Week
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Stories To Read From FNArena

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FNArena
Financial News, Data & Analysis

GPO Box 3145
Sydney NSW 2001

info@fnarena.com

Your editor
Rudi Filapek-Vandyck

Your dedicated team of journo's
Greg Peel
Eva Brocklehurst

Contents

Crown Outlook Fails To Impress

Brokers welcome the new focus on domestic assets at Crown Resorts but are unimpressed with the near-term outlook.

-Main positive is the $375m buy-back to supplement existing capital management -Net profit estimates downgraded as company has signalled a step up in the tax rate -Is the cost reduction story largely over?

By Eva Brocklehurst

Crown Resorts ((CWN)) has completed an eventful year, with a renewed focus on domestic assets. International investments have been exited and VIP operations in China have been wound down. The business has been simplified through asset sales, instead of the initial strategy which was to de-merge international business and launch a real estate investment trust for the hotel assets.

Nevertheless, brokers were disappointed with the FY17 results, which were boosted by a $15m investment gain. Earnings were negatively affected by a -49% fall in VIP volumes and a decline of -1% in main floor revenue. An aggressive cost reduction program meant operating earnings (EBITDA) declined -8%. Australian casino earnings declined by -11% on a -13% decline in revenue.

The company guided to an effective future tax rate of 30% versus 22% and indicated net interest expense will be higher than expected, given the maintenance of gross debt. No significant cost savings are expected in addition to those already achieved. The main positive aspect of the announcement was another $375m buy-back to supplement existing capital management.

Deutsche Bank reduces earnings estimates by -21-26% to reflect the net impact of lower earnings across Crown Melbourne, Crown Perth and Aspinall's (UK) as well as higher net interest and tax expenses. The broker notes the consumer environment is soft in both Perth and Melbourne but gambling expenditure appears to have improved in the last 2-3 months on the east coast.

The broker expects the company to struggle in the VIP market, as it is re-evaluating its VIP strategy and has closed a majority of its international offices. Following an extensive review of funding alternatives for the Alon project in Las Vegas the company has determined it will not proceed. Alternatives will be explored to optimise the value of the investment in Alon, including a outright sale.

Citi's FY18-20 earnings estimates are trimmed by -2-2.5% largely because of reductions to growth assumptions for the main floors of Melbourne and Perth. This is partly offset by upgrades to VIP in Melbourne and digital forecasts. The broker no longer expects further capital management in the near term, given the buy-back just announced.

UBS calculates around -9% of its downgrade to earnings estimates of -17% in FY18 and -14% in FY19 is related to the change in effective tax rates going forward, as the business generates less income from its offshore businesses. The remainder of the decline is attributed to ongoing weakness on the main floor in Perth and higher interest costs, as the company attempts to repair an inefficient balance sheet caused by the illiquidity of its subordinated notes.

Credit Suisse believes the stock is likely to retain an elevated multiple because the balance sheet is currently under-geared and there are expectations of more capital returns. Moreover, Crown Sydney has value but no earnings as yet. The broker downgrades operating earnings by -8% principally because of a more conservative outlook for VIP and a higher cost base in Perth.

Net profit estimates are downgraded further, by -18%, because the company has indicated its future tax rate will approach the Australian statutory rate of 30%. The broker also substantially reduces dividend forecasts as the company has, instead, announced another share buy-back.

Morgan Stanley believes the outlook for Australian VIP and mass market revenue is weak and cost reductions are largely factored in. Moreover, there is a risk of higher capital expenditure associated with Crown Sydney. Support should come from the buy-back and the balance sheet. The broker questions why a higher tax rate of 30% is expected when its major divestment, the Melco stake, should not affect the tax rate.

Australia's consumer environment is under pressure from falling incomes and this should mean mass gaming growth remains weak. The broker observes 6-12 month leading indicators in the macro VIP environment are showing signs of slowing and this could have an impact on recovery. Capital expenditure for Sydney has been pushed out and is expected to step up significantly in FY19-20.

FY17 results were below Ord Minnett's forecasts as a result of VIP weakness. Uncertainty around the corporate strategy has persisted but the broker believes cost savings, share buy-backs and debt capacity will allow Crown to undertake significant changes. The broker is increasingly confident that management will focus on shareholder returns and domestic growth, to underpin value.

More Cost Reductions?

UBS believes a simplified structure means the company can remove -5% of its cost base by FY18. While FY18 guidance already implies -$38m of corporate cost reductions the broker believes another -$50m could be removed from domestic casino assets.

In the broker's opinion a return on Crown Sydney will be predicated on the VIP market closer to the FY22 opening, while Melbourne and Perth will be able to achieve a higher return on investment capital over the next three years amid a slowing of capital expenditure and renewed focus on cost. UBS believes the company can pay a $0.60 dividend each year and comfortably fund its current capital expenditure requirements.

The cost reductions story came to fruition in FY17, Morgan Stanley asserts. Given labour costs can only be reduced by so much and be sustainable, and corporate costs are expected to increase in FY18, there is little more the company can do, in the broker's opinion.

Following the repositioning of the business Goldman Sachs expects earnings will be driven by consumer spending and efficiency gains. A gradual cyclical recovery in expenditure is expected of which Crown should be a beneficiary. The broker, not one of the eight monitored daily on the FNArena database, maintains a Buy rating and $14.30 target and prefers to gain exposure to a recovering consumer through Crown versus the retail names.

There are three Buy ratings and four Hold on FNArena's database. The consensus target is $12.75, suggesting 7.4% upside to the last share price. The dividend yield on FY18 and FY19 forecasts is 4.9% and 5.4% respectively.

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FY17 Subdued, Merger Tops Tabcorp's Agenda

Brokers found little to excite in Tabcorp's FY17 results with the focus squarely on the upcoming merger plans with Tatts.

-Several months delay to merger plans with Tatts -Sun Bets extends losses, indications agreement can be terminated in FY19 -Regulatory environment seen improving for traditional wagering operators

By Eva Brocklehurst

Tabcorp Holdings ((TAH)) provided a subdued FY17 result, albeit at the top end of recently lowered guidance. There was no trading update or outlook commentary, as is the norm. The main focus is to complete the proposed merger with Tatts ((TTS)), although this is been delayed several months.

Importantly, Deutsche Bank notes, the company has stepped away from its 14% return on invested capital target because of the uncertainty of both the proposed merger and the turnaround required in Sun Bets.

FY17 net profit was down -3.8% on declining growth in sports and the tote. This could be exacerbated by the Tatts result in August 17, Ord Minnett suggests. The two companies have delayed their merger plans for around three months.

Management expects the merger to be completed in the December quarter, with both agreeing to defer the release of the merger scheme booklet until after Tatts reports on August 17. The merger is also subject to the ACCC and CrownBet's ((CWN)) appeal against the Australian Competition Tribunal decision supporting the merge, which will be heard this month.

Citi envisages scope for value creation upon the merger on the back of synergies and the incorporation of Tatts' lotteries business. Still, the broker would prefer to wait for a more compelling entry point and retains a Sell rating.

Ord Minnett suggests the business is facing pressure from a declining tote industry and increased competition in sports betting and this is unlikely to abate. Increasing operating expenditure in FY18 is expected, as merger integration and challenging trading conditions drive de-leverage.

Credit Suisse continues to rate the stock Neutral but now concedes it is better value. The first half of FY18 is unlikely to be exciting and the broker downgrades FY18 forecasts for earnings per share because of the delay in the merger.

Credit Suisse assumes the company proceeds with the post-merger $500m share buy-back. Wagering operating earnings (EBITDA) fell -17% in the second half amid lower revenue, higher costs, wet weather, event outcomes and a myriad of other excuses, Credit Suisse asserts. Despite 10% growth in new customers, the company had about 10% growth in account base revenue and this suggests to the broker that the company is not stimulating existing customers.

Sun Bets

Sun Bets extended its run of losses in FY17, -$46.2m, and this is expected to continue. The company has indicated that if certain revenue payment obligations are not met in FY18-19 then it can terminate the agreement.

Credit Suisse upgrades FY20 estimates, now convinced the company can exit the loss-making Sun Bets operation if minimum performance hurdles are not met.

The results were reasonable, in Deutsche Bank's opinion, relative to recently lowered market expectations. The broker finds some encouraging trends within the core wagering business, with digital turnover up 14% in fixed odds revenue growth of 15%.

Operating earnings were in line with Citi's estimates although wagering and media missed expectations. This was because of lower-than-expected margins. Citi reduces FY18-19 operating earnings estimates by -2% and lowers FY20 forecast by -5%, largely reflecting revisions to Sun Bets forecasts. The broker takes on more conservative assumptions from FY20.

Deutsche Bank reduces earnings estimates by -3% to reflect the net impact of lower wagering & media earnings and higher net interest expense.

The broker notes Luxbet and Trackside dragged on the business in FY17. The company is reviewing Luxbet and will either divest or close it down within the next six months. A review of Trackside's product and marketing has been completed and new initiatives are planned for FY18.

Deutsche Bank estimates the proposed merger with Tatts could provide earnings upside of 13%, while the regulatory environment is improving for the traditional wagering operators. This is because of the ban on click-to-call in-play betting services, the proposed ban on credit betting and gambling advertising restrictions, as well as the potential for a point of consumption tax to be adopted nationally.

There is one Buy (Deutsche Bank), one Hold (Credit Suisse) and two Sell ratings on FNArena's database. The consensus target is $4.51, suggesting 4.7% upside to the last share price. The dividend yield on FY18 and FY19 forecasts is 5.9% and 6.3% respectively.

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Patience Still Required For James Hardie

James Hardie's first quarter disappointed brokers. The question is whether the situation will improve from here.

-Volumes and margins fall short of expectations in North America in the first quarter -Recent performance warrants a de-rating but several brokers urge patience -Capital expenditure to accelerate but can this be managed without a drag on margins?

By Eva Brocklehurst

Higher costs still feature for James Hardie's ((JHX)) North American fibre cement business. The company delivered first quarter net profit of US$61.7m and both volumes and margins fell short of expectations.

Brokers are somewhat comforted that margins appear to be on a path to recovery but remain cautious about the company's performance, with several stating they prefer to await further evidence before before taking a more positive stance.

The main disappointment for Ord Minnett was the volume growth in North America, as capacity constraints compromised the service. Furthermore, management suggests the second quarter volumes could also be underwhelming.

The broker assumes the share price will recover in the second half, although growth in FY18 as a whole should struggle to exceed the market index. This is at odds with management's 6-8% primary demand growth (PDG) target and medium-term assumptions.

The decline in first quarter margins in North America was attributed to higher production costs, only offset somewhat by higher prices. Management suggests manufacturing performance is showing signs of promise and unit costs are improving. Ord Minnett expects margins to improve through FY18, resulting in a full year outcome of 22.5%.

Credit Suisse concedes it was a tough year. The broker counts up four solid profit downgrades, which have tested the patience of some of the shareholders and, for a stock that more prides itself on manufacturing excellence, the recent performance warrants a de-rating of the multiple. Nevertheless, Credit Suisse advises not to throw the baby out with the bathwater. The company is about the long-term game.

Volume growth in market penetration will ultimately drive value. While near-term margin issues should not be ignored, the broker asserts these have little impact on the net present value, because costs can easily be optimised as a company gets closer to terminal market share.

The company had previously foreshadowed a relatively weak first quarter margin in North America but has confirmed that month-on-month unit costs are falling, so the trend is positive, and, as usual, North American earnings margins should improve as the year progresses.

Credit Suisse agrees margins should sit around the 22.5% range. The company is also past the peak start-up in terms of its plant, although this is running below capacity until inefficiencies are completely ironed out.

The broker does not doubt that the company incurred some damage to its reputation FY17, as it was unable to meet market demand and customers in certain regions turned to competitors. In context, 95-97% of those customers have returned to the business now that inventory is sufficient to meet demand, according to management.

Order Book

Citi found volume growth of 2.4% disappointing in North America against system growth of 6.7%, which implies negative PDG of -4.3% and the soft order book that management flagged suggests that risks exist to top-line growth through the balance of FY18.

Credit Suisse defends the company's explanation of a soft order book, noting Texas had been particularly weak and some of competitors are also reporting the renovations market was down -4% over the past quarter. Such conditions are largely out of management's control and the broker remains confident the growth trajectory will turn positive.

Macquarie ascertains that, while US margins showed little improvement, the plant is stabilising and that is now driving an improvement in the unit cost of manufacturing. The broker believes, following product outages, that the company does have work to do to lift service levels but its competitive capability does not appear fundamentally impaired. Macquarie takes a more cautious approach to margins in FY19 and continues to believe the investment case has merit at current levels.

Capital Expenditure

Citi believes capital expenditure will accelerate dramatically and remain elevated throughout FY19 and FY20. The broker asserts this is necessary to meet PDG targets, but negative free cash flow yield in FY18, and a continuation of a poor performance on this front in FY19-20, could trigger a de-rating of the valuation multiple premium.

Given forecast quarterly average capital expenditure more than doubles through the balance of FY18 and remains elevated, Citi queries whether this can be managed without a drag on margins, notwithstanding the impact to free cash flow.

All up, the broker believes the focus on the price/earnings ratio and the enterprise value/operating earnings multiples ignores the poor free cash flow forecasts for the next three years and the disappointing net profit growth experienced over the last few years, given the company's inability to fully participate in the US housing recovery. Hence, a Sell rating is maintained.

UBS is more upbeat, albeit disappointed with North American volume growth. The broker reduces profit forecast by -2% in FY18 to reflect this but retains an expected operating earnings (EBIT) margin of 22%, although expects the company to only achieve the top end of its target range as it exits the fourth quarter of FY18.

Manufacturing performance appears to have turned the corner and the broker notes a material lift in inventory in the period suggests the company should be in a better position to use its sales efforts in coming quarters. Hence, UBS is not concerned about PDG or market penetration.

The broker does not believe current trading levels in the stock are warranted on a medium-term view, despite the underperformance in North American fibre cement earnings, and expects the company will deliver as the housing cycle continues to recover.

Deutsche Bank agrees the significant manufacturing cost impost should start to unwind and drive improved earnings. The broker continues to rate the stock a Buy, given the potential upside to the current share price, US market growth, a robust balance sheet and a re-invigorated management team.

There are four Buy, two Hold and one Sell (Citi) on FNArena's database. The consensus target is $19.89, suggesting 12.8% upside to the last share price. Targets range from $16.00 (Citi) to $22.50 (UBS).

Transurban Readies For Busy FY18

Transurban maintains a full development pipeline for its toll roads and FY18 guidance implies lower growth than previous years.

-Guidance may be conservative and capital raising considered highly likely -Corporate costs expected to be sustained at higher levels -Focus on expansion and constructing new toll roads

By Eva Brocklehurst

Transurban ((TCL)) maintains a full development pipeline in FY18 and strong employment, car registration growth and fuel usage continue the growth trend on its toll roads. Sydney is stable but there is the potential for further ramp up in Melbourne and Brisbane as the effects of roadworks diminish.

Nevertheless, FY18 guidance implies a lower growth year versus previous years. FY17 results were marginally weaker than many brokers expected because of an acceleration in costs. A combination of around 3% growth in journeys, CPI, toll increases and capital investment delivered around 11% growth in proportional toll revenue. Free cash flow per security increased 9%.

The company has provided FY18 distribution guidance for the first time, at $0.56 per security, up 8.7% on FY17. This is below the double-digit growth rates experienced over the last four years.

Free cash flow was covered 99% and this suggests some underperformance versus guidance provided back in February, although UBS acknowledges this is hard to pin down exactly. Distribution guidance for FY18 implies 9% growth versus the 13.5% growth experienced over the last four years. This reflects the run-off of a number of toll enhancements and funding costs for developments. UBS retains forecasts that imply 101% coverage of guided distribution, suggesting some potential upside.

Capital Raising?

Morgans suspects guidance is intentionally conservative, in order to sustain, or upgrade, the distribution into a capital raising. A trend of strong corporate costs growth continues, with heightened investment in business development acquisitions, customer initiatives and technology.

The company expects to fund current commitments from its balance sheet, supported by its distribution reinvestment plan and a possible future release of capital. Hence, equity capital may be used to fund the proposed West Gate Tunnel project (Melbourne), which has commercial close targeted for the end of the year.

Morgans suspects this may take place alongside a capital raising to fund acquisition of a stake in the NSW government's WestConnex sell-down, if the company is successful. The transaction is likely to be timed mid 2018. The NSW government has indicated it will sell at least 51% of WestConnex.

Macquarie observes the company is taking a very conservative line regarding development, expensing bid costs as they are incurred, having highlighted expectations that costs will remain elevated, reflecting the ongoing bidding opportunities within its development pipeline.

Credit Suisse also expects corporate costs to remain at the higher level as the company bids for WestConnex and maintains a focus on customer value initiatives. Distribution guidance is expected to increase at the first half result, when clarity is provided on CityLink (Melbourne) traffic post completion of the widening, to maintain growth above 10%.

Credit Suisse forecasts FY18 distributions of $0.57 per security. The broker also notes the potential for an equity raising for the West Gate Tunnel and forecasts around $600m.

Toll Concerns

Macquarie observes Andrew Head's role has narrowed, with his sole focus on the development of the NSW opportunities. Michele Heuy has taken on operations for existing roads in NSW. The broker suggests this management change highlights how important NSW has become, along with managing stakeholders, in obtaining both government and consumer acceptance of toll roads.

The broker believes the numerous examples in the company's presentation citing value for money and the quantum of tolling versus other countries is an attempt to address a emerging backlash regarding tolls.

Meanwhile, the current opportunities are full, with around $1.6bn of committed expenditure and at least $4.4bn in pending expenditure. This should firm up in the coming 12 months. Replenishment of the pipeline potentially comes from WestConnex, and other projects in NSW and Queensland as well as another US city.

Technology

The company has highlighted investment in technology as a key theme, driving network enhancements. Such investments this year include the roll-out of Glide as well as mobile GPS trials for retail and commercial customers. The company has launched Linkt, a new tolling platform to replace some of the smaller brands.

There is still a problem in that various brands co-exist across the eastern states. Macquarie notes, Linkt, Roam and Citylink all have the same engine and there are scale benefits with integration.

Overall, the results re-affirmed the quality of the network for Citi, as well as the growth pipeline. The broker envisages further upside in the share price towards a 12-month valuation of $12.62, and additional upside on successfully achieving financial close for the West Gate Tunnel project. Valuation does not include future projects that have not yet reached financial close. Adjusting the numbers provides a total return estimate of 12.5% and Citi downgrades the stock to Neutral from Buy.

Macquarie emphasises Transurban is not a concession distribution company and judges the business to be about extending concession life through expansion and new toll roads. Valuation is centred around the internal rate of return of 8.6% rather than the dividend yield. This is expected to be the theme for the next 4-5 years as the next construction phase is managed.

There are three Buy ratings and three Holds on FNArena's database. The consensus target is $12.58, suggesting 8.4% upside to the last share price. Targets range from $11.77 (Morgans) to $13.30 (UBS). The dividend yield on FY18 and FY19 forecasts is 4.9% and 5.4% respectively.

Merged Janus Henderson Off And Running

Janus Henderson has made a strong start in its inaugural first half as a merged company and brokers are upbeat about the outlook.

-Integration exceeds expectations while investment performance is improving -Increase in pre-tax cost synergies largely from a reduction in personnel -Company flags potential to return some cash to shareholders

By Eva Brocklehurst

Janus Henderson ((JHG)) made a strong start in its inaugural first half as a merged company. The integration task of consolidating global asset managers has exceeded broker expectations and the investment performance is improving.

Assets under management (AUM) of $344.9bn at June 2017 was up over the quarter and supported by moderating net outflows. Net outflows slowed materially, by -$1bn in the June quarter versus -$7bn in the March quarter, with a -20% reduction in redemptions.

The result was boosted by both higher performance fees, and sustainable components such as lower cost ratios. First half assets under management finished higher and there was a more rapid realisation of cost synergies versus the pro forma earnings outlook. Pre-tax cost synergies realised at the end of the half year were largely because of savings from a reduction in personnel.

The company has updated its expected realisation of synergies to US$85m, from $80m, by the end of the first 12 months post the merger. The company wants to examine the extent of likely expenditure before considering any revision to its overall US$110m target, but Citi is confident and forecasts a higher US$130m target.

Citi believes the merged entity has made a good start and synergies are running ahead of expectations. Yet, the broker considers the share fairly valued and retains a Neutral rating. Macquarie upgrades FY17 estimates for earnings per share by 17.8%, largely on the back of performance fees. FY18 estimates are upgraded by 3.7%.

The broker considers the recovery at Intech was outstanding, with 71% of assets under management outperforming respective benchmarks on a three-year basis. The one aspect the broker believed is less than ideal is the fact that US mutual fund flows continue to be dominated by passive funds, and active equity flows in the June quarter incurred an annualised organic loss of -2%.

The results came in for high praise from Bell Potter. Now the company has provided increased disclosure the broker calculates reported and underlying estimates for operating earnings (EBITDA) and net profit. Net, there is a real increase to forecasts and the price target is revised to $60.00 from $57.50. Bell Potter, not one of the eight stockbrokers monitored daily on the FNArena database, maintains a Buy rating.

Margins

A net operating margin of around 41% was well ahead of broker estimates. Bell Potter points out that at the current levels of funds, the company expects operating margins will revert back to a more appropriate level in the mid to high 30% range. This reflects a normalisation of expected performance fees and a more normal cost base.

UBS, too, suggests that second half operating margins should remain in the high 30% range and the stock has upside risk for cost reductions and fund flows. Citi notes changes in mix drove the improved management fee margins but this was mainly because the greatest outflows in FY17 were from the lower-margin Intech.

Shareholder Returns?

The company has flagged the possibility of returning some of its strong net cash position to shareholders but will await further developments on the integration front to assess when the right opportunity presents. The balance sheet was net cash of US$245m at the end of June, retaining a further US$659m in investment assets.

Morgan Stanley was impressed, as the result beat its forecasts by 30%, and even adjusting for stronger performance fees it was still ahead by 15%. The main beat on forecasts came with higher margin equities, as Henderson retail funds returned to positive flows. Nevertheless, alternatives also rose more than Morgan Stanley expected.

The broker believes the result bodes well for future flows, as 69% of assets are ahead of benchmark on a one-year basis versus 50% in the March quarter, and agrees better flow and margin trends, as well as faster realisation of synergies, coupled with higher funds under management, all create upside risk.

There are three Buy and one Hold (Citi) ratings on the database. The consensus target is $50.11, suggesting 12.1% upside to the last share price.

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Material Matters: Nickel, Oil & Aluminium

A glance through the latest expert views and predictions about commodities. Nickel; oil; LNG; and aluminium.

-Fears of Philippines ban on nickel ore exports considered overdone -Renewed oil demand growth in the US and China -Oil price supported but not seen sustaining a major rally in 2017 -Conflicting signals for aluminium amid doubts over the enforcing of Chinese production cuts

By Eva Brocklehurst

Nickel

While recent comments from the Philippines president regarding restricting nickel ore exports have spooked the market, Macquarie suspects that significant disruptions to 2017/18 supplies are unlikely. Following the removal of Gina Lopez as secretary for the Department of Environment and Natural Resources it was assumed by many investors that most mines would be allowed to continue operating.

Macquarie suggests the majority of miners are not concerned about any imminent change, believing that the current review process will run into next year and most mines will be able to address the issues. It appears likely that some smaller mines, currently closed, will not be permitted to re-open. An outright ban on exports is not expected to gain traction, as in reality projects for processing domestic ores are clearly not economic.

The Philippines will supply around 400,000 tonnes of recoverable nickel this year, 20% of world supply. Exports of nickel ore from the Philippines are expected to grow from reduced levels in 2016 but remain well below 2015 levels. Macquarie observes the main threat to 2018 supply could come from the surge in ore exports from Indonesia following the relaxation of its ban.

With the prospect of further licences being granted before the end of the year it is possible that Indonesian exports could exceed 10mt in 2018. In the short term, the broker notes the slow start to Indonesian ore exports and an extremely tight situation for stocks at Chinese nickel pig iron producers has meant that ore prices remain at attractive levels for suppliers.

National Australia Bank analysts concur that the outlook for nickel remains uncertain. Demand from China appears to have weakened, as scheduled maintenance by steel producers was carried out and some switched to carbon steel from stainless steel to tackle the stainless steel glut. Average prices for 2017 and 2018 are forecast at US$9920/t and US$9770/t, respectively.

Oil

Having rallied around 17% from the lows of the year-to-date, oil prices have paused as the bullish fundamentals are being countered by a West Texas Intermediate price of around US$50/bbl, which is triggering the selling of deferred crude futures. This situation, Citi notes, has led the crude structure to do most of the heavy lifting in getting spot oil prices back above US$50/bbl.

As a result, further gains will need to be triggered by a rally in the crude structure and/or a fresh wave of long positions being added by the investment community. The broker expects, if fundamentals remain strong, new long additions are likely.

Citi notes, after a sluggish start, oil demand this year has renewed life, led by growth in both the US and China. Along with very strong petrochemical demand, growth for key refined products is also on the rise and this has filtered through to stronger refinery margins. Meanwhile, the broker observes from weekly inventory data that clean product stocks have fallen since the peak in the first quarter.

Citi also suggests summer in the northern hemisphere may not be the peak for oil prices in 2017. Broader macro sentiment and geopolitical risks appear supportive of the oil price for now, as is the US dollar weakness. The main factors working against further rises in oil prices are seen as a defensive speculative community and technical traders continuing to exert a significant influence, having been heavy sellers of crude in the northern hemisphere spring.

National Australia Bank analysts believe the worst of the June slump in oil prices is over and optimism is building. In late July, Saudi Arabia made further commitments to cut oil exports while US shale production appears to be tapering off after a steady growth for much of the year. The analysts acknowledge there is some pessimism returning to the market, as surveys have pegged July OPEC production at higher-than-expected volumes in July.

Ultimately, they believe the oil market will not sustain a major rally this year. There are some signs that US shale growth may be slowing but production remains a fairly high levels. Moreover, it remains unclear whether OPEC is in a position to maintain its production cuts in perpetuity.

Without further cuts to production or a sustained up-tick in demand, prices are expected to remain in the low-to-mid US$50/bbl for the rest of 2017. The analysts forecast Brent to trade at around US$53/bbl in the December quarter. Prices are still expected to climb to the mid US$60/bbl levels by the end of the decade.

LNG

With most Australian LNG export prices tied to the price of oil, and oil likely to remain subdued, the National Australia Bank analysts do not expect major upside for export prices and forecast around $8-9/GJ in the coming two years. Domestic spot gas prices continue to trend higher and, in many cases, are above export prices.

The analysts note, while earlier modelling indicated Victoria should be paying less for gas than Queensland, because of higher net-back costs, the opposite appears to have occurred, as gas remains scarce in Australia's largest domestic market. While contract prices are not publicly available, the analysts note some reports are pegging prices at up to $20/GJ. They also point out it remains unclear whether the Commonwealth government will declare 2018 a domestic shortfall year.

Aluminium

Aluminium has lagged the rest of the base metals complex and is confronted by conflicting signals. ANZ analysts observe China is attempting to minimise the impact of the industry on the environment, with closures planned for the winter. The aluminium market has been under pressure from excess Chinese capacity for several years and the build up has pushed the domestic industry into a significant surplus.

Despite new capacity being added, the analysts expect the market to significantly tighten over the next six months and prices ascend above US$2000/t in coming months. China's aluminium production continues to grow, and was up 11% for the first six months of this year. However, the analysts estimate up to 6mtpa in capacity could be shuttered and most of this will be in Shandong, with about 9% of the total production for 2017 at risk of closure.

The analysts have a base case of around -350,000t of reductions to occur over the northern winter and around 500,000tpa of capacity being closed because of a lack of approval over the next 18 months. This could push the market into a -200,000t deficit in 2017.

National Australia Bank analysts note there is increasing doubt over the enforcing of cuts to Chinese production. Chinese production accounts for over half of the global primary aluminium output. There have been reports that June re-starts have offset curtailments while some closed "illegal" capacity has the ability to apply the production permits retrospectively.

They suggest the markets may have doubted the extent and the serious nature of such reductions, which explains the limited movement in aluminium prices. Overall, the analysts forecast prices to be steady or to rise slightly for the rest of the year.

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 31 to Friday August 4, 2017 Total Upgrades: 7 Total Downgrades: 17 Net Ratings Breakdown: Buy 41.87%; Hold 41.87%; Sell 16.26%

It was inevitable, given stockbroking analysts continue to issue more downgrades than upgrades for ASX-listed stocks; total Neutral/Hold ratings for the eight stockbrokers monitored daily by FNArena have caught up with the Buys to now equal 41.87% each of total ratings.

Investors will be hoping the change in dynamics will start translating into a better performing share market. There hasn't been a lot of sustained momentum since May, and that's putting it mildly. The week past was no exception.

In terms of downgrades and upgrades, the week ending Friday, 4th August 2017 generated seven upgrades, including for Webjet, a2 Milk and ResMed, significantly outnumbered by 17 downgrades.

Amongst the downgrades we find Sandfire Resources (3x), Mantra Group (2x), Select Harvests, Freelancer, Fortescue Metals, Navitas and, yes, ResMed. Attentive readers would have picked up quite a number of the downgrades relates to disappointing market updates in the opening week of the local August reporting season.

In terms of target prices/valuations, a2 Milk continues to outperform just about everyone's expectations, adding yet another 41% during the week, followed by Northern Star (+5.7%), GUD Holdings (+4.4%) and Webjet (+4.3%). On the negative side, the week's biggest loser is Sandfire Resources (-5.1%), followed by Mantra Group (-4.1%) and Syrah Resources (-2%).

One observation to highlight here is that, for the first time in a long while, positive adjustments turned out noticeably larger than average reductions.

The same observation stands for amendments to earnings forecasts, with the added notion that changes on both sides of the ledger proved substantial. Western Areas took the honours on the positive side with a gain of no less than +90%, handsomely beating Alacer Gold (+36%), Resolute Mining (+18%) and ResMed (+12%).

On the other side, Beadell Resources' forecasts suffered a decline by -100%, while Syrah Resources' decline stopped at -68%. For iSentia, yet another profit warning was good for a decline of -9.5%. WorleyParsons' decline stopped at -9.3%. Bankinsurer Suncorp whose financial report proved shockingly disappointing doesn't even figure in the top ten of stocks suffering declines to forecasts!

There'll be more fireworks either way this week. No doubt.

Upgrade

THE A2 MILK COMPANY LIMITED ((A2M)) Upgrade to Buy from Neutral by Citi .B/H/S: 3/1/0

Citi has upgraded its rating to Buy from Neutral while increasing its price target by no less than 41% to $5.15. Consider this a mea culpa from a team of analysts who had been the bears in the market when it comes to selling milk and milk products into the Chinese market.

Underlying the above changes, the analysts lifted FY18 EPS estimate by 34%. The justification given is the out of stocks situation that a2 Platinum has experienced since March. This, say the analysts, indicates demand remains stronger than expected.

CYBG PLC ((CYB)) Upgrade to Outperform from Neutral by Credit Suisse .B/H/S: 1/2/1

Following the June quarter trading update Credit Suisse upgrades earnings estimates by 1-4%. The broker observes strong execution on the cost restructuring story while revenues remain intact. Bad debts are low and stable.

Rating is upgraded to Outperform from Neutral. Target is $5.25.

GOODMAN GROUP ((GMG)) Upgrade to Hold from Lighten by Ord Minnett .B/H/S: 3/4/0

Following an update to the model, Ord Minnett raises its recommendation to Hold from Lighten and lifts the target to $7.90 from $7.80.

NORTHERN STAR RESOURCES LTD ((NST)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 1/3/2

Northern Star has delivered substantial upgrades to the Jundee and Kalgoorlie operations. Macquarie observes this is a significant upgrade to the long-term outlook, and the company now has a reserve and resource base capable of supporting a 600,000 ounces per annum run rate over 10 years.

Incorporating near-term guidance means a modest reduction to the broker's earnings forecasts for the next three years. FY18, FY19 and FY20 forecasts are lowered -8%, -13% and -7% respectively. Target is raised to $5.40 from $4.00. Rating is upgraded to Outperform from Neutral.

OCEANAGOLD CORPORATION ((OGC)) Upgrade to Buy from Hold by Deutsche Bank .B/H/S: 4/2/0

Deutsche Bank believes the sell-off in the stock is overdone. Commissioning problems at Haile have been identified and are being resolved. Meanwhile, gold output fell in the quarter as Didipio milled grade declined, as per guidance.

The broker believes the stock screens cheap and upgrades to Buy from Hold. Target is reduced to $4.40 from $4.50.

RESMED INC ((RMD)) Upgrade to Buy from Neutral by Citi .B/H/S: 4/2/0

Q4 numbers proved better than expected and Citi analysts are of the view that management's guidance for FY18 looks "cautious", seen as a reflection of company's expectation the positive potential of the new masks will arrive incrementally and gradually through the financial period.

New masks have faced headwinds from supply bottlenecks, highlights Citi. Solid growth in devices in France should now be expected too. Small changes to estimates have been made. Target price moves to $10.50, up 50 cents, on rolling forward of valuation modeling.

See also RMD downgrade.

WEBJET LIMITED ((WEB)) Upgrade to Add from Hold by Morgans .B/H/S: 3/2/0

The company will acquire UK-based JacTravel for $330m. Morgans observes the size and nature of the transaction means the acquisition is not without risk but the strategic importance of the deal is irrefutable, as it transforms Webjet into the number two player in business-to-business travel globally.

The transaction will be funded via a combination of an entitlement offer, cash and debt. Morgans continues to view diversification into this higher quality and higher margin market positively.

With a materially stronger growth profile, the broker believes the valuation is compelling and upgrades to Add from Hold. Target is raised to $13.50 from $12.80.

Downgrade

AWE LIMITED ((AWE)) Downgrade to Neutral from Buy by UBS .B/H/S: 1/4/1

UBS was disappointed with June quarter production primarily because of lower output at Casino. Field production will be constrained until a work-over can be conducted.

The broker downgrades to Neutral from Buy because of the reduction in the valuation of Casino and recent share price appreciation.

Almost 50% of the broker's asset value is now attributed to Waitsia, highlighting the growing importance of this field for the company. Target is reduced to $0.56 from $0.60.

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

First half results were materially below UBS expectations. Job conversion issues affected the marketplace division and the take rate also fell.

The broker is positive on the longer-term potential of the business but recognises, at this stage, a lack of revenue growth will be a key consideration for investors.

Rating is downgraded to Neutral from Buy. Target is reduced to $0.70 from $1.50.

FORTESCUE METALS GROUP LTD ((FMG)) Downgrade to Hold from Add by Morgans .B/H/S: 3/4/1

Morgans believes the stock is trading close to fair value, and with benchmark iron ore prices back above US$70/t the broker downgrades to Hold from Add.

The broker suspects the stock could rally from this point if the large discounts on its lower-grade iron ore starts to normalise towards the long-term range. To get there though, China needs to absorb a large stockpile that has been building at port. Target is $5.95.

JAPARA HEALTHCARE LIMITED ((JHC)) Downgrade to Neutral from Buy by UBS .B/H/S: 1/2/1

UBS believes the future is bright for Japara Healthcare. The company carries the most options on its balance sheet of the three listed players and a significant opportunity for margin upside.

While positive on long-run growth the broker envisages significant risk that FY17 guidance is missed, given the quantum of the turnaround required from the first half.

Rating is downgraded to Neutral from Buy. Target is reduced to $2.15 from $2.40.

LEND LEASE CORPORATION LIMITED ((LLC)) Downgrade to Hold from Accumulate by Ord Minnett .B/H/S: 4/2/0

Ord Minnett has revised earnings estimates and dividend forecasts, noting Lend Lease is reasonably well-positioned to deliver growth in earnings per share over coming years. Nevertheless, the share price has rallied over recent months, pushing up multiples and thus the broker downgrades to Hold from Accumulate.

Target is reduced to $17.00 from $17.20. Ord Minnett raises FY17 estimates by 1% and cuts FY18 by -2%. The broker's view on the company is underpinned by a substantial list of development projects and a solid construction backlog.

MAGNIS RESOURCES LIMITED ((MNS)) Downgrade to Underperform from Outperform by Macquarie .B/H/S: 0/0/1

Changes to Tanzanian law have had negative impact on the share prices of many companies with exposure to the country.

Magnis Resources has continuing uncertainty relating to its special mining licence and mineral development agreements, with the potential for the government to increase its free-carried share to 16%.

A lack of progress at Nachu and confusing messages leaves Macquarie to question the direction of the company. Downgrade to Underperform from Outperform. Target is reduced to $0.30 from $1.05.

MANTRA GROUP LIMITED ((MTR)) Downgrade to Neutral from Buy by Citi and Downgrade to Equal-weight from Overweight by Morgan Stanley .B/H/S: 3/5/0

Citi downgrades to Neutral from Buy on the belief that consensus market forecasts are too optimistic, albeit not dramatically so. One factor mentioned is the anticipated Commonwealth Games uplift which Citi suggests is likely to be more moderate than the market expects.

A strong Aussie dollar represents yet another downside risk, point out the analysts. Estimates have been cut. Price target drops to $3.15 from $3.27 in response.

Morgan Stanley observes strength in Australian outbound growth and moderation in inbound growth as a higher Australian dollar makes the country more expensive for foreigners and translation of offshore assets.

The broker finds it hard to draw many positives for the company from the current conditions and downgrades to Equal-weight from Overweight. Target is reduced to $3.20 from $4.20. Industry view is In-Line.

NAVITAS LIMITED ((NVT)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 0/5/1

FY17 EBITDA was in line with guidance but below Macquarie's forecasts. The broker transfers coverage of the stock to another analyst and downgrades the rating to Neutral from Outperform. Target is lowered to $4.51 from $5.00.

Although industry conditions remain favourable the broker observes a number of company-specific headwinds will affect FY18. Reduced AMEP contracts and a cessation of income from closed colleges leads to a downgrade to FY18 forecasts for earnings per share by -14.2%.

RESMED INC ((RMD)) Downgrade to Neutral from Outperform by Credit Suisse .B/H/S: 4/2/0

Flow generators drove revenue growth in the June quarter but masks were below Credit Suisse forecasts. The broker notes the lack of expansion in gross margin came from an adverse shift in mix, with robust sales of lower-margin flow generators relative to higher-margin masks.

Credit Suisse forecasts stronger mask growth versus flow generators in FY18 but suspects the impact on gross margin may be limited.

Target is reduced to $9.40 from $9.70. Rating is downgraded to Neutral from Outperform.

See also RMD upgrade.

SARACEN MINERAL HOLDINGS LIMITED ((SAR)) Downgrade to Neutral from Buy by Citi .B/H/S: 1/1/0

Citi has downgraded to Neutral from Buy, while lifting its price target to $1.48 from $1.46. The move follows a positive news announcement by the company, as reserve lives have been extended significantly.

The explanation for the move is simply "valuation". Citi's bull case scenario lifts valuation to $1.89/sh while the bear case pulls it down to $1.12/sh. A fall in Deep South grades is responsible for reduced FY18/19 earnings estimates.

SANDFIRE RESOURCES NL ((SFR)) Downgrade to Neutral from Outperform by Macquarie and Downgrade to Hold from Add by Morgans and Downgrade to Hold from Speculative Buy by Ord Minnett .B/H/S: 1/5/2

June quarter production was in line with Macquarie's expectations but guidance for FY18 is well below. The broker materially lowers earnings forecasts as a result.

Exploration around Doolgunna continues to disappoint the broker and the pressure on the company to make a meaningful discovery is building.

Hence, in the absence of an acquisition or exploration success, Macquarie downgrades to Neutral from Outperform. Target is reduced to $6.40 from $7.70.

FY17 production was in line and Morgans notes a consistent track record in operations. Cash accumulation also impressed the broker but investor intention is expected to focus increasingly on near-mine exploration success.

The broker downgrades to Hold from Add and reduces the target to $6.44 from $6.79.

June quarter results were relatively solid, Ord Minnett observes. The recent performance of the share price leads the broker to downgrade to Hold from Speculative Buy.

Ord Minnett will become more positive if and when there are signs of further growth plans, such as the Black Butte project, or other exploration adding mine life. Target is reduced to $6.30 from $6.70.

SELECT HARVESTS LIMITED ((SHV)) Downgrade to Reduce from Hold by Morgans .B/H/S: 0/1/1

The company has issued materially lower guidance for FY17 net profit because of a lower Australian dollar almond price and cost pressures. Morgans consequently downgrades FY17 net profit forecasts by -40.3% and makes material revisions to FY18 and FY19 as well.

The broker observes the quantum and timing of the downgrade is disappointing and reflects one of the most difficult seasons on record for the company.

Moreover, the belated recognition of material cost pressures is a concern. Rating is downgraded to Reduce from Hold and the target to $4.05 from $4.75.

SYRAH RESOURCES LIMITED ((SYR)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 3/2/0

Commissioning has begun at Balama and initial sales contracts have been formalised but delays to construction of some key components have pushed first production to October.

Macquarie now takes a more conservative view on the ramp up. The broker expects the next 12 months will present plenty of technical challenges. Rating is downgraded to Neutral from Outperform. Target is reduced to $3.20 from $3.60.

TRADE ME GROUP LIMITED ((TME)) Downgrade to Underperform from Neutral by Macquarie .B/H/S: 1/2/2

Macquarie has reviewed forecasting assumptions and downgrades the stock to Underperform from Neutral as a result. Target is lowered to NZ$5.00 from NZ$5.30.

This downgrade reflects the strong margins currently being enjoyed, and the market's expectations for margin growth at a time when competitor activity has stepped up.

Macquarie does not expect margin growth and would not be surprised if the company signals further investment in development.

Total Recommendations Recommendation Changes

Broker Recommendation Breakup

Broker Rating Order Company New Rating Old Rating Broker Upgrade 1 CYBG PLC Buy Neutral Credit Suisse 2 GOODMAN GROUP Neutral Sell Ord Minnett 3 NORTHERN STAR RESOURCES LTD Buy Neutral Macquarie 4 OCEANAGOLD CORPORATION Buy Neutral Deutsche Bank 5 RESMED INC Buy Neutral Citi 6 THE A2 MILK COMPANY LIMITED Buy Neutral Citi 7 WEBJET LIMITED Buy Neutral Morgans Downgrade 8 AWE LIMITED Neutral Buy UBS 9 FORTESCUE METALS GROUP LTD Neutral Buy Morgans 10 FREELANCER LIMITED Neutral Buy UBS 11 JAPARA HEALTHCARE LIMITED Neutral Buy UBS 12 LEND LEASE CORPORATION LIMITED Neutral Buy Ord Minnett 13 MAGNIS RESOURCES LIMITED Sell Buy Macquarie 14 MANTRA GROUP LIMITED Neutral Buy Citi 15 MANTRA GROUP LIMITED Neutral Buy Morgan Stanley 16 NAVITAS LIMITED Neutral Buy Macquarie 17 RESMED INC Neutral Buy Credit Suisse 18 SANDFIRE RESOURCES NL Neutral Buy Morgans 19 SANDFIRE RESOURCES NL Neutral Buy Macquarie 20 SANDFIRE RESOURCES NL Neutral Buy Ord Minnett 21 SARACEN MINERAL HOLDINGS LIMITED Neutral Buy Citi 22 SELECT HARVESTS LIMITED Sell Neutral Morgans 23 SYRAH RESOURCES LIMITED Neutral Buy Macquarie 24 TRADE ME GROUP LIMITED Sell Neutral Macquarie Recommendation Positive Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 A2M THE A2 MILK COMPANY LIMITED 75.0% 50.0% 25.0% 4 2 CYB CYBG PLC -10.0% -30.0% 20.0% 5 3 FXJ FAIRFAX MEDIA LIMITED 80.0% 60.0% 20.0% 5 4 GUD G.U.D. HOLDINGS LIMITED -20.0% -40.0% 20.0% 5 5 WEB WEBJET LIMITED 60.0% 40.0% 20.0% 5 6 OGC OCEANAGOLD CORPORATION 67.0% 50.0% 17.0% 6 7 NST NORTHERN STAR RESOURCES LTD -17.0% -33.0% 16.0% 6 8 GMG GOODMAN GROUP 43.0% 36.0% 7.0% 7 Negative Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 SFR SANDFIRE RESOURCES NL -13.0% 19.0% -32.0% 8 2 MTR MANTRA GROUP LIMITED 38.0% 63.0% -25.0% 8 3 SYR SYRAH RESOURCES LIMITED 60.0% 80.0% -20.0% 5 4 FMG FORTESCUE METALS GROUP LTD 19.0% 31.0% -12.0% 8 5 LLC LEND LEASE CORPORATION LIMITED 67.0% 75.0% -8.0% 6 6 GPT GPT 29.0% 33.0% -4.0% 7 7 REA REA GROUP LIMITED 13.0% 14.0% -1.0% 8 Target Price Positive Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 A2M THE A2 MILK COMPANY LIMITED 5.150 3.650 41.10% 4 2 NST NORTHERN STAR RESOURCES LTD 4.757 4.498 5.76% 6 3 GUD G.U.D. HOLDINGS LIMITED 11.398 10.918 4.40% 5 4 WEB WEBJET LIMITED 12.646 12.118 4.36% 5 5 FMG FORTESCUE METALS GROUP LTD 5.731 5.494 4.31% 8 6 FXJ FAIRFAX MEDIA LIMITED 1.170 1.150 1.74% 5 Negative Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 SFR SANDFIRE RESOURCES NL 6.281 6.620 -5.12% 8 2 MTR MANTRA GROUP LIMITED 3.263 3.403 -4.11% 8 3 SYR SYRAH RESOURCES LIMITED 4.610 4.710 -2.12% 5 4 GMG GOODMAN GROUP 8.194 8.229 -0.43% 7 5 OGC OCEANAGOLD CORPORATION 4.708 4.725 -0.36% 6 6 CYB CYBG PLC 4.928 4.945 -0.34% 5 7 LLC LEND LEASE CORPORATION LIMITED 16.943 16.977 -0.20% 6 Earning Forecast Positive Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 WSA WESTERN AREAS NL -0.031 -0.317 90.22% 7 2 AQG ALACER GOLD CORP 40.569 29.768 36.28% 5 3 RSG RESOLUTE MINING LIMITED 27.200 23.000 18.26% 3 4 RMD RESMED INC 39.933 35.446 12.66% 6 5 GUD G.U.D. HOLDINGS LIMITED 68.502 62.126 10.26% 5 6 ORG ORIGIN ENERGY LIMITED 18.103 16.703 8.38% 7 7 FBU FLETCHER BUILDING LIMITED 42.835 41.503 3.21% 6 8 JHG JANUS HENDERSON GROUP PLC. 266.695 259.054 2.95% 5 9 KMD KATHMANDU HOLDINGS LIMITED 17.302 16.983 1.88% 3 10 BAL BELLAMY'S AUSTRALIA LIMITED 22.500 22.167 1.50% 3 Negative Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 BDR BEADELL RESOURCES LIMITED 0.000 2.100 -100.00% 3 2 SYR SYRAH RESOURCES LIMITED -8.979 -5.330 -68.46% 5 3 ISD ISENTIA GROUP LIMITED 12.300 13.600 -9.56% 3 4 WOR WORLEYPARSONS LIMITED 48.475 53.475 -9.35% 5 5 OGC OCEANAGOLD CORPORATION 36.904 40.237 -8.28% 6 6 RIO RIO TINTO LIMITED 551.877 580.439 -4.92% 8 7 FMG FORTESCUE METALS GROUP LTD 94.350 98.503 -4.22% 8 8 JHX JAMES HARDIE INDUSTRIES N.V. 79.691 82.625 -3.55% 7 9 BKW BRICKWORKS LIMITED 124.600 128.775 -3.24% 4 10 BPT BEACH ENERGY LIMITED 7.321 7.557 -3.12% 6 Technical limitations

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

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Uranium Week: No Traction

By Greg Peel

The parlous state of the US nuclear power industry continued to dominate the uranium industry last week.

A subsidiary of South Carolina Gas & Electric and the state-owned Santee Copper announced last week they would walk away from two partially built reactors at the Summer Nuclear Station, despite having already spent billions. The projects were over time and over budget.

The decision has sparked an inquiry by the state nuclear regulator as to why the projects have failed and South Carolina senators have called for a special session to discuss the project and ensure no laws have been breached.

Faced with a similar decision, Southern Co has decided it still sees the benefit of completing its two-unit construction project at Plant Vogtle in Georgia despite estimates the cost has blown out to over US$25bn. While Southern Co is still deciding the fate of the project, which is also well over time and budget, the CEO has conceded there would be “nothing to show” for the company’s investment if it were to simply walk away.

The news did not engender any confidence in the uranium spot market last week, which currently features a wide bid/ask gap on the vagaries of differing delivery timing and location. Five transactions were concluded totalling 500,000lbs U3O8 equivalent, industry consultant TradeTech reports. TradeTech’s weekly spot price indicator has fallen -US20c to US$20.40/lb.

The spot price has now been stuck below US$21.00/lb since mid-May.

Spot market participants continue to await an expected pick-up in utility demand in term markets to provide any reason to inflate bid prices. To that end, four transactions were concluded in term markets last week, several utilities are continuing to evaluate offers and new demand emerged in the long term market.

But such demand is doing nothing to prop up prices. TradeTech’s monthly mid-term price indicator fell at the end of July by -US5c to US$24.40/lb and the long term indicator by -US$2.00 to US$32.00/lb.

There was some good news last week nonetheless. There are currently five Japanese reactors that have achieved restart status – a process which has taken six years – and the Japanese Institute of Energy Economics believes there will be ten by March 2019.

Given the long period of time it took to get the count to five largely reflected the protests of local residents in relevant regions, one might have to take that forecast with a grain of salt.

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 August 3, 2017

Last week the ASX200 drop down from the top of the range to the bottom of the range, again.

In last week's Report I noted a lot of green in the table as short positions were apparently trimmed ahead of result season, which is typically the case. Well last week the season was yet to start in earnest, but below shows a lot more red.

None of the red or green represents short movements of one percentage point or more nonetheless, so while the shorters have appeared busy, magnitude is limited.

The exception last week was iSentia ((ISD)), which saw its shorts rise to 12.2% from 10.4%.

Weekly short positions as a percentage of market cap:

10%+

WSA 20.7 ORE 19.3 SYR 18.4 MYR 16.7 IGO 14.4 JBH 13.0 RFG 12.4 ISD 12.2 MTS 11.8 MYX 11.7 ACX 11.6 DMP 11.5 SHV 11.2 AAD 11.7 HVN 10.3

No changes

9.0-9.9%

JHC, GXY, FLT, AHG, GTY In: JHC, GXY, AHG, GTY

8.0-8.9%

A2M, APO, NXT, BKL, HSO, NEC, CTD

In: APO, NXT Out: GXY, JHC, AHG, GTY, QIN

7.0-7.9%

BEN, TPM, RWC, RIO, QIN

In: QIN Out: NXT, APO, AYS, NWS

6.0-6.9%

IPD, VRT, BAP, AYS, NWS, SEK, PRU, SAR, MND, EHE, OFX, OSH, NSR, CCP, VOC

In: AYS, NWS, VRT, NSR, CCP

5.0-5.9%

AAC, GEM, GXL, AWC, PPT, CSV, GMA, KAR, BGA, DCN, BAL, AWE, MSB, RCG, CSR, IFL

In: CSV, DCN, AWE, MSB, RCG Out: VRT, NSR, CCP, TAH

Movers and Shakers

Media monitoring SaaS company iSentia had seen its share price slowly recover at least some of the steep loss it had suffered following a big earnings miss in the February result season. Then last week the company issues another profit warning and the share price lost most of that ground once more.

One might have expected some profits to thus be taken on short position but no, it appears the shorters are shaping up for more, increasing to 12.2% from 10.4%.

The profit warning included a write-down to zero of the failing King Content business – a "what was I thinking?" prior acquisition the board must rue every day. But brokers are pleased to see King Content written off as it rebases the company's outlook. That outlook remains positive over the longer term according to the one Hold and two Buy ratings on the FNArena database, but it will take time to again restore confidence.

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: Global Rates And Oz Building

Weekly Broker Wrap: Global rate outlook; Australian building; motor vehicle replacement; Capilano Honey; Paragon Care.

-Western Asset suggests no imminent increase in global inflation or interest rates -Accident replacement motor vehicles expected to double -Key to growth for Capilano Honey is export markets -Hard work by Paragon Care pays off in FY17

By Eva Brocklehurst

Global Rate Outlook

Western Asset, a global fixed income specialist, believes that despite subdued signals in many economies, global growth of around 3% is sustainable. The analysts believe that a slowing in overall growth will soon become apparent to the US Federal Reserve and may lead to the central bank being more cautious about rate hikes.

Western Asset continues to favour long US government bonds and is less keen on European, UK and Japanese government debt. Nevertheless, the view suggests that there is no imminent increase in inflation or interest rates.

Western Asset downgrades the outlook for the US based on the recent absence of growth in capital spending, export activity and the related flattening out in the US factory sector. The eurozone is expected to grow at around 1.7-2.0% in 2017. With deflation risks dissipating, the analysts suggest the market focus has shifted to when the European Central Bank will normalise its monetary policy stance.

Western Asset believes the ECB will continue to maintain low interest rates, and asset purchases will continue into 2018. In Japan, growth is expected to improve to around 1.5% in the context of the current fiscal and monetary policies. The Bank of Japan is expected to continue with an accommodative monetary policy for some time in order to meet inflation goals. Western Asset still expects the yen to continue with its weakening trend against the US dollar.

Australian Building

Economic and industry researcher BIS Oxford Economics suggests Australia's building market will move into reverse over the next three years with a collapse in residential building commencements. In its Building in Australia 2017-2032 report, the researchers suggest the value of national building commencements peaked in 2015/16 at $107.3bn, up 22% in real terms since the end of the resources investment boom in 2012/13.

Over the next two years the fall in residential building commencements is expected to accelerate sharply, particularly in the investor-driven apartments segment, as supply catches up to demand. The total residential market is expected to fall by around -31% over the next three years but the decline in the number of private, high-density apartments being started nationally will be closer to -50%.

The slump is expected to be, in percentage terms, similar to the residential downturns in the mid 1990s and during the introduction of the GST in 2000/01. The analysis indicates that dwelling construction in all states, with the exception of Victoria and NSW, is either in balance or oversupply.

High-density dwellings take longer to complete than traditional detached housing but the researchers suggest that when the end of the boom comes it will be swift. A milder decline is forecast for detached houses.

In contrast, the value of non-residential building commencements is expected to rise in 2017/18. Improved economic conditions along the eastern seaboard are driving new commercial and industrial developments. Further afield, the total value of non-residential building commencements is expected to ease later in the decade, meeting the downturn in residential commencements.

Weaker prospects for growth in retail sales are expected to feed through to a narrow pipeline for retail projects, and a tripling of accommodation commencements since 2012/13 may also push activity in this segment to its peak, resulting in a correction.

In summary, with residential building activity now set for a sharp decline, along with the multiplier impact on industries such as construction, manufacturing and retailing, the researchers believe the Australian economy will need new drivers of investment to support growth and employment.

Accident Replacement

Under Australian common law a driver that is not at fault is entitled to a hire car paid for by the at-fault driver but this right is largely unrecognised, as only 18% of potential hires take up the offer. Nevertheless, Morgan Stanley observes take up has been growing in the last five years and calculates the potential number of hires based on the experience in the mature UK market, where 70% of drivers not at fault take up the offer.

The broker expects this market to more than double in Australia and determines the market opportunity using factors such as the penetration rate of potential hires, average length of repair and rental price per day and estimates a total addressable market of $703m in Australia.

EclipX ((ECX)) owns the Right2Drive business, a leading operator in the accident replacement vehicle market. The business may make up only 14% of the company's operating earnings in FY17 but is a meaningful driver of growth and is likely to contribute 3-5% to earnings growth over FY18-20 on Morgan Stanley's new forecasts.

For the insurers, Morgan Stanley calculates an increase in premiums by around 8% would cover the claims costs in a fully penetrated market. Insurers are expected to price to offset claims inflation and earnings estimates would only decline for the major insurers by -1-2% if price increases are not implemented.

Capilano Honey

Capilano Honey's ((CZZ)) FY17 results were subdued because of increased investment. Morgans expects the company to return to double-digit growth in FY18 but has lowered forecast to reflect the additional costs associated with the development of new product, such as Beeotic, and increased marketing activity.

Beekeeping operations were affected by unfavourable seasonal conditions, resulting in both joint ventures sporting small losses. The stock trades at a material discount to peers and the broker maintains an Add rating and $18.05 target.

Looking into FY18, Canaccord Genuity believes the key to growth will be export markets. Growth in the domestic market is expected to become harder, amid more competition from Beechworth. The broker believes the company's strong position in its category justifies a market multiple despite the lack of growth.

Should demonstrable growth materialise in export markets a re-rating to a growth market multiple could be justified. Hence the broker, not one of the eight monitored daily on the FNArena database, retains a Hold rating and a $16.38 target.

Paragon Care

Paragon Care ((PGC)) pleased Bell Potter with its second half result, confirming that earnings are now heavily skewed to the latter half of the year. The broker still finds estimating the organic growth in revenue problematic, as there have been numerous acquisitions recently, but its best estimate is around 6.5%.

The company has not provided specific earnings guidance for FY18 but the outlook remains supportive of growth. The broker notes strong growth in ophthalmic, aged care and service and maintenance businesses. Bell Potter, not one of the eight monitored daily on the database, maintains a Buy rating and $1.02 target.

The result beat Shaw and Partners' forecasts and is seen validating the hard work management has put into re-building the earnings profile. The broker believes this stock is a non-discretionary exposure to Australia's ageing population, with a footprint that enables bolt-on acquisitions to be grown quickly and relatively cheaply. Shaw and Partners, also not one of the eight monitored daily on the database, retains a Buy rating and $0.95 target.

Mantra Expansion Welcomed

Hotel chain operator Mantra Group will acquire The Art Series hotels, and brokers largely welcome the acquisition.

-Increases exposure to the Melbourne market, with soft conditions expected to continue -Acquisitions important drivers of growth, given weak organic performance -Valuation considered fair, pending evidence of a sustained industry improvement

By Eva Brocklehurst

Hotel chain operator Mantra Group ((MTR)) will acquire The Art Series hotels, a chain inspired by Australian contemporary artists with operations in Melbourne, Adelaide and Brisbane.

Morgans considers The Art Series a high-quality portfolio, complementing the company's existing brands and providing first rights to future developments. Moreover, the purchase price of $52.5m appears reasonable, the transaction is accretive and there are synergies with existing systems and infrastructure.

The broker believes the acquisition should underpin earnings growth in the CBD segment over coming years and is a good use of the excess capacity on the balance sheet. Nevertheless, because of softer operating conditions in some CBD markets and the Gold Coast, Morgans lowers forecasts and, with less than 10% upside to the price target, maintains a Hold rating.

The acquisition is expected to support FY18 consensus expectations and reduce concerns on that front. While positive on the acquisition, the broker would still prefer to wait and witness the underlying quality of the FY17 results, scheduled for August 29.

The transaction reflects an attractive acquisition multiple, in Deutsche Bank's opinion, and FY18 and FY19 forecasts are raised by 3% and 7% respectively. The broker points out it does leave the company with a fully geared balance sheet and increased exposure to the Melbourne market, which is expected to encounter soft conditions over the medium term.

Citi suspects an acquisition premium may slowly creep back into the company's price/earnings multiple, given the acquisition of The Art Series, together with the new relationship with the developer, Deague Group, represents the first major acquisition since the first half result.

Still, the broker retains questions about the fit with the company's existing three-brand portfolio. Each of the hotels acquired have a degree of goodwill and the broker expects them to retain existing banners.

While operating boutique hotels is considered a reasonable strategy against Airbnb, they are different to operating mass-market brands, and the company may be required to maintain a separate management team in order to be successful.

Citi is pleased the company is acquiring properties in Australia versus new markets but suspects, while some synergies exist, others may be harder to achieve versus an acquisition of hotel stock more closely related to the existing product.

Citi recently downgraded to Neutral but now returns to a Buy rating, given this unforeseen acquisition delivers FY19 accretion of 5% and the share price has fallen 8% since the beginning of the month. This has now sufficiently priced in the broker's concerns about FY18 expectations being too high.

Credit Suisse believes a re-rating requires an improved organic outlook and maintains a Neutral rating. The acquisition appears broadly consistent with the company's stated strategy but underlines the fact that acquisitions are an important avenue for growth, given weak organic improvements across the rest of the portfolio. The broker considers the current FY18 price/earnings ratio of 15.4x as fair, pending sustained evidence of an improving industry performance.

Moelis believes the acquisition will help drive CBD segment earnings growth in FY18 onwards. The broker notes the company typically acquires assets on a 4-6 multiple of operating earnings (EBITDA) and this transaction has a face value multiple at the top end of this range.

The stock remains attractive in the broker's view, given the exposure to domestic tourism. Catalysts are expected to be an improvement in CBD performance and further accretive acquisitions. Moelis, not one of the eight brokers monitored daily on the FNArena database, has a Buy rating and $3.74 target.

Acquisition Detail

The acquisition comprises seven 4-5-star hotels in Australian capital cities with over 1,000 hotel suites and apartments, predominantly Melbourne, complemented by a number of conference and event facilities. The acquisition includes freehold title to key commercial lots with arrangements in place to deliver new Art Series properties in the future providing an additional growth avenue in Australia.

The company forecasts $7m in underlying operating earnings in the first 12 months of ownership. This includes the impact of The Chen at Box Hill, which opens in November 2017 and will be loss-making in the first year. Upon the portfolio stabilising, it is expected to contribute around $8.5-9.0m per annum. The transaction is funded by existing cash and debt.

There are four Buy ratings and four Hold on the database. The consensus target is $3.28, suggesting 12.3% upside to the last share price. Targets range from $3.05 (Credit Suisse) to $3.78 (Macquarie, yet to comment on the acquisition).

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Turnaround For Bapcor

By Michael Gable

This week is a busy one with plenty of companies reporting their results. Make sure you view the calendar in this report to see what lies ahead this week. Last week brought with it the usual trail of victims such as Suncorp (which we previously warned about) and Navitas, along with yet another profit downgrade from former market darling iSentia. In this week's report we have taken a good look at Bapcor ((BAP)) which was on a slippery slope for a while but surprised the market with some unexpected news the other day.

After we sold BAP at the end of last year near $6, the share price started to trend lower, falling towards $5 in June. Up until the end of July, the chart was looking fairly weak as it continued to make lower highs. Then at the end of July we saw it break that downtrend on an unexpected announcement. The chart has turned from negative to positive and over the next few months we now expect it to trend higher, eventually heading above the January peak near $6.

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Michael is RG146 Accredited and holds the following formal qualifications:

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

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