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Stories To Read From FNArena

Friday, 24 August 2018

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Confidence Grows In IPH

Brokers have become increasingly confident in patent filing business IPH and expect strong growth in both Asia and Australasia in FY19.

-Track record of robust cash flow -Currency tailwind in FY19 -Potential for sustained upgrade cycle

By Eva Brocklehurst

Patent support business IPH Ltd ((IPH)) turned a corner in its second half, posting improved financial results that are expected to restore confidence in the company's outlook. Australian filings appear to have returned to trend growth and Asian filings are expected to maintain strong momentum. The company grew its patent filings ahead of the Australian and Singapore markets and experienced substantial growth in China, up 44% for FY18.

Underlying FY18 operating earnings (EBITDA) of $74m were up 3.4%. After contracting -3% in the first half underlying earnings did rebound in the second half, up 5%. This was driven by a return to strong organic growth in Asia.

Market share in Singapore continue to hold steady a 24.4%. After contracting -5% in the first half, Australasian revenue returned to positive growth in the second half as well. Market share in Australia strengthen to 23.8%.

The recent acquisition, AJ Park, contributed operating earnings of NZ$6.25. Brokers believe there is upside risk to margins in FY19 for this business through further efficiencies.

Bell Potter highlights a track record of strong cash flow, supported by low working capital and low expenditure requirements. The balance sheet is strong with a small net debt position. The broker, not one of the eight stockbrokers monitored daily on the FNArena database, has a Buy rating and $6.15 target.

While FY18 was challenging, Macquarie suggests the business should now benefit from weaker comparables and favourable currency movements. Acquisitions are also likely to be a growth lever as there are consolidation opportunities among the listed domestic operators.

Commitment To IPH

Morgans notes that over 80% of principals from the Pizzeys and FAKC businesses recommitted to IPH and the company promoted 13 new principles during the year. Filings from Pizzeys tripled in 2017 to 124 cases, and in 2018, 133 cases have already been filed.

In Asia, IPH has retained the number one patent market position in Singapore. Morgans also suspects the America Invents Act has been laid to rest, which should be welcome news to investors, and patent filings should revert to long-term growth rates moving forward. Given the current trading multiple and attractive dividend yield, the broker retains an Add rating on the stock.

Deutsche Bank also hailed the improvement in the second half and believes management has done a good job of integrating its business. AJ Park exceeded the broker's expectations and allayed concerns following a patchy first half. The broker believes IPH is well-placed to leverage a dominant position in an attractive market.

Canaccord Genuity raises FY19 and FY20 revenue forecasts by 3% and 5% respectively, driven by currency benefits and higher assumptions regarding growth rates in Australia.

Currencies are set to be the major tailwind. The broker calculates currency sensitivity at $1.3m in revenue for every $0.01 change in the Australian/US dollar rate. Moreover, a high proportion of that revenue change flows to the earnings (EBITDA) line.

If IPH is now in a sustained upgrade cycle for earnings Canaccord Genuity believes the shares will perform well. The broker, also not one of the eight monitored daily on the database, maintains a Buy rating and increases the target to $6.00 from $5.30.

FNArena's database shows one Buy (Morgans) and two Hold ratings. The consensus target is $5.57, suggesting 0.2% upside to the last share price. Targets range from $5.30 (Deutsche Bank) to $5.92 (Morgans). The dividend yield on FY19 and FY20 forecasts is 4.4% and 4.8% respectively.

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Challenges Continue For Link Administration

Link Administration is expected to find FY19 challenging, although the new Link Asset Services business should provide synergies and growth.

-Percentage of recurring revenue declining -Europe expected to deliver an earnings upgrade -Lack of clarity on use of proceeds from capital raising

By Eva Brocklehurst

Link Administration Holdings ((LNK)) is bedding down recent acquisitions and, while growth in the domestic business is likely to be soft over the next year, most brokers expect synergies from the new Link Asset Services to underpin momentum.

Macquarie is more confident in the growth trajectory for revenue from this newly-acquired division and increases revenue growth forecasts to a compound 5% over the next three years. While the percentage of recurring revenue declined in FY18, the broker believes the opportunity for further fee-for-service work is still attractive.

Ord Minnett considers the result boosted by cyclical tailwinds, masking structural challenges in funds administration. The effect of contract losses is emerging and the broker expects the greatest impact will be felt in FY19. After a strong appreciation in the share price, and amid lower starting margins in Link Asset Services, Ord Minnett downgrades to Lighten from Hold.

The market should unwind the price/earnings discount on the stock, in Morgan Stanley's view, as growth is evident across all four of the company's businesses. Fund management grew 12%, loan servicing grew 10%, trust services grew 4% and market services grew 2%. The broker believes its bullish thesis is playing out.

Citi, on the other hand, expects a modestly challenging year ahead, as accounts are being lost in funds administration and there is significant price competition in corporate markets in Australasia. The main growth areas are Superpartners and Link Asset Services, which are still calculated to provide around 10% growth in earnings per share.

FY18 results were assisted by a lower tax rate in the second half while margins also expanded in both funds administration and the technology division, amid the synergies from Superpartners. Morgans points to margins in both divisions being within 1% of returning to FY14 levels. Technology margins expanded by 5% in the second half and funds administration by 2%.

Nevertheless, the broker acknowledges revenue growth was assisted by significant non-recurring revenue and second half recurring revenue, ex Link Asset Services, was actually down -2%. Ord Minnett also points to an increasing component of revenue coming from non-recurring sources.

Credit Suisse downgrades to Neutral from Outperform. The trends in the broader business are soft and the broker agrees that while higher levels of fee-for-service revenue provided an offset in FY18 this is not likely to be repeated to the same extent in FY19. The broker reduces forecasts by -3% for earnings per share in FY19 and FY20, largely from -4-5% downgrades to operating earnings (EBITDA) estimates.

Credit Suisse acknowledges the company should be able to grow its earnings despite the regulatory headwinds and account losses but nevertheless envisages the growth profile being significantly lower than it once was, and the headwinds are likely to consume most of the synergy benefits from acquisitions.

Uncertainties

While retaining a -$45m negative impact from the Commonwealth budget proposals in its estimates, Citi is increasingly convinced the company's assessment of the impact will prove conservative, given the mitigating factors.

Moreover, regulatory uncertainty from both the Financial Services Royal Commission and the Commonwealth budget may actually boost client demand for project work, Morgan Stanley asserts.

The broker accepts that the market is complacent around the risks of further regulatory measures to remove duplication, expecting superannuation account numbers will shrink by 30% by 2023, but considers the headwinds are factored into the stock price and the long-term growth story remains intact.

Link Asset Services

Link Asset Services reported maiden operating earnings of $94m for the eight months to June 2018. The strong revenue trends in this business provide Morgan Stanley with greater conviction that Europe will deliver an earnings upgrade cycle, although a British exit from the EU does reduce growth opportunities in the UK franchise.

So far, Morgan Stanley believes investors are unclear about the long-term vision and lack confidence in Europe. The final two months of the first half are seasonally strong and this, too, makes it difficult to make comparisons half on half. Credit Suisse observes that Australian dollar results in isolation are difficult to analyse as they only represent earnings for part of the period.

Following the acquisition of this business, the company has reinvested GBP7m over the last year reflecting higher operating costs and an increase in bonuses following a rundown of bonuses under the previous owner. Going forward, as the company starts to realise the synergies, this reinvestment should be offset but Credit Suisse calculates it will lower growth synergies by around -50%.

Morgans finds a lack of clarity on the full use of the proceeds from the recent capital raising. Management has revealed 20% of the proceeds were applied to two small acquisitions - TSR Darashaw in India and Leveris, a UK banking data platform.

FNArena's database shows four Buy ratings, three Hold and one Sell (Ord Minnett). The consensus target is $8.43, signalling 7.6% upside to the last share price. Targets range from $7.00 (Ord Minnett) to $9.55 (Morgans).

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Dividend May Resuscitate Origin Energy

Several brokers have found it hard to become positive about Origin Energy amid the challenges in the energy market and sizeable reductions to FY19 guidance.

-De-leveraging considered no longer enough amid weaker guidance -APLNG expected to break even on costs in FY19 -Management indicates dividends to recommence in FY19

By Eva Brocklehurst

The outlook for Origin Energy ((ORG)) is now materially softer and brokers suggest the company will have its work cut out in the months ahead to restore confidence. A resumption of dividends, as promised, may help.

Energy market earnings were $1.8bn in FY18, at the upper end of guidance and underpinned by a very strong performance in gas. APLNG sales were driven by mix of commodity price increases, higher LNG cargoes and a delay in supply coming online.

Yet the company has guided to FY19 energy market earnings of $1.5-1.6bn, which implies a decline of -6% year-on-year. The majority of the difference is a change to the accounting treatment of certain hedging contracts which were previously excluded from underlying results.

Moreover, Origin Energy indicated, in the integrated gas operations, a fair-value adjustment of $75-85m in FY19 as well as oil put options that add up to $150m. Adding these adjustments together results in a sizeable downgrade to operating earnings (EBITDA) forecasts for Ord Minnett, of -32% in FY19 and -21% in FY20. Thus, the broker finds it difficult to remain positive, given the scale of the downgrades and reduces its recommendation to Hold from Accumulate.

Citi's forecasts are also now materially weaker than previously modelled. Negative features include weaker growth in gas margins, higher capital expenditure, weaker cash conversion and delays to cost reductions. The broker downgrades to Neutral from Buy.

Credit Suisse believes the de-leveraging is no longer enough and the magnitude of the challenges cannot be ignored. Guidance is well below prior forecasts and the broker becomes another one to downgrade to Neutral.

As the company is guiding to a modest increase in gas earnings, flat procurement costs and an increase in commercial prices, Credit Suisse suspects it is retail margins that are the weak link in guidance and does not expect any near-term improvement. Morgan Stanley is more positive about the APLNG outlook but reduces its valuation of the stock on re-based energy market earnings as well as a reduced margin for safety.

On a more positive note, UBS finds evidence the company is retaining and winning new customers, as retail customer numbers were up 1%. The broker considers the company well-positioned in an increasingly volatile electricity market as the generation business creates a natural hedge to volatile pricing.

Meanwhile, a combination of rising oil prices, increasing APLNG output and higher National Energy Market (NEM) electricity prices has improved the balance sheet. UBS believes the market has oversold the stock and maintains a Buy rating.

The company has factored in little impact from digitisation benefits into guidance, which could provide momentum from FY20 onwards, although Macquarie suspects this is at risk of being competed away.

Energy Markets

Origin is now recognising around $160m in annual insurance premiums within its electricity hedging portfolio as operating expenditure. The hedging portfolio is expected to evolve over time but Morgan Stanley does not consider the investment thesis that positive at present. Regulatory uncertainty and policy is manageable, nonetheless, and the broker expects cost reductions and falls in wholesale electricity costs will mitigate gradual losses of market share.

Structurally, Macquarie finds the energy market business attractive as the company's large short position in base-load generation allows it to capture falling electricity prices in its costs, while its gas plants, even though not being utilised, gain by selling gas and obtaining firm premiums in electricity.

APLNG

The company has reaffirmed a target for APLNG to break even in FY19 and has hedged around 73% of its share of contract LNG volumes. Despite success in reducing break-even costs to US$39/boe Morgans considers Origin Energy late to the party in view of the aggressive cost reductions that have already been completed by its peers.

The broker expects realised prices to continue trending higher for APLNG, with lagged oil-linked LNG prices. This should be partly offset by higher FY19 break-even guidance - US $39-44/boe - as exploration/appraisal expenditure recovers and infrastructure expenditure rises.

UBS anticipates a continued increase in distributions from APLNG as a result of higher prices and the focus on cost reductions. This should allow Origin Energy to achieve a net debt/operating earnings ratio of 2.5-3x by the first half of FY19 and this could lead to a reinstatement of the dividend.

Dividend

Origin Energy did not provide a final dividend, despite being well below its FY18 debt target of $7bn and amid strong operating cash flow from APLNG and energy markets. Subject to board approval, the medium-term outlook supports a recommencing of dividends in FY19, the company said. Still, Macquarie suspects it may take time to ramp up to a 60% pay-out.

FNArena's database shows three Buy ratings and four Hold. The consensus target is $9.54, indicating 10.7% upside to the last share price. This compares with $10.32 ahead of the results. Targets range from $8.80 (Citi) to $10.08 (Morgan Stanley).

Food Sales Growth Falters At Woolworths

Food remains central to the market's concerns regarding Woolworths, as previously robust supermarket sales growth falters in the first quarter of FY19.

-Slower supermarket sales in first quarter affected by factors considered "one-off" -Elevated costs growth remains a concern -Opportunity to drive growth through efficiencies not yet evident

By Eva Brocklehurst

Supermarket sales growth for Woolworths ((WOW)) appears to be plateauing and moderation is expected in FY19 as competition in food intensifies. The first seven weeks of FY19 showed growth of just 1.3%, which is now behind rival Coles ((WES)). Meanwhile, Coles appears to be on the rise.

Food is the centre of the market's concern regarding Woolworths. Australian food revenue grew 4% in FY18 while operating earnings (EBIT) grew 10%, below many forecasts.

Like-for-like sales, comparably robust and averaging growth of 4.3% over FY18, appear under pressure. This is been affected by significant deflation in fruit and vegetables, the removal of the plastic bag bans, which have affected items per basket, and amid the very successful Little Shop promotion from Coles.

Woolworths may have lagged Coles, which grew 2.4% in the first quarter, for the first time in two years but Credit Suisse is not overly worried, given the performance was potentially held back by the aforementioned factors.

The broker believes Woolworths is a solid long-term story, albeit its near-term performance is stymied. Additional expenditure on e-commerce and warehouse automation are expected to widen the competitive advantage with respect to Metcash ((MTS)).

Citi also expects the gap to Coles to be short lived, as those previously outlined factors cease to affect sales from the end of August. However, elevated growth in the cost of doing business (CODB) is a concern. Cost benefits from the investment in distribution centre infrastructure are expected to drive a flat outcome in FY20 for CODB/sales for the first time since FY14.

UBS downgrades to Neutral from Buy, observing Australian food CODB growth outstripped sales growth. While continuing to believe there is an opportunity to drive efficiencies, the broker points out this is not yet evident. For UBS to become more positive requires a tangible sign of returns on investment being achieved in the form of increased customer loyalty, cost reductions and gains in working capital.

Deutsche Bank is more positive and does not believe the recovery for Woolworths is over. The broker suggests the business is continuing to please customers, as they chase free plastic bags and toys. Sales growth is expected to improve in the second quarter when the headwinds have passed. Still, the broker downgrades to Hold from Buy.

Competition

Shaw and Partners, not one of the eight stockbrokers monitored daily on the FNArena database, maintains a Sell rating and $27.75 target. The broker does not expect Coles, Aldi or the Metcash-supplied IGA to take a backseat to Woolworths.

Australia is a second most concentrated grocery market in the world behind New Zealand and competition is expected to become far, far more aggressive. Moreover, Australian supermarket margins are still high on a global basis. The broker also believes strategies to turn Big W around are uncertain and the discount department store is likely to be a drag on the company's profitability at least into FY19.

Credit Suisse admits its excitement at seeing the earnings (EBITDA) loss at Big W reduced to -$30m dissipated when the increase in capital expenditure to $95m was noted. The broker agrees cash break-even is still some way off, although expects FY19 will provide a better indication of whether Big W is sustainable.

While the turnaround over the past two years was impressive, Morgans believes the stock is fully priced relative to its earnings growth profile. Morgans was pleased with the $0.10 special dividend and that the company is considering further capital management as part of the exit from the petrol business.

Capital Return

Citi does not foresee gross margins rising above 30%, given the competitive nature of the industry. The broker suspects a capital return may occur in the second half, via a small special dividend, which could set the stage for a more material return post the divestment of the petrol business.

Yet, while capital management may entice some investors, Macquarie believes the outlook is questionable. The broker believes an eventual recovery at Big W or a turnaround in New Zealand are not large enough in isolation to matter.

Macquarie does not expect margin expansion will occur in food. The business has highlighted a need to continue investing in order to improve the customer experience and the broker believes this will hinder margin expansion.

Ord Minnett also expects the earnings margin to narrow in FY19 because of rising costs, tough comparable numbers and a more competitive Coles. Nevertheless, the broker believes the company's investments are sound uses of the growth in sales, while lower inventory losses will aid gross margin expansion and sustain the turnaround in food.

What Metric?

As an aside, Shaw and Partners is not a fan of the like-for-like comparable metric. The broker believes the market's obsession with this numeral can be manipulated by the closure of underperforming stores, treatment of refurbishment and online sales, as well as promotional periods or discounting activity.

The broker prefers to focus on underlying operating metrics such as sales per square metre, operating earnings (EBIT) margins or return on invested capital (ROIC). The broker suggests low single-digit growth in earnings per share at Woolworths does not deserve a price/earnings ratio of 21x.

FNArena's database has six Hold ratings and two Sell. The consensus target is $28.47, signalling -1.4% downside to the last share price. Targets range from $23 (Morgan Stanley, yet to comment on the results) to $32 (Citi).

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Consumables Income Flows For Nanosonics

While the US market dominates earnings for infection control developer Nanosonics, other markets are growing rapidly.

-Earnings from consumables growing substantially -Launch of Trophon-2 temporarily impacts device sales in US -New products for infection control slated by the end of FY20

By Eva Brocklehurst

Disinfection device developer Nanosonics ((NAN)) reported a 25% increase in its installed base of its infection control device Trophon in FY18. The vast majority of this growth is in the US, although momentum has picked up in the UK with a management equipment service agreement.

FY18 revenue was below forecasts, down -10% because of a large order by GE in FY17 and slowing sales in the second half, but net profit was substantially ahead because of the recognition of previously unrecognised tax losses in the US. This is expected to be a one-off item.

The market was clearly prepared for a softer result as the company increased its investment in new product development and infrastructure and there was a temporary impact on device sales in the US because of the launch of Trophon-2.

The US market continues to dominate revenue and earnings, although other markets are growing rapidly. The North American installed base now reflects a 39% market penetration.

Canaccord Genuity expects first half FY19 sales will be supported by Trophon-2 as well as initial orders from GE. Meanwhile, UK agreements, while not generating revenue from upfront sales, should provide stronger, long-term annuity revenue from the higher priced consumables.

Reported consumables now account for around 58% of revenue and, while the proportion is likely to be elevated in FY18 by reduced device sales, Canaccord Genuity believes this demonstrates the company's robust commercial model.

The broker also expects France and Germany to make a greater contribution to the accounts in FY19 and clinical data to support approvals and guidelines in Japan is expected shortly. Canaccord maintains a Hold rating, increasing the target to $2.95.

Wilsons also expects increased consumable earnings will manifest in the second half of FY19 and be boosted again in FY20, maintaining a Hold rating and $3.50 target. Although the broker views the business quite favourably the stock is assessed as fairly valued. Nanosonics guided to $53m in operating expenditure but did not provide formal guidance beyond that.

Bell Potter is optimistic about the outlook, amid expectations for double-digit growth in the installed base and the launch of Trophon-2. In view of the recent appreciation in the share price the broker downgrades to Hold from Buy, with a target of $3.42.

The release of one or more new products for infection prevention are slated by the end of FY20. To fund development management has guided to $13m in research & development costs in FY19, up from $9.9m in FY18.

Morgans suggests investor attention should be held by the growing revenue from consumables and the new products being launched. Upside risk centres on a higher rate of adoption in Europe, while downside risk centres on pricing pressures if hospital budgets tighten. Morgans maintains a Hold rating and looks for a better entry point to the stock, retaining a target of $3.32.

Speculation Feasting On BHP's Cash Pile

The decision by BHP Billiton to exit the US onshore business and a substantial build in cash flow has provided a feast for speculation regarding probable uses and returns to shareholders.

-Scale of opportunities in petroleum may be material -Cost pressures likely to grind higher -Will it be buybacks or extra dividends?

By Eva Brocklehurst

BHP Billiton ((BHP)) generated substantial cash flow in FY18, achieving efficiency gains that offset cost pressures. Realised prices for all commodities, excluding natural gas, copper and thermal coal were up half on half and nickel, oil and coking coal stood out in terms of volume growth.

Guidance remains the same, except that near-term productivity targets have been reduced to US$1bn in FY19, from US$2bn over FY18-19, because of the divestments and challenging conditions at Blackwater and Broadmeadows.

Underlying operating earnings (EBITDA), including onshore, of US$24.1bn were up 19% in FY18. A record final dividend of US$0.63 per share was announced, above the minimum pay-out policy of 50%. Cash flow from operations impressed brokers, totalling US$18.5bn. With copper equivalent production to be flat and costs rising across the board in FY19, Citi expects free cash flow will fall to around US$8bn in FY19.

The FY19 exploration program comprises expenditure for petroleum appraisal of US$750m, including two wells in Trinidad & Tobago, one well at Trion and one in the Wildling Basin in the Gulf of Mexico. The scale of these opportunities interest Credit Suisse and may be more material than what the expensing of around 73% of the US$709m expenditure on exploration would otherwise suggest.

Goldman Sachs found the results somewhat confusing, probably because US onshore business was likely included in some consensus forecasts and excluded from others. The broker believed there was scope for a higher dividend given the net debt position.

Still, with the sale of US onshore in progress and the company indicating this money will be returned, investors should be satisfied and the broker, not one of the eight stockbrokers monitored daily on the FNArena database, retains a Buy rating and $41.80 target.

The main downgrade in costs came from Queensland coal but costs are expected to move up again on the back of higher strip ratios and re-basing of contractor rates. CLSA is not confident in the cost guidance of US$57/t provided by the company and increases its estimates to US$65-70/t. Macquarie notes higher near-term costs for Escondida were offset by lower medium-term cost targets for iron ore but the trend is up and this drives modest reductions to its earnings outlook.

Shaw and Partners, not one of the eight monitored on the database, believes cost reductions have pretty much run their course. Some cost pressures may be one-off in nature, such as geotechnical issues in Queensland coal or major expenditure at Olympic Dam, but the broker suggests the business is now at a stage where only annual incremental gains are the realistic yardstick. The broker has a Buy rating and $40 target.

Conventional Petroleum

CEO Andrew McKenzie has made it clear that BHP Billiton has no intention of removing its conventional petroleum segment. Petroleum lagged other divisions in FY18, with Macquarie noting underlying earnings posted a meaningful -8% miss to its forecasts.

Production will continue to be affected by natural field decline but BHP Billiton has identified significant latent capacity and brownfield potential in its portfolio. Extensions at the existing Gulf of Mexico and Trinidad & Tobago assets are upside to Macquarie's base forecasts.

Credit Suisse is not entirely sure whether the projects in hand in conventional petroleum will simply be replacement barrels or provide growth but suggests, with the number of these projects growing, there is plenty to feed this discussion.

The broker would welcome a move towards re-investing in higher-returning growth, noting there has not been a detailed petroleum briefing from the company since 2016 and pointing out that onshore was still described as being a place to compete for capital not long before exit plans were announced. While the company clearly has organic latent capacity and value options in excess of its peers the question is the extent to which they can be achieved.

BHP Billiton will, under some instances, consider an acquisition but believes this is not critical. No further details were provided regarding how, or when, the proceeds from the US onshore sale will be returned to shareholders. Once the sales process has been completed, expected at the end of October, full details are to be released.

Capital Management

Management has signalled that the criteria for any capital management will be the amount remaining after allocating a minimum of 50% of cash as dividends, and whether a buyback adds more value than a dividend. UBS calculates, at present, there is not enough to justify a buyback.

CLSA is underwhelmed by the capital management so far but believes elevated commodity prices will be a driver of returns over the next few years and this bodes well for BHP Billiton. The broker, also not one of the eight monitored daily on the database, has a $34.49 target and an Outperform rating.

Shaw and Partners agrees that the stock performance is ultimately reliant on commodities and recent headwinds may be abating. The broker suggests a top up to the ordinary dividend is already well covered by the current levels of free cash flow and favours a buyback off-market in Australia as a key option.

Macquarie expects BHP will return the bulk of free cash flow to shareholders, via a combination of dividends and buybacks, while maintaining a US$8bn per annum capital expenditure budget. Credit Suisse also expects a higher proportion of free cash flow will be returned when debt balances are below US$10bn.

Citi, meanwhile, would be calling for capital management initiatives at the interim result in February, even without the US onshore divestment proceeds. Timing appears to tight to return onshore proceeds before the end of 2018 but a return through a combination of off-market and on-market buybacks, and keeping net debt at US$10bn by the end of FY19, would be 8% accretive in FY20 on the broker's calculations.

The database shows seven Buy ratings and one Hold (Credit Suisse). The consensus target is $35.54, indicating 10.3% upside to the last share price. The dividend yield on FY19 and FY23 forecasts is 5.9% and 5.1% respectively.

Alliance Aviation Flying On A High

Brokers are keen on FIFO specialist Alliance Aviation after the company provided a strong outlook with its FY18 result.

-Completing purchase of Austrian Airlines fleet frees up cash flow -Dividend up 193%; analysts expect further increase -Market downturn, greater competition is a cloud on the horizon

By Nicki Bourlioufas

Alliance Aviation Services ((AQZ)) received a bouquet of upgrades after announcing a 33% increase in pre-tax profit to $18.1 m for FY18. The result was achieved on a 23% rise in annual revenue to $248m and a -26% cut in net debt to $53.4 m. Total flying hours were up 35% and operating cash flow came in at a record $38.3m.

Alliance Aviation shares closed at $2.09 a share on August 9, the day of the announcement. The stock shot up to $2.38 the following day and has since traded around $2.25. The full-year dividend is a fully franked 8.8 cents a share, up 193% on 2016-17.

Analysts responded enthusiastically. Most optimistic was Ord Minnett, who raised its target price to $2.60 from $2.30 while rating the stock a Buy. Credit Suisse raised its target price to $2.45 from $2.20 and maintained an Outperform rating. Wilsons revised its target price to $2.38 and upgraded the stock to Buy.

Alliance Aviation Services is a mining services company that provides fly-in fly-out (FIFO) transportation services to the mining and energy sector in Australia. The company also offers charter services and “aircraft, complete crew, maintenance, and insurance” (ACMI) services – also known as Wet Leasing – to a range of corporate and government customers.

At the end of 2015, Alliance Aviation acquired a fleet of 21 Fokker aircraft from Austrian Airlines, a subsidiary of Lufthansa, providing it with operations in Europe. The US$15m deal, which comprised a cash payment of US$9.5m and the issue of US$5.5m in new shares to Austrian Airlines, was to be completed over 26 months.

Capacity to grow market share and dividends boost expectations

According to Ord Minnett, while the result was ahead of expectations across almost all metrics, it was the outlook that drove the upgrade. The key positives include that Alliance’s aircraft inventory will now be deployed much faster than previously anticipated, positioning the company to build market share, the analysts said.

“AQZ is planning on bringing 9 additional aircraft into active service over FY19 (we had expected 4), taking the active fleet to 42 by end of FY18 (including some spare capacity),” the Ords team said.

“Demand for Alliance’s services continues to be strong across the board, with additional flight hours in most categories (predominantly wet leasing and contract/charter). With free cash flow generation on the rise, we anticipate an increase in dividend payout for FY19 onwards.”

Credit Suisse agrees, noting: “In signaling an expected increase in its Fokker aircraft fleet from 33 to 45 (about 3 of which are likely to be in maintenance at a given time), AQZ has given a clear indication of its conviction in a favourable operating environment.

“Strong demand in contract flying (FIFO boosted by mining conditions), charter and wet lease (including the Virgin partnership) as well as constrained competitor capacity leave AQZ well positioned to utilise its fleet potential,” according to the Credit Suisse analysts.

Wilsons believes potential catalysts for growth include new contract wins or renewals, increased regular public transport activity with Virgin, and announcements on the Austrian Airlines fleet.

Wilsons finds Alliance Aviation has capital management opportunities given its strong free cash flow enabled by earnings growth and the near completion of the Austrian Airlines payments. The company’s options include to retire debt faster, and to continue to increase the dividend payout ratio. Wilsons assumes a payout ratio of 75% from 2018-19.

Risks are downturn in demand, rise in competition, lower utilisation

Ord Minnett has identified four key risks, the major one being a downturn in demand for FIFO services. As well, there is a risk of an increase in competition in the charter leasing or FIFO market; a chance that sales of aircraft parts could fall below expectations; and operational risks.

Credit Suisse concurs, nominating a downturn in demand, potential contract losses, and increased competition as key risks.

Wilsons pings loss of contracts, revenue volatility on regular public transport routes, and inability to monetise the Austrian Airlines fleet. The team notes that management expects another nine aircraft to join the operating fleet in FY19, confirming the positive view on demand for the core flying business.

However, Wilsons also points out this presents a small headwind to margins for the operating business in the short term as the analysts expect lower utilisation, combined with higher depreciation and amortisation and cash capex. This implies the monetisation of those spare aircraft will now be achieved over a longer period rather than more rapidly through aircraft and parts sales.

Why The Uranium Price Must Go Up

Richard (Rick) Mills Ahead of the Herd

As a general rule, the most successful man in life is the man who has the best information.

The Trump Administration is at it again. On July 18 the financial press got a-hold of a story that said the next target of the Trump tariffs is likely to be the uranium/ nuclear energy sector. In what looks like a repeat of what happened with steel and aluminum, the White House said it would investigate whether uranium imports threaten national security, given how dependent the United States is on the nuclear fuel. If the sector is threatened - and why wouldn't it be, where 90% of the uranium needed for American nuclear reactors comes from abroad - import tariffs would likely be imposed.

If that happens, it would hurt nuclear power plants, who are already struggling with low electricity prices and flat demand, Bloomberg noted in reporting the story.

But this isn't really about national security, or in legal terms, section 232 of the 1962 Trade Expansion Act which allows the US government to impose tariffs without a vote by Congress if imports are deemed a national security threat. Section 232 was used to slap 25% tariffs on steel imports and 10% on imports of aluminum in March.

It's about two US uranium producers who are fed up competing with state-owned companies in Russia and Kazakhstan (ie. Rosatom and Kazatomprom). Energy Fuels and Ur-Energy petitioned the government in January for the probe. Notably absent from the complaint was Uranium Energy Corp, which mines uranium in the United States and Paraguay and processes it in Texas.

Since they supply less than 5% of the uranium needed for US nuclear power plants, Energy Fuels and Ur-Energy feel threatened, and want protection. Are they likely to find a sympathetic ear in the US government? You bet. Despite the prices of practically everything made from imported steel and aluminum going up, including of course, cars (GM is already losing money), this government doesn't seem to get the fact that slapping tariffs on strategic metals that are in short local supply will hurt domestic industries that must buy those raw materials from abroad.

If the complaint is successful, two things could happen: a "buy American" quota that limits uranium imports and reserves 25% of the market for domestic production; or a requirement that utilities purchasing nuclear power buy US uranium. We'll address the likely impact of section 232 on the uranium market in another section, but the truth is, 232 is a red herring.

It's a distraction from what is really going on with uranium, which is the setting up of an extremely bullish scenario for uranium investors due to supply shortages in the face of high demand for the nuclear fuel as a result of the ever-growing need for clean power globally. The supply-demand imbalance will mean higher prices. This article will explain how this will come about, and why now is an excellent time to be investing in junior uranium companies which offer the greatest leverage to a rising commodity price.

Demand picture

Demand for uranium of course is directly tied to the need for nuclear power, which is growing exponentially especially in Asia due to the problems with air pollution from coal-fired power plants. The global demand for electricity is expected to increase by 76% by 2030, and while everyone knows about the electric vehicle "revolution", what is not often talked about is how will all that extra power be generated. Much of it will have to come from nuclear.

There are currently 452 operating nuclear reactors and 56 new ones under construction globally. According to the World Nuclear Association, China with its appalling air pollution is the leader with 17 new reactors under construction and 184 planned or proposed. Up until recently Japan was out of the nuclear mix, with all but a handful of nuclear reactors shut down for safety checks following damage to the Fukushima Daiichi plant during the 2011 earthquake/ tsunami. But Japan which has no oil and gas of its own and depends heavily on nuclear, now has 9 reactors back in operation - a tripling from 2017 - and aims for nuclear to represent just under a quarter of its power mix by 2050. Japan's Abe Administration is pro-nuclear. Russia is building 9 new reactors and India is constructing 7.

According to nuclear consultant UxC, this means the global capacity for nuclear power is expected to grow by 27% between 2015 and 2030. And that means a whole lot more uranium. How much? UxC estimates annual uranium demand will spike by nearly 60%, from the current 190 million pounds of U_3O_8 to 300 million pounds by 2030.

But there's a problem. Uranium supply has been steadily dropping since 2016. That year total mined supply was around 163 million pounds, in 2017 it was 154 million, and this year it's estimated to be under 135 million. With current U3O8 demand at 192 million pounds, that leaves a shortfall of at least 57 million pounds. More on why that is in the next section, but first, it's important to understand uncovered uranium demand.

Uncovered demand

Nuclear utilities buy uranium on long-term contracts, in order to lock in the price. These contracts usually last four to 10 years. The long-term demand for uranium is calculated by figuring out utilities' requirements for U3O8 that is not covered by contracts. This is known as uncovered demand. According to UxC, uncovered uranium demand is projected to increase by up to 54 million pounds by 2020, or just under a third of total demand that year. Then it just keeps rising: 150 million pounds in 2025, 179 million pounds by 2030. That 179 million pounds of uncovered demand is actually 16 million pounds more U3O8 than total mined production predicted for that year.

Why is this important? Because it means utilities will have to start negotiating long-term contracts soon, in order to prevent themselves being in a situation where their requirements are uncovered. If not, they will have to buy uranium on the spot market to have enough nuclear fuel. The trend since 2010 has been for utilities to buy a greater percentage of material on the spot market, with lower volumes contracted. This means contracting will have to increase in the very near future. By 2025 almost two-thirds of existing contracts will expire.

Supply picture

At current prices, about three-quarters of uranium mines are uneconomic. This is why several large uranium mines have shut down recently. In 2017, operations at Cameco's McArthur River/ Key River were suspended. Rabbit Lake was shut down in 2016. State-owned producer Kazatomprom announced it will cut 20% of its production over the next three years, all in the hope that decreased supply will lift uranium prices beyond the $20-something range per pound, which is below the cost of production. The effect was to give a short-term boost to the uranium spot price. Recently the Kazakh Energy Minister suggested that there would be another 6% production cut, to 56.2 million pounds.

Since 2016, between 30 and 33 million pounds of mined uranium has been curtailed, representing about 23% of global production.

As mentioned, uranium mines will only produce around 135 million pounds in 2018, compared to demand of about 190 million pounds. That leaves a shortfall of roughly 55 million pounds. This shortfall could be met with secondary supply ie. uranium that is stockpiled by governments and utilities for strategic reasons. However, much of this supply is locked up and not available for the market. It's not "mobile", meaning it cannot be counted on to add to primary mined supply.

Back to the long-term contracts. Over the next seven years the majority of them are going to expire. The utilities could buy uranium on the spot market, and with the price in the low-$20s, this would make sense. But heavy buying would drive the spot price higher, so they don't really want to do this. They prefer to negotiate long-term contracts at a slightly higher price, say $30 a pound. But this price is still low for uranium miners to make profits. The lowest-cost producing mine breaks even at $20 a pound. They need higher prices. How do they get higher prices? By cutting production. So uranium miners are likely to keep slashing production to drive up contract prices.

There's one more factor affecting uranium supply: depleted uranium mines. Big mines like Ranger in Australia, and Rossing in Africa are running out of ore. As the grades become too low to be economic, these multi-million (annual) pound producers will scale back production, or even close down, further inflating prices. The Ranger mine operated by Rio Tinto will stop operating in 2021 and is slated for closure in 2026. Paladin Energy has cancelled a planned expansion and has shuttered its aging Langer Heinrich open-pit mine in Namibia.

Depleting spot supply = higher prices

On top of constrained mine production, coupled with higher demand for nuclear energy as new reactors get built, there is expected to be more buying on the spot market which is about to put upward pressure on the spot price. Let's take Cameco as an example. The Canadian producer has closed down mines, but it still committed to supplying uranium to its long-term contracts with utilities. With prices so low, it's actually cheaper for Cameco to buy uranium on the spot market than to mine it. Cameco will have to buy 8 to 10 million pounds of spot uranium over the next six months or so. This represents around a quarter of the spot market. And with Cameco just announcing that it has suspended production at McArthur River/ Key Lake indefinitely, Cameco is likely going to buy even more.

Second, enter a new uranium holding company aptly named "Yellow Cake". Over the last few months this London-based fund raised US$200 million in an IPO and bought 8.1 million pounds of uranium from Kazatomprom - uranium that would otherwise have been sold into the spot market. The material is being held at Cameco's storage facility in Ontario.

So between Cameco and the Yellow Cake fund, these two entities are either buying (in the case of Cameco) or withholding from (Yellow Cake) the spot market, an amount equivalent to about 50% of the total spot market for uranium. Another 6.5 million pounds has been stripped out of the spot market by producers or funds last year and this year (see graphic below), for a total of 24.6 million pounds.

This is bound to spark an upward price reaction in the spot market - something that Cameco and Kazatomprom, which represent around 60% of the uranium market, would love to see.

Cameco is a publicly traded company whose shares rise and fall with the spot uranium price. And they've just laid off hundreds of workers. State-run Kazatomprom is planning on doing an IPO on 25% of the company. They don't want to IPO with the uranium price in the low-$20s. Instead, they're hoping to push it into the $30s or beyond, which would command a much higher IPO price.

Why uranium tariffs won't work

Back to Trump's uranium tariffs. Can US nuclear utilities really be forced to buy American uranium when the country is 90% dependent on foreign imports? And could they even produce enough? The answer of course is no. The US uses 50 million pounds of U3O8 annually but only produced 2.5 million pounds last year. US nuclear utilities get the rest of what they need from Canada, Australia, Russia, Kazakhstan and Kyrgyzstan. This makes the United States the most vulnerable country to the risk of uncovered uranium. While the US consumes the most uranium, with its 99 reactors, it only produces enough fuel for one reactor.

According to David Talbot, the most knowledgeable uranium analyst, it's just not feasible for US uranium producers to be able to ramp up to the level required (12 million tonnes per annum) without significantly higher uranium prices to make increased output profitable:

Even if a political threat is determined by DOC, we don't expect the US gov't to force utilities to buy up to ¼ of its requirements domestically as recommended by the producers. While the US might have sufficient licensed production capacity and ample resources to cover, based on the current state of the industry we don't believe US producers are capable to increase production from an expected near 1-2 MM lbs in 2018 to beyond 12 MM lbs pa, in the absence of higher uranium prices. About 4-5 MM lbs pa of stable US production seems more likely, although again higher prices are likely required to provide production incentive.

And while Russia would gladly disrupt its shipments to the US in the event of a US-Russia trade war, including uranium, Talbot writes that even with other importers stepping in to replace Russian imports, "it could result in rapid price appreciation." While this would be good for uranium producers and investors, it would be bad for nuclear utilities, and ultimately, power consumers. It's another unintended consequence (like the auto industry for steel tariffs) of the Trump tariffs on a domestic industry dependent on imports. Another key point: If US nuclear utilities think that section 232 is going to be imposed on the uranium/ nuclear sector, these companies will start buying on the spot market, where U3O8 can be purchased for cheap, because they know the price will go up if uranium tariffs come into play. In other words, the threat of uranium tariffs will put more upward pressure on the spot price.

Conclusion

The uranium price is going to rise and when it does, uranium explorers, producers and investors are going to get taken for a very exciting ride. The uranium market is looking at a perfect storm of factors that are very good for U investors right now. Despite its perceived risks, nuclear is a green form of power generation that is emissions-free. The return to nuclear power for uranium-dependent Japan is already happening. The global demand for U3O8 is very likely to increase not only due to that 76% figure mentioned at the top, but because of the need for more power to run electric vehicles. When EVs are plugged in, where does the power come from to recharge them?

A bear market in uranium since 2012 has dropped the price to a point where uranium is no longer profitable to mine for most producers. Hence the shutdowns of major uranium mines like McArthur River, Langer Heinrich, and curtailment of production from Kazatomprom. On top of that, big funds are emerging to buy uranium from the spot market. Top producers like Cameco are also buying from spot in order to keep fulfilling its long-term contracts despite cutting production. In the next seven years three-quarters of uranium contracts will expire. Re-contracting will have to take place before then, or before all the uranium in the spot market disappears. Utilities need to re-sign long-term contracts to ensure their uncovered demands are met, and as shown above, uncovered demand is increasing.

The shift in the spot market is key; with so much buying going to come into the spot market, it's only a matter of time before the price responds in kind.

I've got restricted uranium supply due to shutdowns and depleted mines, steady demand due to global electrification needs and EVs, heavy buying on the spot market and a select junior uranium explorer (juniors historically offer the most leverage to a rising commodity price) on my radar screen.

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Richard is the owner of Aheadoftheherd.com and invests in the junior resource/bio-tech sectors. His articles have been published on over 400 websites, including:

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If you're interested in learning more about the junior resource and bio-med sectors, and quality individual company's within these sectors, please come and visit us at www.aheadoftheherd.com

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Weekly Ratings, Targets, Forecast Changes

By Rudi Filapek-Vandyck, Editor FNArena

Guide:

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

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

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

Summary

Period: Monday August 13 to Friday August 17, 2018 Total Upgrades: 12 Total Downgrades: 28 Net Ratings Breakdown: Buy 43.19%; Hold 41.16%; Sell 15.64%

We are past the halfway mark of the month, and past halfway in the local reporting season if we measure by market capitalisation, but far from it in terms of numbers of Australian companies reporting.

And it is raining downgrades for individual ASX-listed entities. For the week ending Friday, 17th August 2018, FNArena registered no less than 28 downgrades against twelve upgrades. Six out of the dozen upgrades only moved as far as Neutral/Hold.

REA Group was the sole recipient of two upgrades, with only one moving to Buy.

Clearly, there was more action going on in the downgrade department, though only five out of the 28 moved to a Sell rating. Aurizon received two downgrades, CSL did so too, GPT was downgraded four times, while ASX20 members Origin Energy and Telstra also received two downgrades each. Telstra was the only one on that list to receive a fresh Sell rating.

Consensus target prices provided a positive offset in that average increases proved larger than downward adjustments. Resurrected Phoenix Baby Bunting enjoyed the week's largest gain (67%), followed by CSL, New Hope, Magellan Financial and Wesfarmers. On the negative side, the largest blow was aimed at Pact Group (-18%), followed by AGL Energy, SG Fleet, Origin Energy and Challenger.

Baby Bunting also tops the table for positive revisions to earnings estimates, handsomely beating BlueScope Steel, Origin Energy, Treasury Wine Estates, REA Group and Magellan Financial. Note the gains booked by these stocks range between 60% for Baby Bunting and 20% for Magelllan.

The table for negative adjustments is this week cut short due to a technical problem, but it is clear nevertheless negative adjustments have been smaller than positive revisions during the week; that can only be a further positive. Aveo Group was hit hardest, followed by Telstra and Pilbara Minerals.

The local reporting season accelerates into much higher numbers in the week ahead.

Upgrade

BELLAMY'S AUSTRALIA LIMITED ((BAL)) Upgrade to Add from Hold by Morgans .B/H/S: 2/0/0

The company's share price has fallen around -60% from its March high, which Morgans attributes to the delay in receiving registration for its Chinese labelled infant formula products. The delay is likely due to the merger of several of China's agencies into a single regulatory body.

Morgans likes the stock and believes the delay has afforded investors the opportunity to acquire a company with a premium brand operating in a growing category.

With the stock oversold and evidence that China's regulatory agency SAMR is back in business Morgans upgrades to an Add rating from Hold. Target is reduced to $13.00 from $18.50.

COMPUTERSHARE LIMITED ((CPU)) Upgrade to Hold from Sell by Deutsche Bank .B/H/S: 0/6/1

FY18 results were in line with guidance and growth was supported by higher margin income and an improved performance in the US, Deutsche Bank observes. Management EPS was up 14.1% in constant currency terms.

The broker upgrades to Hold from Sell on the back of stronger than expected margins in the US mortgage services. Target is $19.20.

DOWNER EDI LIMITED ((DOW)) Upgrade to Outperform from Neutral by Credit Suisse .B/H/S: 5/0/0

Downer delivered a full-year result in line with guidance for the seventh year in a row. Management provided a very confident FY19 outlook, Credit Suisse notes, underpinned by expected significant improvement from Spotless.

Ongoing state government investment in infrastructure and a strong resources sector translate to attractive growth opportunities for Downer. The risk profile is thus improving, leading Credit Suisse to upgrade to Outperform from Neutral. Target rises to $8.25 from $7.00.

INDEPENDENCE GROUP NL ((IGO)) Upgrade to Neutral from Underperform by Macquarie .B/H/S: 2/3/2

While the ramp up at Nova is complete, Macquarie notes hitting guidance remains key to the outlook. The broker believes FY19 production and cost guidance is the critical target, given the number of downgrades to guidance the mine has suffered to date.

Following the fall in the share price stock is now trading at a modest discount to the target, raised to $4.70 from $4.50, and Macquarie upgrades to Neutral from Underperform.

JAMES HARDIE INDUSTRIES N.V. ((JHX)) Upgrade to Hold from Lighten by Ord Minnett .B/H/S: 5/2/0

First quarter net profit was below estimates but Ord Minnett is pleased to observe that exterior volume growth has returned to a rate above the segment's market index. The broker notes management is positive about the Fermacell business.

Rating is upgraded to Hold from Lighten based on valuation. Target is raised to $23.00 from $22.30.

MCMILLAN SHAKESPEARE LIMITED ((MMS)) Upgrade to Buy from Neutral by Citi .B/H/S: 1/3/0

Citi has made a valuation call, upgrading to Buy from Neutral. Target price has increased to $17.26 from $16.69.

It is the stockbroker's view that organic growth in novated leasing and salary packaging remains robust, while discussions from industry participants seem to be indicating good opportunities for ongoing growth as some fleets transition from corporate to consumer.

OZ MINERALS LIMITED ((OZL)) Upgrade to Buy from Neutral by UBS .B/H/S: 5/2/0

UBS believes the share price has fallen too deeply, probably on the back of a weakening copper price. Hence the decision was made to upgrade to Buy from Neutral. Target price has lifted to $11.00 from $10.50.

About the FY18 result, the analysts suggest it came out ahead of expectations, with Carrapateena on schedule and on budget.

REA GROUP LIMITED ((REA)) Upgrade to Add from Hold by Morgans and Upgrade to Neutral from Underperform by Macquarie .B/H/S: 3/3/1

REA remains on track to deliver 20%+ earnings growth in FY19, Morgans suggests, following the recent expansion in the number of agents subscribing to Premiere All and Highlight All packages. The notable increase offsets the impact of a -5% drop in capital city listings.

REA is thus more insulated from the impact of falling house prices than market concerns would suggest, Morgans believes. The US and Asian businesses are also contributing, albeit at a slower pace than domestically. Target rises to $95.41 from $87.66. Upgrade to Add from Hold.

FY18 earnings were in line with expectations. Macquarie has a more positive outlook for mix and depth penetration heading into FY19, to offset volume weakness.

The broker lifts the target 4.7% to $90 and upgrades to Neutral from Underperform.

SG FLEET GROUP LIMITED ((SGF)) Upgrade to Buy from Neutral by Citi .B/H/S: 2/1/0

Citi has decided to upgrade to Buy from Neutral on management's signals that acquisitions remain very much on the agenda. The FY18 report itself was a "beat", as already established on the day of the release (see Broker Call Report yesterday).

It is the analysts view that rather modest organic growth will be supplemented by increased penetration of clients with services offerings, apart from acquisitions. Target price loses -3% to $4.18.

Citi analysts have earlier speculated about potential synergies were SG Fleet to combine with EclipX ((ECX)) and that speculation is again hinted at today.

WESFARMERS LIMITED ((WES)) Upgrade to Hold from Lighten by Ord Minnett .B/H/S: 0/5/2

Wesfarmers' FY18 result beat the broker by a nose thanks to department store operations and the chemicals, energy and fertilisers business. The $1.20 dividend missed the broker's $1.22 estimate.

Despite signs of slower sales from Bunnings, Ord Minnett believes sales will moderate rather than fall sharply.

The broker notes valuation support is emerging for Wesfarmers thanks to higher EBIT, lower capex, an improved business mix, and growing potential for capital management.

The broker upgrades to Hold from Lighten and increases the target price to $50 from $45.

WOODSIDE PETROLEUM LIMITED ((WPL)) Upgrade to Neutral from Sell by Citi .B/H/S: 2/5/1

First half results slightly missed forecasts. Citi increases the value for Browse in its analysis. However, tolling revenue for the North West Shelf is reduced, which is a net positive, the broker suggests, considering Woodside has a larger equity interest in Browse.

First half dividend exceeded the company's 80% pay-out ratio but, assuming no repeat of one-offs, Citi suspects the second half dividend will return to normal. Rating is upgraded to Neutral from Sell. Target is raised to $34.14 from $30.07.

Downgrade

THE A2 MILK COMPANY LIMITED ((A2M)) Downgrade to Neutral from Outperform by Credit Suisse .B/H/S: 3/2/1

A new analyst has taken up coverage of a2 at Credit Suisse, with the broker having not updated since February. The result is a downgrade to Neutral from Outperform and a target reduction to NZ$11.90 from NZ$12.75.

Supply diversification, expended distribution and China growth are all positive drivers but there's more to do, the broker suggests, and risks remain while the price is heavily influenced by momentum trading. The share price has been weak since May but is in line with the broker's valuation.

AUSTRALIA & NEW ZEALAND BANKING GROUP ((ANZ)) Downgrade to Hold from Add by Morgans .B/H/S: 3/5/0

Morgans finds the extent of the slowdown in the bank's owner-occupied home loan portfolio baffling and suspects that margin pressures in the institutional business may also be intensifying.

While the ongoing benign credit environment is assisting, the broker notes the low charge in the third quarter was also affected by a high level of write-backs and recoveries in the institutional loan book. Morgans downgrades to Hold from Add because of share price strength. Target is raised to $30 from $29.

AURIZON HOLDINGS LIMITED ((AZJ)) Downgrade to Neutral from Buy by UBS and Downgrade to Neutral from Outperform by Credit Suisse .B/H/S: 1/4/3

UBS analysts highlight the risks and challenges that lay ahead for this company, forecasting a flat EPS growth profile for the next four years. While observing the stock has recovered from its lows, the rating is being pulled back to Neutral from Buy.

Even though cash flows will settle at a lower level, UBS analysts still think Aurizon is now a true yield stock, forecast to still offer 7% after the UT5 regulated revenue step-down. Valuation/target remains unchanged at $4.60.

Aurizon's result was slightly ahead of consensus, Credit Suisse reports. Looking ahead, the broker sees a company fighting on too many fronts. It is facing three material court cases, the UT5 regulatory review remains challenging, and labour negotiations with some 80% of staff remain ongoing in the face of a weak safety performance.

Credit Suisse forecasts lower earnings than FY18 right out to FY22. The dividend payout is expected to fall in FY19 before recovering in FY20. The broker drops its target to $4.60 from $4.75 and downgrades to Neutral from Outperform, suggesting a more attractive entry point lies ahead.

BEACH ENERGY LIMITED ((BPT)) Downgrade to Underperform from Neutral by Macquarie .B/H/S: 1/3/2

The company will announce FY18 results on August 20. Macquarie expects production for FY19 to be around 29.5mmboe, an increase in volume because of the higher Cooper and Otway Basins' production.

The broker downgrades to Underperform from Neutral believing, with oil prices stabilising and cost reductions primarily completed, the path ahead will become more challenging and more costly to sustain. The target is $1.90.

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

Challenger's FY18 results fell -4% shy of the broker, triggering a downgrade to Neutral from Outperform and a target reduction to $12 from $13.20.

Challenger posted a -22 basis point reduction in common operating environment margins, thanks largely to gyrations in capital markets. It also posted a one-off loss of income on Insurance Linked Securities.

Credit Suisse expects asset yield pressures to continue into FY19, and Challenger's guidance flags a higher tax rate.

CSL LIMITED ((CSL)) Downgrade to Neutral from Buy by Citi and Downgrade to Neutral from Buy by UBS .B/H/S: 2/6/0

Citi analysts have downgraded, inspired by "valuation", to Neutral from Buy while retaining a price target of $232. The analysts note the shares are now trading at a 31% and 35% premium over the 3-yr trading average P/E and EV/EBITDA, respectively.

In a general sense, Citi remains of the view this company's investments in R&D and capex should allow it to maintain its market leading position in innovation and plasma. Citi sits above market consensus, anticipating 3-yr EPS CAGR of 12-14%.

FY18 net profit was in line with UBS estimates. The broker notes revenue growth in Behring product and a strong performance in Seqirus. The broker forecasts a similar outlook for FY19, albeit with a step up in R&D and capital expenditure.

Rating is downgraded to Neutral from Buy. Target rises to $220 from $196.

DOMINO'S PIZZA ENTERPRISES LIMITED ((DMP)) Downgrade to Lighten from Hold by Ord Minnett .B/H/S: 3/1/3

Domino's Pizza's FY18 profit missed guidance of 20% growth and fell marginally short of the broker. FY19 guidance also missed consensus. Ord Minnett reduces FY19 and FY20 EPS estimates, reflecting weaker same-store sales.

Target price is reduced to $42.50 from $47. Ord Minnett notes that a question mark over expansion targets translates into a less attractive valuation on a discounted cash flow basis. Also, the price-earnings multiple is still too high in the broker's opinion.

The broker downgrades to Lighten from Hold, noting growth headwinds, lower FY19 guidance and missed guidance for FY18. Risk rating is Higher.

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

Dexus Property's FY18 result was in line with the broker's estimates. FY19 guidance outpaced the broker by 2%, triggering an earnings upgrade for FY19 through to FY21.

Ord Minnett notes 95% office occupancy and 98% industrial occupancy, a gearing ratio of 24% and an average debt maturity of seven years. Net tangible asset backing rose 14%, closing the gap with the broker's valuation.

Ord Minnett downgrades to Hold from Accumulate. Target price jumps to $10.50 from $9.50.

GPT ((GPT)) Downgrade to Neutral from Outperform by Credit Suisse and Downgrade to Neutral from Outperform by Macquarie and Downgrade to Neutral from Buy by Citi and Downgrade to Hold from Accumulate by Ord Minnett .B/H/S: 0/6/1

GPT Group's half-year result beat the broker by a nose and maintained FY19 guidance. Credit Suisse is optimistic on the Office portfolio but cautious on the Retail portfolio, and reduces FFO forecasts -4% across FY18-20.

The broker downgrades to Neutral from Outperform, reflecting concern over timing of disposals, particularly Wollongong Central, and reduced assumptions for net operating income and higher debt costs. Rising risks from development overruns, leasing shortfalls and a further deterioration in retail are also of concern to the broker.

Target price rises to $5.39 from $5.35.

2018 guidance has been reaffirmed for growth in FFO of 3%. Macquarie had expected an upgrade to 2018 earnings growth estimates because the sale of Wollongong Central was not proceeding. However, this was not the case.

Despite the potential for re-gearing to supplement growth there are limited catalysts in the near term and the broker downgrades to Neutral from Outperform. Target is $5.47.

The interim report was in line but Citi analysts had been anticipating an upgrade with the FY18 guidance, and it didn't arrive. Higher debt costs seem to be the culprit, the analysts comment today.

Citi analysts also found the tone on retail was more cautious than expected. Target price moves to $5.53 from $5.54. Downgrade to Neutral from Buy.

GPT reported a half-year profit in line with the broker. Higher than expected capital expenditure on retail assets has caused Ord Minnett to cut free-cash-flow forecasts by -6% for CY18, -11% for CY20 and -3% for CY21, which is dilutive to valuation.

The broker shifts it rating to Hold from Accumulate to reflect these changes and recent share-price strength. Target price eases to $5.15 from $5.35.

INFOMEDIA LTD ((IFM)) Downgrade to Neutral from Buy by UBS .B/H/S: 0/1/0

FY18 earnings beat UBS estimates, predominantly driven by revenue growth in Superservice. The broker expects strong earnings growth and margin expansion in FY19 but retains conservative forecasts, and does not extrapolate the second half FY18 outcome as it contained a few one-offs.

UBS downgrades to Neutral from Buy, believing the outlook is largely reflected in the share price. Targets raised to $1.30 from $0.95.

NEW HOPE CORPORATION LIMITED ((NHC)) Downgrade to Hold from Add by Morgans .B/H/S: 1/2/0

The company has negotiated to buy Wesfarmers' ((WES)) 40% stake in Bengalla. A lift in Morgans' long-term coal price assumptions amplifies the valuation uplift.

The broker suggests the stock now appears expensive for value investors, but ongoing coal price momentum and the company's increasing leverage can sustain a premium for momentum investors. Rating is downgraded to Hold from Add. Target is raised to $3.20 from $2.36.

1300 SMILES LIMITED ((ONT)) Downgrade to Hold from Add by Morgans .B/H/S: 0/1/0

1300 Smiles' FY18 result fell well short of the broker, triggering a downgrade to Hold from Add. Morgans blames the weakness on the timing and scale of acquisitions and margin compression.

No guidance was provided so the broker reduces growth forecasts, assuming a benign environment. Target price falls to $6.85 from $6.69.

ORIGIN ENERGY LIMITED ((ORG)) Downgrade to Hold from Accumulate by Ord Minnett and Downgrade to Neutral from Outperform by Credit Suisse .B/H/S: 4/4/0

FY18 net profit was -14% below Ord Minnett's estimates. The contribution from energy markets was above expectations but the performance of the APLNG business fell short.

Ord Minnett finds it difficult to remain positive, given the scale of the downgrades to its estimates, these being -32% for FY19 and -21% for FY20. Rating is downgraded to Hold from Accumulate. Target is reduced to $9.40 from $10.30.

Origin's result missed Credit Suisse and consensus and FY19 energy markets guidance is well below the broker's forecast. The impact of competition and concessionary measures is greater than expected implying retail margins are lower, as the broker found with peer AGL Energy ((AGL)).

The good news is dividends should be reinstated in FY19 as deleveraging continues, supported by strong oil prices, but the deleveraging story is no longer enough, Credit Suisse contends. Downgrade to Neutral from Outperform. Target falls to $9.70 from $10.50.

PACT GROUP HOLDINGS LTD ((PGH)) Downgrade to Neutral from Outperform by Credit Suisse .B/H/S: 1/4/0

Credit Suisse's response to Pact's "bad miss" is to cut forecast earnings by -20%, the target to $4.35 from $5.80 and downgrade to Neutral from Outperform.

Volumes were lower and costs higher than the broker expected, and FY19 is not yet offering much relief. The broker suggests Pact is prioritising acquisitions ahead of fixing the core business.

PLATINUM ASSET MANAGEMENT LIMITED ((PTM)) Downgrade to Sell from Buy by Ord Minnett .B/H/S: 0/2/2

Ord Minnett observes the relative and absolute performance has waned over the last six months. Flows remain reasonable but the broker envisages deterioration leading into FY19. Having upgraded in May on the back of flow momentum, Ord Minnett now downgrades on new evidence including a negative -2.2% absolute performance for the international fund for August.

Ord Minnett suspects a softer FY18 result will be forthcoming and several factors combine, leading to a downgrade to Sell from Buy. Target is reduced to $4.77 from $6.50.

SONIC HEALTHCARE LIMITED ((SHL)) Downgrade to Underperform from Neutral by Credit Suisse .B/H/S: 3/4/1

Sonic Healthcare's result was in line with Credit Suisse and guidance. The broker is forecasting no earnings growth in FY19, as higher pathology volume growth is offset by German and US fee cuts and the rising cost of consumables.

Despite a stable regulatory environment for local pathology, the broker sees limited margin expansion in Australia, and sees ongoing risks in Germany. The stock's premium valuation to the sector is overstretched, Credit Suisse believes. Downgrade to Underperform from Neutral. Target falls to $23.50 from $24.00.

SUNCORP GROUP LIMITED ((SUN)) Downgrade to Neutral from Buy by Citi .B/H/S: 2/5/1

Citi saw a positive surprise from the insurance business. Further expansion in underlying margin past management's 12% guidance now looks likely in FY19, in the analysts' view.

In contrast, the banking operations are doing it tougher, also because of less opportunity to collect non-interest income and increased regulatory compliance costs. This is now the weak link in the group, argue the analysts.

Alas, all the good news is being offset by what looks like a full valuation, in Citi's opinion. Neutral rating now preferred, downgrade from Buy, while the price target rises to $16 from $15.35.

TELSTRA CORPORATION LIMITED ((TLS)) Downgrade to Underperform from Neutral by Macquarie and Downgrade to Neutral from Buy by UBS .B/H/S: 4/1/3

Telstra's FY18 result was at the low end of consensus with unchanged guidance. The broker expects intensifying competition, particularly in the mobile market where earnings fell -11.6%, will outweigh positives going forward.

Macquarie raises EPS forecasts by 1.6% in FY19 but reduces FY20 and FY21 forecasts by -1.9% and -1.1% respectively.

The target price rises to $2.80 from $2.75 and given the recent run in the share price the broker downgrades to Underperform from Neutral.

FY18 results and FY19 guidance were both pre-announced. UBS downgrades to Neutral from Buy, given the recent re-rating of the stock. The broker still envisages some short-term earnings upside but finds it difficult to bridge revenue in FY18 to the mid point of FY19 guidance.

The broker envisages upside to the unchanged target of $3.00 from a more rational industry, 5G and the potential for TPG Telecom ((TPM)) to have a lesser impact than currently anticipated. Equally, the broker envisages downside to a $2.50 target if Telstra fails to execute on its plans and long-term EPS falls to around $0.14 per share.

TREASURY WINE ESTATES LIMITED ((TWE)) Downgrade to Equal-weight from Overweight by Morgan Stanley .B/H/S: 2/3/2

FY18 earnings were in line with expectations. However, Morgan Stanley notes operating cash flow conversion the quality of earnings deteriorated badly in the second half.

A higher Penfolds allocation, annualisation of the French portfolio and new Italian launches should drive revenue and earnings acceleration for Asia in FY19.

Despite very strong growth prospects the broker believes better buying opportunities will emerge and downgrades to Equal-weight from Overweight. $20 target retained. Industry view: Cautious.

WHITEHAVEN COAL LIMITED ((WHC)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 3/5/0

FY18 results were in line with expectations. Production guidance has been downgraded, particularly Narrabri, the highest margin mine. Costs are expected to rise to $64/t.

The company provided a surprise special dividend, but with no franking credits and net debt back up to $270m, Macquarie is curious why a buyback was not used.

Nevertheless, the broker suggests higher prices can erase a lot of problems. Rating is downgraded to Neutral from Outperform. Target is reduced to $5.10 from $5.70.

WISETECH GLOBAL LIMITED ((WTC)) Downgrade to Neutral from Buy by Citi .B/H/S: 1/3/1

Citi has made a valuation call on the stock, downgrading to Neutral from Buy. Target price has increased to $16.21 from $14.12.

Total Recommendations Recommendation Changes

Broker Recommendation Breakup

Broker Rating Order Company New Rating Old Rating Broker Upgrade 1 BELLAMY'S AUSTRALIA LIMITED Buy Neutral Morgans 2 COMPUTERSHARE LIMITED Neutral Sell Deutsche Bank 3 DOWNER EDI LIMITED Buy Neutral Credit Suisse 4 INDEPENDENCE GROUP NL Neutral Sell Macquarie 5 JAMES HARDIE INDUSTRIES N.V. Neutral Sell Ord Minnett 6 MCMILLAN SHAKESPEARE LIMITED Buy Neutral Citi 7 OZ MINERALS LIMITED Buy Neutral UBS 8 REA GROUP LIMITED Buy Neutral Morgans 9 REA GROUP LIMITED Neutral Sell Macquarie 10 SG FLEET GROUP LIMITED Buy Neutral Citi 11 WESFARMERS LIMITED Neutral Sell Ord Minnett 12 WOODSIDE PETROLEUM LIMITED Neutral Sell Citi Downgrade 13 1300 SMILES LIMITED Neutral Buy Morgans 14 AURIZON HOLDINGS LIMITED Neutral Buy UBS 15 AURIZON HOLDINGS LIMITED Neutral Buy Credit Suisse 16 AUSTRALIA & NEW ZEALAND BANKING GROUP Neutral Buy Morgans 17 BEACH ENERGY LIMITED Sell Neutral Macquarie 18 CHALLENGER LIMITED Neutral Buy Credit Suisse 19 CSL LIMITED Neutral Buy Citi 20 CSL LIMITED Neutral Buy UBS 21 DEXUS PROPERTY GROUP Neutral Buy Ord Minnett 22 DOMINO'S PIZZA ENTERPRISES LIMITED Sell Neutral Ord Minnett 23 GPT Neutral Buy Macquarie 24 GPT Neutral Buy Citi 25 GPT Neutral Buy Credit Suisse 26 GPT Neutral Buy Ord Minnett 27 INFOMEDIA LTD Neutral Buy UBS 28 NEW HOPE CORPORATION LIMITED Neutral Buy Morgans 29 ORIGIN ENERGY LIMITED Neutral Buy Credit Suisse 30 ORIGIN ENERGY LIMITED Neutral Buy Ord Minnett 31 PACT GROUP HOLDINGS LTD Neutral Buy Credit Suisse 32 PLATINUM ASSET MANAGEMENT LIMITED Sell Buy Ord Minnett 33 SONIC HEALTHCARE LIMITED Sell Neutral Credit Suisse 34 SUNCORP GROUP LIMITED Neutral Buy Citi 35 TELSTRA CORPORATION LIMITED Sell Neutral Macquarie 36 TELSTRA CORPORATION LIMITED Neutral Buy UBS 37 THE A2 MILK COMPANY LIMITED Neutral Buy Credit Suisse 38 TREASURY WINE ESTATES LIMITED Neutral Buy Morgan Stanley 39 WHITEHAVEN COAL LIMITED Neutral Buy Macquarie 40 WISETECH GLOBAL LIMITED Neutral Buy Citi Recommendation Positive Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 SGF SG FLEET GROUP LIMITED 67.0% 33.0% 34.0% 3 2 REA REA GROUP LIMITED 19.0% -6.0% 25.0% 8 3 BBN BABY BUNTING GROUP LIMITED 75.0% 50.0% 25.0% 4 4 DOW DOWNER EDI LIMITED 75.0% 58.0% 17.0% 6 5 IGO INDEPENDENCE GROUP NL -7.0% -21.0% 14.0% 7 6 CPU COMPUTERSHARE LIMITED -19.0% -31.0% 12.0% 8 7 HT1 HT&E LIMITED 60.0% 50.0% 10.0% 5 8 JHX JAMES HARDIE INDUSTRIES N.V. 71.0% 64.0% 7.0% 7 9 WES WESFARMERS LIMITED -29.0% -36.0% 7.0% 7 10 OZL OZ MINERALS LIMITED 71.0% 67.0% 4.0% 7 Negative Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 GPT GPT -14.0% 25.0% -39.0% 7 2 NHC NEW HOPE CORPORATION LIMITED 33.0% 67.0% -34.0% 3 3 AGL AGL ENERGY LIMITED 6.0% 36.0% -30.0% 8 4 TLS TELSTRA CORPORATION LIMITED 6.0% 31.0% -25.0% 8 5 CSL CSL LIMITED 25.0% 50.0% -25.0% 8 6 PGH PACT GROUP HOLDINGS LTD 20.0% 40.0% -20.0% 5 7 ORG ORIGIN ENERGY LIMITED 50.0% 69.0% -19.0% 8 8 A2M THE A2 MILK COMPANY LIMITED 33.0% 50.0% -17.0% 6 9 MFG MAGELLAN FINANCIAL GROUP LIMITED 33.0% 50.0% -17.0% 6 10 MGR MIRVAC GROUP 7.0% 21.0% -14.0% 7 Target Price Positive Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 BBN BABY BUNTING GROUP LIMITED 2.653 1.588 67.07% 4 2 CSL CSL LIMITED 213.638 192.375 11.05% 8 3 NHC NEW HOPE CORPORATION LIMITED 3.083 2.803 9.99% 3 4 MFG MAGELLAN FINANCIAL GROUP LIMITED 28.607 26.797 6.75% 6 5 WES WESFARMERS LIMITED 47.406 44.979 5.40% 7 6 DOW DOWNER EDI LIMITED 7.962 7.565 5.25% 6 7 TWE TREASURY WINE ESTATES LIMITED 18.316 17.416 5.17% 7 8 SUN SUNCORP GROUP LIMITED 15.230 14.606 4.27% 8 9 CPU COMPUTERSHARE LIMITED 18.103 17.403 4.02% 8 10 REA REA GROUP LIMITED 87.926 84.708 3.80% 8 Negative Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 PGH PACT GROUP HOLDINGS LTD 4.706 5.776 -18.52% 5 2 AGL AGL ENERGY LIMITED 21.539 23.924 -9.97% 8 3 SGF SG FLEET GROUP LIMITED 3.867 4.277 -9.59% 3 4 ORG ORIGIN ENERGY LIMITED 9.796 10.321 -5.09% 8 5 CGF CHALLENGER LIMITED 11.643 12.234 -4.83% 8 6 JHX JAMES HARDIE INDUSTRIES N.V. 24.457 25.079 -2.48% 7 7 AMP AMP LIMITED 3.873 3.958 -2.15% 8 8 NAB NATIONAL AUSTRALIA BANK LIMITED 30.144 30.781 -2.07% 8 9 SCP SHOPPING CENTRES AUSTRALASIA PROPERTY GROUP 2.273 2.278 -0.22% 4 Earning Forecast Positive Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 BBN BABY BUNTING GROUP LIMITED 12.325 7.675 60.59% 4 2 BSL BLUESCOPE STEEL LIMITED 216.233 149.333 44.80% 7 3 ORG ORIGIN ENERGY LIMITED 71.413 52.668 35.59% 8 4 TWE TREASURY WINE ESTATES LIMITED 63.967 49.026 30.48% 7 5 REA REA GROUP LIMITED 259.986 214.271 21.34% 8 6 MFG MAGELLAN FINANCIAL GROUP LIMITED 168.150 139.983 20.12% 6 7 WES WESFARMERS LIMITED 273.257 228.938 19.36% 7 8 MIN MINERAL RESOURCES LIMITED 145.600 122.100 19.25% 3 9 DOW DOWNER EDI LIMITED 49.080 41.242 19.00% 6 10 DHG DOMAIN HOLDINGS AUSTRALIA LIMITED 10.486 9.073 15.57% 7 Negative Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs

Uranium Week: Increasing Power

Global nuclear power generation marked its fifth successive increase in 2017, as last week spot market activity surged on price variance across the globe.

-Nuclear power increasing -Kazatomprom to go public -Arbitrage activity boosts spot volumes

By Greg Peel

Global nuclear power generation increased in 2017 for the fifth successive year to provide more than 10% of global electricity demand, according to the World Nuclear Association's World Nuclear Performance Report released last week.

For new reactor projects, the average median construction time was 58 months, down from 74 months in the previous year and less than half of the time taken in the period 1996-2000. But only four new reactors began supplying power in 2017, down from ten in each of the previous two years.

The news comes as China reached a milestone with the world's first AP1000 plant reaching power generation last week. Testing will continue before the reactor goes into commercial service towards the end of the year. Another two AP1000s are expected to fire up by the end of 2018 and another in 2019.

Despatches from Kazakhstan

The Kazak government has reported a -6% decrease in uranium production in the first half of 2018 compared to the first half 2017. Kazakhstan – the global swing producer – has vowed to decrease production in 2018 to support prices but a similar promise made in 2017 fell short of target.

The government has promised a -20% reduction over three years.

As to what the policies of state-owned producer Kazatomprom will be in the future will be a matter of public consideration. Kazakhstan's sovereign wealth fund confirmed last week an initial public offering for Kazatomprom will be launched before year's end.

Busy Week

In the week prior, industry consultant TradeTech's weekly spot price indicator sat at US$26.10/lb, some 30% higher year on year. By the middle of last week, 800,000lbs U3O8 equivalent had changed hands at or near US$26.25/lb.

This brought out the sellers, and by week's end TradeTech's indicator had fallen to US$26.00/lb, down US10c on the week. A further 1.2mlbs changed hands to bring the week's total volume to an impressive 2mlbs. It was the first weekly price decline in two months.

TradeTech offers its price as an indicator but the consultant notes prices globally are currently fluctuating depending on delivery location. Delivery points in the US, Canada and Europe are seeing variance in prices, to the extent last week saw some traders arbitraging between locations. This no doubt boosted the volume.

Three transactions were reported in term markets last week – one for a total of 11mlbs U3O8 to be delivered in the period 2021-25. Two smaller transactions were for the 2025-26 period.

TradeTech's term market price indicators remain at US$29.50/lb (mid) and US$31.00/lb (long).

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 UIKeyInputLeftArrowamounts in this report refer to percentage of ordinary shares on issue.

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

Summary:

Week ending August 16, 2018

Last week saw the ASX200 rally to finally punch through 6300. It has since fallen back, thanks to Canberra.

Last week was the first week featuring a steady stream of corporate earnings results. It made little difference to short positions. The smattering of red and green below reflects incremental bracket creep.

The only mover of note was G8 Education ((GEM)), which reports next week. The child care centre operator has been under pressure of late due to rising competition in the space, leading to falling occupancy.

Last week saw G8 Education move up into the elite 10% shorted club with a rise to 10.2% from 9.2%, suggesting an earnings “miss” is being anticipated.

That’s all of note, hence no Movers & Shakers this week.

Weekly short positions as a percentage of market cap:

10%+

SYR 20.8 JBH 18.8 GXY 17.5 DMP 15.8 ORE 15.7 ING 13.0 MTS 12.0 MYR 11.7 VOC 10.6 GEM 10.2 HVN 10.2 GXL 10.0

In: GEM

9.0-9.9

IGO, IFL

Out: AAC, GEM 8.0-8.9%

AAC, NWS, CSR, BIN, NUF, NAN

In: AAC

7.0-7.9%

IVC, TNE, SFR, HT1, BWX, NEC, KAR, GMA

In: BWX, KAR

6.0-6.9%

FLT, MOC, SIG, MLX, MYO, PLS, SEK, NWL, BEN, GNC, SUL, BGA

In: BEN, SUL Out: KAR, BWX, RFG, CCP

5.0-5.9%

CCP, TPM, BKL, BAP, MYX, BLA, IPD, RSG, CAB, RFG, CLQ, QUB, AAD

In: CCP, RFG, CAB Out: SUL, BEN, NSR, WEB

Movers & Shakers

See above.

ASX20 Short Positions (%)

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

IMPORTANT INFORMATION ABOUT THIS REPORT

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

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

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

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

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

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

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

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

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

The Wrap: Drought, Energy, Anxiety & Property

Weekly Broker Wrap: drought; energy demand; consumer anxiety; property; and US elections.

-Severe east coast drought unlikely to impact on RBA policy -Demand for major fossil fuels not likely to peak until 2030 -Consumer anxiety rises sharply -Investors warming to the A-REIT sector -International trade may shape US mid-term elections

By Eva Brocklehurst

Drought

NSW, southern Queensland and northern Victoria are in the grip of the most serious drought since 2002-03. Serious rainfall deficiencies along with above-average temperatures have led to rapid dehydration, with sub-soil moisture levels in NSW at the third lowest level on record. Drought typically means farm GDP falls -25-35%, taking around one percentage point off net GDP.

Given circumstances are more favourable in Western Australia, ANZ analysts suspect the impact of this drought will be slightly less, probably around -0.6 percentage points, although the risk is tilted to the downside. The analysts do not believe the drought will have much impact on the trajectory of employment and underlying inflation.

Moreover, some farmers do have buffers, with farm management deposits at high levels thanks to the strong rise in agricultural incomes through 2016-17. The analysts expect the Reserve Bank of Australia will probably look through the drag on growth from the drought and it is unlikely to impact policy.

Energy Demand

DBS Group Research expects global energy demand will increase at an average rate of 1.5% per annum out to 2030, on the back of global GDP growth of around 3.25%. Despite a shift towards renewables, the analysis suggests demand for the three main fossil fuels - coal, oil, and natural gas - will not peak until 2030.

Natural gas demand is expected to be around 33% above 2016 levels in 2030 while demand for coal and oil will grow more slowly. Natural gas is supported by the Chinese government as a fuel that burns cleaner than oil or coal. China is targeting an increase in the overall proportion of natural gas to 15% of energy consumption by 2030.

Natural gas production in the US has boomed thanks to technological breakthroughs, allowing it to become a net natural gas exporter, and its LNG exports are set to quintuple by 2019 from 2017 levels. The US then will become the world's third-largest natural gas exporter by 2020, behind Australia and Qatar.

Passenger transport accounts for around 20% of global oil consumption and the DBS Group analysis suggests the increase in sales of electric vehicles will affect around 6% of oil demand by 2030. Supply is expected to be the key determinant for oil prices in the medium to longer term. The analysts expect the 2018 Brent crude oil price to average between US$70-75/bbl and in 2019 around US$65-70/bbl

The analysis also suggests coal usage is yet to peak in Asia, as coal accounts for around 50% of the energy mix. Slow growth is expected out to 2030 with declining demand from Europe and flat demand from China offset by growing demand from India and Southeast Asia. DBS Group forecasts a benchmark price for energy coal of US$75/t in FY18-20 and US$70/t in FY21 and beyond.

China's power supply has been dominated by coal but the mix is changing to include more wind and solar power. The analysts expect from 2020 to 2030 non-hydro renewable energy will account for a 53% increase in China's power generation. Advances in technology are driving down the construction and operating costs of wind and solar farms and renewable energy may reach tariff parity with coal earlier than expected.

Consumer Anxiety

National Australia Bank's index of consumer anxiety rose sharply in the June quarter as concerns about the economy and household finances grew. Anxiety was highest in Western Australia and lowest in Tasmania. Consumers have indicated they are more concerned about their household financial position than at any time since late 2016.

Being unable to finance retirement remains the biggest worry followed by the ability to provide for their family's future and raise $2000 for an emergency. Hence, the measure of household spending behaviour reveals a consumer reluctant to spend on non-essentials with more expenditure on essential goods and services, particularly utilities.

Hardship is more prevalent amongst women and also rose for 30-49-year-olds. However, in the June quarter the measure fell notably for 18-29-year-olds, particularly men. Being unable to pay a bill was the most common cause of hardship, for around one in five consumers overall.

Property

Thinktank, in its quarterly market update, observes Australian real estate investment trusts (A-REITs) did well in FY18, climbing back from trading at a discount to book values.

A recognition that unit prices were trading at below net asset values has pushed up A-REIT prices as investors warmed to the sector. Commentators paid close attention to residential markets during the June quarter, amid a further levelling of the Sydney and Melbourne markets.

Macro prudential tightening by the Australian Prudential Regulatory Authority (APRA) has had its desired impact. So much so that the regulator has announced it will remove restrictions on authorised deposit-taking institutions (ADI) lending to investors.

Office markets, meanwhile, have improved, along with falling incentives, particularly so in Sydney. Vacancy rates remain high in Adelaide and Brisbane as these cities experience weaker demand for office space. Perth has improved slightly but vacancy rates for secondary properties remain high as tenants take advantage of favourable conditions to upgrade premises.

Thinktank notes the CBD office sector is strong in Sydney and continues to improve, with withdrawals playing a large role. In Melbourne higher levels of net absorption continue to keep the market strong on an improving trend. Both cities report low vacancy rates and some modest tightening of yields. The analysts note, even in weaker leasing markets, such as Brisbane, yields for prime properties have fallen.

In the retail A-REIT sector CBD yields continue to be stable in most capitals and yields are also not that much higher in regional centres. It remains to be seen whether the weakness in retail businesses will be reflected in retail property prices and the analysts suggest it may take an increase in interest rates to trigger a re-evaluation, although owners remain confident in their ability to replace vacating tenants.

In the industrial sector the analysts retain a positive view for Sydney as rents are tightening. Perth has an oversupply of available property relative to demand and is considered to be approaching the bottom of the market. Industrial rental levels across the country are stable, except in Perth, although yields continue to tighten everywhere.

US Elections

In November the US will vote on its legislative government, commonly known as the mid-terms. All 438 members of the House of Representatives and 35 of 100 Senate seats will be decided. ANZ analysts believe the race for the lower house is too close to call. There are around 115 seats that could be up for grabs and these would be enough to sway the majority of the house.

The Democrats face a battle in the Senate, the analysts observe. Of the 35 seats to be decided, 26 are currently held by Democrats and only nine by Republicans. The Democrats would have to successfully defend all 26 and win over two Republican seats in order to have a majority in the Senate.

The analysts suggest, for the Republicans, losing the House would hamper their ability to put forth new laws and engage in further reform on contentious policies. However, the Democrats would also be unable to implement new policy as the Senate is unlikely to approve motions. Meanwhile, even if both the House and Senate majorities change, the president will still hold veto power.

One issue that may shape the elections is international trade. The ANZ analysts suggest this is been a contentious issue under the Trump presidency. Aside from the blanket tariff on steel and aluminium, the president has unilaterally imposed tariffs on many Chinese imports.

China has reciprocated with its own tariffs, particularly damaging to US farmers. Reduced farm income is expected to weigh on consumption and confidence. On the import side, tariffs will raise domestic prices and erode purchasing power.

August Results Thus Far: Quality, Costs And Dividends

In this week's Weekly Insights:

-August Results Thus Far: Quality, Costs And Dividends -Rudi In The Australian -Rudi On TV -Rudi On Tour

August Results Thus Far: Quality, Costs And Dividends

By Rudi Filapek-Vandyck, Editor FNArena

One prediction made prior to the August corporate reporting season in Australia has proved to be 100% accurate: volatility has spiked in both directions on the back of corporate performance releases.

Making matters a little more complicated for investors is that share price responses on day one are not necessarily indicative of what follows next. Take JB Hi-Fi ((JBH)), for example. Its FY18 release was first met with share price weakness, but on the second day the shares rallied by 10%+ and they have been creeping higher since.

Shares in GUD Holdings ((GUD)) displayed a similar pattern, though not with the same magnitude. The same observation can be made for Zip Co ((Z1P)), as well as for Navigator Global ((NGI)), for Praemium ((PPS)), for ResMed ((RMD)), for Cochlear ((COH)), for Seek ((SEK)), and for Domino's Pizza ((DMP)).

Works the other way as well. News Corp ((NWS)) results seemed at first well-received, predominantly because of REA Group ((REA)), of course, but they've been falling since. Post result enthusiasm for Suncorp ((SUN)) did not last either. Ditto for Whitehaven Coal ((WHC)).

A second accurate pre-assessment was that cost inflation is starting to bite into companies' operational growth, and it's not just manufacturers and other industrial energy users that are feeling the squeeze; mining companies and energy producers themselves are equally battling to keep cost growth benign.

Heavy disappointments from the likes of Pact Group ((PGH)) and Ansell ((ANN) have thus been accompanied by cost growth disappointments from Rio Tinto ((RIO)), Origin Energy ((ORG)), and Beach Petroleum ((BPT)).

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And still, the earnings season remains relatively young. In terms of market capitalisation, circa 60% of the ASX200 has by now revealed their financial numbers for the six months ending June 30th, but in terms of actual releases we've not even crossed the one-third mark.

FNArena Corporate Results Monitor now contains 93 company results -we anticipate in excess of 300 by early September- and the good news is total "beats" are higher than total "misses" -30 against 26- but I have to add colleague Greg has been somewhat generous in his assessments by including the likes of QBE Insurance ((QBE)) and Hansen Technologies ((HSN)) as a "beat".

Stockbroking analysts are issuing more than twice as many downgrades as upgrades and earnings expectations essentially seem to be going nowhere, with increases on one hand being offset with reductions elsewhere. Maybe the most depressing observation is that, on Morgan Stanley's calculations thus far, only three local sectors have unequivocally enjoyed an increase to average profit growth forecasts; energy, consumer staples and telecom.

Sectors with the heaviest decline are industrials, utilities and discretionary retailers.

Market analysts at Deutsche Bank have tried to emphasise the positive in that forecasts for FY19 and FY20 are only declining by small percentages, as an average. In reality analysts' reductions are enormous, but they are huge in both directions, effectively offsetting each other, sort of.

Another important point made by Deutsche Bank is that commodity prices no longer imply free upside potential from here onwards, while, as we already established, costs are starting to bite for commodity producers as well. One of the key questions this month will thus be whether investor attitude towards miners and energy companies is about to change?

Interestingly, I note that on Deutsche Bank's assessment, the largest falls in profit growth forecasts to date have befallen the Resources sector (also the largest contributor to market growth estimates).

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One surprise thus far this month are companies further lifting their dividends and paying out specials. While this would be well-received by retirees and other shareholders, it can also be interpreted as a gesture from company boards who feel their operational performance is not up to scratch, and it might not get better in the year ahead.

Certainly, Woolworths ((WOW)) tried the good old fashioned higher than expected dividend trick on Monday, but it didn't stop the share price from falling on the weak trading update that accompanied a not too flash FY18 performance. Telstra ((TLS)) did it too. Even CommBank ((CBA)) made a point of increasing its dividend, despite all the operational headwinds, the regulatory scrutiny, and the embarrassment from the Royal Commission.

Both Deutsche Bank and Morgan Stanley make the observation local dividends have been the key surprise thus far this season. As such, Australian dividends are rising in line with the global trend, with research conducted by Janus Henderson suggesting dividend payouts globally have surged to a new all-time high this year.

The key difference is, alas, that dividends internationally are growing strongly as a result of noticeable increases in profitability and in cash flows, while locally dividends are increasing further, from already elevated levels of payout, as a defensive measure; to please shareholders in the absence of strong growth.

On Janus Henderson's numbers, global dividends jumped 12.9% year-on-year in the second quarter to $497.4bn, with new records set in twelve countries, including Japan and the USA. The Janus Henderson Global Dividend Index ended the quarter at a new record 182.0, meaning global dividends have risen by more than four-fifths since 2009.

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One prediction that has quickly turned into a misguided ghost story, is that richly valued companies were set up for a fall-off-the-cliff experience. It did not work out that way in February, and neither is it happening in August. From GUD Holdings ((GUD)), to REA Group, to CSL ((CSL)), ResMed ((RMD)) and Cochlear ((COH)), plus a whole bunch of others, if anything investors are incredibly quick to start buying in case some weakness does occur.

The reason, I believe, remains that these companies are in much better shape than most of the so-called "value" laggards, with better growth prospects, less operational and regulatory risks, and with much better adaptation to modern day disruption from the internet and other factors.

I have written about this before, but I also sense there remains a large wall of disbelief and of resistance against this observation. It's easy for me to add that those investors who are still refusing to accept this, have unlikely done themselves, and their portfolios, any favours over the past 5-7 years.

The latest example of this comes from Goodman Group ((GMG)), high quality achiever inside the global property development sector, with leverage to modern technology through the planning and construction of large warehouses and distribution centres. Prior to the release of FY18 financial performance numbers, analysts pointed out the shares did not look cheap.

This has not stopped the share price from rallying higher following the release of a result that met already elevated expectations, supplemented with enough evidence operational momentum remains strong, with risk to the upside. Analysts' forecasts have risen post the release, pushing up the consensus price target, but the share price remains at a sizable premium.

So what is an investor to do?

My suggestion is the same as with the High Quality Achievers I keep on pointing out, time and again: you wait for share price weakness, which you use to climb on board. This is a time and context that reward quality and investors will not be able to purchase these shares at a comfortable discount. The alternative is to buy cheaper looking stocks, that thus have a problem, or simply are of lesser quality, and carry more risk.

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One pleasing observation is the 3.17% average increase in consensus price targets for companies having reported to date. Certainly, were this number to remain unchanged over the coming eleven days, that would make August a "great" reporting season according to this specific measure. But with more than 200+ companies yet to report, it's probably better to refrain from any heavy handed forecasts.

The Australian share market has continued its positive performance in July and thus far in August it has added 1.3%. I would not ascribe most of this performance to the local reporting season. Instead, I continue to believe Australia remains a key beneficiary from global macro-developments, with Emerging Markets experiencing net outflows and some of those funds finding their way into Australian equities instead.

There is, however, no room for complacency and investors are better off watching their risk tolerance and their exposure to potential risk of disappointing market updates, as shown daily through heavy share price falls in case reported financials do not meet market expectations.

The local reporting season continues until early September, after which a number of out-of-cycle companies starts releasing their financial updates, but in a more measured manner.

Investors who are as yet not familiar with FNArena's Corporate Results Monitor can catch up with the latest updates here:

https://www.fnarena.com/index.php/reporting_season/

Rudi In The Australian

I have been granted the opportunity to share my early insights about corporate reporting season in Australia with readers of The Australian.

My story appeared in the recent Weekend Australian (August 18-19). Unfortunately, due to the newspaper's policy of hiding its content behind a pay wall, I cannot include a link to the story.

My twitter newsfeed contains an image of the story, which I can also pass on via email to those who have no access via Twitter and would still like to read it.

Send an email to info@fnarena.com

Rudi On TV

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

-Tuesday, 10.30am Skype-link to discuss broker calls -Friday, 11am, Skype-link to discuss broker calls (unlikely, probably too busy, but possible)

Rudi On Tour

-Presentation to ASA members and guests Wollongong, on September 11 -Presentation to AIA members and guests Chatswood, on October 10 -Presentation to ATAA members and guests Sydney, on 18 October -AIA Celebrity Lunch, Brisbane, on November 3

(This story was written on Monday 20th August 2018. It was published on the Monday in the form of an email to paying subscribers at FNArena, and again on Wednesday as a story on the website).

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