4 COLLINS FOODS LIMITED Buy Neutral UBS 5 DULUX GROUP LIMITED Neutral Sell Credit Suisse 6 GREENCROSS LIMITED Buy Neutral UBS 7 INSURANCE AUSTRALIA GROUP LIMITED Neutral Sell Morgans 8 LINK ADMINISTRATION HOLDINGS LIMITED Buy Neutral Citi 9 MEDIBANK PRIVATE LIMITED Buy Neutral Macquarie 10 METCASH LIMITED Neutral Sell Deutsche Bank 11 SEVEN WEST MEDIA LIMITED Neutral Sell Deutsche Bank 12 WHITEHAVEN COAL LIMITED Buy Neutral Morgan Stanley Downgrade 13 BT INVESTMENT MANAGEMENT LIMITED Sell Neutral UBS 14 FLIGHT CENTRE LIMITED Neutral Buy UBS 15 INSURANCE AUSTRALIA GROUP LIMITED Sell Neutral Macquarie 16 INSURANCE AUSTRALIA GROUP LIMITED Sell Neutral Citi 17 METCASH LIMITED Neutral Buy Credit Suisse 18 MYER HOLDINGS LIMITED Sell Neutral UBS 19 NEWCREST MINING LIMITED Sell Neutral Morgan Stanley 20 NINE ENTERTAINMENT CO. HOLDINGS LIMITED Neutral Buy Macquarie 21 NORTHERN STAR RESOURCES LTD Sell Buy Morgan Stanley 22 SANDFIRE RESOURCES NL Sell Neutral Morgan Stanley 23 SEYMOUR WHYTE LIMITED Neutral Buy Morgans 24 SPARK INFRASTRUCTURE GROUP Sell Neutral Credit Suisse 25 TABCORP HOLDINGS LIMITED Neutral Buy Credit Suisse 26 TPG TELECOM LIMITED Neutral Buy UBS Recommendation Positive Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 SWM SEVEN WEST MEDIA LIMITED -25.0% -50.0% 25.0% 4 2 LNK LINK ADMINISTRATION HOLDINGS LIMITED 60.0% 40.0% 20.0% 5 3 CL1 CLASS LIMITED 67.0% 50.0% 17.0% 3 4 AWC ALUMINA LIMITED -21.0% -36.0% 15.0% 7 5 ALQ ALS LIMITED 43.0% 29.0% 14.0% 7 6 DLX DULUX GROUP LIMITED -36.0% -50.0% 14.0% 7 7 ILU ILUKA RESOURCES LIMITED 21.0% 7.0% 14.0% 7 8 MPL MEDIBANK PRIVATE LIMITED -43.0% -57.0% 14.0% 7 9 WBC WESTPAC BANKING CORPORATION 25.0% 13.0% 12.0% 8 10 WHC WHITEHAVEN COAL LIMITED 31.0% 19.0% 12.0% 8 Negative Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 NST NORTHERN STAR RESOURCES LTD -33.0% 17.0% -50.0% 6 2 TAH TABCORP HOLDINGS LIMITED -13.0% 13.0% -26.0% 4 3 ORE OROCOBRE LIMITED 60.0% 80.0% -20.0% 5 4 SKI SPARK INFRASTRUCTURE GROUP 17.0% 33.0% -16.0% 6 5 CTD CORPORATE TRAVEL MANAGEMENT LIMITED 60.0% 75.0% -15.0% 5 6 MYR MYER HOLDINGS LIMITED -7.0% 7.0% -14.0% 7 7 NCM NEWCREST MINING LIMITED -56.0% -44.0% -12.0% 8 8 DXS DEXUS PROPERTY GROUP -42.0% -30.0% -12.0% 6 9 SFR SANDFIRE RESOURCES NL 19.0% 31.0% -12.0% 8 10 TPM TPG TELECOM LIMITED -6.0% 6.0% -12.0% 8 Target Price Positive Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 LNK LINK ADMINISTRATION HOLDINGS LIMITED 9.008 8.482 6.20% 5 2 SWM SEVEN WEST MEDIA LIMITED 0.750 0.713 5.19% 4 3 ALQ ALS LIMITED 6.817 6.481 5.18% 7 4 CTD CORPORATE TRAVEL MANAGEMENT LIMITED 21.140 20.450 3.37% 5 5 ILU ILUKA RESOURCES LIMITED 8.636 8.431 2.43% 7 6 AWC ALUMINA LIMITED 1.843 1.800 2.39% 7 7 DLX DULUX GROUP LIMITED

6.404 6.290 1.81% 7 8 DXS DEXUS PROPERTY GROUP 9.385 9.218 1.81% 6 9 WHC WHITEHAVEN COAL LIMITED 3.253 3.209 1.37% 8 10 NST NORTHERN STAR RESOURCES LTD 4.465 4.432 0.74% 6 Negative Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 MYR MYER HOLDINGS LIMITED 0.917 0.953 -3.78% 7 2 CL1 CLASS LIMITED 3.543 3.615 -1.99% 3 3 SFR SANDFIRE RESOURCES NL 6.706 6.794 -1.30% 8 4 TPM TPG TELECOM LIMITED 7.025 7.113 -1.24% 8 5 TAH TABCORP HOLDINGS LIMITED 4.588 4.638 -1.08% 4 6 NCM NEWCREST MINING LIMITED 19.551 19.708 -0.80% 8 7 PRG PROGRAMMED MAINTENANCE SERVICES LIMITED 1.970 1.976 -0.30% 4 Earning Forecast Positive Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 AAD ARDENT LEISURE GROUP 1.241 0.607 104.45% 7 2 MTS METCASH LIMITED 21.100 19.611 7.59% 7 3 LNK LINK ADMINISTRATION HOLDINGS LIMITED 33.840 32.520 4.06% 5 4 SWM SEVEN WEST MEDIA LIMITED 10.811 10.426 3.69% 4 5 GUD G.U.D. HOLDINGS LIMITED 62.126 60.526 2.64% 5 6 OGC OCEANAGOLD CORPORATION 40.769 39.722 2.64% 6 7 FMG FORTESCUE METALS GROUP LTD 101.014 99.126 1.90% 8 8 ALQ ALS LIMITED 28.564 28.070 1.76% 7 9 BHP BHP BILLITON LIMITED 196.469 193.256 1.66% 8 10 NCM NEWCREST MINING LIMITED 66.857 65.881 1.48% 8 Negative Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 VCX VICINITY CENTRES 18.250 20.450 -10.76% 6 2 TAH TABCORP HOLDINGS LIMITED 20.798 22.012 -5.52% 4 3 IGO INDEPENDENCE GROUP NL 7.785 8.198 -5.04% 6 4 STO SANTOS LIMITED 18.095 18.941 -4.47% 8 5 MIN MINERAL RESOURCES LIMITED 99.460 103.260 -3.68% 3 6 CWN CROWN RESORTS LIMITED 91.703 94.417 -2.87% 7 7 ORE OROCOBRE LIMITED 8.569 8.789 -2.50% 5 8 BAP BAPCOR LIMITED 23.825 24.250 -1.75% 4 9 FXL FLEXIGROUP LIMITED 24.617 24.933 -1.27% 6 10 TCL TRANSURBAN GROUP 20.393 20.648 -1.23% 7 Technical limitations

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

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## Uranium Week: Slow Process

The spot uranium price pushed higher last week before falling back again, to be only marginally stronger on the week.

By Greg Peel

Having spent most of the month of June trading under US\$20/lb, two weeks ago the uranium spot price finally managed to crack that barrier and end the week slightly above, at US\$20.15/lb. Last week saw the daily price rise as high as US\$20.50/lb during the week.

But by week's end, the sellers were winning again and industry consultant TradeTech's weekly spot price indicator slipped back to US\$20.20/lb, to be up a mere US5c for the week.

It looks like a case of two steps forward, one step back, but we might note that given Friday was also the end of the quarter and end of the half, there might have been some squaring up.

The average traded price for the half to June was US\$22.69/lb, down -14% from the 2016 average of US\$26.32/lb. At US\$20.20/lb, the spot price is currently down -24% from the 2017 high of US\$26.50/lb reached in February.

A total of 4.1mlbs U3O8 equivalent changed hands in the spot market in June in thirty transactions. While utilities were involved in purchases to some extent, the bulk of the buying came from traders.

June saw the spot price rise US25c above the May closing price of US\$19.95/lb.

Perhaps the best news comes from the term markets.

2017 was another year which began with the expectation that utilities will shortly need to start stocking up on material, and that low prices would provide the incentive. Such demand would push up contract prices and this would spill over into stronger spot prices. But alas, 2017 has been another year, to date, in which such confidence has proven optimistic.

Utilities have indeed been active in terms markets, certainly more so than the stock market, but not enough to move the dial. TradeTech's term price indicators have actually been slipping quietly into the sunset over the course of the year. But last week came a breakthrough, perhaps.

TradeTech's long term price indicator remains unchanged at US\$34.00/lb, but the consultant's mid term price indicator has risen US20c to US\$24.45/lb. Not quite a reason to break out the champagne, but perhaps a welcome change in trend, nonetheless.

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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 June 28, 2017

Last week saw the ASX200 fall to 5680 before commencing a rally back to 5800 before falling back to 5680 before rallying back towards 5800. If traders are giddy, it appears short players are really not sure what to do either.

Few of the red and green movements in the table below represent any more than bracket creep.

One exception is beleaguered Ardent Leisure ((AAD)), which last week took a tumble on yet another downgrade to guidance. The company's once acclaimed Main Event business continues to struggle and in the light of Ardent's other issues, primarily lost theme park attendance, it has been a tough time all around for the leisure fund.

The shorters have cashed in to some extent, with Ardent shorts falling to 8.5% from 11.4%.

An interesting move is that of Japara Healthcare ((JHC)) which saw its shorts rise to 9.4% from 8.4%. Gateway Lifestyle Group ((GTG)) also saw a rise, to 8.3% from 7.9%. Japara is a closer link to the residential aged care sector now under scrutiny since the Aveo ((AOG)) story broke than Gateway, but both have ties to aged accommodation.

We might thus detect a theme but for two contradictions. Shorts in peer Estia Health ((EHE)) fell to 7.3% last week from 8.3% and shorts in Aveo itself only amount to 0.2%. The Japara/Estia switch may simply imply a pairs trade.

These are the only moves of note last week, hence no Movers & Shakers.

Weekly short positions as a percentage of market cap:

10%+

ORE 20.0 SYR 18.6 WSA 15.5 IGO 15.0 MYR 15.0 ISD 13.0 RFG 12.6 MTS 12.5 JBH 12.4 DMP 12.3 FLT 12.2 ACX 12.1 MYX 12.0 SHV 10.8

Out: AAD

9.0-9.9%

GXY, JHC, HVN, NEC In: JHC

8.0-8.9%

QIN, AAD, BKL, GTY, HSO, CTD

In: AAD, GTY, HSO Out: JHC, BGA, EHE



## 7.0-7.9%

OFX, BGA, AHG, NWS, MND, A2M, EHE, TPM, BAP, VOC

In: BGA, EHE , BAP Out: GTY, HSO, SAR, IPD

## 6.0-6.9%

IPD, BEN, GXL, SAR, SRX, RIO, RWC, PRU, CSV, NXT, SEK, IFL

In: IPD, SAR, CSV Out: BAP, MYO, PLS

## 5.0-5.9%

MYO, APO, PLS, KAR, RCG, BAL, OSH, AWE, AAC, AWC, DCN, MSB, CCP, VRT

In: MYO, PLS, APO Out: CSV, WGX, BDR, MTR, QUB

Movers and Shakers

See above.

## ASX20 Short Positions (%)

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

## IMPORTANT INFORMATION ABOUT THIS REPORT

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

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

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

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

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

Aside from all the above reasons as to why it would be a potential misconception to draw simply conclusions on short percentages, there are even wider issues to consider. ASIC itself will admit that short position data is not an exact science given the onus on market participants to declare to their broker when positions truly are "short". Without any suggestion of deceit, there are always participants who are ignorant of the regulations. Discrepancies can also arise when short positions are held by a large investment banking operation offering multiple stock market services as well as

proprietary trading activities. Such activity can introduce the possibility of either non-counting or double-counting when custodians are involved and beneficial ownership issues become unclear.

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

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

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## The Wrap: Retail, Asset Managers & Building

Weekly Broker Wrap: Retail centres; superannuation; asset managers; Australian equity strategy; building; Afterpay Touch; and Paragon Care.

-Outlook for shopping centres still bright despite Amazon, Moelis asserts -Industry funds making gains from super at expense of other categories -Morgan Stanley expects uptick in flows for asset managers in June quarter -Australian demographics underpin residential, Queensland-exposed stocks -Oz dollar fall versus euro supportive of stocks exposed to Europe

By Eva Brocklehurst

### Retail Centres

Moelis believes the future of shopping centres in Australia is bright, despite the potential for some isolated losses as the market adjusts to competition and changes in the way people shop. Retail A-REITs have come under pressure as investors fear the impact of Amazon in the local market.

The broker suspects supply of new centres will moderate, with few new outlets being rolled out by major tenants. Shopping centres typically do not get built without a supermarket anchor in Australia.

Nevertheless, the broker's analysis suggests demand for physical supermarkets should still exceed the current supply, even if online sales double in the next five years. This is based on a growing population, geographic & planning constraints and limited new supply.

Moelis highlights the successful re-development of Myer's ((MYR)) department store at Warringah, which involves less space - footprint reduced by around -35% - and more productivity for the store. There is still a place for the strongly performing discount department stores although the space allocated is expected to shrink and provides for alternative use.

The broker acknowledges large-format retailing appears vulnerable to the threat of increased supply, a slowing housing market and the growing online threat.

### Super

Bell Potter forecasts Australia's superannuation system to reach \$3trn by June 2020. In addition, the compulsory contribution level is set to increase to 12.0% from the current 9.5%, starting to rise again in around two years by 50 basis point increments each year.

The main winners in super are self-managed super funds and industry funds, both gaining over 8% of total market share since 2004. Most recently, industry funds appear to be making the gains at the expense of every other category.

IOOF ((IFL)) appears to be bucking the trend, Bell Potter observes, by differentiating with an adviser-first strategy and growing its adviser network. The move away from large incumbents such as the four major banks and AMP ((AMP)) continues the trend to independence, a key theme in the sector which the broker believes will continue. Bell Potter has a Sell rating on AMP and a Buy rating on IOOF.

### Asset Managers

Morgan Stanley observes retail flows appear better in the June quarter at Janus Henderson ((JHG)), while there is upside risk for flows and performance fees at BT Investment ((BTT)). Janus Henderson is the broker's top pick among Australian asset managers because of its higher earnings quality, undemanding trading multiples and flows that benefit from cross selling geographically diverse products.

Meanwhile, Morgan Stanley envisages upside risk to its BT Investment forecast of \$1.1bn in retail flows from the JO Hambro division for the June quarter, given that amount seems to have already been collected in April and May based on the latest analysis.

Performance fees at Magellan Financial ((MFG)) are also looking higher. The broker suspects a slowdown in retail flow momentum could be a reason why Magellan Financial is exploring a new LIC launch. A strong turnaround in international funds bodes well for improving flows in the future performance fee potential at Platinum Asset ((PTM)), in the broker's view.

## Oz Equity

Deutsche Bank outlines several themes to underpin equity strategies going forward. Australia's population growth continues to rise and overseas migration has picked up in response to improvements in the labour market in 2015. This is supportive of housing demand and underpins earnings growth for those companies exposed to construction. The broker retains a view of housing under-supply.

Migration to Queensland has also hit a six-year high and has further to go the broker suspects. Cheaper housing is the key attraction and sentiment has risen to the national average for the first time in six years, which suggests jobs growth should be buoyant enough in that state to attract migrants. The broker continues to back exposure to Queensland in stocks such as Stockland ((SGP)) and Suncorp ((SUN)).

The broker prefers large industrials to their small peers, despite the fact that the price/earnings discount for small cap stocks has risen to -17% from -11% in late 2016. This is based on a view that a soft economy puts more pressure on small cap stocks.

Meanwhile, for the first time in a while, the euro area is delivering the strongest growth in all the major regions. The Australian dollar has fallen against the euro this year, delivering an earnings boost for those companies with European operations.

Deutsche Bank notes this has beneficial implications for Amcor ((AMC)), Link ((LNK)) and ResMed ((RMD)). Other companies which have exposure to this region include Brambles ((BXB)), Ramsay Health Care ((RHC)), Ansell ((ANN)), Sonic Healthcare ((SHL)) and CSL ((CSL)).

## Building Outlook

Macquarie observes the outlook for the residential building market in Australia continues to subside, although the existing pipeline of building approvals suggests activity will be underpinned for a time but the risks are rising. Seasonally adjusted, 12-month rolling building approvals fell -8.4% in May. Multi-residential approvals remain weak nationwide and there were notable falls recorded in NSW, Victoria and Queensland in the month.

As a result, Macquarie continues to prefer infrastructure-exposed stocks such as Boral ((BLD)) and Adelaide Brighton ((ABC)), where the outlook for activity is robust and pricing power is improving. Macquarie continues to like the US building market, which underpins Outperform ratings on Boral, James Hardie ((JHX)) and Reliance Worldwide ((RWC)).

## Afterpay Touch

The merger of Afterpay and Touchcorp into Afterpay Touch ((APT)) has resulted in a substantial upgrade to Bell Potter's view of the business. The risk weighting has been upgraded to Buy from Speculative Buy and the price target to \$4.90 from \$4.50. The earnings are now on a firmer footing given a much more mature Touchcorp earnings profile, coupled with a strong growth in Afterpay, explains the broker.

Bell Potter upgrades FY17 forecasts for earnings per share by 14.6% and FY18 by 3.1%. The chances of the stock being included in the ASX300 over the year ahead are significantly improved, which the broker considers is another key positive catalyst.

## Paragon Care

Shaw and Partners has initiated coverage of Paragon Care ((PGC)) with a Buy rating and \$0.95 target. The earnings profile has evolved significantly over the last year or so and acquisitions have made the company significantly larger and more diversified from a defensive play on government-funded hospitals and aged care.

The broker notes there is also an increased level of long-term consumable contracts delivering recurring earnings, and a number of significant, as yet, unrecognised growth opportunities.

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## Brokers Attracted To BWX Acquisition

BWX has acquired US natural cosmetics outfit Mineral Fusion, providing an opportunity to expand its business globally.

-Opportunity to expand both major brands to other markets  
-Product range in line with current customers for Sukin in Australia  
-Are consensus margin expectations overly optimistic?

By Eva Brocklehurst

Personal care product business BWX ((BWX)) will acquire Mineral Fusion, a natural cosmetics brand in the US, for US\$38.4m, with a potential earn-out over the next 12 months of US\$4.6m based on meeting gross margin targets.

The acquisition will be funded by debt and accretive to earnings per share in FY18. This business has generated a three-year sales growth rate of 20.4% over 2013-16 and is expected to generate net sales of US\$24m in 2017.

Acquiring Mineral Fusion makes strategic sense to brokers, as sales are generated from natural cosmetics and are highly complementary to the company's existing product range. This also presents the opportunity to expand the current BWX product offering in Australia.

### Opportunity For Sukin

In turn, the move opens distribution channels in the US for the Sukin brand across a number of retailers. BWX expects to introduce Sukin into the US over the next 12-24 months. Bell Potter does not expect any meaningful contribution on that front until at least FY19 but notes Mineral Fusion has further organic growth opportunities, as less than 10% of the addressable US market has been penetrated.

Bell Potter, not one of the eight stockbrokers monitored daily on the FNArena database, remains attracted to the offshore sales opportunities that are ahead of the company and retains a Buy rating, raising the target to \$6.75 from \$6.00.

Canaccord Genuity, also not one of the eight, has a Hold rating and \$5.74 target, envisaging BWX is less likely to find a positive catalyst in the short term. The broker agrees the transaction is strategically beneficial and the price paid is reasonable. Mineral Fusion has over 150 stock units and is available in over 3,000 US retail outlets.

The broker is increasingly confident around Sukin sales growth heading into FY18 in China, reflecting encouraging figures for June, at a time when domestic sales growth is facing a more challenging outlook.

Yet, while concerns around China and increased competition have eased, Canaccord Genuity continues to believe consensus margin expectations are overly optimistic, as Europe and North America are generating an increasing percentage of sales and both are more expensive operating environments that will require increased marketing costs. After this acquisition, the broker's estimates for FY18 operating earnings (EBITDA) margins are reduced to 28.5% from 33.4%.

The acquisition price is not cheap, Moelis asserts, although it is a strategic fit. The broker expects double-digit sales growth for Mineral Fusion will continue as further retail partners are added and products are expanded. Moelis upgrades FY18-19 estimates for earnings per share by 7-12% to reflect earnings from Mineral Fusion in FY18 and initial Sukin sales into the US in FY19, calculating the acquisition will be 7% accretive in FY18.

The broker believes the company will continue to grow earnings at strong double-digit rates for the next 3-5 years as its international expansion continues. Moelis, not one of the eight monitored daily on the database, has a Buy rating and \$6.85 target.

### Mineral Fusion Background

The company was formed in 2009 and developed for the demand for high-quality, natural cosmetics. It currently sells its skin, hair and nail care products, fire a number of grocery retailers such as Sprouts, Natural Grocers and Earth Fare as well as traditional retailers such as Wegmans and Meijer. The company recently signed a supply contract with CVS pharmacies.

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## Metals X Raising Tin Profile

Metals X has furthered its definitive feasibility study on the Rentails tin and copper re-treatment project, providing robust economics. Canaccord Genuity estimates a final investment decision will take 6-9 months.

-Could become a substantial global supplier of tin -Rentails offers growth in a segment with few options -Uncertainty lies with partner ability to fund contribution

By Eva Brocklehurst

Metals X ((MLX)) has furthered its definitive feasibility study on the Rentails re-treatment project in Tasmania (50% owned), providing robust economics. Initial capital costs are slightly higher than brokers expected but the life-of-mine and guidance on costs is broadly in line with previous development assumptions.

The company, along with its joint-venture partners, will now ponder financing options and timing of long lead items and undertake the final approval process before a final investment decision, which Canaccord Genuity estimates will take 6-9 months.

Rentails is expected to produce 5,400tpa of tin and 2,200tpa of copper over an 11-year life. Macquarie updates its estimates for returns as the definitive feasibility study has translated into higher production in the early years, although there is no meaningful change to valuation for the internal rate of return of 22% for the project.

Canaccord Genuity estimates the Renison mine and Rentails combined could supply 13,400-13,900 tonnes of tin, which would represent around 3.75% of primary global supply.

### Rentails

The tailings have an average grade of 0.45% tin and 0.23% copper. The process will incorporate a reclamation of the tailings which will be ground using conventional technology. Copper is then removed via flotation into concentrate, with the tin undergoing further separation before flotation to produce a concentrate.

The concentrates will be high-quality, expected to grade 72% tin and 70% copper. The company has indicated revenue is likely to be around 94% of London Metal Exchange pricing for tin and 75% for copper.

At this stage, Canaccord Genuity maintains its nominal value for Rentails unchanged at \$50m until there is clarity on funding and a development timeline. The broker expects margins at the operation to be around \$10,000/t for tin, after accounting for capital expenditure and sustaining capital against a current Australian dollar tin price of \$26,000/t.

The tin segment has few growth options, the broker observes, and Rentails is a logical avenue for the company to pursue in order to increase its exposure to the metal. There is a lack of meaningful tin production coming online globally and stockpiles continue to trend lower.

Canaccord Genuity notes that tin was one of the best performing metals in 2016 and the market appears structurally supported in the medium term. Metals X used a US\$20,000/t tin price for its definitive feasibility study, which the broker suggests is conservative against consensus estimates for the commodity over the next five years.

### Funding

Canaccord Genuity suggests an interesting dynamic may arise with regard to the joint-venture partners. Partners include L'Sea Resources with 42% and Yunnan Tin with 8%. The former, the broker notes, only has a market capitalisation of around \$100m.

Assuming development went ahead in 2018, Metals X should be in a reasonably comfortable position to fund its attributable \$102.5m from existing cash flow from its Renison and Nifty (copper) mines, in the broker's estimate.

Canaccord Genuity, not one of the eight brokers monitored daily on the FNArena database, maintains a Buy rating and \$1.15 target and flags the company as a top pick among the base metals players under coverage. Macquarie has a

Outperform rating and \$1.00 target. At full production for both Nifty and Renison, which should occur in FY20, Macquarie estimates Metals X trades at a free cash flow yield of over 25%.

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## Buying Opportunity In Oil Search

By Michael Gable

It's interesting how two weeks after "Oil hits bear market territory" hits the headlines, the commodity has had its best run of gains this year, rising 7 days in a row. We looked at Woodside Petroleum (WPL) a few weeks ago and noted that it should dip under \$30 and then bounce again. Having done that, we can safely say that current levels represent a buying opportunity. On the back of that, we have had a look at the Oil Search ((OSH)) chart this week and that also looks like a buying opportunity.

There has been a bounce generally in resources with our tip on Bluescope Steel (BSL) at the end of still May doing pretty well and it now has an upside target of about \$15. Banks should also bounce here in the short term. The other item of interest in the last week is bond yields. Bonds have been sold off and yields are going up again. This has provided a bit of red ink for the bond proxies such as infrastructure and property stocks. Gold is also a bit sluggish but still provides a good medium-term hedge against further market weakness.

### Oil Search

OSH broke under some trendline support in early June but the last week has looked very bullish on the chart. In the last week (circled), we can see OSH retesting the June low and then bouncing very strongly. We have also see a buy signal generated on the MACD. OSH is likely to retest resistance near \$7. If it can get above that, then it becomes clear that weakness in June was a "false break". This means that OSH could rally back up towards \$7.50 where we will need to assess whether it will go on to rally even further. OSH looks like a buy here and traders should consider a tight stop near last week's low.

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## Spark Infra: Risk To The Downside

### Bottom Line

6/7: Daily Trend: Down WeeklyTrend: Down Monthly Trend: Up Support Levels: \$2.45 / \$2.19 - \$2.17 / \$2.11 / \$1.90  
Resistance Levels: \$2.88

### Technical Discussion

Spark Infrastructure Group ((SKI)) is an Australia based company engaged in investment in regulated electricity distribution and transmission businesses in Australia. The Company operates through several sections, being Victoria Power Networks, SA Power Networks and TransGrid. Victoria Power Networks holds interest in two electricity distribution businesses in Victoria, which include CitiPower and Powercor. It also invests in regulated water and sewerage assets.

For the year ending the 31st of December 2016 revenues decreased 10% to A\$243.9M. Net income decreased 8% to A\$81.1M. Revenues highlight the SA Power Networks section decrease of 33% to A\$98.2M. Dividend per share increased from A\$0.06 to A\$0.07. Basic Earnings per Share excluding extraordinary items remained flat at A\$0.03. Broker consensus is currently "buy". The dividend yield is 5.7%. Reasons to be bullish longer term (caution short-term): → Attractive dividend. → Strong and positive earnings bias. → Certainty over the regulation reset. → Low risk proposition with major assets VPN & SAPN outperforming. → Greater value due to cost efficiency and TransGrid. → Attractive yield, supported by high-quality regulated assets. → Cost reductions are in place with revenue growing.

Price action was looking exceptionally strong during our last review with the line of resistance having been overcome. A push above the wave equality projection was the next hurdle which is also a box that can be ticked. However, regarding the short-term price action that's the good news out of the way. The clear problem here is the swift and impulsive movement down from the recent pivot high around \$2.90. In fact, the typical retracement zone has already been tagged which would be fine if a corrective pattern down had unfolded.

Clearly this isn't the case meaning we are now on alert for the larger degree patterns also taking a turn for the worse. Despite the wave equality projection being overcome it could well be that a corrective pattern higher has unfolded off the November 2016 lows, completing as a 3-wave movement. If this is the case then a continuation down toward the zone of support between \$2.10 - \$2.00 is likely.

It isn't quite all doom and gloom yet although a push beneath the lower boundary of our target at \$2.45 would likely be the final nail in the coffin regarding anything more bullish unfolding any time soon. Bigger picture, there's nothing not to like about the company with an exceptional trend unfolding off the March 2009 lows. In other words, even if a deeper retracement unfolds, as is looking more likely, the bullish longer-term case remains intact. For now though, caution is required.

Trading Strategy Bearish divergence on this daily chart has now unwound with our oscillator deep into the oversold position. However, at best we can look for a bounce only from current levels which has the hurdle of resistance to overcome before morphing into something more bullish although this isn't our highest expectation. Notwithstanding a rally, the risk is to the downside over the coming weeks and likely months ahead. As such there is no reason to want to be involved for the foreseeable future.

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## Treasure Chest: Qantas Still Ascending

Why does a stock that's run so hard in a year still attract seven from eight Buy ratings from major brokers?

- Stable duopoly in Australia - Stronger margins - Discount to international peers

By Greg Peel

Qantas Airways ((QAN)) has come a long way since the infamous grounding of 2011. When the stock hit its nadir of close to \$1.00 in early 2014, questions were being raised as to whether the airline could survive and whether it could be sold, which would require a change to federal legislation.

The stock is now trading at \$5.75. That's a 418% rally in three and a half years and a 115% rally since the previous low set on a pullback one year ago. Supporting the rally has been the big fall in oil prices over the period, and a move within the airline industry to cease mutually destructive competition and rationalise capacity. On such an exponential surge, one would expect brokers would be calling the move overextended.

Of the eight major brokers on the FNArena database covering Qantas, none has a Sell (or equivalent) rating. One has Hold. The rest retain Buy ratings.

Underpinning ongoing positive views is the fact, noted by brokers, that despite the Lazarus performance Qantas is still trading at a discount to global peers. Early last month Citi suggested there will likely be "material upgrades" to consensus earnings forecasts from FY18 onwards.

If the Australian airline industry has learned one thing over the past decades, it is that the domestic market cannot handle a third airline. So many have tried and failed.

After a period of rationalisation, Qantas' domestic service now operates in a stable duopoly with Virgin, Credit Suisse suggests. Qantas' loyalty program arguably enjoys better-than-duopoly status. Together these make up around 70% of stock valuation.

While popular with Dustin Hoffman, Qantas' international service only accounts for 15% of value. This balance means Qantas enjoys more stable earnings than its international peers, Credit Suisse notes.

Over the past 20 or so years, Qantas has only suffered two years of pre-tax losses. US and European airlines have suffered many years of losses. Domestically, Qantas is able to enjoy a ticket price yield of around 15% above Virgin, at a unit cost that is only around 5% above Virgin, Credit Suisse points out. The broker believes Virgin's focus from here will be on attempting to improve its profitability rather than trying to gain market share.

This means duopoly conditions should remain stable for some time, Credit Suisse suggests. A stabilised domestic duopoly deserves a premium in the broker's view.

Credit Suisse already had a Buy (Outperform) rating on Qantas but last week lifted its target price to \$6.75 from \$5.00 to apply said premium to valuation.

This is still not the high marker among FNArena database targets. Citi has set \$7.09. The consensus target of eight brokers is \$5.54, suggesting downside, but then neither Deutsche Bank (\$4.10) nor Morgan Stanley (\$4.30) have updated since the February result season.

The only real sceptic is Ord Minnett, who as late as May retained a Hold rating with a \$4.15 target.

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