Week
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Stories To Read From FNArena

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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

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Caution Uppermost For GUD Holdings

Weaker economic conditions and increased competition look like hampering automotive and water product distributor GUD Holdings in the year ahead.

-Aftermarket service and supply slowdown accelerated in the fourth quarter of FY19 -Preferred supplier arrangements in place to limit market share losses -Accretive acquisitions the main potential for upside

By Eva Brocklehurst

A softer outlook for the automotive division meant brokers were disappointed with the FY19 results from GUD Holdings ((GUD)). Management has highlighted a number of issues, such as weaker economic conditions, increased competition and a failure to cut through significantly with the launch of the new catalogue.

Activity in the aftermarket service and repair industry has been sluggish and trade customers appear hesitant to spend. Moreover, new entrants in the market, particularly in the filtration category, have put pressure on industry margins.

The company has guided to modest growth in FY20 but brokers are becoming increasingly cautious. Several have downgraded their ratings, Macquarie and Citi to Neutral, and UBS to Sell from Buy. UBS believes the company - share price has been on a downward trend since May - will find it difficult to grow earnings (EBIT) in FY20.

Citi sums up the outlook as involving too much short-term uncertainty. The broker considers the FY19 results was a story of two halves. The first half was "reasonable" while the second half slowdown accelerated in the fourth quarter, leaving little confidence in a definitive turnaround in the first half of FY20.

Macquarie suspects FY20 is likely to be a year of consolidation and only modest earnings growth. Under new management, GUD Holdings has stopped giving a definitive earnings guidance range but has flagged re-seller softness, which affected second half sales but also resulted in unintended accumulation of inventory, in turn affecting working capital.

The launch of the Narva catalogue was disappointing for UBS, as industry feedback has signalled weaker sales. The broker was surprised that organic revenue declined in the automotive segment, given its recent history of firm gains, although a potential catalyst for upside could be accretive acquisitions.

This is the area where Macquarie was most disappointed as there were no acquisitions over FY19. The broker's forecast had assumed $20m in automotive acquisitions would support FY20 and FY21. Removing these factors drives a -50% revision to estimates.

The broker assesses, while the automotive division is an attractive asset, it will take time to recover. UBS forecasts long-term automotive earnings margins of around 23% and agrees that, while automotive division remains defensive, as a result of expansion of major automotive parts distributors in the trade channel and low single-digit price increases, only modest top-line growth is likely to be achieved.

Competition

Moreover, current margins are unlikely to be sustainable over the next 3-5 years in the automotive division. The company, UBS notes, has a high market share and an imported brand consumer business and is also expanding its customer base. Yet the perpetual threat of private-label competition and the move away from internal combustion engine parts will reduce margins over the longer term.

UBS also envisages risks emerging in the form of supply-chain consolidation amid difficulty in generating price increases. Preferred supplier arrangements are now in place across several major customers to limit potential market share losses but Macquarie points out there were no details regarding any potential impact on margins.

Moreover, acknowledging the competitive environment, the company's Ryco brand did not implement price increases. This is a key aspect to the substantial FX headwinds that the company faces over FY20, UBS suggests. The broker calculates that in FY20 the failure to increase prices will affect earnings by around -$4.6m.

While not overplaying Mann's entry into the market, the broker believes it remains a risk as does private-label penetration across all the company's categories. UBS suspects weaker volumes versus history could be an ongoing theme over the next five years as customers rationalise warehouses.

Preferred supplier arrangements are now in place across several major customers to limit potential market share losses but Macquarie notes no details were provided regarding any potential impact on margins.

Competitive threats and the dominance of a handful of channel partners will continue to be important, although Ord Minnett believes this is now adequately priced into the earnings multiple the stock. On the positive side Davey improved in the second half with revenue growth in all regions, despite a continuation of drought conditions, as new products and growth initiatives came into play.

Wilsons, not one of the seven stockbrokers monitored daily on the FNArena database, suggests relative value is emerging in the stock and the dividend yield remains attractive.

The broker has become increasingly concerned about the organic earnings growth prospects and the erosion of the elevated margins in the key filtration category. Hence, the outlook commentary has validated concerns and a Hold rating is maintained with a $10.25 target.

The database has one Buy (Ord Minnett), three Hold and one Sell (UBS). The consensus target is $10.66, signalling 5.6% upside to the last share price. This compares with $13.28 ahead of the results.Targets range from $9.50 to $12.00. The dividend yield on FY20 and FY21 forecasts is 5.7% and 6.0% respectively.

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Connected Care Working Well For ResMed

After a strong FY19, sleep apnoea specialist ResMed is expected to make further inroads into market share in FY20 with its "connected-care" strategy.

-Stable pricing environment signal strong growth in US masks and devices -Software-as-a-service revenue could present upside risk to growth outlook -Earnings dilution in the near term likely from Propeller Health and the Verily JV

By Eva Brocklehurst

Strong market conditions are expected to prevail for ResMed ((RMD)) after the sleep apnoea product franchise extended its leading position in FY19. Revenue rose 13%, ahead of expectations.

Credit Suisse believes ResMed has benefited from having the broadest product portfolio and the launch of three new masks in the past 12 months. There are limited new competitive pressures on the horizon as well. Hence, there is an opportunity for further gains in market share.

The broker is also upbeat on the company's ability to to use data to improve the quality of care to patients in the home setting and increase its penetration rate within the sleep and COPD (chronic obstructive pulmonary disease) markets.

The sleep business grew 8% in the June quarter, ahead of rival Philips. Mask sales grew 15%, driven by share gains and better re-supply rates. While US growth was in line with the trends, the rest of the world cycled difficult comparables, specifically in France and Japan.

The next round of competitive bidding in the US is now open and the ultimate impact of changes on product prices will not be known until these are finalised. As the next round does not come into effect until 2021, with a stable pricing environment, Credit Suisse expects continued strong growth in US masks and devices.

Connected Care

Morgan Stanley is increasingly confident that the company's connected-care strategy will drive market share gains and higher rates of re-supply sales. The broker also envisages less pressure on gross margins versus the previous five years. The company has guided for gross margins in FY20 to be in line with the fourth quarter, at 59.3%.

Upside could come from penetration of the COPD market via portable oxygen concentrators and Propeller Health. The Verily JV may also lead to higher diagnosis rates of OSA (obstructive sleep apnoea) sufferers and support long-term CPAP (continuous positive airway pressure) device growth.

Wilsons believes the decision to combine its software-as-a-service business (Brightree, HEALTHCAREfirst and MatrixCare) into interoperable ecosystem is creating leverage and opportunities for greater market share.

Ultimately, the company's strategy will support market share gains for the core medical device businesses. Wilsons, not one of the seven stockbrokers monitored daily on the FNArena database, maintains a Buy rating and lifts the target by 17% to $21.05.

While the company has the objective of growing sustainable software-as-a-service revenue by double-digits no timeframe has been provided. Hence, Citi forecasts high single-digit organic revenue growth in FY21 and beyond, but acknowledges this could represent a source of upside to forecasts if the company can achieve its goal.

Citi assesses the business is fairly valued, noting there are a number of one-off items that made comparisons in the results difficult. The one-off items include restructuring costs in Germany as well as software-as-a-service.

Macquarie is less enthusiastic, believing forecasts are already capturing opportunities from the increased penetration of the potential OSA population and further improvements in relation to mask and accessory re-supply. The broker also envisages the current share price is ascribing limited risk in relation to reimbursement changes.

While mask and accessories revenue growth impressed, devices growth was slightly weaker than the broker expected in the Americas, and the rest of the world more materially so. Macquarie was also not so impressed with the restructuring charges, which arose from the workforce planning review and the respiratory care business as well as the closure of an R&D facility in Germany.

ResMed has tentatively agreed with the US government to resolve the Department of Justice investigation for payment of US$39.5m relating to issues around re-supply. The settlement is expected to be finalised before the end of 2019 and the cash outlay is likely to occur, in Citi's estimates, in the fourth quarter of FY20. The settlement relates to investigation dating back to 2016.

Management has signalled confidence in its numbers and does not expect any significant change to the way it operates. Macquarie notes the Department of Justice has also requested information regarding leasing arrangements with customers as well as the provision of diagnostic devices/master medical providers and the diagnostic auto-scoring function.

Headwinds

It remains too soon to know when Propeller Health will become profitable and, hence, no contribution is incorporated into Citi's earnings estimates. The broker expects ResMed will continue to publish results from studies to continue proving the value of this offering.

Management has previously indicated it will invest in the Verily joint venture at current levels for two years, having guided to a loss of -US$7m per quarter in FY20. Citi is a little sceptical about the modelling and requires further clarity.

Morgan Stanley suspects both Propeller Health and Verily will cause earnings dilution in the near term. Device segment growth is also likely to be low, outside of the Americas, as periods which benefited from favourable reimbursement changes are cycled.

There are four Buy ratings, two Hold and one Sell (Macquarie) on FNArena's database. The consensus target is $17.95, signalling -4.7% downside to the last share price. Targets range from $15.35 (Macquarie) to $20.10 (Credit Suisse).

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Where Is The Upside For Credit Corp?

Credit Corp delivered its traditionally conservative guidance at its FY19 results and brokers assess where the upside may lie.

-Is guidance even more conservative than usual for FY20? -Second US debt acquisition facility to be opened in the December quarter -Strongly positioned with capital options on the balance sheet

By Eva Brocklehurst

In keeping with tradition, Credit Corp ((CCP)) has delivered conservative guidance for FY20, implying book growth of around 12% and net profit growth of 7-10%. Debt has started off the financial year at a lower level and this should result in less interest expense.

Guidance for FY20 is disappointing, at $75-77m, despite broker suspicions it may be conservative given the company's track record of providing a cautious outlook at the start of each financial year. Credit Corp is particularly conservative regarding purchased debt ledger acquisitions.

Canaccord Genuity believes guidance for FY20 is more pessimistic than usual, counteracting some fairly bullish consensus forecasts at a time when the stock is trading at record forward multiples.

Yet, the broker concedes, little has changed in the business outlook. In trying to assess where the conservatism lies, the broker notes consumer lending is pivoting towards automotive finance where the economics could be worse.

The company also expects to open a second US collection facility in December and is likely to be investing ahead of the curve in both debt ledger assets and staffing. An efficiency lag, therefore, may not be captured in analysts' modelling.

While contracted purchased debt ledgers (PDL) are lower than where the company was positioned in the prior year, the guidance range is much higher. Some reasons behind this, in the broker's view, could be expectations for expanded investment in the US or some bullishness, perhaps, about possible market share gains in Australia.

The guidance is also likely to be subdued because the $140m in fresh capital has not been deployed as yet and contracted purchasing of $51m is less than 20% of planned expenditure.

Moreover, Canaccord Genuity, on its calculations, assesses management is either not counting the cost savings on interest or believes the domestic PDL business is going backwards. While aware that the domestic PDL business is suffering from under-investment the broker points out purchasing guidance remains healthy and some of this should relate to domestic operations.

Morgans assesses FY20 will benefit from an earnings uplift in the US, a 16% increase in the consumer lending book and significantly lower debt. The broker acknowledges its positive view has an element of faith in management's ability to deliver on its of 16-18% return-on-equity target. Morgans sets a price target of $27, at a 10% premium to valuation, and maintains an Add rating.

Canaccord Genuity has upgraded to Buy from Hold, with a target of $25.03, assessing the market is buying Credit Corp for defensive growth, although the range of possible outcomes for net profit is arguably wider than usual this year.

Automotive Lending

Credit Corp has stated that further expansion of its automotive lending pilot will be subject to ongoing review of underwriting accuracy. Automotive settlements doubled in FY19, almost entirely ascribed to the "finance only" product, which suggests to Canaccord Genuity the company has aspirations for further growth.

Morgans notes that the "finance only" product will incur around 20% of upfront provisioning if the company accelerates originations, which will, in turn, create some drag on reported earnings during a growth phase.

Meanwhile, the company has increased its US head count to 363, up 69%. A second facility will be opened in the second quarter of FY20 to take the total personnel capacity to 700. At full capacity Morgans estimates this would facilitate $140m per annum of PDL acquisitions.

Ord Minnett assesses some supportive features of the outlook are assisted by changes in the market structure. Supply conditions over the next 12-18 months are likely to improve in the US and competitive dynamics potentially change in the Australian PDL market. The stock has meaningfully re-rated over the past two months and, hence, the broker maintains a Hold rating with a $24.50 target.

Capital Options

Ord Minnett points out there is room to move with debt levels, while there are three divisions generating returns above the target rate where capital can be deployed through FY20, a good position relative to the company's major competitors in Australia.

Morgans agrees the organic growth outlook is enhanced by the options on the company's table amid upside potential from increased capital deployment. The timing of any acquisition is uncertain, while the broker assesses the company can increase its domestic PDL buying share into FY21.

The balance sheet of positions of listed peers are stretched and a large private competitor has experienced recent action from the ACCC which has potential to impact on its PDL purchases.

Canaccord Genuity agrees the upside case is supported by the latent capacity on the balance sheet and there are a number of assets potentially in play that could procure meaningful upgrades for the stock.

This could take pressure of domestic purchasing and/or build further scale in the US while accelerating consumer lending aspirations. Even if excess capital is not deployed, the broker assesses growth in earnings per share returns to double digits in FY21.

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Orica's Technology Advantage Key To Upside

Orica believes its technological breakthrough should offer a competitive advantage and contribute to earnings growth in FY21. Yet brokers assess the positive outlook is already factored into the shares.

-Potential to break five-year earnings range in FY20 -Lingering uncertainty around near-term profit profile of Burrup -Margin assumptions lift but will this be foiled by higher gas prices?

By Eva Brocklehurst

Explosives markets are moving positively for Orica ((ORI)), in step with the company's technological advancements that provide a major breakthrough in safety and efficiency in complex mining situations. Management believes its electronic blasting system (EBS), WebGen 100 and BlastIQ, offer a competitive advantage and should contribute to earnings growth in FY21, and more meaningfully in FY22.

The BlastIQ digital blasting data platform has now been adopted by 25 customers across 35 mining sites, improving mine productivity by 5% and reducing drill costs by -10%. For WebGen 100 customers, a 34% ore recovery and 20% productivity improvement has been reported.

Morgan Stanley is now more confident the company may break its five-year earnings (EBIT) range of $600-700m in FY20. That said, the current share price approximates fair value and the broker would need to witness further upside to earnings before adopting a more positive stance. Citi also points out the company has conceded that while confident of solid earnings growth, capital expenditure should stay high at around $350m per annum, for the next few years.

Management has indicated incremental upside in Latin America, Minova products and GroundProbe. GroundProbe is increasingly adopted to prevent failures in tailings dams, with an ability to target blasting more precisely. Morgan Stanley assesses the improved earnings outlook in these areas is somewhat offset by higher assumption for the AUD/USD.

While management has indicated the performance of the business has stabilised, partially because miners have returned to more normal mine plans, Ord Minnett envisages risk with respect to clear growth drivers in the years ahead, for both EBS and electronic delay detonator (EDD) sales.

Credit Suisse considers the hesitancy of management in specifically forecasting upside is natural. The broker has been critical in the past of the way in which the company has managed its manufacturing base. However, this now appears more in tune with the fundamental improvements.

Technology

Yet, an incomplete business proposition was presented for the size and adoption rates for the WebGen EBS, as well as where the drivers of growth in technology will come from, Ord Minnett asserts.

WebGen 100 and Bulkmaster 7 have been the key advances in the technology of blasting but, in the broker's view, the 220 blasts that have been fired globally are not conclusive. Hence, Ord Minnett reserves judgment regarding the feasibility of the technology outside ring blasting and underground metal mines and assesses the bull case relies on the mass adoption of a more expensive product, and competition is likely to cause price deflation.

Credit Suisse is also a little cautious about technology stories in mature industries but believes Orica has demonstrated increasing customer take-up. If the company is correct, the broker expects the industry to move to a higher technology base and raise barriers to entry, which will drive consolidation and improving returns.

While acknowledging the merits of the technological proposal, Morgan Stanley observes history has revealed that monetising and maintaining the benefits of being a key differentiator can be difficult. Still, Macquarie points out the building up and adoption of technology is a slow process, even though it may erode the company's first-mover advantage in coming years.

Burrup/Yarwun

Ord Minnett assesses the primary driver of weaker profits in FY20 is Yarwun amid the shifting of volumes to account for any shortfall at Burrup, which will result in higher freight costs. There is also lingering uncertainty around the near-term profit profile of Burrup.

Burrup has produced around 40,000t of ammonium nitrate and 12% utilisation is expected over FY19. Management was positive about the prospects of Burrup going live in the second half of FY20 and has guided to FY21 production of around 290,000t. Macquarie agrees the performance of Burrup post the current rectification work needs to be assessed. New equipment is being installed over the next 6-9 months, with March the key month for start-up.

UBS concludes, as the market recovers from the commodities downturn and mine production normalises, there will be an increase in explosives demand, but while the company has late-stage leverage to the mining recovery and the market dynamics are firming this is largely factored into the stock.

Credit Suisse is also more confident about tightening supply and robust demand as well as product mix leading to a lift in margin assumptions through FY22-25. Supply is tight on the east coast, with imports to Australia running at 200,000t in 2019 versus 100,000t in 2018. This creates scope for Yarwun to fill capacity, in the broker's view, once Burrup is operational and Yarwun's commitments to west coast supply cease.

Macquarie notes contract renewals will not occur in the Asia-Pacific book until FY22 so price improvements are unlikely until then. Contracts for gas supply are now under discussion and the company has highlighted the risk of Kooragang Island and Yarwun gas increasing again in three years time.

FNArena's database shows six Hold ratings and one Sell (Ord Minnett). The consensus target is $20.29, signalling -6.8% downside to the last share price. Targets range from $16.20 (Ord Minnett) to $21.50 (Citi).

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Negatives Pile Up For CYBG

CYBG is underperforming a weak UK banking sector, as redemptions and margin pressures take their toll. Then there is Brexit.

-Changing mix in total loans increasing credit risk profile -Net interest margins likely to contract over the near term -Brexit pall likely to keep UK rates lower for longer

By Eva Brocklehurst

Risks to margins dominated the third quarter performance of CYBG ((CYB)), reflecting challenging conditions in UK banking. The bank has guided to a new target for its asset mix, moving to higher margin products such as business, credit cards and other personal loans.

The bank is underperforming a weak UK sector because of heavy legacy Virgin redemptions and, given the large decline in net interest margins was attributed to this refinancing, Shaw and Partners believes this is unlikely to be the end of the story.

The company's average mortgage rate was 2.6% in the first half but Virgin Money is now offering new mortgages at rates that are -80 basis points lower. Mortgages represent 70% of the company's interest-earning assets in the first half and if all are ultimately priced -80 basis points lower more declines can be expected in net interest margins.

Morgans was disappointed with the trading update as the mortgage book contracted by -0.2% over the third quarter. The broker was expecting subdued mortgage growth because of the significant redemptions but this was worse than expected.

Business lending growth was also underwhelming, with growth of only 0.5%, attributed to a subdued market. At the same time CYBG is indicating the new lending pipeline is strong and unsecured personal lending experienced strong growth of 5.7%. Morgans assesses the changing mix of the total loan book is increasing the credit risk profile.

To offset the impact on income, loans need to increase by 7%, Shaw and Partners calculates. Should this rate of growth fail to be achieved then net interest income will decline in FY20 and, the broker asserts, this is not a pretty outlook. Shaw and Partners has a Sell rating and $3 target for CYBG.

The deadline for complaints regarding mis-selling Payment Protection Insurance (PPI) is approaching. CYBG has confirmed a substantial increase in PPI information requests ahead of the August 29 2019 complaint deadline. The bank asserts, while the uphold rate relating to these requests is low, it is not possible yet to determine just how many valid complaints will surface. At this stage, Morgans continues to forecast a provision charge for PPI of GBP45m in the second half.

Macquarie envisages longer-term fundamental value in the stock but reduces forecasts to reflect the tough market conditions. Margins are expected to remain under pressure, given the current outlook for interest rates.

Margins

The bank is sticking with its guidance for net interest margins for FY19 of 165-170 basis points, albeit now expecting the lower end of this range. Morgans continues to expect net interest margins to contract and reduces its forecast for the outer years.

At current rates, mortgage profitability is approaching the cost of capital and, while trends should improve over the next 6-12 months, in the short term, Macquarie acknowledges this will affect bank margins. The broker expects margins to contract by -17 basis points by FY22, and a large share of this decline will be captured in FY19 exit margins. Meanwhile, changes in the lending mix should boost margins by around 12 basis points.

Following recent changes in interest-rate expectations, any upside to margins has now been largely eliminated, a material driver of earnings downgrades, and Macquarie also has a -25% discount in its valuation to capture the uncertain economic outlook resulting from Brexit and risks associated with integration.

The bank retains a CET1 ratio of 14.6% and the broker believes the capital position will decline to around 12.5% when restructuring costs, amortisation and conduct-related charges are taken into account. Still, with an improved returns outlook there is scope to increase the pay-out ratio over time and for CYBG to potentially buyback around GBP150m.

This can only take place when management and the regulator have clearer visibility on the progress of integration and Macquarie does not expect a buyback before FY21. The broker, which retains an Outperform rating and $4.10 target, expects CYBG to achieve a sustainable 11% return on equity over the course of the next three years.

The main downside risk Morgans envisages for the bank is a disorderly Brexit as well as the legal action in relation to fixed-rate tailored business loans. Morgans maintains a Hold rating and $3.16 target.

Brexit

Political ambiguity may result in UK interest rates remaining lower for longer, in Macquarie's view. New UK Prime Minister, Boris Johnson, intends to take the UK out of the European Union on or before the end of October 2019. If he fails to find get Brexit through the UK Parliament it may be necessary to call a general election.

Macquarie points out the governor of the Bank of England has indicated he would be likely to act in the event of disruption around the time of the scheduled date for Brexit. This, Macquarie surmises, would probably involve lowering UK interest rates by -25 basis points from the current level of 75 basis points and a reduction of this size has been largely priced into the yield curve.

In turn, this would exert margin pressure on the UK banking sector, including CYBG, at a point when credit losses are likely to increase because of deteriorating macro conditions.

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Adelaide Brighton Needs To Re-Position

Adelaide Brighton has slashed net profit estimates for 2019. Brokers believe the housing market alone cannot be blamed.

-Structural change a significant component of the profit decline -Caught wrong-footed with a lack of vertical integration in Queensland and Victoria -Interim dividend suspended, brokers suspect final may also be at risk

By Eva Brocklehurst

A sombre outlook confronts building material supplier Adelaide Brighton ((ABC)), which has slashed its forecasts for the second time this year. A deteriorating housing market, competition and higher raw material costs remain the culprits.

The company has pointed out improved sentiment in the housing market is yet to translate into activity, and volumes are down by around -15%. Delays in infrastructure and non-residential projects have also frustrated activity.

Adelaide Brighton does not expect an upturn in the housing market to emerge for another 12-18 months. Underlying net profit is expected to be $120-130m, down 32-37% on 2018 and, for the first time in 20 years, the board has scrapped the interim dividend.

Macquarie finds the real challenge is in the positioning of the business in some markets, over and above the softening in market conditions. The broker concludes Adelaide Brighton is a victim of of stock-specific issues that are exacerbated by the backdrop, particularly in multi-residential construction.

The significant drop in profitability and coincidence of several factors signal to Credit Suisse a medium-term improvement could occur, but the company's commitment to preserve capital and "rightsizing" is inconsistent with the short sharp recovery that was priced into the stock since the first downgrade in May.

Management has attributed half of the latest downgrade to a deterioration in the market and half to company-specific factors. In Credit Suisse estimates, the specific factors do not explain half, which implies a larger decline in broad operating performance or perhaps "belated conservatism".

UBS asserts the commentary around reduced activity, increasing competition and falling pricing power should serve as a negative leading indicator for much of the building materials sector.

The broker believes the market is still adjusting to the known contraction in residential activity. Positive sentiment may have been building from an expected bottoming of housing approvals but the earnings outlook continues to be challenged.

Few of the issues appear to be easily solvable at any rate and the "good times are over", Morgan Stanley asserts, expecting the decline will likely continue into 2020. Structural change represents a meaningful component, particularly in South Australia, where the company has enjoyed favourable prices and margins, and, the broker argues, has been over-earning for a number of years.

Morgan Stanley believes the current 2019 price/earnings ratio of 18.3x is excessive and ignores the risks and high degree of uncertainty, downgrading to Underweight. Macquarie also downgrades, back to Neutral from Outperform, having foreseen some earnings risk, albeit the latest downgrade is greater than expected.

Ord Minnett now expects 2019 guidance can be achieved, assessing there is no sign of any near-term negative catalysts, raising its rating to Hold from Lighten. That said, the broker does not consider the stock "cheap". The main contributor to the decline, Ord Minnett believes, is the lowering of cement prices in South Australia, done to hold market share, estimating every -$10/t drop in the price in that state could have a -$7m impact on earnings (EBIT).

Specific Factors

The business model has been caught out by not being sufficiently vertically integrated in Queensland, sustaining a price squeeze in aggregates, Credit Suisse notes. This is also the case in Victoria, where it is vital to pick up infrastructure work. Meanwhile, cement prices have been pushed too far above import parity South Australia, where the company is undermined by a competitor entering the cement import market, attracted by high prices and profitability.

Adelaide Brighton lacks a strong infrastructure-oriented business which is a real problem in the current market, as infrastructure would help soften the impact of a slowdown in residential construction, Macquarie concurs.

Moreover, the lack of an integrated market position in Queensland in particular has meant the company is exposed to large increases in raw material prices at a time when the market dynamics have not been supportive. Despite the challenges, Adelaide Brighton continues to expand into the infrastructure market, targeting areas where it has operating advantages such as western Sydney.

Citi considers a Barro family takeover is the key risk to its Sell rating. The broker lowers its net profit forecast by -10-25% over 2019-21 on lower volume assumptions for cement, lime, concrete and aggregates and concrete products.

No Interim

While well within banking covenants, the interim dividend will be suspended in order to conserve capital and maintain balance sheet flexibility. This is a significant decision, in Citi's view. While including a final dividend for 2019, the broker has now removed any special dividends and acknowledges its assumptions may now be at risk.

Credit Suisse believes the decision to suspend the dividend is motivated as much by the unsustainability of the prior dividend and reduced profits as it is by the need to grow downstream. The broker, downgrading to Underperform, does not expect a final dividend in 2019 and expects a reduction to the 70% pay-out ratio subsequently, sufficient to fund $50m in acquisitions per annum.

FNArena's database has four Sell ratings and two Hold. The consensus target is $3.28, signalling -3.1% downside to the last share price. This compares with $3.94 ahead of the announcement. The dividend yield on 2019 forecasts is 2.5% and on 2020 5.3%.

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Better Conditions Ahead For Nufarm

A preference share deal with a major shareholder has reduced the likelihood of a substantial equity raising for Nufarm and brokers now focus on the longer-term outlook.

-FY20 outlook improved by potential for lower debt levels and higher earnings -Despite flooding in some parts, US business in a strong position -Main growth opportunities lie with seeds and Omega-3

By Eva Brocklehurst

Inclement weather in North America has combined with a drought-stricken Australia to cause Nufarm ((NUF)) to pull back on FY19 guidance, although support from the company's major shareholder has placed a plank under the balance sheet. With the reduced likelihood of a substantial equity raising, brokers can now focus on the longer-term outlook, anticipating a return to more normal seasonal conditions in FY20.

The company has placed $97.5m in preference securities with its largest shareholder, Sumitomo Chemicals. While a capital raising was widely expected, support from Sumitomo was probably under-estimated, Credit Suisse suggests. Removing the balance sheet risk is a clear positive.

The company has guided to operating earnings (EBITDA) of $420m versus $440-470m previously. Morgan Stanley was disappointed with this downgrade, although acknowledges it was largely anticipated. Offsetting this, the preference share transaction has removed the risk of a large equity raising. Hence, with these most significant concerns removed, the broker believes investors can focus on the inherent value in the stock.

Citi agrees the placement is a strategic move that relieves balance-sheet concerns and confirms the commitment of the company's largest shareholder, providing valuation support, reiterating a Buy rating. Bell Potter, not one of the seven stockbrokers monitored daily on the FNArena database, also has a Buy call, basing this on the prospective multiplier effect of higher earnings, under more normal weather conditions, and lower net debt levels.

The broker finds it worth noting that the 17% short interest on the stock has scope to unwind should this more positive outlook prevail, and maintains a target of $6.15. Ord Minnett is more circumspect, mainly concerned about the earnings profile as Australian drought conditions and European supply chain issues prevail.

Europe, which contributes around 20% of group revenue, remains constrained. Macquarie notes supply problems with China have worsened, resulting in higher costs and lower sales for the European business although Nufarm expects to control the supply chain in time for the autumn selling period. Credit Suisse allows for an additional sourcing impact in its numbers in the second half that are partially carried forward into FY20.

While flooding is currently an issue in the US, Ord Minnett acknowledges the US business is in a strong position to capitalise on increased receivables and recent flooding may create favourable conditions in the crop, turf and ornamental segments. Corn and soybean plantings received good to excellent conditions as of late July, while continued rain caused poor soil conditions in the midwest.

Yet, the dividend has been reduced and there are lingering issues on the balance sheet. In the broker's view, the main growth opportunities are in the form of Omega-3 canola. Macquarie is positive about FY20, believing the Sumitomo support and improved earnings outlook should help reduce gearing, noting the Omega-3 opportunity is also likely to firm up via US FDA approval. The broker is attracted to the potential in the seeds business, closely linked with Omega-3.

Dividends

Citi assumes no final dividend will be paid in FY19 and that payments return in FY20 with a 30% pay-out policy. Credit Suisse, too, assumes no final dividend is paid in FY19 and removes an FY20 interim dividend from forecasts as "insurance".

Assuming some detriment to the North American margin and only a partial recovery in Australia in FY20, the broker forecasts closing debt of $1.6bn in the first half and $1.1bn at the end of FY20 and considers the valuation undemanding on the back of the FY20 outlook.

Placement

Morgan Stanley assesses the Sumitomo transaction effectively works as bridging finance, providing Nufarm with the flexibility to navigate the high point in working capital. Having Sumitomo as a counterparty should also address concerns about the outlook for that company's existing 16% stake in Nufarm. Citi also makes this point, as Sumitomo did not participate in the last two equity raisings.

The securities placed with Sumitomo may be exchanged at any time after 24 months at a price of $5.85. If it chooses to do so, Sumitomo's stake would rise to 19.9%, Citi calculates, still below the 20% threshold where Foreign Investment Review Board approvals are required.

A quarterly distribution of 6% is payable for the first 12 months and 10% thereafter. No ordinary dividend is may be declared until distributions are declared on the Sumitomo securities.

Nufarm has underperformed global peers over the past year, Macquarie points out, since a Brazilian judge placed a suspension on the use of glyphosate in Brazil and the Californian jury found Monsanto liable for damages from a claim that glyphosate caused an individual's cancer.

The broker accepts that Nufarm is dealing with a more highly leveraged balance sheet (which may be partly to blame for the -28% fall in its share price since August 2018) and has greater exposure to poor Australian seasons versus global peers, but finds the glyphosate litigation against both Bayer and Monsanto a useful context in which to judge the stock's performance.

FNArena's database has four Buy ratings and two Hold. The consensus target is $6.20, suggesting 28.7% upside to the last share price. Targets range from $4.90 (Ord Minnett) to $8.24 (Credit Suisse).

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ESG Focus: Executive Remuneration In The Spotlight

FNArena's dedicated ESG Focus news section zooms in on matters Environmental, Social & Governance (ESG) that are increasingly guiding investors preferences and decisions globally. For more news updates, past and future: https://www.fnarena.com/index.php/financial-news/daily-financial-news/category/esg-focus/

Executive Remuneration In The Spotlight

-Growth in institutional voting blocs is shifting the balance -Global trends in remuneration KPIs -Focus switching to long-term incentives

By Sarah Mills

While many environmental, social and governance (ESG) issues may occasionally pull a cynical yawn, there is one ESG subject that always seems to excite management and shareholders alike; remuneration.

As a range of demographic and structural cycles decline, and as the world enters what is largely being dubbed “the era of enforcement”; the shareholder indulgence extended to executive remuneration in the past 30 years is set to be tested.

During periods of growth, which has been the backdrop since the baby boomers entered the economy in the late 1960s, gaining a greater portion of the expanding pie, and consolidating wealth post the fall of the Soviet Union and the information technology boom, have been priorities.

But as baby boomers enter their dotage and demographics shift away from reliable growth, and as the consolidation phase settles, defending the business base is paramount, and the focus is shifting from short-term to long-term profits.

Managing human stakeholders – the wealthy and the community

There are other factors behind this turning tide across Western economies.

The major beneficiaries of the consolidation phase tend to be majority shareholders in corporations and large investment institutions. Given the immortality (perpetual existence) of corporations, and the power that implies, there exists an innate tension between the two.

Theoretically, corporations exist to enhance returns to shareholders but in reality, this is not always the case. Rogue management, traders, accounts, sales people, and lazy unethical boards, can easily disrupt the balance.

Increasingly the world has witnessed the rise of institutional voting blocs and institutional shareholder activism as a check on corporate freedom.

And, as with most environmental, social and governance issues, there is a strong financial rationale.

According to a Morgan Stanley report titled ‘Executive Compensation Matters’, companies that have failed to pass shareholder votes on pay have underperformed 67% of the time in the year after the vote by roughly -15%.

Then there are the community stakeholders.

As metrics on wealth distribution approach pre-French-revolution levels, social stability becomes a greater priority for big capital holders. Capital, after all, is easily destroyed.

The Occupy Movement in the United States, the Gilets Jaunes in France, the earlier Jasmine revolutions of China and Tunisia are examples of the tensions bubbling below the surface of modern governments.

Three quarters of Australians surveyed consistently believe differences in incomes are too large. About the same favour redistributing incomes towards ordinary working people.

Throw in intensifying global trade and sovereign competition into the mix, and the stakes are rising.

This is the situation that boards and managements now face, as well as an imminent period of disruption, which will yield its typical quotas of winners and losers, while offering huge potential to drive wealth and freedom to all sectors of society.

Saving companies from themselves

In the past 60 years, there has also been sufficient time to track the historical performance of companies. Shareholders now have the information and resources to better identify risky behaviours and practices.

The intensified focus on executive remuneration is as much about saving companies from themselves as it is about limiting rewards.

Despite being immortal, very few companies, not even large companies, survive more than 30 years.

The average lifespan of an S&P 500 company is less than 20 years, according to Credit Suisse. Even in the relatively stable 1950s, the average age of a company was only 60 years.

The handful of very large companies to survive more than 200 years includes: Cambridge University Press; Sotheby's of London, Lloyds of London, Rothschild & Co, and Metallgesellschaft.

Major brands to have endured more than 100 years include: Coca Cola; Nestle; JP Morgan; Westinghouse; Mitsubishi and GE.

Much has been made of Jack Welch's helming of GE during the second half of the 20th century, the only one of its peers to prosper during that period. Yet it too recently succumbed to a series of poor management decisions.

Naturally, shareholders would prefer more of 20th-century GE, and less of the 21st-century GE and, as technology improves corporate reporting capability, giving shareholders greater visibility into the decisions and actions of management, executive remuneration will be a key lever in their armoury.

Global movements on board remuneration and structure

The trend is global.

In Britain, the former Prime Minister Theresa May has proposed far harsher measures to limit corporate power and pay than exist in Australia, including placing employee representatives on boards and remuneration committees, binding shareholder votes on pay, duties to promote long-term success and potential government control over executive pay.

In countries such as Germany, long-standing agreements with workers ensure that workers representatives sit on boards.

Regulators have been tightening the power of boards to ignore shareholder remuneration votes both in Australia and internationally; and say on pay provisions have been enacted across most Western democracies since the global financial crisis.

The inclusion of malus and claw-back provisions (see below) have also been popular tools internationally, although less so locally. Boards are increasingly tinkering with variable pay components.

In 2015, a proposed rule to The Dodd-Frank Act of 2010 strengthened US clawback laws by enabling companies to take back incentive-based compensation in the event of an accounting restatement after an error or misconduct.

In Australia, the two strikes rule was enacted in the Australian Corporations Act in 2011, giving shareholders the power to spill the board if at least 25% of shareholders vote against the board's decision on executive pay in two consecutive years.

Battle between soft and hard metrics

Increasingly, shareholders are calling for executive pay to also be linked to soft figures such as customer satisfaction and ESG performance, as shareholders seek to incentivise long-term financial performance and to control behaviours, particularly risk-taking behaviours.

Revenue and profit metrics are the most commonly applied short-term key performance indicators (KPI) for financial performance; total shareholder return (TSR) is the most commonly used long-term KPI.

But their dominance is being challenged.

According to Meridian Compensation Partners in an article titled 'The demise of TSR as the primary performance measure', the prevalence of TSR as a key performance indicator against which executive pay is benchmarked rose from 39% in 2011 to 63% in 2017, but has started to decline, retreating to 53% in 2018.

Meridian also noted a fall in the use of TSR as the sole performance metric (39% from 48%); an increase in coupling TSR with an earnings or return measure, and an uptick in the number of those using TSR as simply a modifier rather

than a baseline measure.

Morgan Stanley expects in the future, TSR will constitute no more than 25% of total performance benchmarks.

Proponents of reducing dependence on TSR cite its inherent flaws: primarily its limited line of sight; the difficulty in finding comparator companies; and its inability to account for a litany of external influences such as stock volatility, buyouts and weather events.

Also, given the coming period of intense digital and technological disruption, the focus on long-term incentives over short-term incentives may be critical.

The demise of Fairfax Media is a classic example of a company failing to survive industry disruption because of the necessity of maintaining short-term returns.

Fairfax failed to position itself in the digital world because to do so would have meant cannibalising its own revenue. The publisher subsequently lost its “rivers of gold” classified dominance to Seek ((SEK)), Carsales ((CAR)), REA Group ((REA)), and other newcomers.

Changes in the wind

In all, there is no one-size-fits-all solution.

Remuneration varies widely across sectors as do demands upon executives, and the gap between short and long-term performance varies largely between companies. Some industries are also more highly regulated than others.

There is a likely to be a period of at least five years in which companies and industries settle on their own patterns.

However, some general trends are emerging.

Morgan Stanley expects a period of growing alignment not just between the company and minority shareholders, but with the customer, the community and regulators.

“Boards are examining remuneration structures that will better match the requirements of the next decade, keeping a keen eye to the regulators, particularly in Australia, which has the most concentrated corporate oligopolies in the world,” the report states.

Major trends in key performance indicators

Other trends include a divergence in divesting, stakeholder benchmarking, management performance assessment; ESG integration; simplified reports to improve transparency; tougher, tighter, less manipulatable KPIs; greater use of balanced scorecards; tinkering with variable and fixed pay components; the increased use of claw-backs and longer malus periods.

Morgan Stanley expects boards will likely shift to placating minority shareholders and make greater attempts to link remuneration to long-term remuneration.

It says key benchmarks are likely to include: value of base sales; percentage of fixed verus at-risk pay; amount deferred, the date of vestment; balance between financial and non-financial (customer, people, compliance and technology); transparent pay hurdles and metrics; level of board discretion; measurability and objectivity; the level of difficulty in achieving hurdles; and whether long-term incentives should be set at fair or face value.

According to The Australian Institute of Company Directors, one upshot of the renewed focus on remuneration is likely to be demands for greater visibility into pay structures for the whole organisation, to ensure they are set in a manner that will attract talent, limit excess, give a line of sight to conflicts of interest, and reduce internal risk-taking behaviours.

The AICD article says the focus will be on ensuring clarity about risk alignment within the organisation to avoid some of the better known financial scandals, such as the Commonwealth Bank’s ((CBA)) insurance debacle that occurred because of poorly structured incentives for sales staff.

Penalising bad behaviour

Increasingly, the trend has been to penalize executives for bad behaviours that occur on their watch, even if they are not directly responsible.

The favoured way to achieve this to date has been through malus and claw-back provisions in executive remuneration contracts.

Malus refers to the practice of cancelling incentive payments if an executive fails to deliver on those expectations.

To date, the use of malus has been criticised for being deployed at lower levels of organisations – rather than the top. It has also been applied in a discretionary manner. Reformers are calling for clear, consistent guidelines on the application of malus provisions.

Claw-back provisions are more pecuniary than malus and demand executives repay remuneration already vested for failing to deliver under certain conditions. They usually include look-back periods of one-to-three years.

To date, its application at CEO level has been muted, although in 2017, Wells Fargo clawed back US$69m from chief executive officer John Stumpf over a fake accounts scandal. According to the New York Times, it was the largest claw-back in US banking history.

Potential shareholder resistance

It is interesting to note that shareholders have demonstrated resistance to remuneration proposals that are linked to soft metrics, particularly when those proposals appear to serve management.

National Australia Bank ((NAB)) received an 88.1% shareholder strike on its 2018 plan that collapsed short-term and long-term incentives into one, with 40% paid in cash each year and the remaining 60% deferred for at least four years.

It included some softer metrics, such as customer and regulatory outcomes, as well as risk and compliance gateways.

Coming as it did, just after posting a -$3.3bn fall in profit, the proposal was roundly rejected by institutional shareholders.

It is not surprising that on a subject with so many diverse stakeholders and opinions, that the regulators have been called in.

(To be continued in Part Two)

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FNArena is proud about its track record and past achievements: Ten Years On

Weekly Ratings, Targets, Forecast Changes

By Rudi Filapek-Vandyck, Editor FNArena

Guide:

The FNArena database tabulates the views of seven major Australian and international stock brokers: Citi, Credit Suisse, 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 22 to Friday July 26, 2019 Total Upgrades: 7 Total Downgrades: 24 Net Ratings Breakdown: Buy 38.38%; Hold 44.24%; Sell 17.38%

The gap between stockbroking analysts issuing upgrades and downgrades for individual ASX-listed stocks only widens further as the major indices continue to push on to post-GFC and all-time highs, which can only be described as "as expected"'.

For the week ending Friday, 26th July 2019, FNArena registered seven upgrades versus 24 downgrades by the seven stockbrokers monitored daily (we recently lost Deutsche Bank).

Six out of the seven upgrades moved to Buy/equivalent of Buy, with Unibail-Rodamco-Westfield the exception (Neutral). Half of the downgrades -twelve- involves downgrades to Sell impacting on ratings for junior gold miners St Barbara (twice), Regis Resources (twice) and Evolution Mining, as well as on Computershare, Domain Holdings, JB Hi-Fi, Rio Tinto, Magellan Financial, and others.

Plenty of stocks are enjoying increases to price targets with the week's top position reserved for Aventus Group, followed by Virtus Health, Perseus Mining, and others. Cimic Group's financial results led to the week's largest losses, with stocks including Reliance Worldwide, Senex Energy and Unibail-Rodamco-Westfield following at arm's length distance.

The stand-out observation to make here is that while the bias remains to the downside as far as earnings forecasts are concerned, the undercurrent is definitely more positive for valuations and price targets.

The table for positive revisions to earnings estimates has Unibail-Rodamco-Westfield on top, followed at a distance by Orocobre, Growthpoint Properties Australia and Alacer Gold. The list of the week's negative revisions is noticeably larger, both at the top and on average, and has Perseus Mining as the biggest loser, followed by EclipX Group, Pilbara Minerals and Woodside Petroleum.

The local reporting season effectively started on Friday with the likes of ResMed and GUD Holdings reporting. The season will gradually intensify this week, but it'll be another ten days or so until the trickle has turned into a genuine flood.

Strap yourself in. Share price responses post financial results releases by ResMed, GUD Holdings and, a little earlier, Cimic Group are strongly suggesting post-event volatility is better not underestimated.

Upgrade

AVENTUS GROUP ((AVN)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 2/1/0

Macquarie believes regulatory changes in the last few months should benefit residential markets and assist the company's tenant base. The broker expects few surprises in the FY19 results.

Rating is upgraded to Outperform from Neutral as the stock is offering an attractive yield and sector-level growth. Target is raised 38% to $2.90.

BLUESCOPE STEEL LIMITED ((BSL)) Upgrade to Overweight from Equal-weight by Morgan Stanley .B/H/S: 4/1/1

Momentum in steel spreads is positive, with US price increases and declining raw material prices in east Asia. Morgan Stanley believes, with spreads moving in the right direction, investors can focus on the favourable fundamentals.

The broker believes FY20 forecasts are substantially de-risked and strong cash flow should eventuate. Rating is upgraded to Overweight from Equal-weight and the target raised to $14.50 from $12.00. Industry view: Cautious.

MYER HOLDINGS LIMITED ((MYR)) Upgrade to Buy from Neutral by UBS .B/H/S: 1/1/2

UBS raises estimates for earnings per share by 9-12% and upgrades to Buy from Neutral. The broker estimates, at the current share price, the market is factoring in an $11m uplift in earnings (EBIT) from the new turnaround strategy.

UBS believes this is too low, given Myer is most leveraged to tax reductions and there is scope to reduce space over the next 3-4 years. Target is raised to $0.64 from $0.59.

OIL SEARCH LIMITED ((OSH)) Upgrade to Overweight from Equal-weight by Morgan Stanley .B/H/S: 3/3/1

Morgan Stanley upgrades to Overweight from Equal-weight. The stock has been driven to multi-year lows amid political concerns and delays in expansion. The broker believes it is now an attractive time to build a position.

The recent de-rating has meant the market effectively wiped out any value for expansion, in the broker's view.

The resource base is considered enormous in PNG and Morgan Stanley believes in 5-10 years there will be another wave of expansions. Target is $8.00. Industry view is In-Line.

SOUTH32 LIMITED ((S32)) Upgrade to Add from Hold by Morgans .B/H/S: 5/1/1

Selling the South African Energy Coal business is a major catalyst for the company. Morgans expects the sale to be finalised in the first half of FY20.

The main benefit in the divestment comes from improved competitiveness in key areas, assuming the company does not recover material proceeds from the sale.

The company will write down a big portion of its remaining $70m in carrying value at the August result before it divests the business. South 32 has also considered offloading its underperforming manganese alloy assets.

Morgans upgrades to Add from Hold, as the stock is sold off just at the time of the company approaching a major catalyst. Target is reduced to $3.45 from $3.49.

UNIBAIL-RODAMCO-WESTFIELD ((URW)) Upgrade to Neutral from Underperform by Macquarie .B/H/S: 0/3/1

Macquarie suspects the company's growth rate will disappoint the market. The large balance sheet is also at risk of devaluations. Despite this, the stock is trading at a -40% discount to net asset value and the broker upgrades to Neutral from Underperform.

Target is reduced -7% to $9.93, reflecting an increase in cap rate expansion assumptions and reflecting continued downside risk to asset values.

VIRTUS HEALTH LIMITED ((VRT)) Upgrade to Buy from Neutral by UBS .B/H/S: 2/1/0

UBS reviews volume trends for the Australian IVF market and the implications. Data is positive for Virtus Health and the broker updates growth assumptions. Earnings estimates are upgraded by 1-11% across FY19-21.

Target lifts to $5.40 from $4.40 and the rating is upgraded to Buy from Neutral. The domestic outlook is the key driver for the business, while organic earnings growth is likely to remain challenging in the international division, in the broker's view.

Downgrade

APN INDUSTRIA REIT ((ADI)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 0/3/0

While the expected lift in assets is intact, Macquarie finds a reduction in M&A appeal. Growthpoint Properties ((GOZ)) had stated it had received interest from third parties acquiring its stake but no transaction is expected at this time.

Moreover, the lease of Link Market Services ((LNK)) expires at Rhodes in FY22 and will be a headwind for the company if not re-signed. Rating is downgraded to Neutral from Outperform. Target is reduced to $2.87 from $3.03.

AUSTAL LIMITED ((ASB)) Downgrade to Neutral from Buy by Citi .B/H/S: 2/1/0

Citi believes Austal has multiple earnings drivers over the longer term, given the backlog in two mature US Navy contracts and margin expansion potential as production ramps up in Asia.

However, the broker downgrades to Neutral from Buy as the share price has appreciated 87% since March.

The FY19 result has largely been pre-reported and the first FFG(X) is likely to be awarded in late 2020, so the stock appears to be lacking short-term catalysts. Target is steady at $4.04.

BEACH ENERGY LIMITED ((BPT)) Downgrade to Neutral from Buy by Citi .B/H/S: 1/4/0

Citi now considers the stock fair value at a conservative US$55/bbl oil price and downgrades to Neutral from Buy.

The broker remains sympathetic to those investors with a higher commodity deck that remain positive on the stock, particularly given the options on the balance sheet to accelerate organic growth or return capital.

However, the broker also believes it is premature to take any profits ahead of FY20 guidance. Target is raised to $2.06 from $2.01.

COMPUTERSHARE LIMITED ((CPU)) Downgrade to Underperform from Neutral by Macquarie .B/H/S: 0/5/2

Macquarie envisages downside risk to FY20 guidance. Global rate expectations have shifted materially lower and multiple reductions are now expected in the US.

The broker suspects downside risk exists for the PE multiple, should the company guide to no earnings growth in FY20.

Macquarie downgrades to Underperform from Neutral and reduces the target to $15 from $17.

DOMAIN HOLDINGS AUSTRALIA LIMITED ((DHG)) Downgrade to Sell from Neutral by UBS .B/H/S: 1/3/3

The stock is now trading at 11% above the UBS price target of $2.75 and the broker lowers the rating to Sell from Neutral. Besides valuation, downside to near-term earnings expectations is also envisaged.

Listings remain extremely weak. The broker factors in revenue declines continuing into the first half of FY20, remaining hopeful of a second-half recovery.

ECLIPX GROUP LIMITED ((ECX)) Downgrade to Neutral from Buy by Citi .B/H/S: 3/2/0

Citi downgrades to Neutral, and removes the High Risk rating, following the normalising of valuation from the lows following the March downgrade.

While the core business is likely to remain appealing, and prove attractive to suitors in due course, there is potential for the underperforming businesses to deteriorate further, in the broker's view. Target is raised to $1.56 from $1.29.

EVOLUTION MINING LIMITED ((EVN)) Downgrade to Underperform from Neutral by Macquarie .B/H/S: 0/4/3

Macquarie observes FY20 guidance is in line with the three-year outlook delivered late in 2018. The year ahead will be strong on exploration, with discovery expenditure up 85%.

Macquarie reduces estimates for earnings per share over FY20-23 by -1-3%. Rating is downgraded to Underperform from Neutral on recent share price strength. Target is reduced -2% to $4.20.

EVENT HOSPITALITY AND ENTERTAINMENT LTD ((EVT)) Downgrade to Hold from Buy by Ord Minnett .B/H/S: 0/1/1

The company presents a medium-long term growth story, Ord Minnett suggests, with likely earnings volatility at times. Growth is expected to come from the development of substantial property projects that currently exist on the balance sheet.

The hotels & resorts division is expected to be adversely affected by the recent deterioration in revenue growth in both Sydney and Melbourne. Yet Ord Minnett remains confident in management's ability to extract value.

The broker downgrades to Hold from Buy, given the near-term headwinds. Target is reduced to $13.99 from $15.20.

FORTESCUE METALS GROUP LTD ((FMG)) Downgrade to Neutral from Outperform by Credit Suisse .B/H/S: 2/3/2

Credit Suisse believes iron ore prices will peak in the current quarter and downgrades to Neutral from Outperform, despite finding the company difficult to fault.

That said, the broker finds little reason to sell the stock, particularly with a $0.22 dividend to come in August. However, it is likely the share price will come under pressure if iron ore prices ease.

The company reported a strong finish to FY19 with record June quarter production. Target is reduced to $8.00 from $8.20.

GOLD ROAD RESOURCES LIMITED ((GOR)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 0/1/0

Macquarie downgrades to Neutral from Outperform as the target is now in line with the current share price. Target is $1.40.

Gruyere will continue to produce gold via the SAG mill and CIL circuits until the commissioning of the ball mill. Commissioning in a timely manner will influence 2019 production costs, the broker assesses, with further delays likely to push back nameplate production.

INSURANCE AUSTRALIA GROUP LIMITED ((IAG)) Downgrade to Hold from Accumulate by Ord Minnett .B/H/S: 0/6/1

The share price has been strong recently and Ord Minnett observes the valuation gap has opened up relative to peers. As a result, the broker downgrades to Hold from Accumulate.

The company is due to report its FY19 result on August 8 and Ord Minnett will look for information regarding whether the company will put a stop to market share losses and seek growth, particularly in commercial insurance. Target is raised to $8.20 from $8.00.

ILUKA RESOURCES LIMITED ((ILU)) Downgrade to Neutral from Buy by UBS and Downgrade to Neutral from Outperform by Credit Suisse .B/H/S: 1/5/0

UBS was disappointed with the June quarter production outcomes because of poor zircon sales. The company has indicated the zircon market has deteriorated over the past three months as higher production from remnant miners and new entrants has caused price discounts for lower grades.

Optimisation studies have continued at Sembehun and the project has now been sent back for further review of scope. UBS factors in delay of 24 months for Sembehun and cuts realised zircon pricing estimates.

Rating is downgraded to Neutral from Buy and target is lowered to $10.60 from $12.00.

Credit Suisse notes a large response in the share price, down -10%, to the June quarter result. The broker finds it hard to envisage a near-term catalysts for the upside and downgrades to Neutral from Outperform.

A softer sales outlook is being driven by tepid end-user zircon demand. Target is reduced to $10.00 from $10.40. The broker notes the timing of the Sembehun study and phase 1 have been pushed out.

Higher capital expenditure would be required if the large-scale operation of over 300,000tpa is still a target, in the broker's view. Hence, part of the design is returning to a scoping stage.

JB HI-FI LIMITED ((JBH)) Downgrade to Sell from Neutral by UBS .B/H/S: 1/4/2

UBS lifts estimates for FY19-21 by 1-10% to reflect the benefit of fiscal and monetary stimulus. The broker believes the company is executing well but rising costs, increased competitive intensity and the need to invest will mean the multiple de-rates.

JB Hi-Fi has the lowest degree of operating leverage among discretionary retailers under coverage and margin headwinds are not factored in, UBS assesses. Rating is downgraded to Sell from Neutral and the target is raised to $26.85 from $23.50.

MAGELLAN FINANCIAL GROUP LIMITED ((MFG)) Downgrade to Underperform from Neutral by Credit Suisse .B/H/S: 0/3/4

Credit Suisse appreciates the positive leverage the company has to favourable equity markets, noting it is the only locally listed fund manager to experience positive flows. A 23% increase in funds under management was reported in the second half.

Credit Suisse increases FY19 estimates by 8% and the outer years by 10-13%. Target is raised to $42.90 from $35.50. As the current share price is around 25% above the broker's valuation the rating is downgraded to Underperform from Neutral.

NAVIGATOR GLOBAL INVESTMENTS LIMITED ((NGI)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 1/1/0

An update from Navigator shows FY19 earnings coming in ahead of guidance and Macquarie's forecast thanks to an improved investment performance in the second half. Assets under management also improved although MAS flows remain in the negative and Lighthouse flows were also negative.

The broker has lifted its target price to $3.62 from $3.45 but on continuing outflows, the need to cut costs to achieve the broker's FY20 forecasts and a 20% rally off 2019 lows, Macquarie downgrades to Neutral from Outperform.

RIO TINTO LIMITED ((RIO)) Downgrade to Underperform from Neutral by Credit Suisse .B/H/S: 2/4/1

Credit Suisse believes a turning point is approaching for iron ore pricing, with momentum in China's port inventory drawdown slowing, and supply continuing to recover.

This, combined with a lack of meaningful valuation support, leads the broker to downgrade to Underperform from Neutral. Target is reduced to $92 from $95.

The main risk to the broker's view is continued strength in iron ore prices via a meaningful stimulus of construction activity in China.

REGIS RESOURCES LIMITED ((RRL)) Downgrade to Sell from Neutral by UBS and Downgrade to Underperform from Neutral by Macquarie .B/H/S: 0/1/5

Quarterly production was -3% below UBS estimates. The broker notes the share price has rallied around 35% in the year to date, largely driven by the rise in the gold price.

However, cost guidance implies only 50-70% of the gold price increase translated into higher cash margins.

The broker considers the stock is more than fully priced and downgrades to Sell from Neutral, although acknowledges an ongoing rally in the Australian dollar gold price is a key risk. Target is reduced to $4.85 from $5.10.

Regis Resources' June Q gold production was in line with expectation but costs were higher. Costs are set to increase further, Macquarie notes, as suggested by FY20 guidance.

A reserve update leads the broker to extend its mine life assumption for Duketon, while McPhillamys timing is key to valuation. On the higher cost outlook Macquarie lowers its target to $5.10 from $5.70 and its rating to Underperform.

ST BARBARA LIMITED ((SBM)) Downgrade to Underperform from Neutral by Macquarie and Downgrade to Underperform from Neutral by Credit Suisse .B/H/S: 1/1/2

June quarter production was affected by elevated costs at both Gwalia and Simberi. Macquarie expects costs to remain elevated in FY20 as Gwalia prioritises development and Simberi production steps down.

There is also the prospect of a decision on the Simberi sulphide option. Macquarie downgrades to Underperform from Neutral and reduces the target by -3% to $3.00.

Credit Suisse observes lower production from Gwalia delivered an adverse impact on reported costs in the June quarter. Production was strong at Simberi, however, which meant costs decline further.

The broker expects FY20 to be another constrained year for Gwalia before the mining bottlenecks are removed. Simberi sulphides remain the next most significant value option organically.

The broker downgrades to Underperform from Neutral. Target is steady at $2.76.

SONIC HEALTHCARE LIMITED ((SHL)) Downgrade to Underperform from Neutral by Credit Suisse .B/H/S: 3/2/2

Despite some stabilisation and improvement offshore, Credit Suisse is cautious about conditions for the company in Australia.

On the back of weaker-than-expected industry data, estimates are reduced by -1% and the target is lowered to $24.20 from $24.70.

The broker is not able to justify the current valuation and downgrades to Underperform from Neutral.

SPARK INFRASTRUCTURE GROUP ((SKI)) Downgrade to Reduce from Hold by Morgans .B/H/S: 0/3/3

Morgans suspects the company will need to cut its distribution to around $0.105 per security from $0.15 per security, in FY21, because of the macroeconomic and regulatory headwinds and the increasing tax take.

For a yield based stock this poses downside risk and the broker downgrades to Reduce from Hold. The target is reduced to $1.96 from $2.25.

SENEX ENERGY LIMITED ((SXY)) Downgrade to Neutral from Outperform by Credit Suisse .B/H/S: 2/4/0

June quarter revenue was in line with Credit Suisse numbers. The broker remains wary of the ramp-up risks at Roma North.

While Artemis does not appear to be a near-term catalyst, it supports the broker's view that the company's position as a local motivated explorer will enable preferential access to acreage.

Rating is downgraded to Neutral from Outperform as the share price has recovered. Target is $0.37.

Total Recommendations Recommendation Changes

Broker Recommendation Breakup

Broker Rating Order Company New Rating Old Rating Broker Upgrade 1 AVENTUS GROUP Buy Neutral Macquarie 2 BLUESCOPE STEEL LIMITED Buy Neutral Morgan Stanley 3 MYER HOLDINGS LIMITED Buy Neutral UBS 4 OIL SEARCH LIMITED Buy Neutral Morgan Stanley 5 SOUTH32 LIMITED Buy Neutral Morgans 6 UNIBAIL-RODAMCO-WESTFIELD Neutral Sell Macquarie 7 VIRTUS HEALTH LIMITED Buy Neutral UBS Downgrade 8 APN INDUSTRIA REIT Neutral Buy Macquarie 9 AUSTAL LIMITED Neutral Buy Citi 10 BEACH ENERGY LIMITED Neutral Sell Citi 11 COMPUTERSHARE LIMITED Sell Neutral Macquarie 12 DOMAIN HOLDINGS AUSTRALIA LIMITED Sell Neutral UBS 13 ECLIPX GROUP LIMITED Neutral Buy Citi 14 EVENT HOSPITALITY AND ENTERTAINMENT LTD Neutral Buy Ord Minnett 15 EVOLUTION MINING LIMITED Sell Sell Macquarie 16 FORTESCUE METALS GROUP LTD Neutral Buy Credit Suisse 17 GOLD ROAD RESOURCES LIMITED Neutral Buy Macquarie 18 ILUKA RESOURCES LIMITED Neutral Buy UBS 19 ILUKA RESOURCES LIMITED Neutral Buy Credit Suisse 20 INSURANCE AUSTRALIA GROUP LIMITED Neutral Buy Ord Minnett 21 JB HI-FI LIMITED Sell Neutral UBS 22 MAGELLAN FINANCIAL GROUP LIMITED Sell Neutral Credit Suisse 23 NAVIGATOR GLOBAL INVESTMENTS LIMITED Neutral Buy Macquarie 24 REGIS RESOURCES LIMITED Sell Neutral Macquarie 25 REGIS RESOURCES LIMITED Sell Neutral UBS 26 RIO TINTO LIMITED Sell Neutral Credit Suisse 27 SENEX ENERGY LIMITED Neutral Buy Credit Suisse 28 SONIC HEALTHCARE LIMITED Sell Neutral Credit Suisse 29 SPARK INFRASTRUCTURE GROUP Sell Neutral Morgans 30 ST BARBARA LIMITED Sell Neutral Macquarie 31 ST BARBARA LIMITED Sell Neutral Credit Suisse Recommendation Positive Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 VRT VIRTUS HEALTH LIMITED 67.0% 33.0% 34.0% 3 2 AVN AVENTUS GROUP 67.0% 33.0% 34.0% 3 3 SM1 SYNLAIT MILK LIMITED -67.0% -100.0% 33.0% 3 4 URW UNIBAIL-RODAMCO-WESTFIELD -25.0% -50.0% 25.0% 4 5 MYR MYER HOLDINGS LIMITED -30.0% -50.0% 20.0% 5 6 BSL BLUESCOPE STEEL LIMITED 42.0% 25.0% 17.0% 6 7 OSH OIL SEARCH LIMITED 29.0% 14.0% 15.0% 7 8 ANZ AUSTRALIA & NEW ZEALAND BANKING GROUP -14.0% -29.0% 15.0% 7 9 S32 SOUTH32 LIMITED 57.0% 43.0% 14.0% 7 Negative Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 SBM ST BARBARA LIMITED -38.0% 13.0% -51.0% 4 2 CIM CIMIC GROUP LIMITED -33.0% 13.0% -46.0% 3 3 PRU PERSEUS MINING LIMITED 33.0% 67.0% -34.0% 3 4 WSA WESTERN AREAS NL 33.0% 67.0% -34.0% 6 5 ASB AUSTAL LIMITED 50.0% 83.0% -33.0% 3 6 ILU ILUKA RESOURCES LIMITED 17.0% 50.0% -33.0% 6 7 RRL REGIS RESOURCES LIMITED -79.0% -50.0% -29.0% 7 8 IFL IOOF HOLDINGS LIMITED -40.0% -20.0% -20.0% 5 9 ECX ECLIPX GROUP LIMITED 60.0% 80.0% -20.0% 5 10 SKI SPARK INFRASTRUCTURE GROUP -50.0% -33.0% -17.0% 6 Target Price Positive Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 AVN AVENTUS GROUP 2.473 2.207 12.05% 3 2 VRT VIRTUS HEALTH LIMITED 5.203 4.870 6.84% 3 3 PRU PERSEUS MINING LIMITED 0.723 0.680 6.32% 3 4 BSL BLUESCOPE STEEL LIMITED 13.642 12.900 5.75% 6 5 ECX ECLIPX GROUP LIMITED 1.652 1.570 5.22% 5 6 MYR MYER HOLDINGS LIMITED 0.496 0.478 3.77% 5 7 MFG MAGELLAN FINANCIAL GROUP LIMITED 44.493 43.436 2.43% 7 8 WSA WESTERN AREAS NL 2.525 2.492 1.32% 6 9 IFL IOOF HOLDINGS LIMITED 5.380 5.310 1.32% 5 10 SHL SONIC HEALTHCARE LIMITED 27.236 27.093 0.53% 7 Negative Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 CIM CIMIC GROUP LIMITED 41.600 46.245 -10.04% 3 2 RWC RELIANCE WORLDWIDE CORPORATION LIMITED 4.632 4.808 -3.66% 6 3 SXY SENEX ENERGY LIMITED 0.433 0.448 -3.35% 6 4 URW UNIBAIL-RODAMCO-WESTFIELD 11.265 11.625 -3.10% 4 5 CPU COMPUTERSHARE LIMITED 16.330 16.759 -2.56% 7 6 ILU ILUKA RESOURCES LIMITED 10.858 11.117 -2.33% 6 7 SKI SPARK INFRASTRUCTURE GROUP 2.247 2.295 -2.09% 6 8 S32 SOUTH32 LIMITED 3.414 3.484 -2.01% 7 9 RRL REGIS RESOURCES LIMITED 4.701 4.773 -1.51% 7 10 SBM ST BARBARA LIMITED 3.240 3.265 -0.77% 4 Earning Forecast Positive Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 URW UNIBAIL-RODAMCO-WESTFIELD 55.370 46.316 19.55% 4 2 ORE OROCOBRE LIMITED 10.309 9.779 5.42% 7 3 GOZ GROWTHPOINT PROPERTIES AUSTRALIA 24.000 23.133 3.75% 3 4 AQG ALACER GOLD CORP 38.066 36.824 3.37% 3 5 QBE QBE INSURANCE GROUP LIMITED 88.642 85.927 3.16% 7 6 SGP STOCKLAND 36.267 35.333 2.64% 5 7 EVN EVOLUTION MINING LIMITED 13.530 13.200 2.50% 7 8 ALL ARISTOCRAT LEISURE LIMITED 132.586 129.471 2.41% 7 9 ALX ATLAS ARTERIA 46.757 45.723 2.26% 5 10 CMW CROMWELL PROPERTY GROUP 7.733 7.567 2.19% 3 Negative Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 PRU PERSEUS MINING LIMITED -0.717 1.433 -150.03% 3 2 ECX ECLIPX GROUP LIMITED 10.340 12.460 -17.01% 5 3 PLS PILBARA MINERALS LIMITED -1.023 -0.913 -12.05% 3 4 WPL WOODSIDE PETROLEUM LIMITED 208.493 235.000 -11.28% 7 5 S32 SOUTH32 LIMITED 28.911 31.457 -8.09% 7 6 SXY SENEX ENERGY LIMITED 0.605 0.657 -7.91% 6 7 AWC ALUMINA LIMITED 20.923 22.136 -5.48% 6 8 ILU ILUKA RESOURCES LIMITED 92.485 97.052 -4.71% 6 9 SFR SANDFIRE RESOURCES NL 68.892 72.117 -4.47% 7 10 OZL OZ MINERALS LIMITED 52.829 54.634 -3.30% 7 Technical limitations

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

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Uranium Week: Stalled Again

With section 232 uncertainty finally put to rest, nuclear utilities remain out of the market as they prepare submissions for the president's nuclear Working Group.

-No utility interest for spot uranium last week -Rush on to prepare submissions -Cameco to continue with spot purchases

By Greg Peel

It was hoped that once the section 232 decision was settled one way or the other, nuclear utilities would be free to return to a uranium market that has been wallowing over the past year as the market awaited the president's answer.

The fact President Trump rejected the request for mandated purchases of US domestic uranium, or any tariff on uranium imports, should have been a relief for utilities already struggling in a competitive energy market.

But no.

Now utilities have to scramble to gather information and make their submissions to the president's nuclear Working Group, which has 90 days to reassess the US nuclear power industry from mining through to electricity generation. It's a tough one, given:

-Even with uranium prices near historical lows, US nuclear power cannot compete with cheaper gas-fired and subsidised renewable power

-US uranium miners cannot compete with cheaper imported product, from both ally and foe alike

-Nuclear energy is considered a necessary element of energy security and a "must have" in the energy mix

-Nuclear energy is zero emission (once operating), although that is not likely a major consideration for Trump

All of the above adds up to a likely conclusion that if the White House wants nuclear power, it will have to fund it as if it were a budget cost item such as defence or welfare rather than a commercial enterprise.

While we wait to find out what the Working Group concludes, utilities remain out of the market. None were involved last week in the six transactions totalling 850,000lbs reported by industry consultant TradeTech, with traders and one financial entity on the buy-side.

TradeTech's weekly spot price indicator rose US25c to US$25.50/lb, although this is net of delivery location disparity.

Production Still Curtailed

Leading Canadian producer Cameco last week reiterated that it would continue to purchase most of its contract requirements in the spot market rather than mine its own, with its MacArthur River mine remaining shut down while the Cigar Lake mine and a joint venture in Kazakhstan provide the only production.

The impact of the announcement was one of traders pushing up prices for material deliverable in Canada, while down south, sellers were offering lower prices for material deliverable in the US.

TradeTech reports utilities are putting out the feelers for purchases from suppliers but are in no rush, with requests for proposal not to be issued for 60 to 90 days.

There were no transactions reported in uranium term markets last week. TradeTech's term price indicators remain at US$28.50/lb (mid) and US$31.00/lb (long).

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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 25, 2019

Last week saw the ASX200 rally hard before taking a breath at the end of the week ahead of the final assault on the summit.

Last week I noted shorts in Syrah Resources ((SYR)) had fallen to 15.6% from 19.3% post June quarter production report, underpinning a share price rally. That rally turned quickly into a decline this week, but last week Syrah shorts fell further, to 13.6%.

I also noted big short reductions for retailers JB Hi-Fi ((JBH)) and Super Retail ((SUL)), which I speculated probably reflected improved sentiment due to RBA rate cuts, but last week those moves reversed. Dodgy ASIC data? I can only guess.

I note Costa Group ((CGC)) shorts also rose to 9.2% the week before but fell back to 7.9% last week. Same deal. Ditto Elders ((ELD)), up and back.

Which leaves us with no Movers & Shakers this week.

I will note that base metal E&P company New Century Resources ((NCZ)) debuted in the 5% shorted bracket last week after announcing a capital raising. At around a -15% discount there is an arbitrage opportunity for those prepared to risk it, hence the short position.

Weekly short positions as a percentage of market cap:

10%+ BAL 17.0 NUF 16.9 ING 16.8 GXY 15.6 ORE 15.4 JBH 14.1 SYR 13.6 NXT 13.1 BWX 12.2 DMP 12.1 PLS 11.9 BIN 10.5 SDA 10.3

Out: MTS, HUB

9.0-9.9

MTS, HUB, IFL, BGA, SGM, HVN, RWC

In: MTS, HUB, SGM Out: CGC 8.0-8.9%

PPT, AMP, IVC, KGN, SUL, CSR

In: SUL Out: SGM, WSA, BKL

7.0-7.9%

CGC, BKL, WSA, BOQ, MYR, DCN, CGF

In: CGC, BKL, WSA, DCN Out: ELD

6.0-6.9%

NEC, GWA, A2M,

Out: SUL, DCN, GMA

5.0-5.9%

GMA, COE, CTD, LNG, CLQ, MSB, NCZ, ELD, SXY, OML

In: ELD, GMA Out: GWA

Movers & Shakers

See above.

ASX20 Short Positions (%)

Code Last Week Week Before Code Last Week Week Before AMC 0.9 1.3 RIO 4.6 4.7 ANZ 0.7 0.7 S32 1.1 0.9 BHP 2.8 2.8 SCP 0.6 0.6 BXB 0.2 0.2 SUN 0.3 0.4 CBA 1.1 1.1 TCL 0.9 0.9 COL 1.3 1.4 TLS 0.4 0.4 CSL 0.4 0.5 WBC 1.2 1.3 IAG 0.6 0.7 WES 1.5 1.5 MQG 0.7 0.9 WOW 1.7 1.4 NAB 0.7 0.6 WPL 0.7 0.7 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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Life360 Offers Strong Growth Outlook

Smart phone technology company, Life 360, has performed strongly in the first half and brokers are impressed with the outlook.

-Presents compelling value, given sales forecasts -Strong execution in monetising the user base -Further features in the pipeline to enhance the value offer

By Eva Brocklehurst

Business momentum continues for technology company Life360 Inc ((360)) as a record number of users were added in the first half. The company has a globally recognised application (app), whereby families can locate children and connect with them at any point in time via their smart phone, with a significant market opportunity.

The rate of US user acquisition was the highest ever for a six-month period in the first half. Moelis is impressed with this, as the second half of the year is typically stronger because of the timing of school holidays in the northern hemisphere.

Moelis reiterates a Buy rating and US$6.55 target, assessing the stock is presenting compelling value with an enterprise value of 4.2x 2020 sales forecasts. The broker suggests the company is just at the beginning of its monetisation opportunity and further progress on initiatives will be a catalyst for the share price.

Average revenue per "paying circle" in the first half was up by mid single digit percentage points compared with flat prospectus forecasts. Paying circles allow users to create separate groups within the app such as caregivers or extended family. The user's location is only visible to those within the circle.

Revenue was up 114%, representing strong execution in monetising the user base through paying subscriptions. Credit Suisse considers the June update a high quality report as the core subscription businesses are outperforming. While finding comparable companies is challenging, the broker continues to believe the stock screens very attractively in terms of revenue multiples and reiterates an Outperform rating and $5.20 target.

Management remains comfortable with prospectus forecasts for revenue of US$58.6m in 2019. Monthly active users were up 4.6m over the first half and total monthly active users ended the month at 23.1m. Full year revenue guidance is achievable, Credit Suisse asserts, and will be a key catalyst to drive a re-rating. Revenue from the sale of anonymous data is the largest component of the company's indirect revenue and the broker forecasts US$5m in the second half.

Monthly revenue from the Allstate automotive insurance partnership was in line with expectations. This is particularly positive, Moelis believes, as it represents the company's first major attempt to commercialise its proprietary user data through generating leads.

Bell Potter has a Buy rating and $5.93 target and includes the stock as a key pick in its coverage, given the robust growth rate and a strong balance sheet. The broker envisages other revenue opportunities as the company deploys its R&D to build more functionality.

Life360 is based in San Francisco, operating a GPS system platform that offers a range of safety features for families. The app is available in over 160 countries while the US accounts for over half of all users. The app has significant usage in India, Brazil and the UK.

Credit Suisse expects the re-design of the app, launched in April, should assist conversion, while the increased focus on Driver Protect should improve the user base in the second half.

The company is working on further features such as ID theft, personal SOS monitoring, stolen phone reimbursement and emergency evacuation to enhance its offer. Credit Suisse points out putting these additional features into different tiers should accelerate average revenue per paying circle, although this is unlikely to have any meaningful impact on 2019 results.

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SMSFundamentals: Just One Fund Please

SMSFundamentals is an ongoing feature series dedicated to providing SMSF trustees with valuable news, investment ideas and services, in line with SMSF requirements and obligations.

For an introduction and story archive please visit FNArena's SMSFundamentals website.

Just One Fund Please

Super members want government to lead on multiple accounts and default funds.

-A quarter of super members aren't aware they have more than one account -Nearly three-quarters want super balances automatically combined when they move jobs -Multiple accounts and underperforming funds cost members $3.8bn a year -Members have lost control of 6,000-plus accounts worth $17.5bn

By Nicki Boulioufas

Australians are piling more and more of their wealth into superannuation, but many remain disengaged from the system, wanting the government to take charge and consolidate their savings into a single account in a low-fee fund with a good track record.

In a new survey commissioned by Industry Super Australia, one in seven people - or 15% of those polled - said they were aware they have more than one account. However, the Australian Taxation Office says 40% of people have multiple accounts. This suggests that about 25% of super members could have more than one account and not realise it.

Nearly 16 million Australians have a super fund account. Industry Super Australia says about 5 million of these belong to an industry fund. The organisation manages collective projects on behalf of the 15 industry superannuation funds. These projects include research, policy development, government relations and advocacy, as well as the Industry SuperFunds joint marketing campaign. The recent polling was carried out on its behalf by UMR.

Three-quarters of members want government to take the lead

Some 70% of people polled for Industry Super Australia said they are in favour of the government taking steps to ensure they have only one super account. They agreed the government could do this by automatically combining their super when they change jobs, an option supported by 71% of those polled, or allocating them to a single fund for life, an option with 69% support.

At the same time, people are concerned about getting stuck in a poorly performing fund, with about 70% agreeing that default funds should have low fees and a history of good performance. By contrast, only 30% supported a less regulated framework, in which employers could choose any fund they want as their default fund, regardless of its quality.

Industry Super Australia acting chief executive Matthew Linden said the results underline the need for the government to stop the proliferation of accounts and implement reforms that enhance consumer protections, not undermine them.

"The last thing chronically disengaged consumers want to worry about is trying to consolidate old super accounts," Mr Linden said.

"Nor do they want to get to retirement and wake up to the fact that they have lost hundreds of thousands of dollars through duplicate fees and premiums."

Mr Linden said the only way to solve the problem is to automatically consolidate or combine a person's super every time they change jobs into a single, quality-checked account.

"It will take the hassle out of super for disengaged consumers and will mean more returns and more money and security for hard-working Australians in retirement," he said.

"Condemning a person to a single fund for life, regardless of its performance, could see people end up hundreds of thousands of dollars worse off by the time they retire if they are stuck in a dud fund."

Super members lose control of $17.5bn in 6,000-plus accounts

The Productivity Commission said in January that fixing the twin problems of multiple accounts and underperforming funds "could benefit members to the tune of $3.8bn each year".

In its report Superannuation: Assessing Efficiency and Competitiveness, the commission said: "Underperformers span both default and choice, and most (but not all) affected members are in retail funds."

The Australian Taxation Office says that, as at 30 June 2018, a total of 6,280 super accounts were classed as lost, unclaimed or held by the ATO on behalf of inactive or uncontactable members. The money held in these accounts totalled a massive $17.55bn.

At the end of June 2018, about a quarter of fund members had two accounts, 9% had three, and so on up to the 1% of members who had six or more. The problem is worst among people aged 41 to 50, with one in five having two or more accounts.

However, there are signs a consolidation is already under way. Between 2014 and 2017, the proportion of super members with only one or two accounts grew from 81% to 85%, while the proportion with three or more shrank from 19% to 15%.

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Treasure Chest: CIMIC View Still Constructive

FNArena's Treasure Chest reports on money making ideas from stockbrokers and other experts. CIMIC Group has been hampered by soft activity in Hong Kong and timing of Australian projects.

-Group margins are at high levels so revenue remains the key profit driver -Cash conversion weak in the first half -Potential support for the stock from reactivating the buyback

By Eva Brocklehurst

Significant weakness in construction-related business put a dampener on the first half result for CIMIC Group ((CIM)) and the stock suffered as a result. Poor cash flow resulted, as pre-tax profit from construction fell -15% on a -7% decline in revenue. This was affected by weaker activity in Hong Kong and the timing of Australian projects and, as Macquarie notes, group margins are at high levels so revenue is the key profit growth driver.

CIMIC is the dominant operator in the Australian infrastructure construction market and UBS assesses the stock provides a high level of leverage to the prospect of increasing investment in major infrastructure.

Still, the broker applies a -10% discount to the ASX 200 industrials ex financials, believing this is appropriate at the current point in time, where any outperformance is more skewed to the successful execution of work in hand.

First half cash conversion was only 52%, versus Macquarie's forecasts for 88%, affected by a change in mix towards alliance-style contracts and growth in mining construction business.

These have a more even cash-flow profile versus the large up-front flows in the case of fixed-price development and construction contracts. The change in mix towards alliance-style contracts lowers the risk profile going forward as well.

Cash Conversion

Credit Suisse expects a lower level of cash conversion to persist, compared to the elevated level of recent years. Hence, the broker suggests the weak cash conversion and slowing growth do not support a multiple that is higher than the historical average.

The main upside risk to the broker's target ($35) comes if management acts on the share buyback. Credit Suisse downgraded in the wake of the results to Underperform, cutting the 2019 net profit forecast by -8% to $761m, below management's guidance of $790-840m.

Macquarie has now decided to upgrade to Neutral, given the extent of the fall in the share price in the wake of the first half results, and because of the potential near-term support from a buyback. The company has reactivated its buyback, which can commence at the beginning of August.

If the Hochtief stake moves to 75% from the current 72.7%, Macquarie understands CIMIC would probably be removed from the ASX indices, with the result being 7.5m of potential index-related selling.

Beyond the buyback, a return to positive construction growth is required to support a more favourable fundamental view. Macquarie estimates a drop of -3% in pre-tax profit from construction in the second half and an increase of 4% in 2020.

Construction Outlook

Nevertheless, the broker still believes the broad outlook for Australian construction is positive, with work in hand stable at $36.8bn at the end of June. Recent concerns in the sector strengthen the company's competitive position, in the broker's view. Of note, competitor Lendlease's ((LLC)) engineering business is now considered non-core.

Macquarie suspects, over time, more rational bidding for projects is likely, along with a better share of risks. Cross River Rail in Queensland was the company's largest win in the first half. Construction work in hand was $14.7bn and stable at the end of June, while mining construction work in hand was $10.8bn, down on the levels recorded in March but higher versus the prior corresponding period.

One aspect Macquarie notes in the result was receivable and payable factoring, a tool used to manage working capital, cash and risk. While slightly higher in the first half, factoring did not rise to the same extent as over 2018.

Still, the company propped up cash flow in the first half by increasing the days payable to 159 from 135 in the second half of 2018. Without this, Credit Suisse assesses, there would have been a net cash outflow of around -$700m from operations.

There are two Hold ratings and one Sell (Credit Suisse) on FNArena's database. The consensus target is $40.33, signalling 9.9% upside to the last share price. The dividend yield on 2019 and 2020 forecasts is 4.2% and 4.4% respectively.

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Rudi's View: The Service FNArena Provides

By Rudi Filapek-Vandyck, Editor FNArena

Dear FNArena, how exactly can I maximise my benefit from your service? Can you help me out?

This question, in various varieties, regularly lands into the FNArena mailbox. For the benefit of many, I am sharing one of my recent responses to one multi-year long subscriber who felt he wasn't using the service as well as he should.

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Hence our unique and proprietary AUSTRALIAN BROKER CALL REPORT keeps readers updated on a daily basis about what analysts think, suspect, conclude and view.

You'll find the Report meticulously registers changes in valuations & targets, forecasts and ratings/recommendations alongside a summary explanation of the views behind these changes.

I personally consider this Report as the financial newspaper every active investor should read. You don't have to necessarily agree with any of it, but at least you are informed and up to date about what is moving share prices and market momentum/sentiment in general.

The Australian Broker Call covers seven stockbrokers (we recently lost Deutsche Bank) covering in total more than 400 ASX-listed stocks. These stocks are not updated every day, hence why we added STOCK ANALYSIS, which allows subscribers to look up each of the 400+ stocks and get an instant overview into what broker views are, alongside valuations/targets, forecasts and direct translation into AUD for companies reporting in a foreign currency.

Here you will also find calculations such as PE ratios and dividend yield. There's even a dividend calculator and franking indicator, plus a price chart with basic moving averages near the bottom of each page, including the trend in earnings forecasts.

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FNArena's SENTIMENT INDICATOR allows for searches on general sentiment, prospective dividend yield and gaps between share prices and consensus target. We also offer a monthly updated AUSTRALIAN SUPER STOCK REPORT which contains key data in Excel spreadsheet format, which allows subscribers to download the data and format and use whichever way they like/prefer/want.

When it comes to COMPARING we have a few options available on the website. FNArena WINDOWS puts all 400+ companies together in sectors and sub-sectors starting with Industrials, Financials and Commodities. You can drill down into smaller sub-sectors until there are no further options left.

The R-FACTOR compares the full ASX200 on the basis of 2-year forward looking forecasts for EPS and/or DPS. This function has historically been quite accurate in highlighting the stocks that seem undervalued compared with consensus forecasts.

Another comparing device is THE ICARUS SIGNAL which highlights which stocks have moved beyond consensus price targets. Again, one has to consider that context is as important as the raw data.

To provide more context and specific insights, FNArena publishes DAILY NEWS STORIES and ANALYSIS, including my personal observations and RESEARCH INTO ALL-WEATHER PERFORMERS in the Australian share market. There is a dedicated section on the website, which is exclusively available for paying subscribers.

You can read my Weekly Insights via RUDI's VIEWS.

We have a GUIDE TO THE WEBSITE on the horizontal black ribbon across the website, where also our main drop down menus are located.

Ultimately, our observations and experience since 2002 tells us the greatest benefits (and financial rewards) befall investors who are willing to read, and learn, and to spend time observing and figuring out why this analyst and why that stock, and who can use their knowledge within a strategy that suits them and feels right.

Financial markets are never static. What worked last year may not be the right strategy this year or next. Similarly, FNArena caters for a wide variety of investors and strategies. Plenty of subscribers have been on board for a decade or longer, and they are relying on FNArena commentary, analysis and tools as a trusted guide through both joyous and challenging times.

You can do this too. Myself and the team here at FNArena are ready to answer your questions and to assist you with finding and executing your strategy, building your portfolio and seeking out opportunities.

Ultimately, a successful investor is the one who can adapt to changing circumstances, who doesn't give up when making a mistake, and who never stops learning. FNArena is here to help you achieving exactly that.

Feel free to ask more questions when necessary.

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