

Week
29

Stories To Read From FNArena

Friday, 20 July 2018

FNArena
Financial News, Data &
Analysis

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Last Hurrah For Wall Street?

By Kathleen Brooks, Research Director, Capital Index

The S&P 500 may have made a fresh 4-month high this week, but we have seen more tentative moves from investors - one day up, one day down. The daily price moves remain small, which is why the Vix remains at a low level. The index is hovering around the 2,800 level, the question is, where will this index go next?

The chart below shows the S&P 500 and its main sectorial components: the consumer discretionary, industrial, technology and financial sectors. This chart has been normalised to show how the sectors move together. As you can see, by far and away the largest contributor to S&P 500 gains has been the technology sector, followed by finance, with consumer discretionary and the industrial sectors actually under-performing the overall S&P 500 for most of the last 12 months.

This is significant, when the sectorial leaders narrow to this extent it is considered a symptom of a late-cycle rally. Thus, while the S&P 500 could continue to move higher, it may be the last hurrah. But just how high could it go?

We believe that the S&P 500's future is dependent on the technology sector, in particular, and to a lesser extent financials, and the medium-term outlooks for these two sectors will be a key driver of where the S&P 500 goes next.

In our view, the technology sector still looks strong, even with the Netflix earnings miss from earlier this week. Apple and Amazon still look on track to be the first trillion dollar companies, and Amazon's share price hit another record high this week after reports of a strong Prime Day.

Regarding financials, the major banks have already reported Q2 numbers and it has been a triumphant earnings season for the likes of JP Morgan, Morgan Stanley, Citi and BOA. The top 5 Wall Street banks made a combined \$5bn last quarter, which could boost sentiment towards these stocks. The interesting thing about the big banks' earnings last quarter is that they were broad-based with investment banking, trading, asset management and wealth management all posting healthy profit levels. Added to that, a favourable environment of low taxes, reduced levels of regulation and higher interest rates may also mean that financials have further to run on the upside.

Overall, if technology and banking stocks are driving the S&P 500, the outlook remains bright for the US index. While investors may be pausing for breath around the 2,800 mark, there is the scope for potential further upside pressure to materialise, especially if the Vix (volatility index) remains stable. Thus, 2,900 and potentially the 3,000 level cannot be ruled out at this stage.

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Margins Stabilise As a2 Milk Lifts Investment

A2 Milk sustained strong growth rates in FY18 but expectations for FY19 have softened because of the increased investment designed to expand the company's presence in China and the US.

-Margin expansion likely to level off amid heightened investment -Benefits expected from increased market share and new distribution agreements -First signs pricing has begun to improve in China

By Eva Brocklehurst

A2 Milk ((A2M)) has an upbeat strategy to expand its scale and presence, which suggests the significant margin expansion previously experienced may level off over the next year or so. The company reported unaudited revenue of NZ\$922m, slightly ahead of the guidance offered in May.

Sales growth was 68% over FY18 and operating earnings (EBITDA) were up 96%. Fourth quarter sales growth of 61% was slightly slower than the prior quarter. These growth rates represent strong demand but were also assisted by the cycling of stock shortages in the prior comparable period. A2 Milk should benefit from increased market share in all regions, new distribution agreements and incremental growth from both regions and products. Some form of capital management is probable, and Morgans will look for an update on investing in a blending and canning facility in Australia at the actual FY18 result.

A2 Milk is forecast to end FY18 with net cash of \$262m. Morgans reduces FY19 and FY20 net profit forecast by -6.9% because of higher marketing expenditure and further investment in corporate overheads.

The company has indicated an FY18 operating earnings (EBITDA) margin of 30% and guided to a similar margin in FY19. This is because of higher marketing expenditure and investment in corporate overheads.

A2 Milk has provided qualitative guidance for further growth and Citi expects sales growth to slow to a still-robust 48% in the first half of FY19 and 23% in the second half.

Marketing

Although expectations for FY19 have been softened because of the increased investment, Morgans believes investing heavily in the brand is extremely important for the longer-term growth profile.

CLSA, not one of the eight stockbrokers monitored daily on the FNArena database, considers investing in sustainability is the right move despite missing out on margin expectations.

The broker had been concerned the company was not spending enough on marketing to build a sustainable presence in China and is encouraged by the commitment to higher expenditure.

Sacrificing short-term earnings to invest in brand and build the necessary infrastructure to support greater scale is considered prudent for a business with a long growth outlook.

Having said that, investors appear to have spent too much time considering the upside and not enough of the downside and the broker believes the positives are reflected in the share price. Hence, CLSA downgrades to Sell on valuation with a target of \$10.25.

UBS suspects there may be modest downgrades to FY19 estimates given the guidance for margins, noting consensus was looking for margins around 32% which implies a -5% downgrade in guidance.

The broker retains a Neutral rating, as valuation is considered fair at current levels, but considers the outlook positive and the risk weighted to the upside for FY19/20 top-line forecasts. UBS forecasts three-year compound growth in earnings per share of 24%.

Pricing

Pricing has begun to improve and old-labelled stock has largely been cleared in China, setting the company up for a clear start to FY19.

Old-label products that need to work through the Chinese system remain, but the first week for 2018 has passed where Citi observes modest platform price increases. Still, the broker prefers to witness a sustained increase in re-seller pricing before concluding that inventory has improved.

Macquarie envisages medium to long-term value in the stock, as it is building a business that is synonymous with a disruptive and growing category. Surprises in FY19 are expected to be limited, other than more detail on product and market execution. The broker's channel checks remain positive and demand is expected to facilitate growth in market share.

As well as market expansion the company will have a number of new products being launched in FY19. The broker acknowledges it is unclear how much of the top line will be derived from new products and markets, but points out these tend to have lower margins initially because of the investment required to establish revenue opportunities.

This may be a factor that dilutes the margin in FY19 despite the increased scale the company is building. Beyond FY19 the US business is expected to move towards breaking even and Macquarie expects this to be positive for blended margins. Therefore, modest underlying margin expansion is expected.

The database shows four Buy ratings and two Hold. The consensus target is \$11.72, signalling 11.9% upside to the last share price.

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Uncertainty Creeps Into Whitehaven Outlook

Whitehaven Coal is riding a wave of multi-year highs in coal prices but a few uncertainties are creeping into the outlook.

-Thermal coal sales weak in June quarter because of increased low value sales -Market shrugging off lower volumes and higher costs because of high prices -Capacity for large capital returns may be pushed out

By Eva Brocklehurst

Buoyant coal prices are supporting Whitehaven Coal ((WHC)) and the outlook for FY19 remains robust, although brokers are increasingly concerned about the issues at Narrabri.

Realised metallurgical coal prices were above most expectations, at US\$131/t, while thermal coal was below most expectations, at US\$98/t in the June quarter. Saleable coal production was 3.8mt and down -9% on the prior corresponding quarter.

The company has achieved FY18 saleable coal guidance of 20.9mt, which is flat year-on-year and Maules Creek and Gunnedah performed well. Narrabri achieved FY18 guidance of 6.3mt, although saleable production was down -44%. The longwall move has now shifted to the September quarter and this will likely impact FY19 guidance.

CLSA is a little worried about the guidance, as price realisation was lower than expected, and thermal coal was surprisingly weak because of increased low calorific value sales. Higher cash costs are implied in FY19, attributable to lower volumes from Narrabri as well as higher diesel costs and sector inflation.

CLSA suggests, in any other market, the stock would have been sold off but, with thermal coal circling US\$110/t or more, the market shrugs this off because of the attractive free cash flow yield and upside to capital returns.

As thermal coal remains tight, the broker is positive on the outlook for prices and believes Whitehaven Coal is the best placed amongst the global coal peers to provide operating leverage to thermal coal. The broker, not one of the eight stockbrokers monitored daily on the FNArena database, retains an Outperform rating and \$5.80 target.

Shaw and Partners, not one of the eight, finds a lot to like about the stock, although concedes the June quarter numbers while good were not great and underpinned by a seven-year high in the coal price. There are also operating headwinds at Narrabri and costs are creeping higher.

The broker finds the sales mix unflattering, with a large uptick in low value thermal coal and a drop off in metallurgical coal sales. The latter is attributable to the negative price arbitrage between thermal and intermediate coking coal as well as lower availability at both Narrabri and Werris Creek. Shaw and Partners has a Sell rating and \$2.70 target.

The share price has had a strong run so Credit Suisse downgrades to Neutral on valuation grounds. The broker is less convinced about the quantum of capital returns to be delivered in August and notes a heightened risk to FY19 guidance for Narrabri.

Achieved thermal coal prices were well below Ord Minnett's expectations as well. Even the robust Maules Creek operation was slightly below expectations. However, the broker notes bullish commentary from the company regarding the outlook for coal prices, particularly thermal coal. The stock is considered quite cheap at current multiples and Ord Minnett maintains an Accumulate rating.

Narrabri

Production issues at Narrabri were more significant in the June quarter with delays in the longwall panel meaning the change over now moves into FY19, putting production guidance of 7.7mt at risk.

Narrabri is the area of most concern to brokers because of ongoing geotechnical problems and new mechanical issues. Credit Suisse considers the FY19 guidance for 7.7mt is now stale and questions the profile beyond FY19.

Despite downgrading, Credit Suisse agrees the stock is not expensive, particularly taking into account the capacity for capital management beyond the current policy.

The broker envisages two offsetting views. The first is those continuing to seek exposure to a strong coal price and the second is those who struggle to justify putting more money into a stock that has had a strong run up, given the uncertainty at Narrabri. Hence, Credit Suisse considers the previous risk/reward trade-off has moderated.

Vickery, Winchester South

Whitehaven Coal is set to lodge its environmental impact statement in August for the expanded Vickery project, which would allow discussions to commence with partners. UBS notes Vickery is increasingly a priority. The company expects an 18-month period for approval processes which means construction could start in early 2020, with first coal by the end of 2020 that can be processed by the Gunnedah plant.

While the capacity for large capital returns has not dissipated, the funds for Winchester South are going out in the current half-year which means a profile for capital returns may be pushed out, Credit Suisse asserts. Winchester South is envisaged as an opportunity that will come after Vickery.

The database shows four Buy ratings and four Hold for Whitehaven Coal. The consensus target is \$5.25, signalling -4.3% downside to the last share price. The dividend yield on FY18 and FY19 forecasts is 5.6% and 4.3% respectively.

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Sal De Vida Offtake Next Catalyst For Galaxy

Galaxy Resources posted an improvement in June quarter production and a further financing deal for Sal de Vida could be the next catalyst.

-Tenement acquisitions could present benefits to Mt Cattlin in future -POSCO underscores strong funding position for Sal de Vida -Further funding deal for Sal de Vida could bolster cash by year's end

By Eva Brocklehurst

Galaxy Resources ((GXY)) delivered a pleasing June quarter report as brokers focused on grades, recoveries and improved throughput at the Mt Cattlin lithium mine. Galaxy produced 47,900t of spodumene at Mt Cattlin in the June quarter and average margins rose to US\$534/t, driven by higher achieved pricing and higher grades (5.8%).

The company acquired three exploration licences surrounding the Mt Cattlin operation during the June quarter, for \$300,000 plus the issue of shares. These tenements have increased the area leased to around 460 square kilometres, and also appear to connect existing leases, which UBS suggests could present benefits in the future as mining progresses.

Recoveries at Mt Cattlin are expected to improve to 70-75% from around 55% as processing upgrades are now underway. Macquarie found the results strong and expects sales to increase further on the back of an upgrade to the processing plant.

Optimisation of the Mt Cattlin processing plant includes the installation of ultrafines DMS, secondary float re-crushing and final product sorters. Resulting increases in output are expected by the December quarter.

Canaccord Genuity adjusts production estimates and revises 2018 forecasts to 190,000t, just short of offtake obligations of 200,000tpa. Achieving the target may not be a stretch, the broker asserts, given timely completion of the plant upgrade and commissioning performance, highlighting positive commentary around an improvement in lithium prices in the second half.

The company has specified a mechanism with fixed pricing for the calendar year, determined in the fourth quarter of each year. Hence, Morgan Stanley suggest comments around better pricing in the second half will need to be clarified.

The company has revised its volume of ore mined in the first quarter to around 529,000t and Morgan Stanley believes the re-stated number has implications for the current strip ratio at Mt Cattlin and, therefore, the costs involved.

Sal de Vida and James Bay

Sal de Vida and James Bay continue to progress. Macquarie believes Sal de Vida's eventual development could be altered by a JV arrangement, while James Bay is a long-term growth prospect, albeit strong.

Feasibility work at James Bay continued over the quarter along with mine, plant design and site infrastructure planning. Metallurgical test work was also undertaken for the proposed downstream conversion facility and results were in line with the company's expectations.

POSCO has provided notice that it has completed its investment review for the purchase of the northern tenements at Sal de Vida and final close is expected in the September quarter. The two companies are in discussions regarding mutually beneficial developments and infrastructure. No updates were provided regarding offtake or equity opportunities that would assist in further funding of Sal de Vida.

Credit Suisse believes the sale to POSCO should be a positive catalyst if completed by the end of the year. The financing hurdle for Sal de Vida is now looking less challenged and this reduces the magnitude or risk of any potential equity sell down in the project. Credit Suisse still envisages a minority sell down as the likely outcome.

Canaccord Genuity believes existing cash, operating cash flow from Mt Cattlin and proceeds from the POSCO sale mean the company is already in a strong funding position for Sal de Vida.

Nonetheless, a deal could deliver even further cash to the company and bolster expected cash reserves by the end of the year. The broker, not one of the eight monitored daily on the FNArena database, considers the finalising of

Sal de Vida offtake/financing is the key near-term catalyst. Canaccord Genuity has a Buy rating and \$5 target.

FNArena's database has three Buy ratings and two Hold. The consensus target is \$3.58, signalling 12.9% upside to the last share price. Targets range from \$2.80 (Morgan Stanley) to \$4.30 (Citi).

See also, Galaxy Finds Solution To Brine Project Funding on May 31 2018.

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Is The RBA Wrong?

The RBA suggests the next move in rates will be up, just not yet, given an economy growing at above-trend. For different reasons, economists disagree.

-RBA forecasts 3%+ growth ahead -Consumption is the swing factor -How far will house prices fall? -What is the impact of population growth?

By Greg Peel

“The recent data on the Australian economy had been consistent with the Bank’s central forecast for GDP growth to pick up to be a bit above 3 per cent over 2018 and 2019.”

The RBA has remained positive throughout 2018 on the Australian economy, believing the nearer term outlook has GDP growing at slightly above trend. The excerpt from the minutes of the July meeting above confirms no change to this expectation.

The caveat is nevertheless uncomfortably high household debt, with consumption remaining uncertain as incomes fail to grow sufficiently to offset such debt at a time interest rates remain low. This balance is keeping the central bank cash rate on hold for now, although the board insists the next move is likely to be up, not down, based on a gradual move lower in unemployment and higher inflation, given robust economic growth.

Westpac chief economist Bill Evans concurs that the economy grew comfortably above trend in January to April, but slowed in May, and in June fell to below trend. Evans’ assertion is supported by the Westpac-Melbourne Institute leading economic index, which dropped to -0.33% in June from +0.05% in May.

The index seeks to indicate the pace of economic activity, relative to trend, three to nine months into the future. June’s was the first below-trend reading since September last year and the weakest since last July.

Further readings will be required, Evans suggests, to confirm a shift to a below-trend outlook, but the numbers are in accord with Westpac’s forecasts for the rest of 2018 and 2019.

The biggest drags in the June index reading came from a turnaround in unemployment expectations, lower AUD commodity prices and a deepening contraction in dwelling approvals. Domestic components are now coming to the fore, Evans notes, whereas over the last year or so movements in the leading index have been explained mostly by international factors, being commodity prices, US industrial production and the yield curve.

With a nod to the RBA’s “next move will be up not down”, Westpac continues to expect no change to the cash rate in either 2018 or 2019.

Houses of Cards

Another leading index to be considered is Morgan Stanley’s forward-looking housing model, MSHAUS, which set a new historical low in the six months to June of -1.0, suggesting the recent decline in housing prices will continue into the March quarter 2019. Credit has tightened further, the analysts note, housing market sentiment is slipping and additional stock is still hitting the market.

All categories of the indicator remain at weak levels, but credit supply was once again the main driver of the fall. No prizes for guessing the regulatory scrutiny forthcoming from the Royal Commission is impacting. Other factors were little changed.

The rationing of interest only-loans continues to bite, Morgan Stanley notes, with APRA data showing only 16% new approvals when the regulator’s cap is 30%. Finance commitments fell -14% in the year to May, reflecting tighter lending standards and a deteriorating outlook for property investment returns.

For four years, the analysts point out, dwelling supply growth has outpaced population growth, despite the latter remaining strong. National prices are now down -2.3% from their peak and Sydney specifically down -4.8%. No one expected rising prices to go on forever, but the debate now is to just how far prices may fall.

Morgan Stanley believes that number will be closer to -10%. Any further and the RBA and/or APRA will be forced to act.

In other words, the next RBA rate change would be down, not up.

Because of high household debt and slow wage growth, the RBA cites consumption as being the uncertain factor in the board's forecast for ongoing above-trend growth. It is a truth universally acknowledged that household consumption will rise if wealth rises, even if that wealth is based only on the market price of the family home which the family has no immediate plans of selling.

Rising house prices make consumers "feel" wealthy, and hence the opposite is true.

Populate or Perish

Australia has famously now posted over 26 years of uninterrupted economic growth. Not even the GFC brought on a recession (using the two quarters of negative GDP measure). The key driver of this success is population growth, UBS points out, and growth in 2017 remained at a robust 1.6%, mostly due to migration.

But what that 1.6% number does not include is migrants on temporary visas. In 2007 they represented 1.4% of the measured population and by 2016 had hit a record 2.7%, UBS notes. More than half are students, the number of which has surged to a record high in 2017.

Surging temporary visa growth will drive ongoing strong population growth in coming years, supporting headline GDP via the "exports" of education and tourism. This will support the need for infrastructure growth, UBS suggests, as well as underpin housing demand.

These migrants are relatively young, skilled, educated and have a much higher participation, providing for a "positive labour supply shock" which caps wage pressure and thus inflation.

This is key, UBS asserts, to keeping the RBA on hold to 2020.

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Material Matters: Metals, Iron Ore And Oil

A glance through the latest expert views and predictions about commodities. Metals; copper; gold miners; iron ore; and oil.

-Solid value envisaged for metal producers despite escalating trade tensions -Continued deficit likely for copper market in 2018 -Gold sector is now benefiting from strong balance sheets and cash -Iron ore premiums may ease but unlikely to revert to historical levels -US bottlenecks suggest crude demand likely to exceed supply in 2019

By Eva Brocklehurst

Metals

Ord Minnett suggests macro indicators are robust for the metals sector, despite escalating trade tensions and a pullback in prices. Solid value is envisaged at spot prices as most stocks are averaging yields of 10%-plus amid earnings multiples that are typically 5x or lower, and there is negligible debt.

The broker does not expect US/China tensions will cause a material decline in commodity demand. Global steel production is robust and improved credit conditions are expected in China in the second half of 2018. Overall, the broker considers the recent sell-off offers an attractive entry point.

Ord Minnett lifts long-term metal price forecasts with the main changes including nickel, up 10%, copper, up 12%, aluminium, up 9%, alumina, up 20% and zinc, up 27%. The broker believes investment hurdle rates are increasing and this will drive higher prices given the lack of tier-1 projects.

The broker prefers BHP Billiton ((BHP)), Rio Tinto ((RIO)), Fortescue Metals ((FMG)), Alumina Ltd ((AWC)), Independence Group ((IGO)), Newcrest Mining ((NCM)), OceanaGold ((OGC)) and Orocobre ((ORE)).

Copper

The copper price has fallen -16% from its peak in early June to US\$2.80/lb because of concerns over the escalating US/China trade war, as well as the capitulation of a large long position on the Shanghai Futures Exchange. UBS expects the copper market will have a deficit of around -300,000t in 2018.

However, the broker notes supply disruptions in the first half of the year were materially less than expected and risks in Indonesia and the Democratic Republic of the Congo have moderated, although the latter's risks remain elevated.

The recent agreement to restructure the ownership of Grasberg reduces the near-term risk of disruption, UBS believes, and the technical risk will also reduce in 2019 when the mine moves to a block cave from being an open pit. The main risks to the copper outlook in the near term are labour contract agreements at Escondida and Chuquibambilla.

Gold Miners

The recent performance of the Australian gold sector has easily outpaced offshore peers and eroded much of the value and upside to price targets, RBC Capital Markets notes. This has eventuated despite a falling US dollar gold price which is commonly the key driver of the sector.

The analysts suggest strong balance sheets, margins and consistent operating performance have supported domestic equities while there are less compelling investment arguments elsewhere for offshore producers or domestic small cap stocks. In this environment the broker believes long-term valuation tends to matter less than momentum and there remains scope for stocks to run further.

Outside of mid-tier stocks, and for those that focus on absolute valuation support, RBC Capital Markets advocates looking further down the curve, as smaller stocks appear to be trading at a discount to net asset values. They also now benefit from strong balance sheets and excess cash.

As with their larger peers, the analysts suggest free cash flow directed towards exploration has a good chance of yielding upgrades and providing further upside beyond the current base case estimates.

The analysts suggests large to mid-cap gold miners on ASX are fully valued and stocks like Evolution Mining ((EVN)), Northern Star Resources ((NST)) and Regis Resources ((RRL)) are screening expensive on valuation. The broker suggests looking further down the curve at Ramelius Resources ((RMS)) and Resolute Mining ((RSG)).

Ord Minnett recommends caution entering gold stocks at current levels but envisages upside potential in Newcrest and OceanaGold.

Iron Ore

Iron ore has sustained relatively stable benchmark pricing as it heads into a slower season and has not experienced the same declines as the base metals complex. Morgan Stanley suggests the relative outperformance is partly because of the differing nature of the end markets, as most steel is installed on the domestic capital stock and not immediately affected by international trade tariffs.

China's crude steel production has been solid. However, the real issue is the blowout in high-grade differentials. The high-grade 65% iron premium versus the 62% grade reached a record 43% in early July, from 20% in January. The broker notes low-grade 58% iron discounts have not diverged further but remain large.

Some normalisation is considered likely but Morgan Stanley does not expect premiums to revert to historical levels. Steelmakers may be paying more for high-grade iron ore than the actual value of the additional benefit to productivity. Still, as environmental pressures continue, this is unlikely to fully revert.

The broker also does not envisage much in the way of near-term high-grade expansion of supply beyond Vale's S11D ramp up. Yet, low-grade, high-cost supply is likely to drop out of the market and narrow the low-grade discount.

Oil

Nomura, assuming OPEC production remains at the June level, expects crude oil demand will exceed supply by 120,000 bbl/day in 2018 and, while envisaging downside risks to demand because of increasing trade tariffs between the US and China, rising prices and US dollar depreciation, expects demand will still substantially exceed supply in 2019.

US output is not expected to run significantly higher than is currently forecast, even if oil prices rise. The International Energy Agency forecasts US crude oil production will increase 1.72m bbl/day in 2018 and 1.19m bbl/day in 2019.

In the Permian region, that drives the growth in output, a lack of pipeline capacity is expected to persist until 2019. There are also issues regarding production costs and a lack of engineers. A detailed review of pipeline capacity expansion plans and the potential for truck/rail crude shipments also reinforces Morgan Stanley's call that Permian growth will be well below expectations.

The broker believes takeaway capacity has emerged as a limiting factor and there is little change in sight until early 2020. Around 98% of capacity is already used. Crude will inevitably need to be moved by truck and rail in the US but this also has limitations.

The broker reiterates a view that production will be constrained. Meanwhile, the market faces an usually large number of supply risks, primarily from Venezuela, Iran and Libya. As US shale growth is hampered by infrastructure bottlenecks an undersupplied market is expected in the second half of 2018 and 2019, and inventories are already low.

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Material Matters: Energy Stocks, Coal & Oil

A glance through the latest expert views and predictions about commodities. Energy stocks; metallurgical coal; and oil.

-Is the upgrade cycle for energy stocks over? -Correction to seaborne coking coal prices likely -Stronger US production a key oversupply risk in oil market

By Eva Brocklehurst

Energy Stocks

Ord Minnett makes changes to its price estimates for oil, increasing long-term Brent forecast to US\$60/bbl. These changes largely result in reductions to near-term earnings estimates but higher valuations for ASX listed stocks.

Following recent price performance the broker now considers the sector fully valued. In most parts, consensus has caught up with Ord Minnett's forecasts, signalling the upgrade cycle is probably over. Within the sector Ord Minnett retains a preference for WorleyParsons ((WOR)) and Senex Energy ((SXY)) based on growth and value, upgrading the latter to Accumulate.

Origin Energy ((ORG)) is also preferred because of an ongoing de-leveraging process. Ord Minnett lowers its recommendation on Oil Search ((OSH)) to Hold based on valuation but remains positive about the outlook and strong growth prospects.

Citi also recently upgraded Senex Energy to Neutral/High Risk because of higher reserve forecasts for the Cooper. The broker now considers the stock to be fairly valued although there is upside for investors that take an optimistic view on long-term oil prices.

Citi notes reserve upgrades reported by Beach Energy ((BPT)) are not merely adding late-life production but there are many fields that are exhibiting a slower decline in production. For those investors buying the stock for momentum this development is supportive.

Citi increases its target by 32% to \$1.62 but retains a Sell rating as the stock appears too expensive. The longer term outlook for growth is also less compelling than peers, in the broker's view.

If Santos ((STO)) were to upgrade reserves in line with Beach Energy, these would increase by around 14%. However, Citi calculates that the increase to valuation would only be small because it would represent plateau extensions rather than higher near-term production.

Metallurgical Coal

The seaborne price for metallurgical (coking) coal has corrected by -US\$20/t in three days, to US\$182/t. Signs that a correction was due, Morgan Stanley observes, include a correction in China's domestic coke price and accompanying fall in domestic metallurgical coal prices.

China has again tightened up import regulations surrounding metallurgical coal and some ports are now preventing ships from berthing, as annual quotas are filled. Meanwhile, traders are unable to import coal without a buyer. This is likely to reduce the call on seaborne supply. Moreover, a weakening yuan offers extra motivation for China's buyers to favour domestic coal.

China's domestic coal supply is also picking up, while environmental restrictions have potential to reduce crude steel output. On balance, Morgan Stanley suggests these drivers, as well as typical seasonality, signal further downside risk for metallurgical coal prices in coming weeks.

Oil

Commonwealth Bank analysts believe stronger US oil production is the key oversupply risk in the market. The US Energy Information Administration is forecasting US oil production will lift by 15.4% to 10.79mb/d this year and rise another 9.3% to 11.8mb/d next year.

The US may even draw on the strategic petroleum reserve to boost domestic output, which adds to fears of oversupply. Nevertheless, rising US oil supply is playing a secondary role in driving oil prices, the analysts contend.

Over-compliance with production cuts by OPEC had resulted in an agreement to boost output. There remains debate on how much OPEC and Russia will add but this over-compliance has reduced meaningfully in June to 19-29%, from 44-62% in May.

The analysts suspect OPEC and Russia may not be enough to offset collapsing OPEC output elsewhere. Venezuelans output is falling amidst an economic and debt crisis and US sanctions add further downside risk. US actions against Iran are also expected to sideline around 0.5-1% of global output.

The main concern regarding US oil supply is constraints on pipeline infrastructure. The Permian Basin is the largest shale oil basin in the US and infrastructure constraints may start weighing on supply growth from August and potentially last until the end of 2019.

Yet, the analysts suggest US oil supply may still grow at higher rates if other US shale basins expand. Bakken and Eagle Ford face fewer infrastructure issues but are typically more expensive when it comes to shale oil production.

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 Rudi Filapek-Vandyck, Editor FNArena

Guide:

The FNArena database tabulates the views of eight major Australian and international stock brokers: Citi, Credit Suisse, Deutsche Bank, Macquarie, Morgan Stanley, Morgans, Ord Minnett and UBS.

For the purpose of broker rating correlation, Outperform and Overweight ratings are grouped as Buy, Neutral is grouped with Hold and Underperform and Underweight are grouped as Sell to provide a Buy/Hold/Sell (B/H/S) ratio.

Ratings, consensus target price and forecast earnings tables are published at the bottom of this report.

Summary

Period: Monday July 9 to Friday July 13, 2018 Total Upgrades: 8 Total Downgrades: 15 Net Ratings Breakdown: Buy 44.55%; Hold 39.95%; Sell 15.51%

This seldom happens, but we missed Deutsche Bank's downgrade of Orora ((ORA)) on Friday, which has been updated since. The result is, however, this downgrade is not as yet reflected in the overview of the week's upgrades and downgrades.

Total downgrades for the week ending Friday, 13th July 2018 (how fitting!) thus stand at 16 versus eight upgrades. Clearly, the buoyant mood in the Australian share market is being met with the usual opposite response from stockbroking analysts.

Commodities stocks feature prominently on the positive side, with Western Areas receiving two upgrades (only one to Buy) as nickel price forecasts continue to rise. Independence Group and Origin Energy also received upgrades during the week.

Apart from Orora, many more high flyers are starting to receive downgrades from analysts, including NextDC, Altium, Appen, Sydney Airport and Fisher & Paykel Healthcare.

Equally noteworthy, ten of the sixteen downgrades moved to Sell, including Orora's.

Consensus target prices are still rising, with the week's top dog, Integral Diagnostics, enjoying a boost of 9%, beating WiseTech Global, Sonic Healthcare and Woolworths for the week. On the other side of the ledger, we find fewer stocks suffering from declining price targets with Magellan Financial, Mineral Resources and Spark Infrastructure the only ones worth mentioning.

The underlying trend for earnings estimates is a mixed one, with both sides amply represented. Ansell takes home the upper crown for the week, enjoying an increase to estimates of 10%, followed by Healthscope, Magellan Financial and Alacer Gold. Those with the largest decreases include gold miner Perseus Mining, Mineral Resources, NextDC, and struggling jeweller Michael Hill.

Upgrade

BANK OF QUEENSLAND LIMITED ((BOQ)) Upgrade to Buy from Neutral by Citi .B/H/S: 3/1/2

Bank of Queensland has underperformed in 2018 and is now more attractively priced in Citi's view. The stock now largely reflects the weaker outlook ahead for retail banking and regional banks.

Moreover, the broker argues that consolidation is probable among regionals, and Bank of Queensland shareholders should be set to benefit. Rating is upgraded to Buy from Neutral. Target is raised to \$11.50 from \$11.00.

INTEGRAL DIAGNOSTICS LIMITED ((IDX)) Upgrade to Equal-weight from Underweight by Morgan Stanley .B/H/S: 2/1/0

Morgan Stanley has integrated recent acquisitions into its model which brings a material rise in valuation and the growth outlook. The broker believes the outlook is now more certain and, moreover, FY18 guidance for 20% net profit growth has been reaffirmed.

Rating is upgraded to Equal-weight from Underweight. Target is raised to \$3.05 from \$2.25. Industry view: In-Line.

INDEPENDENCE GROUP NL ((IGO)) Upgrade to Buy from Hold by Deutsche Bank .B/H/S: 2/3/2

In a general sector update, Deutsche Bank analysts observe how trade war tensions between China and the USA have had a downward impact on metals prices. The analysts see weakness in aluminium, copper and nickel providing opportunities for investors.

All three metals mentioned should be supported by short term supply limitations. Nickel has commenced a bullish uptrend, in the analysts' opinion. Net present Value (NPV) for Independence Group has jumped to \$5.50 from \$4.40 on higher nickel price forecasts. Upgrade to Buy from Hold.

JUMBO INTERACTIVE LIMITED ((JIN)) Upgrade to Add from Hold by Morgans .B/H/S: 1/0/0

Tabcorp ((TAH)) has exercised its option to acquire 3.5m shares in Jumbo Interactive at \$2.37 each. Subsequently Tabcorp sold around 2.85m shares at \$4.26 each and now holds 12.5% of the stock.

Morgans believes the decline in the share price has been caused by investors speculating that Tabcorp will not take over the company. The broker never anticipated such a move believing that, while the business is a good fit down the track, Tabcorp has a significant amount of work to do internally.

Rating is upgraded to Add from Hold. Target is raised to \$4.84 from \$4.81.

ORIGIN ENERGY LIMITED ((ORG)) Upgrade to Buy from Neutral by Citi .B/H/S: 6/2/0

Citi adjusts its estimates, marking to market for oil and FX in the June quarter and reflecting pipeline flow and LNG cargo data in production forecasts. The broker also makes adjustments to the debt schedule leading to lower interest expense.

As a result, near-term earnings for FY18-20 are raised by up to 6%. Rating is upgraded to Buy from Neutral and the broker continues to prefer Origin Energy over AGL ((AGL)), given it has less exposure to lower wholesale prices. Target is raised to \$11.02 from \$10.38.

SONIC HEALTHCARE LIMITED ((SHL)) Upgrade to Neutral from Sell by Citi .B/H/S: 3/5/0

Ahead of upcoming reporting season, Citi has transferred coverage of healthcare stocks to a new lead analyst, which has led to a general re-assessment of preferences, forecasts and valuations.

In a general sense, the new king in town remains most positive on those with international exposure, even with elevated valuations suggesting a little bit of caution seems justified.

The latter also applies for Sonic Healthcare, but more so because of ongoing risks and not because of valuation. Upgrade to Neutral from Sell. New price target \$26 (was \$21.75).

WESTERN AREAS NL ((WSA)) Upgrade to Buy from Sell by Deutsche Bank and Upgrade to Hold from Sell by Ord Minnett .B/H/S: 3/2/2

In a general sector update, Deutsche Bank analysts observe how trade war tensions between China and the USA have had a downward impact on metals prices. The analysts see weakness in aluminium, copper and nickel providing opportunities for investors.

All three metals mentioned should be supported by short term supply limitations. Nickel has commenced a bullish uptrend, in the analysts' opinion. Net present Value (NPV) for Western Areas has jumped to \$4 on higher nickel price forecasts; from \$2.90 previously.

Double-whammy upgrade to Buy from Sell.

Ord Minnett expects the nickel market to remain in deficit beyond 2018, while higher prices are required to provide the incentive for new supply to keep up with the growth in demand.

The broker considers nickel one of the few commodities that is trading below its long-run real average price. New sources of supply will be higher cost and technically challenging as well.

The broker upgrades to Hold from Sell and raises the target to \$3.70 from \$2.65.

Downgrade

ALTIUM LIMITED ((ALU)) Downgrade to Sell from Neutral by UBS .B/H/S: 0/2/2

UBS believes the valuation has become stretched and the minimal downside risks are now priced in. Business momentum remains strong and earnings risks in the medium term are to the upside.

As valuation risks are now heightened the broker downgrades to Sell from Neutral. Target is raised to \$18.50 from \$15.60.

APPEN LIMITED ((APX)) Downgrade to Neutral from Buy by UBS .B/H/S: 1/1/0

Following the strong share price performance UBS downgrades to Neutral from Buy. The broker's core investment thesis is intact and the earnings outlook for the medium term remains positive.

UBS estimates first half earnings of \$24m. Target is raised to \$13.10 from \$12.00.

CHARTER HALL LONG WALE REIT ((CLW)) Downgrade to Neutral from Buy by UBS .B/H/S: 1/1/1

UBS downgrades to Neutral from Buy on the back of a strong performance in the share price. The broker expects the asset mix to remain in demand but this is incorporated in the price, while there is increased uncertainty around acquisitions.

Security holders are being asked to approve the sale of the ATO building in Adelaide. After taking into account the divestment of Grace Logistics, WW Dandenong's final payment and this building sale, UBS expects the company to swiftly deploy proceeds to maintain a growing distribution profile. Target is unchanged at \$4.25.

EVOLUTION MINING LIMITED ((EVN)) Downgrade to Sell from Hold by Deutsche Bank .B/H/S: 1/4/3

It appears, analysts at Deutsche Bank have used a general sector update on mining to re-assess valuations and outlooks for gold mining operations listed on the ASX. The report suggests a lot of detailed analysis has preceded.

Despite a general increase in Net Present Value (NPV) of about 9% across gold miners, Evolution Mining has been downgraded to Sell on valuation.

FISHER & PAYKEL HEALTHCARE CORPORATION LIMITED ((FPH)) Downgrade to Sell from Neutral by Citi .B/H/S: 0/0/3

Ahead of upcoming reporting season, Citi has transferred coverage of healthcare stocks to a new lead analyst, which has led to a general re-assessment of preferences, forecasts and valuations.

In a general sense, the new king in town remains most positive on those with international exposure, even with elevated valuations suggesting a little bit of caution seems justified.

Rating is downgraded to Sell from Neutral following share price rally. Price target falls to NZ\$12.50 from NZ\$13.40.

GATEWAY LIFESTYLE GROUP ((GTY)) Downgrade to Neutral from Buy by UBS .B/H/S: 1/1/0

Hometown has come back with a \$2.30 (\$2.35 pre-dividend) bid for Gateway, gazumping Brookfield's bid which gazumped Hometown's initial bid. Hometown now holds 18.2% of the company, UBS notes.

UBS does not rule out another counter from Brookfield, or someone else, but believes an even higher price is pushing into overvalued territory. Hence a downgrade to Neutral from Buy, given the share price is aligned with the latest bid. Target rises to \$2.30 from \$2.10.

INGHAMS GROUP LIMITED ((ING)) Downgrade to Sell from Neutral by UBS .B/H/S: 1/4/1

UBS downgrades to Sell from Neutral, believing consensus expectations are too high for FY19. FY19-21 forecasts are reduced by -6-7%. Target is reduced to \$3.40 from \$3.70.

The broker believes the market is over estimating cost reductions and the ability to pass through costs. The main risk to the stock's Sell rating, UBS acknowledges, is capital management at the FY18 result.

INVOCARE LIMITED ((IVC)) Downgrade to Neutral from Buy by Citi .B/H/S: 0/5/1

Ahead of upcoming reporting season, Citi has transferred coverage of healthcare stocks to a new lead analyst, which has led to a general re-assessment of preferences, forecasts and valuations.

In a general sense, the new king in town remains most positive on those with international exposure, even with elevated valuations suggesting a little bit of caution seems justified.

Ironically, InvoCare is part of the healthcare sector at Citi. Rating downgraded to Neutral from Buy following share price appreciation. Price target improves to \$14.25 from \$14.

LOVISA HOLDINGS LIMITED ((LOV)) Downgrade to Underweight from Equal-weight by Morgan Stanley .B/H/S: 2/1/1

Morgan Stanley believes Lovisa is an expensive stock. While acknowledging the options in a global roll-out the broker suggests that maintaining the multiple is crucial to the steeper and longer-dated growth profile.

Regardless of the potential, the broker envisages the stock has elevated execution risks and lower terminal multiple than others which have engaged in such a roll-out. Rating is downgraded to Underweight from Equal-weight. Target is raised to \$9.50 from \$5.05. Industry view is In-Line.

MAGELLAN FINANCIAL GROUP LIMITED ((MFG)) Downgrade to Hold from Add by Morgans .B/H/S: 2/2/1

The company reported funds under management of \$69.51bn, up 3.2% in June. Flows weakened over the second half, as expected. Morgans believes the balance sheet and the acquisition of Airlie provide options for growth.

Airlie is expected to raise retail funds in the near term which can add some growth, although Morgans believes the US low-carbon strategies need to attract meaningful flows, or further acquisitions may be required.

Rating is downgraded to Hold from Add. Target is reduced to \$26.05 from \$28.30.

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

Deutsche Bank has downgraded to Sell from Hold, arguing the market is ignoring the risks that are attached to the company's significant expansion. The broker also points at the valuation premium vis-a-vis offshore peers.

The current significant increase in capex will weigh on NextDC's free cash flow generation, point out the analysts. Their negative stance is centred around the prediction that greater demand driven by hyperscale service providers is likely to lead to a deterioration in pricing. Target \$6.50 (was \$7.10).

PENDAL GROUP LIMITED ((PDL)) Downgrade to Hold from Add by Morgans .B/H/S: 2/4/0

The company reported funds under management were up 1% in the June quarter. Further minor outflows were experienced by JO Hambro. The annualised risk is relatively minor, although Morgans envisages some risk of small outflows in the coming six months.

The broker downgrades to Hold from Add, believing the prospect for further outflows, concentration of performance fees, high fixed cost growth and the potential sell down by Westpac ((WBC)) will weigh on sentiment. Target is reduced to \$11.00 from \$11.60.

ST BARBARA LIMITED ((SBM)) Downgrade to Sell from Hold by Deutsche Bank .B/H/S: 0/3/2

It appears, analysts at Deutsche Bank have used a general sector update on mining to re-assess valuations and outlooks for gold mining operations listed on the ASX. The report suggests a lot of detailed analysis has preceded.

Despite a general increase in Net Present Value (NPV) of about 9% across gold miners, St Barbara has been downgraded to Sell on valuation.

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

Draft rate of return guidelines have been released by the Australian Energy Regulator to determine the next five-year periods from 2020. The reduction to allowed equity risk premium is worse than Credit Suisse expected.

A clear agenda to reduce the network outperformance versus allowances has emerged as a response to high energy prices, in the broker's view.

Several factors are expected to constrain Spark Infrastructure's cash flow and the broker downgrades to Underperform from Neutral. Target is reduced to \$2.20 from \$2.45.

SYDNEY AIRPORT HOLDINGS LIMITED ((SYD)) Downgrade to Underperform from Neutral by Credit Suisse .B/H/S: 4/3/1

The company faces a period of higher regulatory and contracting risk, Credit Suisse observes. Dividend growth for the next five years is expected to be lower than the growth over the past five years.

Sydney Airport is expected to start paying tax in 2021 and the broker expects management to smooth dividend growth to avoid any decline post 2021. Dividend estimates are reduced by -5% and -3% for 2019 and 2020 respectively.

The broker lowers the rating to Underperform from Neutral and trims the target to \$6.75 from \$6.80.

Total Recommendations Recommendation Changes

Broker Recommendation Breakup

Broker Rating Order Company New Rating Old Rating Broker Upgrade 1 BANK OF QUEENSLAND LIMITED Buy Neutral Citi 2 INDEPENDENCE GROUP NL Buy Neutral Deutsche Bank 3 INTEGRAL DIAGNOSTICS LIMITED Neutral Sell Morgan Stanley 4 JUMBO INTERACTIVE LIMITED Buy Neutral Morgans 5 ORIGIN ENERGY LIMITED Buy Neutral Citi 6 SONIC HEALTHCARE LIMITED Neutral Sell Citi 7 WESTERN AREAS NL Buy Sell Deutsche Bank 8 WESTERN AREAS NL Neutral Sell Ord Minnett Downgrade 9 ALTIUM LIMITED Sell Neutral UBS 10 APPEN LIMITED Neutral Buy UBS 11 CHARTER HALL LONG WALE REIT Neutral Buy UBS 12 EVOLUTION MINING LIMITED Sell Neutral Deutsche Bank 13 FISHER & PAYKEL HEALTHCARE CORPORATION LIMITED Sell Neutral Citi 14 GATEWAY LIFESTYLE GROUP Neutral Buy UBS 15 INGHAMS GROUP LIMITED Sell Neutral UBS 16 INVOCARE LIMITED Neutral Buy Citi 17 LOVISA HOLDINGS LIMITED Sell Neutral Morgan Stanley 18 MAGELLAN FINANCIAL GROUP LIMITED Neutral Buy Morgans 19 NEXTDC LIMITED Sell Neutral Deutsche Bank 20 PENDAL GROUP LIMITED Neutral Buy Morgans 21 SPARK INFRASTRUCTURE GROUP Sell Neutral Credit Suisse 22 ST BARBARA LIMITED Sell Neutral Deutsche Bank 23 SYDNEY AIRPORT HOLDINGS LIMITED Sell Neutral Credit Suisse

Recommendation Positive Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 IDX INTEGRAL DIAGNOSTICS LIMITED 67.0% 33.0% 34.0% 3 2 BOQ BANK OF QUEENSLAND LIMITED 7.0% -7.0% 14.0% 7 3 SHL SONIC HEALTHCARE LIMITED 38.0% 25.0% 13.0% 8 4 ORG ORIGIN ENERGY LIMITED 69.0% 56.0% 13.0% 8 5 IGO INDEPENDENCE GROUP NL -21.0% -33.0% 12.0% 7 6 WSA WESTERN AREAS NL -14.0% -17.0% 3.0% 7 Negative Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 LOV LOVISA HOLDINGS LIMITED 25.0% 67.0% -42.0% 4 2 CLW CHARTER HALL LONG WALE REIT -17.0% 17.0% -34.0% 3 3 FPH FISHER & PAYKEL HEALTHCARE CORPORATION LIMITED -100.0% -67.0% -33.0% 3 4 MFG MAGELLAN FINANCIAL GROUP LIMITED 20.0% 40.0% -20.0% 5 5 PDL PENDAL GROUP LIMITED 33.0% 50.0% -17.0% 3 7 SKI SPARK INFRASTRUCTURE GROUP 21.0% 36.0% -15.0% 7 8 IVC INVOCARE LIMITED -21.0% -7.0% -14.0% 7 9 NXT NEXTDC LIMITED 43.0% 57.0% -14.0% 7 10 WOW WOOLWORTHS LIMITED 6.0% 19.0% -13.0% 8 Target Price Positive Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 IDX INTEGRAL DIAGNOSTICS LIMITED 3.013 2.747 9.68% 3 2 WTC WISETECH GLOBAL LIMITED 12.594 12.003 4.92% 5 3 SHL SONIC HEALTHCARE LIMITED 26.021 25.171 3.38% 8 4 WOW WOOLWORTHS LIMITED 28.488 27.786 2.53% 8 5 IGO INDEPENDENCE GROUP NL 4.836 4.758 1.64% 7 6 ORG ORIGIN ENERGY LIMITED 10.230 10.106 1.23% 8 7 BOQ BANK OF QUEENSLAND LIMITED 10.743 10.671 0.67% 7 8 IVC INVOCARE LIMITED 12.393 12.357 0.29% 7 9 NXT NEXTDC LIMITED 7.954 7.940 0.18% 7 Negative Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 MFG MAGELLAN FINANCIAL GROUP LIMITED 25.610 27.460 -6.74% 5 2 MIN MINERAL RESOURCES LIMITED 18.833 19.875 -5.24% 3 3 SKI SPARK INFRASTRUCTURE GROUP 2.501 2.564 -2.46% 7 4 PDL PENDAL GROUP LIMITED 10.875 10.975 -0.91% 6 5 LOV LOVISA HOLDINGS LIMITED 9.680 9.740 -0.62% 4 6 SYD SYDNEY AIRPORT HOLDINGS LIMITED 7.396 7.403 -0.09% 8 Earning Forecast Positive Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 ANN ANSELL LIMITED 140.436 127.588 10.07% 6 2 HSO HEALTHSCOPE LIMITED 9.576 8.947 7.03% 7 3 MFG MAGELLAN FINANCIAL GROUP LIMITED 140.120 132.160 6.02% 5 4 AQG ALACER GOLD CORP 6.378 6.052 5.39% 4 5 RHC RAMSAY HEALTH CARE LIMITED 281.043 270.071 4.06% 8 6 SXY SENEX ENERGY LIMITED -0.757 -0.771 1.82% 7 7 SBM ST BARBARA LIMITED 38.295 37.775 1.38% 5 8 OGC OCEANAGOLD CORPORATION 27.384 27.110 1.01% 6 9 APE AP EAGERS LIMITED 50.215 49.715 1.01% 4 10 RMD RESMED INC 43.484 43.076 0.95% 8 Negative Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 PRU PERSEUS MINING LIMITED 0.315 0.735 -57.14% 4 2 MIN MINERAL RESOURCES LIMITED 143.700 156.000 -7.88% 3 3 NXT NEXTDC LIMITED 3.467 3.686 -5.94% 7 4 MHJ MICHAEL HILL INTERNATIONAL LIMITED 7.400 7.750 -4.52% 4 5 NUF NUFARM LIMITED 42.021 42.893 -2.03% 7 6 CTX CALTEX AUSTRALIA LIMITED 235.914 238.814 -1.21% 7 7 SKI SPARK INFRASTRUCTURE GROUP 7.553 7.603 -0.66% 7 8 LLC LEND LEASE CORPORATION LIMITED 131.520 132.320 -0.60% 5 9 SHL SONIC HEALTHCARE LIMITED 111.900 112.400 -0.44% 8 10 LOV LOVISA HOLDINGS LIMITED 33.760 33.900 -0.41% 4

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: Japan Moves Forward

Japanese government approval of a 2030 energy mix target implies acceleration of reactor restarts and/or new reactor builds.

-Uranium spot price ticks higher -Utility demand remains muted -Japan sets 2030 nuclear energy goal

By Greg Peel

The uranium market was back in business last week following what was effectively a holiday week with the US Independence Day break in the middle.

Industry consultant TradeTech reports seven spot transactions concluded in the week totalling 1mlbs U3O8 equivalent but such solid trading volume is more reflective of catch-up than increased demand, TradeTech warns. Activity slowed into week's end.

TradeTech's weekly spot price indicator rose US25c to US\$23.25/lb.

Four transactions were reported in uranium term markets last week but not for notable volume. Utilities remain reluctant to make commitments while the section 232 petition in the US hangs over the market, with no sign of any decision soon.

TradeTech's term price indicators remain at US\$26.50/lb (mid) and US\$28.00/lb (long).

Shot in the Arm

The pace of Japanese reactor restarts post Fukushima has to date been glacial at best, with only nine of an original forty-plus reactors having restarted in the ensuing seven-year period. Market analysts have not held much hope for an acceleration, but the approval of the Japanese government's Basic Energy Plan last week may provide some hope.

Under the plan, Japan's energy mix target for 2030 is 20-22% nuclear, 22-24% renewable and 26% coal-fired, in line with a plan put forward three years ago.

In order to reach a 20-22% nuclear ratio by 2030, a further 21 reactors will need to be restarted over 12 years.

While it's all very well for the federal government to set such a target, restart approvals still ultimately come down to approval at local and provincial government levels and from relevant courts. This, in turn, comes down to whether local residents living nearby protest against reactor restarts due to safety concerns.

To that end, local residents did win a victory in a local court to force the suspension of operations at Kansai Electric's restarted Ohi units 3 and 4, but that decision was last week overruled in the High Court. Residents claim the plant is vulnerable to major earthquakes.

I imagine a lot of things are vulnerable to major earthquakes, but one can't blame the Japanese for being fearful in the wake of Fukushima.

While restart approval requires legacy Japanese reactors to satisfy new, stringent safety requirements, today's next-generation reactors are not only safer but more cost effective. To that end, the Japanese government is seeking to launch a public-private initiative with the aim of building such reactors, with an eye on the 2030 energy mix goal.

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The Short Report

Guide:

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

Please take note of the Important Information provided at the end of this report. Percentage amounts in this report refer to percentage of ordinary shares on issue.

Stock codes highlighted in green have seen their short positions reduce in the week by an amount sufficient to move them into a lower percentage bracket. Stocks highlighted in red have seen their short positions increase in the week by an amount sufficient to move them into a higher percentage bracket. Moves in excess of one percentage point or more are discussed in the Movers & Shakers report below.

Summary:

Week ending July 12, 2018

Last week saw the ASX200 enter a period of sharp inter-day volatility that has resulted in whiplash and little more.

With the market seemingly confused, or at the very least uncertain, about what the direction should be, the shorters appear to have moved to the sidelines.

There were no short positions changes in the 5% plus table of more than one percentage point last week. Moves below are no more than up/down bracket creep.

In lieu of anything more to say, we might note that building materials company CSR ((CSR)) has been gradually but definitively moving up the table in past weeks and has now crept into the 9% bracket.

Another gradual upward mover is Sigma Healthcare, following the company's loss of the Chemist Warehouse supply contract and subsequent share price plunge.

No Movers & Shakers this week.

Weekly short positions as a percentage of market cap:

10%+

SYR 20.8 JBH 18.7 DMP 15.2 GXY 14.2 ORE 13.1 VOC 12.3 MYR 12.2 ING 11.8 MTS 11.6 AAC 11.0 GXL 11.0 NWS 10.2 IVC 10.2 NAN 10.1 GEM 10.1

In: GEM Out: HVN

9.0-9.9

HVN, CSR, MLX

In: HVN, CSR Out: GEM 8.0-8.9%

HT1, IGO, BIN, IFL, MYX

Out: CSR

7.0-7.9%

FLT, SFR, SIG, CCP, GMA, RFG, NSR, BGA

In: SFR, SIG Out: PLS, IPH

6.0-6.9%

MOC, KAR, TNE, BKL, NEC, IPH, MYO, SEK, PLS, BAP

In: IPH, PLS Out: SFR, SIG, APT, RSG, AAD

5.0-5.9%

RSG, BEN, TPM, AAD, QUB, WEB, BWX, APT, CLQ, SUL, NUF, MSB, JHC,

In: RSG, AAD, APT

Movers & 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: Supermarkets, Oz Economy & Media

Weekly Broker Wrap: supermarkets; tourism; Oz economy; health insurance; media; and infant formula.

-Supermarket industry growth needs to lift to 3.5% or more -Unfavourable trends in tourism likely to continue - Strong population growth seen supporting GDP, education & tourism sectors -Major health insurers seen well placed to deal with any cap on premiums -Cyclical strength in advertising supporting traditional media sector

By Eva Brocklehurst

Supermarkets

UBS believes Coles ((WES)) needs to lift capital expenditure materially across both its stores and supply chain. Meanwhile, Metcash (MTS)) could spend more to lift wholesale sales. The broker also believes industry growth will need to lift a 3.5% or more to avoid reduced rates of return.

UBS estimates refurbishments will contribute around 1% to growth in the next three years and investments should be supportive of margins. The broker believes Woolworths ((WOW)) is investing for the long-term and should benefit from the recent investment in its stores and distribution centre.

Woolworths is expected to maintain its growth lead over Coles until FY20 and UBS retains a preference for Woolworths and Metcash. The broker does not factor in accelerated refurbishment activity for Coles or Metcash into forecasts and assumes Woolworths continues its current run rate.

Tourism

Outbound departures grew 5% in May 2018 while growth in short-term visitor arrivals during the month was below trend for the second consecutive month. Citi considers the continuation of these trends unfavourable for companies exposed to Australian tourism.

The broker expects theme parks to be loss-making in FY18, ie both Village Roadshow ((VRL)) and Ardent Leisure ((AAD)), and retains a Neutral and Buy rating, respectively.

Preliminary data suggests Melbourne's revenue per average room rate declined for the second consecutive month in June. This supports a negative outlook, in Citi's opinion, because of rising supply and meaningful Airbnb supply located near the CBD. The broker retains a Neutral rating for Event Hospitality ((EVT)). Melbourne represents around 19% of Event Hospitality's owned rooms.

Oz Economy

Strong population growth is the driver of Australia's record 26-plus years of GDP growth without recession. However, UBS analyses recent data on immigration and finds standard population growth under-estimates the reality.

Temporary visa numbers doubled since 2007 to a record level in 2016 and 2.7% share of population. The ABS data also indicates there were a record number of permanent visas issued in 2016, although these do not add to population growth in their entirety, as some people flow from temporary visa to permanent visa or citizenship.

Still, strong population growth and large number of temporary student visas in coming years are expected to support headline GDP via exports, particularly in education and tourism. This will underpin the need for infrastructure investment and support housing demand.

The population growth data also helps explain the low rental vacancy rate despite record housing supply. Given migrants are relatively young and skilled or educated, the broker suggests the positive labour supply shock will put a dampener on wages and keep the CPI low. This could be key to the Reserve Bank maintaining official rates on hold until 2020.

Health Insurance

The Labor Party is now signalling it will modify its policy of a 2% lid on premium rate increases for two years to protect smaller, largely not-for-profit insurers. Citi suggests, without such a carve out, many smaller insurers would be tipped into underwriting losses.

The broker estimates the cap would also be a major earnings headwind for the larger private health insurers, potentially causing earnings downgrades of over 25%. While Labor may not be elected, the broker suspects premium increases under the current government are unlikely to be much greater.

Nevertheless, given years of expanding margins and with claims inflation at a nine-year low, the industry appears well-placed to deal with any lid on premiums.

Media

Morgan Stanley remains a structural bear on traditional media but acknowledges that cyclical strength in advertising can help paper over the cracks. The advertising market has surprised on the upside and for businesses with high fixed costs this matters.

The broker has an Equal-weight rating for Nine Entertainment ((NEC)), and Underweights for Seven West Media ((SWM)), Prime Media ((PRT)) and Southern Cross Media ((SXL)).

In addition, a relatively strong domestic economy has delivered robust job advertising. Morgan Stanley expects Seek ((SEK)) to benefit in FY18 from a lift in SE Asian business and China/Zhaopin should benefit from the strong growth trends highlighted by listed peers.

The broker remains bullish on REA Group ((REA)) and Domain Group ((DHG)) but points out listings growth in May-July has decelerated and, if annualised for a full 12 months, could hit EPS by -10-15%.

The broker also believes recent M&A in the outdoor advertising sector could continue and scale become more important. Industry data suggests some upside risk to earnings for APN Outdoor ((APO)) and HT&E ((HT1)).

Infant Formula

UBS analyses trends in the Chinese infant formula market, which totals one third of the global market. Imported brands retain their popularity but the price premium is now down to just 11% from 50% in January 2016.

The broker suspects the easy ride for multinationals may be coming to an end as both Nestle and Danone are losing momentum on the bestseller lists and a2 Milk's ((A2M)) pricing is down for the first time in two years.

The broker suspects the market is not pricing in any downside risk to the long-term profitability of the multinationals in the Chinese market. Regulatory changes in 2018 are expected to reduce the number of Chinese-labelled infant formula brands sold in China to 500 from 2000 and could free up 10% of the market. Still, UBS suspects the market is underestimating the likely rebound in domestic brands in 2018 and these brands are showing price discipline.

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Brokers Confident In Perseus Mining

Softer-than-expected June quarter gold production at Perseus Mining's Edikan put a damper on the stock but brokers remain confident in the outlook.

-Sissingue recoveries from oxide feed higher than expected -Guidance implies a softer outlook for Edikan -Main issue for Perseus is not production but perceptions of reliability

By Eva Brocklehurst

Production at Perseus Mining's ((PRU)) main mine, Edikan, did not meet guidance in the June quarter, although a material improvement on the prior quarter was evident.

The company's first half guidance for FY19 of 130-150,000 ozs at costs of US\$950-1150/oz is below expectations, and brokers were disappointed this was not split by operations, as it makes assessing the outlook difficult.

Meanwhile, Sissingue's maiden commercial quarter was very strong and well above the annualised sustainable production rate. This reflected both elevated grade and throughput while mining softer, near-surface oxide ore. Canaccord Genuity notes optimising ore feed is proving somewhat challenging at Edikan and recoveries were well down on previous quarters. In contrast, Sissingue beat expectations and recoveries from the oxide feed were significantly higher than modelled.

The broker, not one of the eight stockbrokers monitored daily on the FNArena database, revises production estimates down for FY19 and FY20 by -7 and -4%, respectively, and maintains a Buy rating and \$0.75 target.

Sissingue

The company may be playing it safe, having not yet assessed the impact of fresh ore at Sissingue and the possible impact of the wet season. Still, Canaccord Genuity suggests the lack of confidence in providing full year guidance, or at least an asset-by-asset split, has unnerved investors, as signalled by the slump in the share price.

Credit Suisse also commented on the lack of visibility over the transition to harder ore at Sissingue, noting oxide ore is rarely without challenges, particularly during wet weather. As the oxide zone is depleted, and mining progresses to harder ore, costs should rise. This transition is likely from around July.

The plan is to recast the life of mine at Edikan to maximise remaining cash generation now that Sissingue is secured as a second generator of funds.

Guidance implies a softer outlook for Edikan but whether this is more conservative projections based on disappointing recoveries with the high-grade all or indicative of a change in strategy is yet to be revealed. Credit Suisse does acknowledge, however, that a review of Edikan is progressing.

The exploitation permit for Yaoure is now expected in the September quarter, while resource definition drilling continues to define life extension beyond the initially-indicated five years. Credit Suisse expects development is likely to be deferred until it is fundable from cash as a preference to issuing new equity.

Macquarie also notes, as Edikan has consolidated recent improvements in cash generation, this is a positive sign which improves the prospect of securing the debt funding for Yaoure.

Growth Plans

Credit Suisse suggests, based on the current mine plans for Edikan and Sissingue, the production profile needs a new operation to be contributing in around five years. With the lead time to production of 4-5 years for a new project the company needs to accelerate its developments, potentially through corporate activity.

The broker accepts financial resources likely put a limit on the area of operating expertise, i.e. Africa. However, as Africa is marked as a no-go region for many of the company's domestic peers, competition for, and pricing of, such assets makes them materially more attractive and affordable if the right one can be identified.

Citi suggests the main issue for the company is not production but perceptions of reliability. Steady, profitable operations at Edikan, even if production is reduced, should help close the valuation gap.

The broker suggests Edikan is an exercise in trading off the throughput of hard high-grade ore against gold recoveries. Even though recoveries of 78.5% and mill grades of 1.2g/t were below estimates, the company has developed a good understanding of Edikan and Citi is confident the mine can meet guidance.

CLSA, also not one of the eight, has a Buy rating and \$0.60 target and also found the weak forecasts for FY19 overshadowed the strength in the June quarter. The broker notes, when including a large gold position held at the end of the year and the US\$63m in debt the business appears to be net cash at around US\$3.5m.

The database shows four Buy ratings. The consensus target is 60.3c, signalling 33.9% upside to the last share price.

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NRW Holdings Kicks Off With Iron Ore Win

NRW Holdings has won the first of several earthmoving contracts expected from the re-investment in iron ore in Western Australia and brokers suggest the stock is a good way to play the cycle.

-South Flank smaller than works likely to be awarded by Rio Tinto, Fortescue Metals -Revenue estimates for FY19 suggest growth of 40% on FY18 -Brokers more confident in NRW's ability to win further work in Pilbara

By Eva Brocklehurst

NRW Holdings ((NWH)) has been awarded a \$176m contract to provide bulk earthworks and concreting at BHP Billiton's ((BHP)) South Flank iron ore project in Western Australia, kicking off a round of work awards expected over the next three years.

Work on South Flank is expected to start in September and run for 15 months. No material capital expenditure is expected as equipment will be internally sourced. UBS expects a 50:50 split in revenue across FY19 and FY20.

The broker's FY19 estimates of work in hand increase to \$963m for revenue guidance of \$1.1bn, implying 86% revenue coverage. UBS has set margin expectations for the civil division below industry targets, i.e. 4.2% versus 5%, which provides a level of confidence around the earnings profile.

The broker expects \$3bn in civil works to be offered during FY19-21 from replacement and sustaining capital expenditure in Western Australian iron ore. South Flank is the first major iron ore project to award civil contracts but its civil works are materially smaller than the projects likely to be emanating from Rio Tinto ((RIO)) and Fortescue Metals ((FMG)).

UBS expects works for Rio Tinto's Koodaideri and Fortescue's Eliwana will be awarded towards the end of the first half of FY19. Collectively, the broker calculates the civil works for these projects which NRW Holdings can address are worth around \$1.6bn.

The broker currently assumes an overall win rate of around 21% for the company. A 33-50% win rate would drive a 12-29% uplift to FY20 EPS estimates, all else being equal. UBS has a Buy rating and \$1.90 target.

Moelis upgrades estimates for operating earnings (EBITDA) for FY18 and FY19 by 2% and 9% respectively on the back of the win. The broker's revenue estimate of \$1.11bn is in line with recent company guidance and represents revenue growth in excess of 40% over FY18.

Moelis considers the stock one of the better ways to play the upcoming reinvestment cycle in Western Australia and for gaining exposure to the potential for further contracts to be awarded over coming months from Fortescue Metals and Rio Tinto. Nevertheless, the broker considers the risk/reward balanced and moves to a Hold rating on valuation grounds, with a target of \$1.87.

Citi maintains a Buy rating and \$1.95 target, now more confident regarding the company's ability to capitalise on the increase in iron ore expenditure in the Pilbara. Citi increases FY19-20 estimates for net profit by 2-5%.

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Treasure Chest: Might QBE Not Disappoint This Time?

Citi upgrades QBE Insurance to Buy amidst much discussion of restructuring and the need to address reinsurance in January.

-Plan to reduce costs -Reinsurance renewal looming -Chance of short term share price upside

By Greg Peel

2018 is proving a fairly benign year on the catastrophe front for QBE Insurance ((QBE)) following what was a costly 2017. Come January, the insurer faces a major reinsurance renewal and has to make an important decision.

A renewal will come at a higher cost. The alternative is to take the risk onto its own books, but this would imply higher earnings volatility. Either choice will dampen market sentiment on the stock, Credit Suisse believes, unless there is a clear improvement in margins.

Cost reduction plans are aimed at increasing margins but these would be undermined by a higher reinsurance cost. A more favourable premium rate environment would certainly help, Credit Suisse notes, but here the outlook is uncertain.

The broker retains a Neutral rating.

Macquarie retains Outperform, suggesting there is scope for QBE to increase its risk exposure come reinsurance renewal time given concerns about the longevity of insurance-linked securities as a capital source have now been allayed.

Citi believes QBE will unlikely be able to renew its reinsurance and also warns of increased earnings volatility as a result. The broker sees a risk that simply redeploying the savings from not renewing will be insufficient for the desired level of reinsurance cover. But at least for now, reinsurance pricing seems relatively stable, Citi notes, which should help the company formulate its new reinsurance policy.

On Citi's analysis, QBE's share price is now at a level that upside should follow when the company reports earnings if the company's first half combined operating ratio is reasonable and in line with the broker's forecast. Some improvement in Asia and North America is likely due to business disposals, the first half appears to have been benign for catastrophes and there have been some premium rate rises, hence Citi gives upside a fair chance.

It will only be a short term response, nonetheless, with execution on the company's restructure plans paramount in the longer term, Citi warns. The broker is a little more confident in its revised forecast for FY19 and beyond and believes the business could deliver a strong combined operating ratio by FY21, which would lead to meaningful share price upside.

But given QBE has disappointed so many times in the past, Citi reinforces that execution remains key.

The broker has nevertheless given QBE the benefit of the doubt in upgrading to a Buy rating, for now.

This brings the number of buy-raters in the FNArena broker database to five, with three Holds. The consensus target price is \$11.10, suggesting 11.3% upside.

QBE reports on August 16.

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Is 'Value' Investing Now Dead?

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

-Is 'Value' Investing Now Dead? -Conviction Calls -All-Weather Stocks: Bell Potter -Rudi Talks -Rudi On TV -Rudi On Tour

[Non-highlighted parts will appear in Part Two on Thursday]

Is 'Value' Investing Now Dead?

By Rudi Filapek-Vandyck, Editor FNArena

Most investors in Australia, be it consciously or otherwise, are "value" investors.

If you haven't figured out what type you are, consider the following two propositions:

1. A share price drops by -20%; has your interest been triggered? 2. A share price rallies by 20%; do you now think this horse has bolted, I am looking elsewhere?

If both your answers are affirmative, you are definitely a "value" investor. As such, you are in good company, including Benjamin Graham, Warren Buffett, and a large majority of local investment professionals. Many tomes of academic research suggest value investing leads to superior investment returns over time, but the harsh truth is it does not always work so well.

The past five years have frustrated many value investors, in particular the past eighteen months. Stocks like AMP ((AMP)), G8 Education ((GEM)), Automotive Holdings ((AHG)), Greencross ((GXL)), JB Hi-Fi ((JBH)), Reckon ((RKN)) Primary Health Care ((PRY)), and numerous others also including Telstra ((TLS)) and the major banks seemed to offer excellent "value" throughout the period but apart from temporary rallies here and there, these share prices have mostly not kept up with the broader market, if they didn't end up becoming cheap-er after a while.

Explanations as to why are plenty and varied; from an overdose in passive investment products (such as the popularisation of ETFs) to short term focused strategies simply chasing positive momentum stocks into irrational, bubble-like territory. Surely this global chase for momentum is but a precursor to the next day of reckoning for investors who keep throwing caution in the wind, forgetting everything has both a price and a valuation?

Maybe.

In theory the most important virtue for a typical value investor is patience. Whatever has caused the share price to weaken shall be resolved over time and thus the share price will respond accordingly, pulling higher and providing the patient investor with a handsome reward. But what if corporate life anno 2018 has become a lot more complicated than that? Can investors still assume that whatever made Warren Buffett wealthy and famous still applies, or are we genuinely witnessing the death of value investing in the share market?

For good measure: simply buying a stock because it has fallen in price is always and under all circumstances a high risk proposition. Those who bought shares in Retail Food Group ((RFG)), AMP, and BlueSky Alternative Investments ((BLA)), among many others, have found this out the hard way. These shares have been sold down savagely, but for good reasons, and a lot will have to change before investors can recoup their losses, if ever.

Yet, the risks involved are not always company specific and not always that easily identifiable. For years I heard fund managers talk about how "cheap" shares in accountancy software provider Reckon were, with the share price bobbing along \$2, paying out an above average dividend yield, and franked too!

Yet this story has come painfully unstuck as the pressure from much better equipped competitors Xero ((XRO)), MYOB ((MYO)) and Sage has proved too much for Reckon. By now, profits are down, dividends have been cut, the share price has more than halved, in particular since a plan to merge operations with MYOB met opposition from the ACCC, and investors are now doubting the longer term survival of the business.

Investors who bought shares in Healthscope ((HSO)) or Gateway Lifestyle ((GTY)) may have been "saved" by the emergence of a corporate suitor, the chances for a similar get out of jail-solution for Reckon seem rather slim.

Taking a broad perspective on things, investors wouldn't be completely out of line if they used the predicament management at Reckon is facing today as a template for the share market overall. Frankly, I am quite surprised about how many market analyses and commentary has been released in months past suggesting a new bubble is building in technology and in growth stocks, worldwide, without any mentioning of what is holding back investors from en masse jumping on board the share market laggards.

In simple terms: the global economy is transforming under the weight of debt, low but rising interest rates, demographics, political populism, social inequality and technological advances, and some companies are ready for the future, benefiting from the many changes that are taking place, and others are not.

Faced with the above proposition, where would you put your money?

This has led to the rather unusual situation whereby stocks that had rallied by 20% simply went on with it and added a lot more as more time went by, whereas investors who jumped on stocks after they'd fallen by -20% have mostly been forced to remain patient or change strategy.

Witness, for example, the numbers I compiled earlier this year for ten of Australia's best performing members of the ASX100 (see overview below). The calculated returns assume share prices had been bought in mid-2012 with a Buy-and-Hold mindset throughout the full five and a half year-plus period. The lowest return, ex-dividends, is the 166% achieved by Carsales ((CAR)).

Bottom line: inequality is not just something that is ripping apart modern day societies; it is alive and well inside corporate Australia and in the share market as well.

One of the prime examples in the Australian share market, included in the table above, is Aristocrat Leisure ((ALL)). Having witnessed the share price rise from below \$10 in 2015 to now above \$30 by mid-2018, investors could be forgiven to think the next item on the menu will be a serious fall-off-the-cliff experience for shareholders who've fallen in love with the stock.

Yet most analysts covering the stock have put forward a valuation/price target in the mid-\$30s, suggesting double digit percentage returns post the incredible gains achieved to date remain justifiable. Analysts at Deutsche Bank have a price target of \$41. Admittedly, Aristocrat Leisure does not operate in a vacuum and risks are always present that something, somewhere -unexpected or otherwise- can disturb or interrupt this Australian born success story, but recent indications are this company remains on a roll, and management continues executing well.

Quite remarkably, after all those gains, and with the share price near an all-time high, the forward implied Price-Earnings (PE) ratio on the basis of current market consensus forecasts is still only 22.5x (FY19), with the added benefit from a potentially weaker AUD/USD.

So what is it that makes Aristocrat Leisure so different from, say, Metcash ((MTS)), Telstra, or CommBank ((CBA))?

Management has turned Aristocrat Leisure into the number one pokie machine operator in the world, which is why local competitor Ainsworth Gaming ((AGI)) is doing it so tough, despite seeking refuge under the wings of Austrian gaming technology company Novomatic. See also Ainsworth's share price: same story as what happened to Reckon applies here, including fund managers climbing on board the "cheap" looking valuation.

Most of all, the global market for "one armed bandits", as critics describe the poker machines that over-populate Las Vegas and Australian RSL clubs, is considered a mature market and increasing market share through superior products can only stretch that far, which is no doubt why management has moved Aristocrat Leisure into digital gaming. Post recent acquisitions, here Aristocrat's global market share is still only 2% with this segment growing at fast pace. The company has effectively secured itself a strong growth engine which, if executed correctly, offers loyal shareholders many more years of ongoing strong growth.

This is, in a nutshell, the key difference that separates the Haves from the Not Haves in today's corporate world. It is harsh judgment, but accurate nonetheless. This is not, however, a static proposition. Those who have been caught sleeping at the wheel while the world around them was changing rapidly are today being forced into action, and this process has already started.

Wesfarmers ((WES)) is spinning off Coles with the promise of turning itself yet again into a higher growth vehicle. Already, investors have rewarded the company by pushing the share price outside the range that had been firmly in place for many years. Telstra is cutting its dividend and re-orienting the corporate strategy. Major banks are selling non-core assets. Additional investments in technology will be next. InvoCare ((IVC)) is investing more in the business and has started acquiring smaller players outside the main cities. Ramsay Health Care ((RHC)) just launched an unsolicited bid to acquire Gothenborg-headquartered Capio AB.

These actions should all be seen as attempts by respective management teams to steer their businesses away from the bleak future that lays ahead for the likes of Reckon, Ainsworth Gaming, Retail Food Group, and iSentia ((ISD)).

Hopefully the end result will be a lot closer to what Aristocrat Leisure, ResMed ((RMD)) and a2 Milk ((A2M)) to date have achieved, but this is by no means guaranteed.

Understanding these dynamics is today understanding the valuation gap between winners and laggards in the Australian share market, and the differences in respective risk profiles.

Investors who had been accustomed to owning shares in old economy blue chips tend to underestimate how much growth can be achieved from success stories such as CSL ((CSL)), Aristocrat Leisure, and a2 Milk, and for so much longer too. On the other hand, any concerns about investing in stocks trading on a higher PE can be easily dismissed with the observation that lower PEs did not prevent CBA shares to fall from \$96 to below \$70 not that long ago, or Telstra shares to more than halve in three years time.

Within this context, I note Morningstar analyst Chris Kallos updated his thoughts on CSL last week, deciding the company's breakthrough medicine candidate CSL112 is ready to be included in today's valuation modeling, with the odds in favour of CSL launching the next potential blockbuster addressing recurrent cardiovascular events in the first 90 days following an initial heart attack by 2023. This area is currently not well covered by existing drug therapies and success would grant CSL a significant first mover advantage.

Morningstar has decided fair value for CSL shares is now situated at \$200, but success with CSL112 can potentially move the dial to \$250. Failure would pull back fair value valuation to \$140, all else remaining equal. In addition, favourable currency movements remain a key sensitivity for the shares with every 1c move in the AUD/USD cross translating into a \$2 move in the share price.

Of course, shares in online retailer Kogan ((KGN)) just lost -30% in only a few weeks time (management sneakily tried to pump up the share price so it could offload some equity). Blackmores ((BKL)) shares went from \$206 to \$91, to \$171, to now around \$145. And shares in Domino's Pizza ((DMP)) have covered everything in between \$77 and \$39 since August 2015. These are all high PE stocks, as are Ramsay Health Care and InvoCare, no doubt fueling anxiety that shares not purchased at bargain basement level pricing must come crashing down, eventually.

Maybe the real message here is that a society and economy in transition have radically altered the risk profile for companies listed on the stock exchange. For investors the key is to understand that, while not every share price that falls in price becomes automatically a great investment opportunity, not every outperformer today is doomed for failure and punishment next.

The upcoming August reporting season should prove exactly that.

The biggest mistake investors in Australia have made in years past is assuming that value investing equals investing. Full stop. This is a mistake investors in the US are less likely to make, and with good reason.

Rudi Talks

Audio interview from last week about the local share market and high valuation stock outperforming their lesser peers:

<https://www.boardroom.media/broadcast?eid=5b4429a484c6a07ee10af84f>

Rudi On TV

This week my appearances on the Sky Business channel are scheduled as follows:

-Tuesday, 10am Skype-link to discuss broker calls (earlier than usual) -Thursday, from midday until 2pm -Friday, 11am, Skype-link to discuss broker calls

Rudi On Tour

-AIA National Conference, Gold Coast QLD, July 29-August 1 -ASA Presentation Canberra, 3 August -Presentation to ASA members and guests Wollongong, on September 11 -Presentation to AIA members and guests Chatswood, on October 10

(This story was written on Monday 16th and Wednesday 18th July 2018. Part One was published on the Monday in the form of an email to paying subscribers at FNArena, and again on Wednesday as a story on the website. Part Two shall be published on the website on Thursday).

(Do note that, in line with all my analyses, appearances and presentations, all of the above names and calculations are provided for educational purposes only. Investors should always consult with their licensed investment advisor first, before making any decisions. All views are mine and not by association FNArena's - see disclaimer on the website.

In addition, since FNArena runs a Model Portfolio based upon my research on All-Weather Performers it is more than likely that stocks mentioned are included in this Model Portfolio. For all questions about this: info@fnarena.com or via the direct messaging system on the website).

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- The AUD and the Australian Share Market (which stocks benefit from a weaker AUD, and which ones don't?) - Make Risk Your Friend. Finding All-Weather Performers, January 2013 (The rationale behind investing in stocks that perform irrespective of the overall investment climate) - Make Risk Your Friend. Finding All-Weather Performers, December 2014 (The follow-up that accounts for an ever changing world and updated stock selection) - Change. Investing in a Low Growth World. eBook that sells through Amazon and other channels. Tackles the main issues impacting on investment strategies today and the world of tomorrow. - Who's Afraid Of The Big Bad Bear? eBook and Book (print) available through Amazon and other channels. Your chance to relive 2016, and become a wiser investor along the way.

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P.S. - All paying members at FNArena are being reminded they can set an email alert for my Rudi's View stories. Go to My Alerts (top bar of the website) and tick the box in front of 'Rudi's View'. You will receive an email alert every time a new Rudi's View story has been published on the website.

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Rudi's View: Telstra, BHP And Netwealth

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

-Is 'Value' Investing Now Dead? -Conviction Calls -All-Weather Stocks: Bell Potter -Next Week -Rudi Talks -Rudi On TV -Rudi On Tour

[Non-highlighted parts appeared in Part One on Wednesday]

Conviction Calls

By Rudi Filapek-Vandyck, Editor FNArena

When you look at the Australian share market, ignoring day-to-day noise and volatility, what do you see?

Stockbroker Morgans sees a complacent investor community ignoring the fact headwinds are building and the outlook is becoming less predictable, if not tougher. Investors can still look forward to making a reasonable return from their portfolio, the stockbroker believes, but maybe not if they continue crowding in the same segments of the share market.

Morgans likes Telstra ((TLS)) and local banks the most. Calendar year 2018 is seen as the window into a new normal wherein interest rates are on the rise, central bank stimulus is being wound back, and exceptionally calm markets are in for a lot more volatility. Whatever might transpire, 2018 is not a year for complacent investing, say the stockbroker's strategists firmly.

For investors looking to re-shuffle portfolios, a few ideas have been put forward. Morgans' favourite among the Big Four banks is Westpac ((WBC)). Among diversified financials, Suncorp ((SUN)) and Link Administration ((LNK)) are offered as best ideas.

Among consumer discretionary stocks, the preference goes to defensive business models of Bapcor ((BAP)) and Apollo Tourism & Leisure ((ATL)), plus Lovisa ((LOV)) and Baby Bunting ((BBY)). Elsewhere Orora ((ORA)) and Reliance Worldwide ((RWC)) remain in favour, as do Telstra and Superloop ((SLC)) in the telecommunication sector.

Equally important: the stockbroker has been advising its clientele to trim positions in stocks that have run hard in FY18.

Morgans' views about prospects for Australian equities would have resonated with market strategists at Morgan Stanley in the US. They have been warming up their clientele for portfolio rotation into defensive stocks and sectors. Last week, Morgan Stanley's view to sell US technology market darlings made headlines around the world, but among investors it was met with a big yawn, report the strategists.

One week later and they reiterate their more defensive view, "with increasing conviction".

The Q2 reporting season will be a bright one, say the strategists, but the market will be forced to focus on the sustainability of growth, and here headwinds are building.

Meanwhile, miners and energy producers continue to enjoy upgrades with every sector analyst who updates the numbers, including for average input prices and the Australian dollar (weaker). Given ongoing robust economic growth on the horizon, albeit slowing, and the recent pullback in share prices, analysts at JPMorgan/Ord Minnett retain a positive position ahead of the August reporting season.

Key stock preferences are BHP ((BHP)), Rio Tinto ((RIO)), Fortescue Metals ((FMG)), Alumina Ltd ((AWC)), Newcrest Mining ((NCM)), OceanaGold ((OGC)), Independence Group ((IGO)), and Orocobre ((ORE)).

Equally noteworthy: market strategists elsewhere have been scaling back their exposure to "Materials" (Commodities).

Big picture, point out global strategists at JP Morgan, below the surface red marks are increasingly appearing on forward looking models and indicators. The global economy is slowing, and investors should pay attention.

Analysts at Canaccord Genuity have updated their Australian Focus List, essentially their selection of High Conviction calls on stocks under coverage. The broker specialises on small cap stocks in Australia, so the composition of the list remains limited to lesser known names in the Australian stock market.

The selection now comprises of 11 members: CML Group ((CGR)), EML Payments ((EML)), FAR Ltd ((FAR)), Macquarie Telecom ((MAQ)), Money3 Corp ((MNY)), Perseus Mining ((PRU)), Pioneer Credit ((PNC)), Redbubble ((RBL)), Scottish Pacific Group ((SCO)), Service Stream ((SSM)), and Speedcast International ((SDA)).

Global strategists at Macquarie describe the investment climate for the second half of calendar 2018 as "complex". No extreme outcomes are by definition on the agenda, but multiple risk factors are presenting themselves nevertheless, say the strategists. If it were up to them, investors should balance portfolios towards "quality", "sustainability" and "thematics", with less exposure to (or even avoiding) "value" and "cyclicality".

One of the conclusions drawn looks like a serious warning in itself: "Peak corporate returns and multiples are here; volatility lies ahead".

For good measure: Macquarie does not believe any of the more sinister scenarios like a recession globally or in the US are on the cards, but the strategists do highlight financial markets at present have embedded a "dangerous cocktail" whereby high asset prices are combined with peak efficiencies and returns for corporates, and expectations remain elevated too, while the pace of disruption is accelerating, at a time when policy errors seem more likely.

Something has to give, at some point.

"Ultimately, we believe policy U-turns are inevitable; it is just a question of timing and the degree of pain that might need to be endured."

All-Weather Stocks: Bell Potter

Most readers of my Weekly Insights market analyses and commentary would be well aware that my personal share market research post GFC has been dedicated to finding All-Weather Performers in the Australian share market; high quality achievers that don't buckle from the moment someone shouts "headwinds" or "change".

But I am not the only researcher whose focus goes beyond the here and now. Last week I reflected upon research conducted by analysts at Morgan Stanley into "Best Business Models". In the meantime, Bell Potter's head of research, Peter Quinton, has updated his selection of local Champion stocks.

These exercises in analysis are by no means exact copies, but they all share that same ultimate goal: finding stocks that are more reliable, more dependable, and more consistent in performance than the average ASX-listed entity. In particular when the going gets a lot tougher for equities, as it always does eventually, such stocks will increasingly attract investors' attention.

In Peter Quinton's words, "These Champion Stocks all have a long term positive thematic, which should drive superior earnings growth and shareholder value over the coming years, notwithstanding inevitable disruptions in the economic and investment environment as well as some corporate stumbles from time to time.

"Therefore, we are not particularly concerned about the current year's investment arithmetic or the analyst's twelve month buy-hold-sell rating. And, of course, the balance sheet ratios must remain strong in order to provide financial support to the positive thematic driver."

Only one change was made since the prior update on selected stocks: Link Administration ((LNK)) has been replaced by Netwealth Group ((NWL)).

The list contains nine stocks in total. The other eight are APA Group ((APA)), Transurban Group ((TCL)), Challenger ((CGF)), Lend Lease ((LLC)), Goodman Group ((GMG)), CSL ((CSL)), Sonic Healthcare ((SHL)), and Brambles ((BXB)). Investors should note APA Group is currently under take-over interest.

In the view of Quinton, all nine stocks should be seen as "must haves" for any standard, long term investment portfolio. Paying subscribers (6 and 12 months) have access to a dedicated section on All-Weather Performers on the FNArena website.

Next Week

I will be attending a presentation by institutional investors on Monday, which is likely to impact on my productivity and available time on the day. As a result, Weekly Insights won't be e-mailed out late on Monday, as is the custom, but more likely in the afternoon on Tuesday. Non-paying members who receive the email on Wednesdays should notice no difference.

Rudi Talks

Audio interview from Tuesday on why value investing has become such a hard slog in the Australian share market, and what are the dynamics behind the scenery:

<https://www.boardroom.media/broadcast?eid=5b4e878073d9bb0cd6e6be58>

Rudi On TV

This week my appearances on the Sky Business channel are scheduled as follows:

-Tuesday, 10am Skype-link to discuss broker calls (earlier than usual) -Thursday, from midday until 2pm -Friday, 11am, Skype-link to discuss broker calls

Rudi On Tour

-AIA National Conference, Gold Coast QLD, July 29-August 1 -ASA Presentation Canberra, 3 August -Presentation to ASA members and guests Wollongong, on September 11 -Presentation to AIA members and guests Chatswood, on October 10

(This story was written on Monday 16th and Wednesday 18th July 2018. Part One was published on the Monday in the form of an email to paying subscribers at FNArena, and again on Wednesday as a story on the website. Part Two shall be published on the website on Thursday).

(Do note that, in line with all my analyses, appearances and presentations, all of the above names and calculations are provided for educational purposes only. Investors should always consult with their licensed investment advisor first, before making any decisions. All views are mine and not by association FNArena's - see disclaimer on the website.

In addition, since FNArena runs a Model Portfolio based upon my research on All-Weather Performers it is more than likely that stocks mentioned are included in this Model Portfolio. For all questions about this: info@fnarena.com or via the direct messaging system on the website).

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- The AUD and the Australian Share Market (which stocks benefit from a weaker AUD, and which ones don't?) - Make Risk Your Friend. Finding All-Weather Performers, January 2013 (The rationale behind investing in stocks that perform irrespective of the overall investment climate) - Make Risk Your Friend. Finding All-Weather Performers, December 2014 (The follow-up that accounts for an ever changing world and updated stock selection) - Change. Investing in a Low Growth World. eBook that sells through Amazon and other channels. Tackles the main issues impacting on investment strategies today and the world of tomorrow. - Who's Afraid Of The Big Bad Bear? eBook and Book (print) available through Amazon and other channels. Your chance to relive 2016, and become a wiser investor along the way.

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P.S. - All paying members at FNArena are being reminded they can set an email alert for my Rudi's View stories. Go to My Alerts (top bar of the website) and tick the box in front of 'Rudi's View'. You will receive an email alert every time a new Rudi's View story has been published on the website.

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