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ResMed Gains Share In Core Sleep Market

Sleep apnoea revenue partly offset weaker software-as-a-service revenue in the March quarter for ResMed, which is gaining share from the strong uptake of new products.

-Limited evidence Brightree has recovered after slowdown -Path to higher profitability in software-as-a-service segment unclear -Robust core business mitigating risks associated with broadening to connected care

By Eva Brocklehurst

Brokers were well pleased as ResMed ((RMD)) delivered a strong result from its core OSA (obstructive sleep apnoea) business in the March quarter and eased concerns that growth was slowing. Sleep apnoea revenue partly offset slightly lower software-as-a-service (SaaS) revenue. Operating profit increased 15% on a year ago and beat most estimates. This was largely because of lower-than-expected R&D and interest expenses.

Deutsche Bank notes the result also demonstrate the company is benefiting from fixed-cost leverage, with operating earnings (EBITDA) margin expansion of 106 basis points. Gross margin of 59.2% was ahead of Citi's estimates. The broker estimates the higher margin was also driven by the increased percentage of mask sales in the quarter. The broker is seeking some clarity about the impact of SaaS on gross margin going forward.

Mask sales rose across all major markets, attributed to both share gains and strong market dynamics. SaaS doubled its sales to $80m because of the contribution from recent acquisitions of MatrixCare and HEALTHCAREfirst.

The increased frequency of masks and accessory supply to each patient per year, particularly in the US, will be contingent on payers maintaining current reimbursement methodologies, UBS points out. The broker estimates resupply revenue growth of 9% across FY19-22.

Market Share

The company gained market share in masks on the strong uptake of its new products. The market appears to be growing faster than historical 8-9%, Citi observes, particularly outside of the US. The broker expects the three masks launched in the last 12 months will continue to drive growth in FY20. There was some share gains in devices, where sales grew 6%. Headwinds in Japan and France are expected to be offset by growth in other markets, particularly in Asia.

Ord Minnett is still cautious about fully extrapolating the positive trends, given the volatility of historical results. After the recent recovery in the share price, the broker notes only limited evidence that the Brightree franchise has recovered after a slowdown in the second quarter. Management reported revenue growth improved for Brightree but it appears some way off the double-digit target.

Citi considers ResMed an excellent business, although fairly valued. No break even date has been forecast for the Verily joint venture, which made a -US$7m loss in the quarter. The broker remains a little sceptical regarding the revenue model in this aspect of the business and looks forward to further clarity in time.

The company has commented that MOBI, the portable oxygen concentrator, has now been launched but sales are minimal and it will take time to have an impact on earnings. The impact of the patent litigation with F&P Healthcare ((FPH)), now ended, on the results was not disclosed but Citi suspects it would be helpful to FY20 now this has cleared.

UBS upgrades to Buy from Neutral after updating modelling assumptions. The results were well ahead of estimates and the broker acknowledges its prior conservatism on the sustainability of the company's US resupply growth appears misplaced.

Software-as-a-service

Resmed has generated over 10% in 12-month rolling average revenue growth in the past five quarters. While the path to higher profitability in the SaaS business remains less clear, UBS believes the ongoing robust core sleep therapy will mitigate the risks associated with the broadening of the business into connected care.

The connected care business is also expected to significantly improve, although this is highly contingent on future operating and capital expenditure requirements, either via additional M&A or within the current suite.

OSA therapy growth should still remain robust from an under-penetrated target base, and increasing installed base and re-supply growth. Diversification holds merit, UBS believes, and COPD (chronic obstructive pulmonary disease) may also bring additional revenue.

Morgans agrees the business is robust and is encouraged by commentary from management, which remains confident about driving sustainable, low double-digit growth over the medium term via its end-to-end solutions which are just starting to penetrate the US$1.5bn out-of-hospital market.

Macquarie on the other hand believes its forecasts adequately capture the positive trends resulting from increased penetration of the OSA population and improvements in masks and resupply, and the risk/reward profile is skewed to the downside.

As a stable pricing environment in the US continues - the next round of competitive bidding rates do not come into effect until 2021 - Credit Suisse forecasts continued strong growth in US masks and devices over the fourth quarter and FY20.

With the company's increased investment in its data platforms, the broker is also upbeat on the ability to use data to prove the quality of care for patients in the home setting and increased penetration rates within the sleep and COPD markets.

Wilsons, not one of the eight stockbrokers monitored daily on the FNArena database, considers the company's portfolio unique in terms of its reach across the US healthcare system, where relevant to chronic disease. The broker, not one of the eight monitored daily on the FNArena database, has a Buy rating and $18 target.

The database shows five Buy ratings, two Hold and one Sell (Macquarie). The consensus target is $16.45, suggesting 2.9% upside to the last share price. This compares with $15.08 ahead of the results.

See also, ResMed Judged Harshly As Costs Mount on January 30, 2019.

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Brokers Still Upbeat On Macquarie Group

After posting profit of $2.98bn in FY19 Macquarie Group has somewhat unsettled investors by suggesting FY20 outcomes could be more subdued.

-Gains on sale and performance fees contributed 30% of net operating income in the second half -Annuity-style business disappointed, but should recover in FY20 -Brokers cite strong prospects for Macquarie Infrastructure and Real Assets

By Eva Brocklehurst

Macquarie Group ((MQG)) has consistently surpassed its own guidance in recent years and FY19 was no different. Now, the company has somewhat unsettled investors by suggesting FY20 outcomes may be more subdued and "slightly down" on FY19.

Macquarie Group delivered 17% growth in earnings in FY19, largely from $2.1bn of investment gains on sale in the second half, a record commodities contribution and strong performance fees. Reported profit was $2.98bn, up 17% and ahead of guidance for growth of around 15%. Revenue rose 19% in the second half, with the FY19 cost-to-income ratio up slightly to 70%.

Ord Minnett found the result heavily reliant on lower-quality items, with gains on sale and performance fees contributing 30% of net operating income in the second half. Given this, the broker is not surprised that the FY20 outlook has disappointed. To obtain the usual "broadly in line" guidance, it may take some effort, with commodities income also likely to fall from record levels.

The result was characterised by a particularly strong performance in markets-facing businesses that grew 76% in terms of net profit and this offset a -4% decline in net profit from annuity-style business.

Citi was disappointed with the annuity-style business. This is despite strong performance fees, strong lending and deposit growth. Still, profits are expected to remain healthy and this business should recover in FY20 to maintain group profits close to the FY19 peak.

Credit Suisse suspects that the underlying business performed better than the headline numbers suggest and there was some conservatism adopted in terms of the timing of fee recognition, as well as impairing assets that only recently had not met performance expectations. The broker asserts that it is only a matter of time before guidance of "broadly in line" is reinstated.

For Morgan Stanley the main issue is whether guidance is conservative or if the record FY19 result is just too hard to repeat. The broker suspects it is the former, given there are several levers for both revenue and costs. There is positive operating momentum across most of the business and Morgan Stanley suggests lower gains on sale and commodities revenue can be absorbed and still meet guidance.

The broker's analysis suggests earnings would be -6% lower if gains on sale were $1bn (versus $2.1bn in FY19) or if commodities revenue fell another $400m to the FY17/18 average. Morgan Stanley forecasts a -2% decline in earnings to $2.93bn in FY20 and believes post FY20 the business will be in an earnings and returns growth cycle, given unrealised gains across a number of operations, a favourable environment, structural tailwinds and flexibility in the compensation ratio.

Outlook

Taking into account the fact that management is typically conservative, FY20 guidance still appears to be a -7% downgrade to consensus expectations, Morgans points out. The second half dividend was also below the broker's expectations while the pay-out ratio is at the lower end of management's target range of 60-80% despite a strong capital position. Morgans expects some flattening in earnings but, after very strong results, this should not be judged too harshly.

UBS describes it as "the afterburner". The company generated the highest level of gains since FY07 in its investment income (gains on sale), which represents 16.5% of revenue. UBS believes this enabled Macquarie Group to take a conservative view on valuations, with $552m in impairment charges, the highest level since FY09.

However, gains on investments are now more heavily concentrated in developments such as green investments, energy & technology and less weighted towards private equity style investments and co-investment with investment

banking clients. Hence, solid gains are expected to continue on investments in FY20 but not at the same scale.

While market conditions are positive, the broker understands why the company is providing a more cautious outlook. The broker remains careful about capitalising the more volatile revenue streams at this stage of the cycle but believes investors will maintain the faith, especially domestic investors with a dearth of alternatives, although the stock is likely to be range bound until momentum is restored.

Morgan Stanley points out Macquarie Group generates two thirds of its revenue outside of Australia and is more positive versus consensus on the near-term outlook for the global economy compared with Australia, favouring companies with global growth options.

MIRA

Ord Minnett downgrades to Hold from Accumulate, given the limited potential upside in the stock. The broker remains positive about the prospects for Macquarie Infrastructure and Real Assets (MIRA) and green energy opportunities for Macquarie Capital, although believes these need to be balanced against the challenges in the principal finance unit and the cycling of tough comparables.

Morgan Stanley notes MIRA is one of the largest global alternative asset managers and should continue to grow base fee revenue, expecting a 6% compound growth rate over FY19-21. This is considered high-quality revenue generated by 10-year closed-ended funds operating in a structurally growing segment, as institutional investors look to increase allocations to real assets.

There are three Buy ratings and four Hold on FNArena's database for Macquarie Group. The consensus target is $128.39, suggesting 2.0% upside to the last share price. Targets range from $115 (Deutsche Bank) to $136 (Morgan Stanley). The dividend yield on FY20 and FY21 forecasts is 4.6% and 4.7% respectively.

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Headwinds Continue To Buffet Westpac

Pressure on margins, slowing loan growth and significant remediation charges are likely to colour the outlook for Westpac for some time.

-More resilient retail banking division versus other major banks -Well-placed in recognising wealth management advice remediation ahead of peers -High likelihood dividend will be reassessed in FY20

By Eva Brocklehurst

With the last major bank financial report for May, Westpac Banking Corp ((WBC)) revealed slightly different trends versus its peers. Retail banking was more positive, while treasury, insurance and business banking underperformed the sector.

The bank had previously flagged significant remediation charges and restructuring and this is expected to colour the performance of the stock over the next year, as well as the pressures on net interest margins and slowing loan growth.

The bank accumulated $1.1bn in remediation and restructuring charges in the half, while income was also affected by $130m of lower-quality items. Revenue and expenses, excluding large items, were broadly flat. Underlying earnings declined by -1.5%, despite mortgage re-pricing benefits. On a positive note the bank retained cost guidance, targeting a -1% reduction on the FY18 cost base.

Morgans assesses retail banking in Australia has had a difficult operating environment and, given the backdrop, remains pleased with the performance of Westpac's consumer bank division. Cash earnings for this division were down -0.5% half on half.

As the consumer business held up, the broker believes the relative weakness in Westpac's share price is not justified. The bank has reiterated its target of $400m in productivity savings in FY19. Morgans continues to believe cost reductions are a source of underlying earnings upside for the whole sector.

Unlike ANZ Bank ((ANZ)) and National Australia Bank ((NAB)), where results were dragged down by retail divisions, Westpac showed some resilience, which Ord Minnett suggests was aided by mortgage re-pricing and good deposit management.

On the other hand, the business bank was more problematic, as earnings were flat. BT Financial Group was also a material negative, with elevated claims costs and the impact from efforts to re-set the business.

Macquarie believes Westpac's overweight position in Australian mortgages does not bode well for the near-term earnings growth outlook, expecting underlying income and expenses growth of just 1% in the second half. Citi takes a different view, believing Westpac is better placed than its peers because it has recognised wealth management advice remediation ahead of the other major banks.

Westpac is also exiting wealth management advice and should emerge as an online platform which can be competitive without the legacy of major bank peers. Still, Citi acknowledges disappointment with insurance income and treasury revenue.

Mortgages

Westpac has enjoyed the mortgage boom more than most, Deutsche Bank points out, and the interest-only book has dropped to around 31%, having been up at 50% in the first half of FY17. Yet, Macquarie counters, it remains 5-13% above peers. Over the same period, mortgage loan growth has slowed to 1% from 8% and margins have dropped 20 basis points to 2.20%.

Deutsche Bank agrees with Westpac's commentary that a further easing in house prices is likely. The bank suspects credit quality is unlikely to improve and system housing growth will slow to 3% in the current year, falling next year to 2.5%. Deutsche Bank is more bearish, expecting a decline of -1% in mortgages and bad debts approaching risk levels in FY20 as the housing cycle unfurls.

Morgans agrees the high interest-only exposure continues to weigh on share price multiples but asserts that concerns are overstated. Westpac's interest-only exposure has been reduced without asset quality underperforming peers in any material way and net interest margins have risen slightly. Bearish views have also not accounted for the

fact that a significant portion of the reduced exposure has been attributable to external re-financing. Morgans expects this to be the case over the next two years as long as securitisation markets remain firm.

Dividend Outlook

A discounted dividend reinvestment plan (DRP) will dilute earnings, as further share issuance puts pressure on growth. Credit Suisse envisages risks around dilution, further remediation and the potential for reductions to the dividend. The broker downgrades forecasts, incorporating the dilutive DRP and more remediation along with a subdued sector outlook.

Morgan Stanley is more bearish, assessing revenue is under pressure, there is no capital buffer and the dividend policy will need to be reviewed. The bank's CET1 ratio was broadly unchanged a 10.6% but remains at the lowest position relative to the sector.

The broker points out capital generation will be modest, unless margins expand or loan losses stay at current levels. The bank has little excess capital to offset the potential for higher NZ capital requirements and/or an increase in capital intensity from potential changes to APRA's (Australian Prudential Regulatory Authority) mortgage risk weights.

Westpac is targeting a 70-70% dividend pay-out ratio which Morgan Stanley believes is increasingly unlikely. The pay-out ratio is now over 90% while the underlying return on equity has fallen to under 12%, increasing the risk of a dividend reduction if operating conditions and profitability do not improve. The dividend may hold up this year but more clarity on regulatory requirements (NZ or APRA) could prompt a review of financial settings in FY20, in the broker's view.

FNArena's database shows two Buy ratings, three Hold and three Sell. The consensus target is $26.93, signalling -0.7% downside to the last share price. Targets range from $22.00 (Deutsche Bank) to $33.00 (Morgans). The dividend yield on FY19 and FY20 forecasts is 6.9%.

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GrainCorp Undeterred As LTAP Pulls Bid

The outlook for GrainCorp is hazy, as the company proceeds with plans to divest and restructure businesses in the wake of LTAP pulling its acquisition proposal.

-Takeover bid prompted a complete re-analysis of the grain, oils & malt business model -Main determinant of the outlook will be how the market assesses the value of the assets -Two tough seasons expected to apply a damper to earnings until FY21 at the earliest

By Eva Brocklehurst

GrainCorp ((GNC)) suitor, Long-Term Asset Partners (LTAP), has walked away after completing due diligence and withdrawn its acquisition proposal. GrainCorp will now move forward with its plans to divest the bulk liquid terminals business and pursue a de-merger of its malt division from the combined grains & oils division.

Morgans considers it fortunate the company has progressed its portfolio review in parallel with the LTAP due diligence process, now that the takeover bid has fallen over. Deutsche Bank agrees the game has changed, as the takeover approach has prompted a complete re-analysis of the business model and led to, among other things, the grains derivative, which has potential to significantly smooth earnings.

While the withdrawal of LTAP may be a negative development, the broker believes the de-merger proposal by GrainCorp offers compelling value. Based on Deutsche Bank's base case, the malt business is valued at $7.06 a share, while the market is currently valuing the grains & oils business at $1.09 a share.

There is some lingering doubt for Bell Potter as to what LTAP found six months into due diligence process, and investors are advised to weigh up whether the share price has fallen sufficiently to make the business attractive as a play on east coast grain.

UBS acknowledges there was always a risk that a potential suitor discovered something materially negative in the business which is not easily visible from the outside, but takes the view that the de-merger will unlock value.

The broker finds the sum of its valuation is $10.35 a share, versus the $10.42 a share takeover offer from LTAP. The broker's calculation applies a 9x enterprise value/FY21 earnings ratio for the malt business and 7x for the new GrainCorp business.

UBS assesses the share price performance of an Australian parent and the spin-off company has generally been positive over the years. GrainCorp has also highlighted the receipt of other approaches for all, or part of, the business since the LTAP proposal was announced.

Hazy Outlook

The main determinant of the outlook will be how the market assesses the value of the assets, ex-malt, with the potential for reduced earnings volatility. Neither the extent of this nor the cost to achieve it has been articulated. Bell Potter believes, to buy GrainCorp at the current share price, would require conviction that residual assets can more than double earnings, or that a materially higher multiple can ascribed to these assets compared with previous assessments.

The broker envisages more value in other drought affected businesses such as Elders ((ELD)), Nufarm ((NUF)), Bega Cheese ((BGA)) and Select Harvests ((SHV)), which have more transparent earnings models. GrainCorp, on the other hand, is more leveraged to effectively price grain into a higher fixed-cost infrastructure network and, therefore, more exposed to trading returns and an exportable surplus.

Bell Potter, not one of the eight stockbrokers monitored on the FNArena database, has a Hold rating and $8.50 target. Morgans downgrades to Reduce from Hold, given there is at least two tough years ahead of the company.

The focus is now on a poor FY19, as well as the current season, which is also turning out poorly. There will be the smallest east coast grain crop in over a decade, while grain marketing has been affected by China's anti-dumping investigation into Australian barley exports. Meanwhile, weak oilseed crush margins have affected the oils business.

Morgans expects a loss from grains and material weaker earnings from oils when the company reports its first half result on May 9. This will not help the investment case for the residual business that combines these two under the

de-merger proposal. The broker also forecasts a loss in FY19 for GrainCorp and considers the next opportunity to benefit from an average season on the east coast will not be until FY21/22.

Derivative Uncertainty

In the absence of a derivative instrument, the new GrainCorp is likely to trade at a material discount to an average season valuation because of difficult trading conditions, the broker adds. While the proposed derivative instrument should protect shareholders in poor seasonal conditions, Morgans points out it will also cap the upside in good seasons. However, the market may, in time, apply a higher multiple to this business if it becomes more comfortable about the intended benefits.

FNArena's database shows three Buy ratings and one Sell (Morgans). The consensus target is $9.56, signalling 17.3% upside to the last share price. This compares with $9.93 ahead of the announcement. Targets range from $7.90 (Morgans) to $10.96 (Deutsche Bank).

See also, Separating Malt Appeals To GrainCorp on April 8, 2019.

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Aurizon Pacifies Coal Miners With Rail Deal

There is a modest financial benefit in the agreement struck between Aurizon and its coal haulage customers. Of greater significance to brokers is the mending of a sometimes fractious relationship.

-Represents a significant step towards minimising uncertainty -Greater certainty over the deal going ahead could add upside to valuation -Aurizon continues to consider restructuring the business into two units

By Eva Brocklehurst

Aurizon Holdings ((AZJ)) and its coal haulage customers have forged a deal, considered no mean feat by brokers, which should ultimately deliver a slight earnings uplift. Several areas of upside exist for the company around costs, leverage and returns.

The agreement represents over 90% of the coal that is railed on the company's central Queensland network. Moreover, what is critical, Macquarie points out, is that it does not discriminate against non-signatories or potential new entrants to the network.

Credit Suisse and Deutsche Bank consider the deal substantially lowers the regulatory risk profile and contains a better allocation of risk, which has potential to create value for the business. The Queensland Competition Authority (QCA) is required to approve the revised undertaking before it becomes operational.

Morgan Stanley assesses the deal adds longer-term certainty to the investment thesis and envisages a strong incentive for Aurizon to plan and invest in a network expenditure reduction program between now and FY27.

Significantly, an independent expert will also be appointed to undertake a capacity assessment of the network. The company believes a capacity deficit versus contracted tonnage could be addressed via maintenance scheduling, capacity relinquishment and expansion. This has potential to add upside to earnings.

There is an immediate lift in the rate of return allowance (weighted average cost of capital) of 0.2% for FY19 and through FY20, until the independent expert issues an initial capacity assessment and the company advises on options to address capacity and contract mismatch. Once completed the WACC steps up 0.6%.

Modest Financial Benefit

The agreement represents a significant step towards minimising uncertainty, UBS agrees, and also helps repair a fractious relationship with the miners. Financially, it is less significant in that, if all goes to plan, the deal adds around $40m per annum to earnings (EBIT), or around 5% to profit from FY21.

This financial benefit is before any rebate is potentially payable by Aurizon for underperformance. Cash flow and dividend stability are a highlight of the stock for UBS, amid a 100% pay-out ratio and a 6% dividend yield. The deal also partially removes the recurring four-year regulatory risk that could increase the appeal of the stock to longer-term investors, the broker adds, although it is considered fair value for generalists.

Credit Suisse believes the deal significantly changes the risk profile of the network and reiterates an Outperform rating. The broker notes the past two regulatory decisions were not finalised until 2-3 years into the regulatory period. Once there is greater certainty regarding a commercial network deal going ahead the broker believes it could be further upside to valuation.

However, Morgans advises trimming overweight positions because of the minimal potential return at current prices. Macquarie assesses the upside is about the potential to improve above-rail relationships and there is now a strong incentive for Aurizon to capture outperformance on operating costs. Still, the broker agrees the immediate movement in the share price has captured much of this value.

The Agreement

The agreement now contains both higher returns and higher risks for Aurizon. The increase in the WACC allowance is the main positive, although this is short lived. The final decision on the latest undertaking from the QCA applied a 5.7% WACC across FY18-21. The agreement will mean this lifts, ultimately, to 6.3% but then will be adjusted for interest-rate changes from FY24, and be fully exposed to review when the undertaking expires at the end of FY27.

The company has agreed to a flat allowance for operating costs between FY21-27 except if the CPI exceeds 2.37%, and Aurizon has the opportunity to pursue costs against the WACC and not share it with customers. This benefit is also not permanent, Morgans points out, as the QCA will use actual costs to derive cost allowances from FY28.

Aurizon will be required to re-pay track access charges to customers when the network is at fault for non-performance. The rebate is only due from Aurizon's actions, such as ineffective maintenance practices, and not for volumes that are lost. However, further detail on this point was lacking and Morgans fears, at the extreme, it could potentially negate the benefit of the increase in the WACC allowance.

Ballast cleaning shifts from capital expenditure to maintenance and this adds to income although has no impact on cash flow. This reduces the risk for Aurizon but also eliminates the issue around the choice of maintenance.

Aurizon continues to consider restructuring the business into two separate units. The case for separation has been made easier, Macquarie suggests, as earnings certainty has increased with the longer-term rail user agreement, the better WACC outcome and the fact the network can capture incentives associated with operating costs. More flexibility can be gained from reorganising the assets and introducing moderate leverage into the above-rail business, especially after the re-contracting cycle has been passed.

FNArena's database shows one Buy (Credit Suisse), six Hold and one Sell (Ord Minnett, yet to comment on the network update). The consensus target is $4.73, signalling -2.8% downside to the last share price. The dividend yield on FY19 and FY20 forecasts is 4.7% and 5.3% respectively.

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CSR Primed For Housing Downturn

Brokers laud CSR for being on the front foot in mitigating the volume losses from the housing downturn, yet expect FY20 will be a challenging year.

-Initiatives and flexibility in cost base should counter reduced building activity -Less exposed to multi-residential dwellings but downturn will still hurt -Conditions could change quickly with supportive fundamentals

By Eva Brocklehurst

A soft outlook prevails for building products supplier CSR ((CSR)) as the housing downturn gathers pace. Lower prices and higher costs are also affecting the company's aluminium business, making FY20 a challenging year. Management is well aware of this and intends to mitigate volume losses by improving the cost base. The Darra site in Queensland and one kiln at Cecil Park in NSW will be temporarily closed.

CSR expects the downturn will be short lived, noting some signs of market stabilisation, but has not provided specific guidance for FY20. The company also pointed out that only 11% of revenue is exposed to multi-residential buildings, which have experienced the greatest weakness so far.

Citi asserts the major impediment in the housing market is the availability of credit rather than the price of credit and population growth should stabilise the Australian housing market over time.

The company reported underlying net profit of $186m in FY19, at the higher end of guidance. The weak point in the result was operating cash flow, Ord Minnett observes, as working capital and cash restructuring charges affected conversion. That said, the company has a solid position in terms of cash which provides ample room for investment or buybacks. Citi agrees the balance sheet provides support for buybacks or opportunistic acquisitions.

Ord Minnett expects the volume declines of -3-4% that were experienced in April will deepen across the rest of the year. Earnings (EBIT) for the building products division are forecast to ease by -11.7% in FY20. Aluminium sales and earnings are expected to decline -3.0% and -26.2%, respectively, in FY20.

Costs

The company has outlined a number of initiatives, amid flexibility in its cost base, to counter reduced market activity. Macquarie cites these as being more flexibility in brick capacity, overhead consolidation and the displacement of/reduction in low-margin exports.

Credit Suisse agrees there is perhaps greater leverage for CSR than the market realises, yet downgrades to Underperform from Neutral, assessing the downturn in housing activity is only just beginning. Building products earnings were in line with expectations, albeit net of $11m in unexpected restructuring costs taken below the line. A second-half increase in coal costs implies an FY20 impost that is $10m higher, in addition to other costs incurred in the second half.

Morgan Stanley agrees there are too many headwinds. The broker accepts the business is primarily exposed to the less-volatile detached dwelling segment but revenue and margins are likely to still be under pressure.

The aluminium business has endured higher prices for electricity and the pass-through of higher coke and pitch prices, and these pressures are expected to continue into FY20, along with higher alumina prices. Yet, energy cost increases appear to have run their course and management has indicated there is potential for power costs to pull back.

Citi also points out the new Hebel (blocks) manufacturing facility should help reduce import costs and improve margins, while recent data from the Australian Bureau of Statistics shows price increases for building products, which should benefit CSR. Plaster prices rose 4.4% and clay bricks 5% in the March quarter. Prices for fibre cement also increased for the eight straight quarter. Insulation products have continued to fall.

CSR confirmed that half of its new alumina contract will be at an 18-18.5% linkage to the London Metal Exchange, up from 15%. Citi estimates each 1% increase reduces net profit by -3%. CSR maintains a view that the alumina market will normalise once Alunorte is back in full production so is only taking up short-term contracts.

Property

The property division, which re-zones and refurbishes residential and industrial sites, continues to experience strong demand. There is strong demand for industrial property, particularly in western Sydney. The company will take advantage of this with two major projects, in Horsley Park and Badgery's Creek.

While the quantum of earnings may fluctuate because of the timing of transactions, Credit Suisse believes the ongoing development of a number of major projects will support property earnings over the next 10 years.

Morgan Stanley suspects the CSR share price will over-correct to the downside and provide an opportunity for patient investors, but this remains some way off and caution is required at present.

Macquarie comes to a similar conclusion, given the company's readiness to cope with the downturn. The balance sheet is strong and there are cost and efficiency-enhancing products in the wings. All up, this should provide an emerging opportunity.

Management has noted that conditions could change quickly in the context of supportive fundamentals such as interest rates, employment and population growth. A new CEO is expected to be announced before the AGM in June.

FNArena's database shows four Hold and three Sell ratings. The consensus target is $3.22, signalling -3.6% downside to the last share price. The dividend yield on FY20 and FY21 forecasts is 6.9% and 6.6% respectively.

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Is Separation The Way Forward For Suncorp?

Amid flat loan growth in the March quarter, brokers ponder the prospect of Suncorp separating its banking business.

-Increase in home loan arrears expected to be short-term -Is there opportunity in separating the banking business? -Cost benefits could go a long way to mitigating headwinds

By Eva Brocklehurst

The market was disappointed as Suncorp ((SUN)) indicated total lending was flat in the March quarter, with business loan growth offset by lower home lending. Total lending in the March quarter declined -0.5% on a sequential basis, spearheaded by a -0.7% decline in retail lending, while business loans increased 0.3%.

Home loan arrears were up by 2.5%, mainly from major weather events such as the floods in Townsville, expected to to be short-term, although overall credit quality was strong. Gross impaired assets decreased by -2.4% in the quarter. The bank's CET1 ratio decreased to 9.1%, following the first half interim dividend payment, yet remains above the target ratio of 8.5-9.0%.

Despite contributing around 30% to group earnings, the bank division has become a drag on valuation, Citi asserts. There is a high regulatory cost burden, potentially, with a need to invest in significant IT at a slow time for system growth.

Macquarie continues to believe the bank business impairment levels are unsustainable and that pressure will continue to be exerted on net interest margins, suggesting Suncorp needs to lower its net interest margin guidance range by -5-10 basis points in FY20. Macquarie suspects overall guidance for FY20 will be lower versus FY19, when the company provides its results in August.

There were no major developments in the bank business that were at odds with either expectations or recent trends in the major bank reporting season, UBS notes. The broker believes the stock's investment case is underpinned by a supportive backdrop in general insurance, particularly for commercial rates, which should provide a floor for earnings.

UBS observes the home lending portfolio is conservatively positioned, with 28% investor exposure, 21% interest-only and 21% with loan to valuation ratios over 80. The company expects improving growth in both home and business lending, as small-medium business and agribusiness is supported by increased lending commitments and recent rainfall.

Bank Separation

The potential separation of the general insurance and banking businesses has some merit for Morgans but this is not likely to fully cover the discount to Insurance Australia Group ((IAG)), as there are other factors at play such as the latter's lower earnings volatility and larger capital returns.

Citi agrees this is a key opportunity and pursuing separation would make sense but highlights the hurdles are large and there is a risk separation could destroy value. Even if a value-accretive separation could be achieved, it is unlikely to be enough to close the gap completely. The gap to its peer was opened up when IAG first announced its quota share deal with Berkshire.

Morgans, too, remains wary of the potential loss of value in any separation. This could amount to the bank business losing its A-plus credit rating amid stranded costs. Citi agrees these two points are valid and imply significant risk. There has been speculation that the company is investigating a separation of the operations, as the lower-multiple banking segment is facing obstacles to earnings growth.

Bell Potter has assessed the benefits of merging banking operations with Bendigo & Adelaide Bank ((BEN)). This is based on that bank's acquisition potential and renewed focus on domestic home lending, as well as increased usage of branch and mortgage brokers. There would also be a an opportunity to reduce surplus Queensland branches.

The broker also looks at HSBC Australia a potential suitor. In that instance, Bell Potter believes Suncorp's bank would add a good quality mortgage and agribusiness book to the portfolio. Bell Potter believes tough market conditions and the fact that individual regional banks have top-line capability and operating scale makes such mergers attractive.

Cost benefits would also go a long way to mitigating headwinds. The broker assesses Bendigo & Adelaide is highly compatible with Suncorp in terms of culture and in understanding regional markets, as well as its familiarity with multi-brand distribution channels.

A merger between the two is also a preferable proposition to merging Suncorp's bank and Bank of Queensland ((BOQ)), in Bell Potter's view, which would increase lending concentration risk in Queensland. Suncorp would probably need to pay a premium to execute any merger versus a spin-off scenario, Citi points out, and finding a way to offset the implications is likely to be critical for success.

Morgans considers Suncorp's recent steps to de-risk earnings will ultimately drive a re-rating and maintains an Add call. Bell Potter, not one of the eight stockbrokers monitored daily on the FNArena database, has a Buy rating and $14.50 target.

The database shows four Buy ratings, three Hold and one Sell (Macquarie). The consensus target is $14.01, suggesting 3.0% upside to the last share price. The dividend yield on FY19 and FY20 forecasts is 5.3% and 5.5% respectively.

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Burrup Remains The Key Concern For Orica

Explosives company Orica produced a robust first half result, as market conditions improved and several issues with manufacturing were largely resolved. Burrup continues to concern brokers.

-GroundProbe performs well and Minova improves on a loss-making position -Explosives markets continue to improve, reflected in import parity pricing -Once Burrup is reliable Orica expects to displace around 200,000t of Chinese imports

By Eva Brocklehurst

Orica ((ORI)) has removed any doubt regarding its performance in FY19, revealing strong revenue and earnings growth in the first half. Market conditions, manufacturing and industry trends are all seen improving.

On the other hand, capital expenditure is expected to increase and there is still risk around the re-commissioning of the Burrup plant. While the growth rate appears impressive in the first half, Morgans points out the company was cycling a soft comparable period, where every operating business unit went backwards and all major manufacturing plants had issues.

Earnings (EBIT) of $301m were up 20% in the first half, supported by higher volumes and value-added products and services as well as favourable FX. Citi suspects FY19 guidance, which is retained, is overly conservative as it implies a flat second half.

Profit was affected by temporary factors in the half year, as margins were reduced 100 basis points to 17.6%. This was largely because of lower contract pricing. The company calculates, excluding the Yarwun cyanide turnaround and disruptions at Bontang, earnings margins would have been around 20%.

The GroundProbe acquisition is performing well, Macquarie observes, and there is finally an improvement in Minova from a loss-making position. However, limited ammonium nitrate contract renewals this year signal to the broker that the benefit of a firming spot price is a FY21 story.

Orica expects the Latin American business will profit from new service and cyanide contracts, and strong copper and gold fundamentals should help mine planning in the region. Strong ammonium nitrate volume growth was reported in key areas such as Kazakhstan, Russia and Africa. Turkish volumes were lower because of economic weakness.

Developments

Credit Suisse notes the take-up of electronic and wireless blasting solutions appears to be accelerating. This, potentially, validates the company's technology. Orica has secured several commercial services contracts with its WebGen technology.

The broker is also pleased with the prospective upside from product rationalisation, with 21,000 obsolete units removed, amid more confidence from management in the price environment. FY20 appears likely to be a flat year for prices in Australia, Credit Suisse assesses.

Based on tightening supply and demand that should mean some expansion in FY21. A new gas contract is required for Kooragang Island from early 2021. The company appears confident the cost increases will be passed through in contracted volumes.

Explosives markets continue to improve and this is reflected in import parity ammonium nitrate prices of $680/t, up from $550-600/t last year. Once Burrup runs reliably, Orica expects to displace around 200,000t of Chinese imports.

Burrup

The main concern for brokers is the Burrup plant, as its ramp-up to full capacity keeps being delayed. Morgans expects Burrup will weigh on profit and market conviction regarding the company's earnings stream over coming years.

The plant is now expected to be at 50% in FY20 (Macquarie assumes 40%) and at full capacity by the end of that year. The rectification of the faulty equipment is likely to be completed at the end of 2019, resulting in a hand-over

to operations from early 2020. In assessing the downside risk, Morgan Stanley estimates a further six-month delay would represent -3% downside to its FY20 earnings forecast.

The company has estimated Burrup's negative impact on cash flow and FY19 is around -$40-45m. Operating earnings (EBITDA) from Burrup are forecast at $45m in FY21, so Citi estimates a $90m swing in cash flow. Additional capital expenditure of $40m is expected at Burrup.

Burrup will have the main earnings impact in FY20/21, Credit Suisse asserts, with modelling suggesting a $25m contribution to earnings on a 270,000t loading. The broker, along with Ord Minnett, believes some downside risk exists, therefore, in terms of Yarwun profitability.

An expected shortfall in meeting contract obligations in the second half of 2020 is likely to put pressure on Yarwun to increase utilisation. Ord Minnett calculates an additional 30-40,000t minimum would be required and incur at least $200/t in shipment costs in the west.

The east coast market remains in balance and Orica is likely to source tonnage from Yarwun or a third party, with freight and costs a key consideration, in the broker's opinion. Orica assesses the east coast explosives market is in balance and the west coast will be balanced in the next 2-3 years.

Citi believes Orica has entered an upgrade cycle and moves to Neutral from Sell, while Ord Minnett maintains a Lighten rating, believing the premium in the stock is unwarranted. Credit Suisse downgrades to Neutral from Outperform, believing while there is a little more momentum in the stock, there are still operating hurdles to clear.

FNArena's database shows one Sell (Ord Minnett) and seven Hold ratings. The consensus target is $18.76, signalling -4.1% downside to the last share price. This compares with $17.69 ahead of the results. Targets range from $16.50 (Ord Minnett) to $20.00 (Morgan Stanley, Citi).

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Material Matters: Iron Ore, Oil And Nickel

A glance through the latest expert views and predictions about commodities. Iron ore; oil; and nickel.

-Troubling decline in Chinese iron ore port stocks -Geopolitical risk likely to stem recent price oil price weakness -Tight oil market to prevail -Negative factors for nickel short-term, structural deficit prevailing

By Eva Brocklehurst

Iron Ore

China's iron ore stockpiles have declined for the fourth week, reaching the lowest level since October 2017. Volumes of both Brazilian and Australian iron ore fell. Shaw and Partners suspects it may be even worse than the numbers are indicating.

Assuming President Trump does not derail a trade deal with China then China/US trade should continue to support a bilateral growth story and steel production stay at or near recent highs. Also, assuming iron ore imports continue to track around recent levels then iron ore port stocks in China should improve. Yet, on the latter point, the broker admits to being troubled by this decline in iron ore stocks.

JP Morgan notes the supply/demand balance for iron ore remains unchanged, despite a return of the Vale 30mtpa Brucutu mine. However, positive market sentiment has been dampened and the announcement of a re-start has stemmed the iron ore rally as the market is expected to re-balance more quickly.

JP Morgan still expects a -46mt deficit in 2019. Price forecasts are maintained, at US$87/t. The key risks are further growth in Chinese domestic iron ore production, which has had the stronger start to the year since 2014, and further disruptions in Brazil.

Shipping rates over the last week have rebounded in Brazil, to 325mtpa, but remain below the average run rate of 400mtpa, Macquarie points out. The broker notes the major Australian iron ore miners are now shipping above average weekly levels. Fortescue Metals ((FMG)) has shipped at a stable three-year average and BHP Group's ((BHP)) weekly rate has reverted back to its three-year average.

Rio Tinto ((RIO)) is now shipping at levels 4% above its three-year average, but will need to maintain this for the remainder of the year to reach the lower end of guidance. Macquarie's forecasts for shipping volumes for the June quarter are above those suggested by the port data run rate. The broker assesses a soft first week in April has now been overcome, as total shipments from all the majors have increased.

Macquarie reiterates Fortescue Metals as its preferred pure play iron ore stock, with benefits from an improved product mix and price realisation. Earnings forecasts are raised across the sector for 2019, at current spot prices, with increases of 30% for BHP Group, Rio Tinto and Mineral Resources (((MIN)).

The Australian iron ore mining sector still does not fully reflect the strong market, JP Morgan asserts, noting consensus earnings have been upgraded steadily, with marking to market upgrades to operating earnings (EBITDA) ranging from 27% for BHP Group to 70% for Fortescue Metals.

Energy

Morgan Stanley notes high-frequency US stock data suggests oil inventory has risen at over double the normal rate in the last five weeks. Most of the explanation is provided by the build-up in US crude stocks and weaker refinery throughput. The broker would become concerned, nonetheless, if this trend did not reverse in coming weeks.

Meanwhile, demand data has been a little weaker in Asia. These data points are risks to its call, although Morgan Stanley sticks with a view that Brent should mostly trade in the US$75-80/bbl range for the rest of the year because of supply tightness.

This is because of three hot spots, notably Iran, Venezuela and Libya, combined with a view that US shale is unlikely to surprise on the upside. The broker is on the look out for any further news of run cuts in refineries in Europe. While bearish news has flowed through oil markets and Brent has lost a little from its recent peak, the broker suspects this is an expression of wider macro concerns.

Citi does not believe the recent price weakness will persist, as OPEC output is stable or falling and escalating geopolitical risk could mean Brent moves back over US$75/bbl. Saudi Arabia continues to signal an extension of oil output cuts.

The broker also suggests other oil price moves could be more about profit-taking than a shift in sentiment. Citi believes a focus on high-frequency US oil inventory data alone can be misleading as it diverges from global stock changes relevant to waterborne markets.

Citi also notes Libyan light sweet supply has turned to being a bullish influence from being bearish. Military confrontation puts up to 600,000b/d at risk of disruption, against the potential for growth of 200,000b/d in the case of a peaceful resolution to the crisis. Libya currently accounts for around 1% of global oil supply.

In an extreme scenario, where other disruptions occur, Citi calculates that flat prices could rise above its forecast of a US$84/bbl average for the September quarter. Assuming US incremental production cannot materialise until some months later, and OPEC reduces its capacity ahead of the hurricane season, this would mean an exceedingly tight situation in the oil market.

Nickel

Nickel was the best performing metal on the London Metal Exchange up until March, rising 25% amidst an ongoing deficit and falling exchange stocks. Still, Macquarie notes, while inventory fell in April, prices have not being sustained and have dropped almost -7% in the month.

The broker suspects the strength of demand may have caused the sell-off, particularly in 300-series stainless steel, and especially in China. A surge in Chinese production of high-nickel containing grades of stainless has been accompanied by a rise in Chinese reported distributor stocks of this product and a steady fall in stainless steel prices.

This has led to speculation that production cuts may be imminent and, therefore, Macquarie suspects prices probably sold off. Other concerns centre on a potential end to recent Chinese economic stimulus, and that nickel pig iron production growth in particular may be running ahead of demand.

Another concern, although the broker considers this less significant, is that demand for nickel in batteries may ease or fall as subsidies on Chinese electric vehicles are removed. All up, Macquarie considers the negative factors are all short-term and the market remains in structural deficit with prices trending higher.

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China's Enviromental Crackdown Buoys Lead, Zinc

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.

China's environmental crackdown buoys lead, zinc

Zinc and lead prices are movin' on up again, following a two-week hiatus in the long-term trend of diminishing inventories in London Metal Exchange warehouses.

Zinc stocks plummeted from 900,000 tonnes (kt=1,000 tonnes) at the beginning of 2014 to around 120,000kt five years later - due to a rash of zinc mine closures over the past few years and tighter environmental restrictions in China, which is lessening the amount smelters can produce.

Antaike, a Chinese metals research firm, estimates national production of refined zinc in 2018 fell to just 4.53 million tonnes, the sharpest downturn since 2013, Reuters said.

The result has been a record amount of zinc imported into the world's largest metals consumer, 715,355 tonnes of refined zinc in 2018. The high demand in China has also pulled a lot of zinc out of LME warehouses.

In February zinc inventories fell to the point where there was less than two days' worth of global consumption locked in London Metal Exchange warehouses. The paucity of the metal used to prevent rusting caused prices to spike to the highest they've been since last June.

Zinc prices were US$2,845 a tonne or $1.29 a pound, after data showed LME warehouses held just over 58,000 tonnes. For perspective, the all-time high for zinc was $2.07/lb in 2006, compared to historic lows below 40 cents back in the early 2000s.

The supply noose loosened at the end of March, however, causing prices to fall, but they're on the rise again. The trigger was 10,625 tonnes flowing into exchange warehouses, causing a price slippage to $1.27/lb, on April 16.

Two weeks of slack prices appear to over, though. The industrial metal has made a slow recovery from $1.29 a pound on April 19 to its current $1.32/lb.

The story is much the same for lead. Due to smelting restrictions, China imported 128,000 tonnes of refined lead last year, the most since the financial crisis of 2008. For the first three-quarters of 2018, world refined lead demand outstripped supply by 110,000 tonnes, notes the International Lead and Zinc Study Group.

In February 2019, lead inventories in LME warehouses plunged by over a third, to their lowest levels since 2009, only enough to cover one week of global demand. Inventories in Chinese warehouse were depleted by 70%, as that country continued to curb output in the world's biggest market for automotive lead batteries.

A report by Wood Mackenzie quoted by Reuters, states that any primary lead smelter in China that fails to get its discharge permit this year will be shut down. Meanwhile secondary lead production is expected to keep contracting.

Just this week, it was reported that China's demand for refined imports of lead and zinc are keeping pace with last year's torrent; during the first three months of 2019, net refined zinc imports were up 2%, from 128,000 to 139,000 tonnes.

Uses

Zinc is the fourth-used metal today, behind only iron ore, copper and aluminum in terms of annual tonnage produced. Zinc's main function is to galvanize metals. Adding a zinc coating to steel or iron protects it against rusting. In fact zinc offers a double layer of protection: the top layer serves as a barrier coating, the bottom layer actually attracts more oxidation than the underlying metal surface; when this layer becomes oxidized, it wears away, leaving just the top layer.

A high percentage of steel that goes into buildings and automobiles, is galvanized with a zinc coating, making it a highly-prized metal.

Indeed, making rust-proof cars could not take place without zinc. The metal is used in many stages of the assembly line, including engine parts, fuel systems and chassis, where components are plated with zinc. Zinc-coated parts are

reportedly able to withstand up to 1,000 hours of salt spray testing.

Auto manufacturers in the US have, for the past 25 years or so, been using a zinc-nickel-alloy for plating. The nickel adds to zinc's anti-corrosive properties, and provides a lustrous sheen.

Zinc alloys including brass are used in corrosion-resistant marine components and musical instruments.

While its primary use is to stop metal from rusting (for example galvanized steel used in automobile production or bridge-building), other applications are shoring up demand. Adding zinc to fertilizer increases soil productivity, and there is research being conducted to develop a nickel-zinc battery for use in electric vehicles.

The US Naval Research Laboratory is working with EnZinc, a California-based firm, on technology that the company's founder said should be ready within the next two years.

Zinc, of course, is already used in alkaline batteries - a type of battery that gets its energy from the reaction between zinc and manganese dioxide.

There are also zinc batteries. Both zinc and alkaline batteries are useful for low-drain appliances like TV remotes and clocks. The difference between the two is the type of electrolyte - ammonium chloride for zinc batteries and potassium hydroxide for alkaline.

Generally, alkaline batteries have a higher capacity and a longer shelf life than zinc batteries. This is because with zinc batteries, both the casing and the anode are made of zinc; the casing is prone to leaks and eventually gets eroded away by the acidic electrolyte inside.

With alkaline batteries (which also contain zinc), the battery's metal body is used to house the anode, which is in powder form ie. it doesn't erode the casing.

Any discussion of zinc would be incomplete without a mention of its medical uses. Zinc is an essential mineral for the human body and zinc deficiency is a serious condition, remedied by zinc supplements.

Infrastructure metal

Zinc is also used heavily in infrastructure build-outs. This includes desperately needed bridges, public buildings, power stations, dams etc. in the US, much of the developing world, and China's Belt and Road Initiative which along with needing billions of tonnes of copper, is going to require a lot of steel containing zinc.

According to the American Society of Civil Engineers (ASCE), the US needs to spend $4.6 trillion between 2016 and 2024 in order to upgrade all its infrastructure to an acceptable standard. But only $2.6T has been earmarked, leaving a funding gap of $2 trillion.

The amount of pipe rehabilitation, the number of dams that need to be upgraded, new ports, airports, bridges, power plants etc., will require billions of tonnes of raw materials. We're talking iron ore, steel, zinc, manganese, vanadium and copper, just to name a few key metals.

Zinc is mostly used in steel fabrication to prevent rusting; it is an essential component of galvanized steel bridges; highways, railways, and high-rise buildings all use zinc.

We only need to look to China, once again, to see how the demand for zinc is poised to skyrocket. Beijing is keen to advance its ‘Belt and Road Initiative' (BRI), consisting of a vast network of railways, pipelines, highways and ports that would extend west through the mountainous former Soviet republics and south to Pakistan, India and southeast Asia.

So far over 60 countries, containing two-thirds of the world's population, have either signed onto BRI or say they intend to do so. According to the Center for Foreign Relations, the Chinese government has already spent about $200 billion on the growing list of mega-projects projects including the $68 billion China-Pakistan Economic Corridor. Morgan Stanley predicts China's expenditures on BRI could climb as high as $1.3 trillion by 2027.

Zinc is among the metals China is looking to source from its 60-odd-country trading block. Beijing is willing to lend money to fund construction projects in nations such as Kenya, Laos, Peru, Sri Lanka, Greece, Serbia and the Philippines. These projects are sure to contain such mined commodities as copper, steel, zinc, etc.

Tight supply

The zinc market was in deficit in 2018. According to the USGS, despite new zinc mines opening in Australia and Cuba in 2017, and increased production at the Antamina mine in Peru, supply failed to keep up with consumption. The International Lead and Zinc Study Group states that global refined zinc production in 2018 was 13.42 million tons versus 13.74 million tons consumed, leaving a deficit of 322,000 tons.

Some very large zinc mines have been depleted and shut down in recent years, with not enough new mine supply to take their place.

MMG's shuttered Century mine for example used to supply 4% of the world's zinc. Between the shutdown of the Lisheen mine in Ireland, Century, and Glencore's Brunswick and Perseverance mines in Canada, over a million tonnes was ripped from global zinc production.

The closed mines represent an estimated 10 to 15% of the zinc market. On the flip side, there have been few discoveries or big zinc projects planned. This is setting the zinc market up for a supply shortage.

The International Lead and Zinc Study Group predicts the zinc market will again be in a deficit position of 72,000 tonnes in 2019.

BMI Research noted in June 2018 that refiners, particularly in China, will have a hard time securing zinc concentrate, due to zinc mine production curtailments. Tightened environmental standards to deal with choking air pollution in China, meant that Zijin Mining cut 8.2% of its zinc production in 2017.

Chinese smelters rely heavily on imported zinc ore. In 2017 China's refined zinc production was at its lowest in two years due to problems acquiring zinc concentrate.

The supply squeeze is also trickling down to junior zinc explorers. When zinc prices were low, exploration dried up, meaning there's not enough new supply to match the growing demand for zinc especially for galvanized steel, Jeff Hussey, president and CEO of Osisko Metals, recently told Kitco News:

"The world needs more zinc mines but we don't have them because there has been no exploration. If you had all the expected development projects come on line at full capacity, analysts expect that demand will still outstrip supply by mid-2020," he said. "This means there is a limited risk of further downside in the price long term."

Wood Mackenzie states that zinc mine closures, attrition and demand growth will require 2.2 million tonnes of new mine capacity a year.

VMS

The majority of the world's zinc deposits contain lead, meaning lead and zinc are mined together. Sphalerite is zinc's main ore and is usually associated with galena, the lead mineral, and chalcopyrite, the copper mineral.

Zinc and lead mineralization generally occur together, within limestone, in veins associated with granitoids, and as volcanogenic massive sulfide (VMS) deposits. The latter can also contain precious metals.

VMS deposits are estimated to have supplied over 5 billion tonnes of sulfide ore. They currently account for 22% of the world's zinc production, 9.7% of the lead produced, 6% of copper, 8.7% of silver and 2.2% of gold.

An estimated 900 VMS deposits are found worldwide, averaging about 17 million tonnes each. And they are still being formed, mostly along tectonic ridges where plate movements form cracks in the earth's crust - allowing a conduit for ancient minerals to travel up through hot liquids and be deposited, through billowing white and black clouds, onto the sea floor.

The Iberian Pyrite Belt running through Spain and Portugal has about 90 VMS deposits, with some larger than 100 million tonnes. Large VMS mines are in Scandinavia including Boliden's Garpenberg mine, a 120-million-tonne VMS monster.

VMS deposits in Canada include Flin Flon, Bathurst, Snow Lake and Noranda.

They have long been recognized, by both majors and juniors, as potential elephant country – and because of their polymetallic content these types of deposits continue to be one of the most desirable because of the security offered against fluctuating prices of different metals.

They can also have long lives. The Kidd mine in Quebec, the deepest base-metal mine in the world, is a VMS deposit that has been in production since 1966.

Boreal Metals

To sum up, more zinc mines are needed to bring supply back into balance with demand, and they will most likely be developed from sulfide deposits. Remember 95% of mined zinc comes from sulfides.

I've got my eye on a company with a VMS deposit in Sweden that is getting excellent results from recent drilling. Boreal Metals (TSX-V:BMX) is aiming for discovery success by investigating past-producing mining areas.

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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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ESG Focus: Central Banks Take On Climate Risk

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Central Banks Take On Climate Risk

Central banks will force financial institutions to account for climate risk The Reserve Bank of Australia, a member of the willing, has detailed its concerns Central banks have called for a massive reallocation of capital and a green rating system By Sarah Mills

In a move expected to have major implications for the banking sector and the global economy, the majority of the world's central banks have signaled their intent to ensure climate risk is properly accounted for in the financial sector.

They warned in the closing week of April that a "massive" reallocation of capital would be required to mitigate the risks of global warming and said the banking system needed to play a central role in this.

Members of the Central Banks and Supervisors Network for Greening the Financial System (NGFS), which includes 36 banks and supervisors from five continents responsible for two thirds of the global systemically important banks and insurers and half of global carbon emissions, called for collective action to manage climate-related financial risks in a bid to establish a global standardised approach to the issue.

The notable exception to the membership is the US Federal Reserve.

The tools at their disposal include monetary policy (they recognise former inflation targets may no longer be appropriate), capital requirements, regulation, quantitative easing, political influence (an unusual public announcement for central banks), research, and the development of a standard reporting protocol.

In late April, the NGFS issued six recommendations that will help central banks lay the groundwork for this project, and to ensure they have their own houses in order. They include:

Integrating climate-related risks into central banks' financial stability monitoring and micro-supervision; Integrating sustainability factors into own-portfolio (i.e. central bank portfolio) management; Bridging data gaps between public authorities through joint working groups to identify gaps; sharing information and making information publicly available to through a data repository; Building awareness and intellectual capacity among central banks and supervisors, encouraging technical assistance and knowledge sharing with their institutions and other wider stakeholders to better understand how climate factors translate into financial risks and opportunities; Policymakers: Achieving robust and internationally consistent climate and environment-related disclosure framework for business climate exposures, particularly companies issuing public debt or equity, and in support of the recommendations of the Task Force on Climate-related Financial Disclosures; Supporting the development of a taxonomy of economic activities risks. It asks policymakers to bring together stakeholders to work on a public taxonomy which would: improve transparency; reduce greenwashing: help financial institutions identify assess and manage climate risks; help improve understanding risks differentials between asset types; and mobilise capital for green and low-carbon investments consistent with the Paris Agreement. The central banks have already started building public awareness.

Australia's own Reserve Bank (a member of the NGFS) deputy governor Guy Debelle in March named climate change as a "systemic risk" to the Australian economy.

Debelle singled out supply shocks to agriculture and fossil fuels as the major issues, which is not surprising given Australia's heavy reliance on the two industries.

"The key point for us is it's not just climate volatility. When countries really take action it's going to mean a negative income shock in Australia."

Debelle also flagged the inadequacies of the bank's inflation targets to deal with climate-related supply shocks.

"The problem we have with an inflation target is that if there's an extreme weather event, the price of goods will go up, and output will go down. If you're targeting inflation, you have to tighten monetary policy. But if you're targeting nominal growth as inflation goes up and output goes down, you don't have to tighten monetary policy," said Debelle.

The rest of the world's central banks are grappling with the same issues.

Central banks have two main issues to consider in their risk assessment:

The level of mitigation taken to reduce carbon emissions; How orderly or disorderly a transition occurs away from carbon. Climate change poses financial risks in two ways:

The physical effects of extreme weather and climate conditions; Any impact of the transition to a lower-carbon economy. The first affects assets and productivity. But the latter can also cause problems for financial institutions through stranded assets.

The NGFS stance essentially pits the central banks against governments that have domestic policies that enhance climate risk.

The central banks have stamped it as their territory and right, claiming climate change is "a source of financial risk" that falls well within the mandate of regulators.

The NGFS announcement has sent a clear signal that financial risks can only be mitigated through an early and orderly transition. They are also calling for more green financing and better risk assessment.

Green loans are already on the rise. The 21 largest commercial banks in China alone hold US$1.2trn in green loans, accounting for 10% of their aggregate loan balance.

This in part reflects the People's Bank of China's introduction of a framework incentivising green activities, which implicitly disincentivises carbon intensive activities.

Other options that have been mooted include green quantitative easing, however, there needs to be greater standardisation of green assets as currently many of such assets do not meet the criteria.

The European Central Bank at present holds about 24% of the eligible green bonds issued in the public sector and about 20% of private sector green bonds – effectively a green quantitative easing.

Basically though, the central bankers seek a systematic approach across all countries to mitigate risk. They seek a new rating system for public and private sector investments – something organisations such as S&P are already working on, and a global standard for financial markets and public procurement.

It is expected that a full rollout should occur some time in 2021.

Technical limitations

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

Weekly Ratings, Targets, Forecast Changes

By Rudi Filapek-Vandyck, Editor FNArena

Guide:

The FNArena database tabulates the views of 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 April 29 to Friday May 3, 2019 Total Upgrades: 12 Total Downgrades: 22 Net Ratings Breakdown: Buy 40.99%; Hold 43.60%; Sell 15.41%

The first week following the April holiday-drought provided yet more evidence that corporate Australia is facing multiple headwinds which may not be accurately reflected in today's share prices. And so it was that when analysts and investors returned to their desks in late April/early may, their re-appraisal of freshly updated insights culminated into twelve upgrades in ratings for individual, listed ASX-stocks, vastly outnumbered by 22 downgrades.

Three companies received multiple upgrades, but the news seems less buoyant when looking into the finer details. Wealth manager Pendal Group's market update attracted three upgrades, but only one went to Buy. Gold miner Regis Resources received two upgrades; both moved to Hold/Neutral. At least nickel, copper, gold, silver and zinc miner Independence Group received two upgrades that both pushed ratings to Buy.

No surprise, there was a lot more happening on the other side of the ledger. ANZ Bank's interim report attracted three downgrades; only one went as low as Sell. A profit warning from Domain Holdings ((DHG)) also attracted three downgrades, but this time two moved to Sell.

In total, ten out of the week's 22 downgrades meant a fresh Sell rating for the stock impacted.

Among those who received a downgrade to Sell we also find Beach Energy, Dexus Group and Mirvac, Mount Gibson, REA Group, Redbubble, and Volpara Health Technologies.

The week's table for positive adjustments to valuations and price target is pretty short with Healius, Independence Group and Super Retail the only ones worth mentioning (with still relatively benign increases). Again, the negative side is showing more action led by Senex Energy and Regis Resources, followed by Scentre Group and Pilbara Minerals, and others.

Here too the average reduction in target remains petite.

Not so when it comes to reductions in earnings forecasts which is directly related to the product price leverage that characterises most commodity producers. The week's top three are all miners, interspersed by REA Group, then followed by more miners, before we meet Transurban and Super Retail Group.

Positive adjustments are enormous. The negative amendments are equally sizeable led by big cuts for Senex Energy, Syrah Resources and Alacer Gold and Northern Star, before we get to Flight Centre (yet another profit warning).

The week ahead sees a number of out-of-cycle profit reports, so no shortage in volatility and changes ahead. Australian banks have failed to concoct a miracle, and for once this includes Macquarie Group.

Upgrade

DOMAIN HOLDINGS AUSTRALIA LIMITED ((DHG)) Upgrade to Neutral from Underperform by Macquarie .B/H/S: 1/4/2

At Macquarie's conference, Domain provided a March Q update which saw weak revenues but improved yields. The new CEO is pursuing cost-outs and moving to a more segmented approach of smaller geographical zones rather than state-based pricing.

The company is also looking to monetise the "unreplicable" digital database of major shareholder Nine Entertainment ((NEC)). Macquarie agrees FY19 remains challenging but sees strong earnings growth in FY20, hence now the share price has pulled back to the broker's $2.70 target, rating upgraded back to Neutral having been downgraded to Underperform early in April.

See also DHG downgrade.

HEALIUS LIMITED ((HLS)) Upgrade to Neutral from Underperform by Credit Suisse .B/H/S: 3/3/0

Amid reports a private equity consortium is working on a bid for Healius, Credit Suisse notes the speculation involves selling of the diagnostic imaging operations to one party and the rump of the operation to another.

Credit Suisse estimates a break-up value of $3.80 a share. On a fundamental basis, there is significant earnings risk with headwinds from labour costs and execution risk from strategic initiatives.

However, in the short term, the share price is likely to be supported by the prospect of M&A. Credit Suisse upgrades to Neutral from Underperform and raises the target to $3.10 from $2.35.

HANSEN TECHNOLOGIES LIMITED ((HSN)) Upgrade to Buy from Hold by Ord Minnett .B/H/S: 1/0/0

Hansen Technologies has announced the acquisition of Sigma Systems for $166.2m. The strategic rationale centres on the high-quality asset, significantly adding scope and scale in telecommunications.

It also provides cross selling opportunity into the utility vertical as well as pay-TV. Ord Minnett estimates the deal is 20% accretive and, while time will ultimately tell, Sigma Systems may represent the circuit breaker the company needs.

The stock has significantly de-rated over the past year. Ord Minnett upgrades to Buy from Hold and raises the target to $3.95 from $3.36.

INDEPENDENCE GROUP NL ((IGO)) Upgrade to Buy from Neutral by UBS and Upgrade to Outperform from Neutral by Macquarie .B/H/S: 4/3/0

March quarter production was well ahead of forecasts and UBS upgrades to Buy from Neutral.

The broker believes that the -10% decline in the share price in April, because of a lower nickel price, has created an opportunity to obtain exposure to a high-quality low-cost producer. Target is steady at $5.

In the wake of Independence Group's March Q report, Macquarie upgrades to Outperform. Overall production was strong thanks to record levels at Nova and consistency at Tropicana. Work on the Downstream Sulphate Study should be completed by year-end.

The DSS offers the potential for the miner to secure higher concentrate payability terms for Nova, the broker believes. Exploration results are encouraging and could provide for material upside. Target rises to $5.10 from $4.90.

OCEANAGOLD CORPORATION ((OGC)) Upgrade to Neutral from Underperform by Credit Suisse .B/H/S: 2/4/0

A very weak production outcome for Haile in the March quarter was offset by strong outcomes for Didipio and Macraes. 2019 guidance is unchanged.

The company has had exploration success at Martha with an underground target, defined as a potential 5-8mt at 4-6g/t gold for around 1.0-1.5m ounces.

Credit Suisse upgrades to Neutral from Underperform and maintains a $4.20 target.

PENDAL GROUP LIMITED ((PDL)) Upgrade to Neutral from Underperform by Credit Suisse and Upgrade to Neutral from Sell by UBS and Upgrade to Accumulate from Hold by Ord Minnett .B/H/S: 3/4/0

First half cash net profit was down -26% and below Credit Suisse forecasts. The miss was largely caused by unexpected revenue margin compression. The broker expects management fee compression to continue in most of the product lines.

Earnings estimates are downgraded by -7% for FY19 and -4-5% for FY20-21. The recent fall in the share price now provides more insulation from the risks and the broker upgrades to Neutral from Underperform. Target is reduced to $7.65 from $7.80.

Pendal's -26% fall in March Q profit was -13% below UBS. With lower performance fees, flows and FUM all preannounced, it was lower base fees that made the difference, the broker notes. Weakness across the JOHCM

funds appear to be a key factor, and the impetus for -9-10% cuts to UBS' forecast earnings.

Target falls to $7.85 from $8.70, but a 15.6x FY20 multiple and a 7% yield warrant an upgrade to Neutral, with further downside appearing more limited.

First half net profit was down -26.2% and below Ord Minnett's forecasts. The interim dividend of $0.20 a share was slightly above expectations.

The broker believes the business will face near-term headwinds and negative news around fund flows.

However, the de-rating on re-based earnings is providing an attractive opportunity over the medium term and the broker's rating is upgraded to Accumulate from Hold. Ord Minnett raises the target to $8.90 from $8.50.

PILBARA MINERALS LIMITED ((PLS)) Upgrade to Hold from Lighten by Ord Minnett .B/H/S: 2/1/0

Ord Minnett notes recent improvements in recovery have been offset by delayed sales and higher cost guidance. Pilgangoora produced 52,000t, although sales were lower at 38,600t.

The project generated negative operating cash flow, despite $8.5m in payments falling into this quarter. Ord Minnett upgrades to Hold from Lighten, as the share price has fallen -30% from its peak in the last month. Target is reduced to $0.65 from $0.70.

REGIS RESOURCES LIMITED ((RRL)) Upgrade to Hold from Sell by Deutsche Bank and Upgrade to Neutral from Sell by UBS .B/H/S: 1/4/2

March quarter production was solid and the company is on track to meet full year guidance. Regis Resources has guided to FY19 production in the mid to upper end of its range of 340-370,000 ounces.

Costs are expected at the lower end of the range of $985-1055/oz. Deutsche Bank upgrades to Hold from Sell. Target is $4.40.

UBS found the March quarter production numbers consistent. Management expects production at the upper end of guidance of 340-370,000 ounces and at the lower end of all-in sustainable costs of $985-1055/oz.

Nevertheless, the broker notes the share price has fallen -17% since its peak in February because of the decline in the Australian dollar gold price. Rating is upgraded to Neutral from Sell and the target reduced to $4.80 from $5.20.

Downgrade

AUSTRALIA & NEW ZEALAND BANKING GROUP ((ANZ)) Downgrade to Hold from Accumulate by Ord Minnett and Downgrade to Hold from Add by Morgans and Downgrade to Underperform from Neutral by Credit Suisse .B/H/S: 0/6/2

The first half result was close to Ord Minnett's forecasts, although the composition was more skewed to the institutional business than expected. Institutional operations delivered a return on equity of just under 11% and this is expected to improve further.

Nevertheless, the broker believes it will take longer to turn the retail bank around and ANZ faces greater exposure versus peers to proposed higher regulatory requirements in New Zealand.

Ord Minnett downgrades to Hold from Accumulate and lowers the target to $29.50 from $31.20.

The first half result was messy, as Morgans suspected. Excluding remediation and the gain on sale from the divestment of OnePath Life, cash earnings beat forecasts by 3%. Disciplined cost performance was the highlight for the broker.

Morgans is downgrading to Hold from Add because of recent strength in the share price. The broker believes the results will provide the market with reasons to focus on the potential earnings upside for the sector, as costs stay flat or decline over the next three years. Target is steady at $29.

ANZ's underlying earnings fell short of Credit Suisse on lower revenues, leading to a lower interest margin. A strong performance from institutional banking was encouraging, as was cost control, with a specific target now set.

The broker nevertheless notes the bank faces "outsized" headwinds from low asset growth, margin decline, a non-linear cost trajectory and capital and regulation uncertainty. Credit Suisse cuts its target to $26.55 from $28.00 and downgrades to Underperform.

BHP GROUP ((BHP)) Downgrade to Neutral from Buy by Citi .B/H/S: 1/6/1

Following updates to commodity prices forecasts, and a general re-appraisal after a strong rally in share prices, Citi analysts have decided to downgrade to Neutral from Buy.

Noteworthy: iron ore price forecasts have remained unchanged. Compared to current spot commodity prices, Citi continues to prefer base metals (ex zinc) exposure over bulks.

Today's update has mainly caused price targets across the mining sector to be reduced. For BHP, the reduction is no more than -50c to $40.

BEACH ENERGY LIMITED ((BPT)) Downgrade to Sell from Neutral by Citi .B/H/S: 1/3/1

Citi recommends investors take profits in Beach Energy, considering the good news is more than reflected in the current share price. The broker downgrades to Sell from Neutral, premised on a US$55/bbl long-term oil price.

At a US$70/bbl long-term oil price the broker's valuation increases to a level largely in line with the current share price, so limited upside is envisaged unless investors are taking a more bullish view on oil. The broker reduces the target to $1.80 from $1.87.

DOMAIN HOLDINGS AUSTRALIA LIMITED ((DHG)) Downgrade to Reduce from Hold by Morgans and Downgrade to Hold from Accumulate by Ord Minnett and Downgrade to Underperform from Neutral by Credit Suisse .B/H/S: 1/4/2

The March quarter update showed depth listings fell -13%. This was offset by yield improvements but revenue growth from all sources was below Morgans' expectations.

The broker considers near-term growth constrained until listings volumes recover. Rating is downgraded to Reduce from Hold and the target lowered to $2.19 from $2.25.

Ord Minnett expects continued weakness in new real estate listings until after the federal election on May 18. The broker reduces earnings estimates, now expecting declines of -16% in the second half of FY19.

Rating is downgraded to Hold from Accumulate and the target lowered to $3.15 from $3.25. Ord Minnett now expects Domain to generate $350.4m in revenue in FY19.

The company's trading update has reflected a weak listings environment. Revenue growth from digital business has been flat in the March quarter. Because of weak top-line trends Domain is taking further action on costs.

Credit Suisse points out weakness in the current year's turnover is usually expected to be countered by a pick up in the following year because of weak comparables, but data from the US/UK market suggests this is not necessarily the case.

The broker downgrades to Underperform from Neutral and reduces the target to $2.30 from $2.40.

See also DHG upgrade.

DEXUS PROPERTY GROUP ((DXS)) Downgrade to Underperform from Neutral by Macquarie .B/H/S: 0/4/1

Dexus has confirmed the acquisition of 80 Collins Street, to be partly funded by a $950m equity raising. The acquisition is at a 5.0% passing yield and 5.3% capitalisation rate. Distribution guidance is for 5% growth in FY20.

While the transaction is marginally accretive, Macquarie does not believe further capital deployed in office at this point in the cycle will be taken well by equity markets and downgrades to Underperform from Neutral.

The broker considers a 5% passing yield on an 8% internal rate of return, funded with nearly $1bn of new equity, is an aggressive capital management decision. Target is steady at $11.36.

FIRSTWAVE CLOUD TECHNOLOGY LIMITED ((FCT)) Downgrade to Speculative Buy from Add by Morgans .B/H/S: 1/0/0

Morgans updates its valuation to reflect the recent capital raising and quarterly result. The company raised $6.5m in a placement and $1.2m via an oversubscribed shareholder purchase plan.

A customer deal has also been re-negotiated to bring for 12 months of revenue which, collectively, should generate cash flow of nearly $13m in the fourth quarter.

Morgans adjusts its recommendation to Speculative Buy from Add to better reflect the higher risk/reward profile. Target is raised to $0.36 from $0.22.

MIRVAC GROUP ((MGR)) Downgrade to Lighten from Hold by Ord Minnett .B/H/S: 1/3/1

In the wake of the quarterly updates from real estate investment trusts, Ord Minnett considers Mirvac is a good business and well-run, albeit fully valued. Pressure is envisaged for residential earnings beyond FY20, as sales rates have slowed noticeably.

The broker downgrades its rating to Lighten from Hold. Target is raised to $2.65 from $2.55.

MOUNT GIBSON IRON LIMITED ((MGX)) Downgrade to Sell from Neutral by Citi .B/H/S: 0/1/1

Following updates to commodity prices forecasts, and a general re-appraisal after a strong rally in share prices, Citi analysts have decided to downgrade to Sell/High Risk from Neutral/High Risk.

Noteworthy: iron ore price forecasts have remained unchanged. Compared to current spot commodity prices, Citi continues to prefer base metals (ex zinc) exposure over bulks.

Today's update has mainly caused price targets across the mining sector to be reduced. For Mount Gibson, the impact on the price target is nil. $0.80 it is.

NATIONAL TYRE & WHEEL LIMITED ((NTD)) Downgrade to Hold from Add by Morgans .B/H/S: 0/1/0

Sluggish demand and heightened competition has meant the company has downgraded FY19 revenue guidance to $165-167m and operating earnings (EBITDA) guidance to $11.5-12.5m.

Morgans is relieved the balance sheet is net cash. The company has reiterated strategies to deal with current conditions including improved price, changes to source of manufacture and a more aggressive push into the SUV segment.

Morgans believes this poses both opportunity and risk. Rating is donwgraded to Hold from Add and the target lowered to 48c from 67c.

NUFARM LIMITED ((NUF)) Downgrade to Hold from Add by Morgans .B/H/S: 5/2/0

The company's presentation highlighted a number of potential downside risks, Morgans observes. FY19 guidance is maintained but, given the downside risk, the broker revises forecasts lower.

Nufarm has acknowledged new weather-related headwinds in Australasia and North America as well as supply disruptions that are affecting the European portfolio.

Morgans downgrades to Hold from Add and reduces the target to $5.50 from $6.30. The broker is concerned that, if the company cannot restore the balance sheet, another equity raising will be required.

ORICA LIMITED ((ORI)) Downgrade to Neutral from Buy by UBS .B/H/S: 1/5/1

Orica is the world's leading supplier of mining explosives, UBS notes, and as such is late-stage leveraged to mining cycle recovery. But the ammonium nitrate market is over-supplied, restricting price growth despite explosives demand growth and hence that leverage is undermined.

The stock price is up 10% year to date to a point the broker considers is fairly discounting the outlook. Hence while lifting its target to $19.20 from $18.86, UBS pulls back to Neutral.

REDBUBBLE LIMITED ((RBL)) Downgrade to Reduce from Add by Morgans .B/H/S: 0/0/1

The company continues to struggle with the severe loss of unpaid customer traffic because of the changes to the Google search algorithm. Morgans expects conditions to remain tough for the next 12-18 months.

Guidance for earnings and cash flow has been downgraded as the costs of a higher share of paid traffic continue to impact. Morgans downgrades its rating to Reduce from Add and lowers the target to $0.67 from $1.27.

REA GROUP LIMITED ((REA)) Downgrade to Lighten from Hold by Ord Minnett .B/H/S: 4/2/0

Ord Minnett expects weakness in new real estate listings will continue until after the federal election on May 18. A decline of -10% is expected for second half earnings. Revenue of $909.3m is estimated for FY19.

The broker downgrades to Lighten from Hold and reduces the target to $74 from $76.

SCENTRE GROUP ((SCG)) Downgrade to Neutral from Buy by UBS .B/H/S: 0/3/3

After the company's quarterly update, UBS is less confident that retail sales have stabilised or will grow materially in the short to medium term. This will put pressure on future operating income growth.

The broker downgrades to Neutral from Buy and reduces the target to $3.74 from $4.18. Regional retail malls are traversing a period of price discovery, UBS believes, as expected asset sales exceed investor demand.

UBS forecasts comparable net operating income growth to slow 1% in 2021/22 from 2.5% in 2019.

SUPER RETAIL GROUP LIMITED ((SUL)) Downgrade to Neutral from Buy by UBS .B/H/S: 2/6/0

Trading in the March quarter was mixed, UBS observes, with sales better and the margin outlook softer. The broker reduces estimates for earnings per share by -2-4% and downgrades to Neutral from Buy.

The main negative was a continuation of the margin pressure in BCF. The outlook is less certain too, with some signs of softening expenditure at retailers directly exposed to housing. Target is reduced to $8.50 from $8.70.

SOUTHERN CROSS MEDIA GROUP ((SXL)) Downgrade to Neutral from Buy by UBS .B/H/S: 1/2/1

The share price has risen 25% since its recent lows and, hence, UBS downgrades to Neutral from Buy on valuation grounds alone.

The overall advertising market remains soft, the broker observes, although the company is winning share from metro radio peers, given audience strength and its digital stack strategy.

The company has guided to flat FY19 costs growth. UBS raises the target to $1.25 from $1.20.

SENEX ENERGY LIMITED ((SXY)) Downgrade to Neutral from Buy by Citi .B/H/S: 2/3/0

The company has indicated that the Surat Basin will incur most of the capital expenditure from FY19-21, at the expense of drilling in the Cooper Basin.

Citi believes the balance sheet should have been capable of continuing to support expenditure in the Cooper Basin, and is disappointed.

The broker forecasts lower and deferred levels of activity in the Cooper Basin, which materially reduces earnings estimates by over -50% for FY20/21.

Rating is downgraded to Neutral/High Risk from Buy/High Risk and the target lowered to $0.41 from $0.48.

VOLPARA HEALTH TECHNOLOGIES LIMITED ((VHT)) Downgrade to Lighten from Buy by Ord Minnett .B/H/S: 1/0/0

Ord Minnett observes a continuation of solid momentum in the fourth quarter cash flow report. FY20 guidance has now been issued, signalling at least 10% penetration.

The broker believes the market has moved too far and, suspecting consensus earnings reductions, downgrades to Lighten from Buy. Target is raised to $1.54 from $1.18.

Total Recommendations Recommendation Changes

Broker Recommendation Breakup

Broker Rating Order Company New Rating Old Rating Broker Upgrade 1 DOMAIN HOLDINGS AUSTRALIA LIMITED Neutral Sell Macquarie 2 HANSEN TECHNOLOGIES LIMITED Buy Neutral Ord Minnett 3 HEALIUS LIMITED Neutral Sell Credit Suisse 4 INDEPENDENCE GROUP NL Buy Neutral Macquarie 5 INDEPENDENCE GROUP NL Buy Neutral UBS 6 OCEANAGOLD CORPORATION Neutral Sell Credit Suisse 7 PENDAL GROUP LIMITED Neutral Sell UBS 8 PENDAL GROUP LIMITED Neutral Sell Credit Suisse 9 PENDAL GROUP LIMITED Buy Neutral Ord Minnett 10 PILBARA MINERALS LIMITED Neutral Sell Ord Minnett 11 REGIS RESOURCES LIMITED Neutral Sell UBS 12 REGIS RESOURCES LIMITED Neutral Sell Deutsche Bank Downgrade 13 AUSTRALIA & NEW ZEALAND BANKING GROUP Neutral Buy Morgans 14 AUSTRALIA & NEW ZEALAND BANKING GROUP Sell Neutral Credit Suisse 15 AUSTRALIA & NEW ZEALAND BANKING GROUP Neutral Buy Ord Minnett 16 BEACH ENERGY LIMITED Sell Neutral Citi 17 BHP GROUP Neutral Buy Citi 18 DEXUS PROPERTY GROUP Sell Neutral Macquarie 19 DOMAIN HOLDINGS AUSTRALIA LIMITED Sell Neutral Morgans 20 DOMAIN HOLDINGS AUSTRALIA LIMITED Sell Neutral Credit Suisse 21 DOMAIN HOLDINGS AUSTRALIA LIMITED Neutral Buy Ord Minnett 22 FIRSTWAVE CLOUD TECHNOLOGY LIMITED Buy Buy Morgans 23 MIRVAC GROUP Sell Neutral Ord Minnett 24 MOUNT GIBSON IRON LIMITED Sell Neutral Citi 25 NATIONAL TYRE & WHEEL LIMITED Neutral Buy Morgans 26 NUFARM LIMITED Neutral Buy Morgans 27 ORICA LIMITED Neutral Buy UBS 28 REA GROUP LIMITED Sell Neutral Ord Minnett 29 REDBUBBLE LIMITED Sell Buy Morgans 30 SCENTRE GROUP Neutral Buy UBS 31 SENEX ENERGY LIMITED Neutral Buy Citi 32 SOUTHERN CROSS MEDIA GROUP Neutral Buy UBS 33 SUPER RETAIL GROUP LIMITED Neutral Buy UBS 34 VOLPARA HEALTH TECHNOLOGIES LIMITED Sell Buy Ord Minnett Recommendation Positive Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 IGO INDEPENDENCE GROUP NL 50.0% 8.0% 42.0% 7 2 RRL REGIS RESOURCES LIMITED -19.0% -44.0% 25.0% 8 3 OGC OCEANAGOLD CORPORATION 25.0% 8.0% 17.0% 6 4 HLS HEALIUS LIMITED 42.0% 25.0% 17.0% 6 5 PLS PILBARA MINERALS LIMITED 67.0% 50.0% 17.0% 3 6 WES

WESFARMERS LIMITED -21.0% -31.0% 10.0% 7 7 WSA WESTERN AREAS NL 71.0% 67.0% 4.0% 7 Negative Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 ANZ AUSTRALIA & NEW ZEALAND BANKING GROUP -25.0% 6.0% -31.0% 8 2 DHG DOMAIN HOLDINGS AUSTRALIA LIMITED -14.0% 7.0% -21.0% 7 3 SXY SENEX ENERGY LIMITED 40.0% 60.0% -20.0% 5 4 SCG SCENTRE GROUP -50.0% -33.0% -17.0% 6 5 NUF NUFARM LIMITED 71.0% 86.0% -15.0% 7 6 SUL SUPER RETAIL GROUP LIMITED 19.0% 31.0% -12.0% 8 7 ORI ORICA LIMITED -6.0% 6.0% -12.0% 8 8 REA REA GROUP LIMITED 50.0% 57.0% -7.0% 7 9 VCX VICINITY CENTRES 13.0% 17.0% -4.0% 4 Target Price Positive Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 HLS HEALIUS LIMITED 3.068 2.943 4.25% 6 2 IGO INDEPENDENCE GROUP NL 4.793 4.650 3.08% 7 3 SUL SUPER RETAIL GROUP LIMITED 8.885 8.735 1.72% 8 4 WES WESFARMERS LIMITED 32.249 32.174 0.23% 7 5 ORI ORICA LIMITED 17.693 17.670 0.13% 8 Negative Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 SXY SENEX ENERGY LIMITED 0.450 0.466 -3.43% 5 2 RRL REGIS RESOURCES LIMITED 4.564 4.708 -3.06% 8 3 SCG SCENTRE GROUP 3.830 3.948 -2.99% 6 4 PLS PILBARA MINERALS LIMITED 0.900 0.917 -1.85% 3 5 NUF NUFARM LIMITED 6.326 6.440 -1.77% 7 6 OGC OCEANAGOLD CORPORATION 4.775 4.850 -1.55% 6 7 DHG DOMAIN HOLDINGS AUSTRALIA LIMITED 2.699 2.736 -1.35% 7 8 ANZ AUSTRALIA & NEW ZEALAND BANKING GROUP 27.856 28.200 -1.22% 8 9 REA REA GROUP LIMITED 86.481 86.939 -0.53% 7 Earning Forecast Positive Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 PLS PILBARA MINERALS LIMITED -0.140 -14.550 99.04% 3 2 WSA WESTERN AREAS NL 6.033 3.086 95.50% 7 3 IGO INDEPENDENCE GROUP NL 12.518 9.228 35.65% 7 4 REA REA GROUP LIMITED 242.733 226.629 7.11% 7 5 MIN MINERAL RESOURCES LIMITED 102.667 96.933 5.92% 3 6 ORG ORIGIN ENERGY LIMITED 63.669 61.111 4.19% 8 7 NCM NEWCREST MINING LIMITED 104.528 100.518 3.99% 8 8 TCL TRANSURBAN GROUP 21.973 21.140 3.94% 8 9 SUL SUPER RETAIL GROUP LIMITED 74.373 72.487 2.60% 8 10 ANZ AUSTRALIA & NEW ZEALAND BANKING GROUP 234.243 229.043 2.27% 8 Negative Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 SXY SENEX ENERGY LIMITED 0.720 1.180 -38.98% 5 2 SYR SYRAH RESOURCES LIMITED -4.209 -3.343 -25.90% 5 3 AQG ALACER GOLD CORP 32.392 40.814 -20.64% 3 4 NST NORTHERN STAR RESOURCES LTD 35.850 41.828 -14.29% 7 5 FLT FLIGHT CENTRE LIMITED 244.571 278.000 -12.02% 8 6 VEA VIVA ENERGY GROUP LIMITED 14.150 15.420 -8.24% 6 7 AWC ALUMINA LIMITED 25.290 26.757 -5.48% 5 8 NAB NATIONAL AUSTRALIA BANK LIMITED 209.043 218.500 -4.33% 8 9 DHG DOMAIN HOLDINGS AUSTRALIA LIMITED 7.223 7.399 -2.38% 7 10 NEC NINE ENTERTAINMENT CO. HOLDINGS LIMITED 14.400 14.728 -2.23% 5 Technical limitations

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Uranium Week: Fading Rebound

The uranium spot price ended April above the end-March price, but momentum faded as the month wore on.

-April rally spot uranium fades -US production plunges -France to extend nuclear reduction timeframe

By Greg Peel

20 transactions were concluded in the uranium spot market in April, industry consultant TradeTech reports, totalling 4.6mlbs U3O8 equivalent. Having been on the slide in recent months, the uranium spot price finally saw some buying emerge in April.

However, the rebound proved short-lived. TradeTech's spot price indicator traded as high as US$25.85/lb during the month but by month's end had fallen back to US$25.15/lb, as perennial uncertainty with regard section 232 continued to deter buyers.

That's still an improvement on the end-March price of US$24.90/lb, but by last Friday the spot price had slipped further, to US$25.00/lb, down -US20c for the week.

In term markets, only one transaction was reported. With several utilities reportedly considering mid and long term delivery contracts, TradeTech's mid-term price indicator has risen US50c to US$28.50/lb for end-April.

TradeTech's long-term price indicator remains at US$32.00/lb.

Supply Side

Weakness in the spot price continues despite ongoing reductions in supply. The US produced 58,481lbs U3O8 equivalent in the March quarter, down -83% from the December quarter and -74% year on year.

US uranium concentrate production for 2018 was -40% lower than 2017, and marked the lowest level of production since 1950.

Uranium producers continue to buy in uranium from the spot market to satisfy term delivery obligations rather than produce at historically low prices. Canada's Cameco sold 4.8mlbs U3O8 in the March quarter, but produced only 2.4mlbs.

Cameco has indicated that in order to meet 2019 sales commitments, it expects to take delivery of 19-21mlbs this year, with 60% coming from the spot market.

Demand Side

France is committed to reducing its nuclear power capacity by -50% by 2025. However, the Macron government also intends to get tough on emissions reductions. Previously France's emission reduction target was one quarter of 1990 levels by 2050. That has now been dropped to one sixth.

In order to achieve this target France would have to build new nuclear power plants, in contradiction to its aim to reduce nuclear power (a desire originally driven by Fukushima), so instead, the deadline to cut capacity by -50% has been extended from 2025 to 2035.

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

The Short Report

Guide:

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

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

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

Summary:

Week ending May 2, 2019

Last week saw the ASX200 drop back from its holiday-thin rally the week before, fall further on end-of-month squaring, and rally back on the fist of May with a bit of help from bank results.

Most of the red and green below represents bracket creep. However, we will note that having provided a profit warning earlier with its quarterly update, Flight Centre ((FLT)) appeared back in the 5%-plus shorted table last week at 5.2%.

The only other movements of interest last week were among the lithium miners.

See below.

Weekly short positions as a percentage of market cap:

10%+

SYR 17.3 ING 16.1 JBH 14.9 GXY 14.9 NXT 14.8 NUF 14.7 ORE 12.2 MTS 11.8 BAL 11.5 BWX 10.9 PLS 10.0

In: PLS Out: SDA

9.0-9.9

SDA, SUL, IVC, PPT, IFL, HVN

In: SDA Out: PLS, DMP, KGN, CSR 8.0-8.9%

BOQ, DMP, AMC, KGN, SGM, CSR, MYR, BKL, HUB

In: DMP, KGN, CSR, HUB Out: RWC

7.0-7.9%

RWC, BIN

In: RWC Out: HUB

6.0-6.9%

BGA, AMP, WSA, MSB, CGF

No changes

5.0-5.9%

RSG, COE, MLX, FLT, CGC, SEK, GMA, HT1, RIO, BEN, LNG

In: FLT, CGC, SEK Out: DHG, KDR, NEC Movers & Shakers

Last week lithium miner Kidman Resources ((KDR)) received a takeover bid from an unlikely suitor in Wesfarmers ((WES)), or at least it would have been unlikely had Wesfarmers not already taken a swing at rare earths miner Lynas Corp ((LYC)). Kidman's share price shot up over 40% on the news.

The takeover bid lit a fire under all lithium miners, which variously rallied strongly on the news. Given their representation at mostly the top end of the shorted table, one might presume short-covering had a lot to do with those rallies.

However, the story is not so simple.

Kidman itself fell out of the 5%-plus shorted table from a prior 5.3%, while shorts in Galaxy Resources ((GXY)) fell to 14.9% from 16.9%. But shorts in Pilbara Minerals ((PLS)) rose to 10.0% from 9.5% and Orocobre ((ORE)) shorts were unmoved.

Graphite miner Syrah Resources ((SYR)) was another to see a related price jump, on the wider battery theme, but shorts in Syrah remained little changed.

So it's not cut and dried. Wesfarmers has scoffed at suggestions it's making a move on the electric vehicle theme, yet lithium is used in batteries and rare earths (such as neodymium and dysprosium) are used to make magnets for electric motors. So draw your own conclusions.

ASX20 Short Positions (%)

Code Last Week Week Before Code Last Week Week Before AMC 8.8 8.8 RIO 5.1 5.2 ANZ 1.2 1.2 S32 1.2 1.3 BHP 3.4 3.5 SCP 1.2 1.3 BXB 0.2 0.1 SUN 0.3 0.3 CBA 1.8 1.8 TCL 1.4 1.6 COL 1.7 1.8 TLS 0.5 0.5 CSL 0.3 0.4 WBC 2.1 2.1 IAG 0.5 0.3 WES 2.0 1.9 MQG 0.3 0.3 WOW 2.5 2.7 NAB 0.9 0.9 WPL 0.7 0.7 To see the full Short Report, please go to this link

IMPORTANT INFORMATION ABOUT THIS REPORT

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

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

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

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

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

Aside from all the above reasons as to why it would be a potential misconception to draw simply conclusions on short percentages, there are even wider issues to consider. ASIC itself will admit that short position data is not an

exact science given the onus on market participants to declare to their broker when positions truly are “short”. Without any suggestion of deceit, there are always participants who are ignorant of the regulations. Discrepancies can also arise when short positions are held by a large investment banking operation offering multiple stock market services as well as proprietary trading activities. Such activity can introduce the possibility of either non-counting or double-counting when custodians are involved and beneficial ownership issues become unclear.

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

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

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Value & The Eye Of The Beholder

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-Value & The Eye Of The Beholder -Conviction Calls -Helping Pengana Selling The ESG Message -CSL Challenge: The Winners -Rudi On TV -Rudi On Tour

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

Value & The Eye Of The Beholder

By Rudi Filapek-Vandyck, Editor FNArena

In early May (last week), the once highly popular ASX-listed funds manager Janus Henderson ((JHG)) released a rather underwhelming March quarter financial performance report.

Among the key performance metrics that stood out was a -21% fall in earnings per share versus a year earlier, a sizable fall in operating margin to 34.4%, net funds outflows of -US$7.4bn, negative growth in performance fees, and an unchanged quarterly dividend of US36c. The latter is disappointing as the board is committed to a progressive dividend policy.

The day after the ASX release, the shares fell from above $35 to near $31, where they have remained since (well below most stockbroking analysts' price targets).

For Australian investors, whether they are shareholder in the company or not, it might be worthwhile to pay closer attention to what exactly is happening at the merger company (Janus and Henderson merged in 2017) because of the potential wider implications, including:

-global equity markets posting a strong V-shaped recovery year-to-date, while share prices for wealth managers in general have not full heartedly participated in the rally;

-Australian share market indices are now back near their post-GFC high, but earnings forecasts ex-resources continue to slide, as again witnessed when the banks reported this month, and with Janus Henderson's update equally triggering further reductions;

-the Value-style of investing has not kept up with Growth and the broader market for six consecutive years. Janus Henderson is a value-investor itself and its own shares would have looked attractive to other value investors pre-quarterly update.

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As per always, there are various company-specific, idiosyncratic factors in play behind the disappointing March quarter update. Janus Henderson has lost the presence of former bond market demigod Bill Gross, while also suffering outflows because its team of Emerging Markets investment specialists has left or is in the process of leaving.

But even adjusting for these two -admittedly major- set backs, one shouldn't lose sight that, underneath the surface, the challenge is 'on' and this very much resembles the industry as a whole, globally. The March quarter report proudly highlights the funds manager improved its overall investment performance with now 69% of all Assets under its Management (AuM) outperforming the benchmark on a three-year horizon.

While this marked a noticeable improvement from the 61% comparable number as at December 31, investors are being reminded back in 2017 the same Janus Henderson was able to advertise close to 90% of its assets were outperforming benchmarks on a 5-year comparison, while for a 3-year horizon the number peaked above 75% in Q3 2017.

Equally important is that the weaker, underperforming strategies, including fixed interest (bonds) and Intech, are seemingly being punished harshly, with sizable funds shifting elsewhere. Look closer, and a picture emerges of funds steadily flowing elsewhere.

As shown in the graphic flash back below (source: UBS), Janus Henderson has only managed to report net inflows in one quarter since the start of calendar 2017. Mind you, all this occurred during a period when equities mostly

performed positively (as did bonds). Imagine the shock impact of a net -US$7bn outflow when share markets go through a prolonged correction, or even a flattish, moribund period.

Not making matters any rosier for the asset manager, analysts already spotted sufficient indications more funds are ready to abandon the Janus Henderson portfolio in quarters to come, including on the back of the EM team leaving. In fact, analysts at both Citi and Macquarie suggest net outflows might remain a feature for the asset manager throughout each of the remaining three quarters of 2019.

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For those investors, and analysts, looking for a potential silver lining there is plenty to choose from. Post the latest public flogging, Janus Henderson shares are trading at a considerable discount versus peers, estimated by some analysts at no less than -42%. FNArena's Stock Analysis (see website) shows analysts' price targets, with exception of Credit Suisse's, sit double digit percentage above the present share price.

The prospective dividend yield, at current AUD/USD and twelve months out, has risen to a juicy 6.8% while the share price should also find support from the company's running buyback program. To date, only US$31m worth of shares have been bought back when the ultimate target is to buy back US$200m in 2019.

The company is keeping a tight lid on operational costs. While -US$7.4bn and -US$8.4bn in net outflows during the past two quarters are sizable losses, the company in total manages some US$350bn. Even if net outflows continue to be of similar size in the quarters ahead (which seems rather unlikely, but not entirely impossible), it will not send the company broke.

At some point, one would have to assume, things should stabilise and the asset manager might even achieve further improvement in performance and performance fees again.

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The Big Question that remains unanswered, however, is how much of the pain that is descending on the industry this year, also impacting peers including AMP ((AMP)), Pendal Group ((PDL)) and Perpetual ((PPT)), is simply of a short-term, fleeting nature, and how much is indicative of rising pressure when the trend remains firmly in favour of passive investment instruments that offer market conform returns at (much) lower cost?

The uncomfortable truth, for all active managers, is that investment funds around the world are increasingly being directed towards lower cost, passive instruments. At the same time, the number of active managers around the world is still increasing as many continue to believe they can outperform indices and their peers, and attract sufficient funds to prove it.

At the same time, many asset managers with a commendable track record going back to inception a long way back, are finding it increasingly harder to consistently outperform their benchmark, and justify their management fee. Here is a simple test every investor can undertake at their own leisure: visit the websites of active managers and look up monthly performance updates.

What you are likely to find is that most performances on a 3- and 5-year horizon remain well below historical track records, and fail to beat indices and benchmarks over that period.

One of the key reasons for this is, of course, the fact that so many seemingly "cheap" stocks, trading below intrinsic value, have proven to be mere value-traps rather than bargain entry points for value seeking investors. And Janus Henderson shares would be among those with the shares having peaked above $62 in November 2015, only to steadily de-rate towards $31-something today.

Herein lies a stern lesson for value investors who cannot look beyond the attraction of a beaten down share price: real future value creation can only materialise when the company in question is able to produce a sustainable turnaround. But what are the odds of that happening when the sector itself goes through transformational turmoil?

I don't know how exactly this sector might look like in, say, five or ten years' time, but my best guess is more money goes towards passive instruments, while the number of active managers needs to shrink, and margins will be under pressure, while human staff has to fend off robots, quants and artificial intelligence.

Put all these factors in the mix, and there is a case to be made that today's active fund managers are in the same boat as bricks and mortar retailers, and landlords of bricks and mortar retailers, as well as numerous other sectors that are challenged for future relevance, if not ultimate survival.

On my observation, many stocks in these sectors have experienced numerous rallies in years past, but share prices have time and again returned to lower price levels, well off from prior peaks and historical averages.

Maybe this is the real message today's investors should heed and incorporate in their strategies?

CSL Challenge: The Winners

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

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Rudi's View: Charter Hall, Lendlease & Pengana

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-Value & The Eye Of The Beholder -Conviction Calls -Helping Pengana Selling The ESG Message -CSL Challenge: The Winners -Rudi On TV -Rudi On Tour

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

By Rudi Filapek-Vandyck, Editor FNArena

Conviction Calls

The latest update on Wilsons' select list of Conviction Calls contains 14 inclusions of ASX-listed small caps stocks that carry the analysts' conviction of providing a better return than their peers or major market indices.

Wilsons' regularly updated selection underperformed the 6.30% gain of the S&P/ASX Small Ords Industrials Accumulation index in April, but is otherwise well ahead of its benchmark on a 3 or 12-month horizon.

Removed since the last update: mining services provider NRW Holdings ((NWH)), following hefty share price appreciation. Two new inclusions have now been added: National Veterinary Care ((NVL)) and Whitehaven Coal ((WHC)).

Other stocks still included are ARQ Group ((ARQ), Bravura Solutions ((BVS)), EML Payments ((EML)), Collins Foods ((CKF)), Ridley Corp ((RIC)), Citadel Group ((CGL)), ImpediMed ((IPD)), EQT Holdings ((EQT)), Pinnacle Investment ((PNI)), Noni B ((NBL)), Ausdrill ((ASL)), and Mastermyne ((MYE)).

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Analysts at stockbroker also updated their selection of High Conviction Stocks which has triggered the removal of PWR Holdings ((PWH)) and Volpara Health Technologies ((VHT)).

Remaining on the list: ResMed ((RMD)), Sonic Healthcare ((SHL)), Reliance Worldwide ((RWC)), Westpac ((WBC)), and Oil Search ((OSH)) among large caps and Kina Securities ((KSL)), Senex Energy ((SXY)), and Australian Finance Group ((AFG)) outside of the ASX-100.

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Plenty of stockbrokers have been updating their views and assessments of A-REITs recently, which has generated the following lists of sector favourites:

-Citi: Charter Hall ((CHC)), Goodman Group ((GMG)), Lendlease ((LLC)), Dexus Property Group ((DXS)), and Mirvac ((MGR)); -JPMorgan: Vicinity Centres ((VCX)), Charter Hall, Lendlease, Shopping Centres Australasia ((SCP)), National Storage REIT ((NSR)), and Aveo Group ((AOG)); -Macquarie: Lendlease, Goodman Group, Charter Hall, and Mirvac ((MGR)); -Stockbroker Morgans: Aventus Group ((AVN)), Centuria Metropolitan REIT ((CMA)), APN Convenience Retail REIT ((AQR)) and Viva Energy REIT ((VVR)); -Shaw and Partners: Lendlease, Stockland ((SGP)), Scentre Group ((SCG)), Vicinity Centres, Centuria Industrial REIT ((CIP)), and Centuria Metropolitan REIT

The list of least liked A-REITs:

-Citi: Scentre Group, GPT ((GPT)), Charter Hall Retail ((CQR)), Shopping Centres Australasia and BWP Trust ((BWP)) -JPMorgan: Mirvac, Goodman Group and Ale Property Group ((LEP)) -Macquarie: Charter Hall Long Wale REIT ((CLW)), Charter Hall Retail, Cromwell Property Group ((CMW)), Dexus Property Group, Growthpoint Properties ((GOZ)), National Storage REIT, Scentre Group, Shopping Centres Australasia, and Unibail-Rodamco-Westfield ((URW)) -Stockbroker Morgans: Centuria Industrial REIT, National Storage REIT, and Hotel Property Investments ((HPI)) -Shaw and Partners: Goodman Group and BWP Trust

The (sharp) differences in views expressed by the various teams of sector analysts comes down to one question: do you believe the pressure on bricks and mortar retailers has much further to run, with noticeable negative consequences for landlords of retail assets?

If the answer is "yes", then those retail landlords are automatically relegated to one's selection of least preferred/best to avoid sector exposures. If the answer is "no" then those lagging retail landlords are seen as

offering excellent value for long term yield investors.

As expressed many times over in the past, I am on the side of the investors and analysts that respond to the crucial question with a firm "yes".

Helping Pengana Selling The ESG Message

Peter Hall, the driving force behind what once was one of Australia's successful and leading ethical investors, Hunter Hall, saw his career abruptly cut short when a too confident bet on local biotech Syrtex turned sour. Since June 2017 Pengana Capital Group is managing the fund renamed Pengana International Equities ((PIA)), which still operates within an ethical framework but solely in international markets.

The new managers in charge have deliberately scaled back the volatility in the fund's performance, and made its dividends to shareholders more reliable and stable, but, nearly two years after taking control, one niggling problem remains unaddressed: a severe lack in liquidity means the ASX-listed shares continue to trade well below the fund's Net Tangible Assets (NTA) valuation, to just about every stakeholder's frustration.

And there doesn't seem to be an easy solution at hand either, with the fund's attempt to increase total shares count via the issuance of options likely to prove futile. It's back to the drawing board thus.

In the meantime, the fund managers are touring Australia in a bid to communicate with shareholders, explain their strategy and ask for understanding as far as the heavy discount is concerned that remains embedded in the share price.

Not completely unexpected, the recent shareholders gathering in Sydney elicited mostly questions about Labor's intended franking policy, its potential impact for retirees living off income from investments and what Pengana can possibly do to cushion any negative consequences.

Questions were also asked as to how the manager's ethically oriented investment process could possibly be to shareholder's best interest, and here, on my observation, the fund managers found it rather difficult to state their case in an overly convincing manner. Which is a shame, because ethical investment is not a guaranteed pathway to subpar investment returns (even though PIA's total returns to date have fallen short of the benchmark and of competitors).

Plenty of international academic research supports the notion that ethical investing over time generates superior returns, irrespective of the observation that stocks with inferior qualities can temporarily rally to the moon and back, as we all know. Instead of trying to argue the point that missing out on a temporary rally in, say, oil and gas stocks does not matter long term, I think the managers of PIA can make a much more attractive, and convincing case by referring to what should be missing in their portfolio.

Take Retail Food Group ((RFG)), for example. For years its shares had been a solid performer on the ASX, until the central holding company was exposed for what it is; a badly managed, profits-above-everything, let's squeeze the franchisers to their last breath kind of operation that, in hindsight, was always going to come unstuck at some point.

It's somewhat hard to believe today, but the shares were exchanging hands on the ASX at a price tag of around $7.50 a piece as recently as March 2015. Today, Retail Food Group shares are trading around 21.5c and they almost certainly are not going anywhere in a hurry.

Meanwhile, the negative news flow simply keeps on generating more revelations. If ever Hamlet's statement about something being rotten at the core applied to one company on the ASX, it must be this one.

The point here is that any scrutiny from an ethical or ESG filter perspective should have prevented fund managers such as Pengana (or Hunter Hall in its previous existence) to go anywhere near an investment in Retail Food Group, irrespective of the company's immediate prospects and general popularity at that time.

This is, in essence, the most valuable aspect of using ESG (ethical, social & governance) as a filter in the investment process. Badly managed companies are most likely to attract bad news flow and operational disasters, and badly managed companies score badly on ESG score cards.

A similar case can be made for past assessment of investing in AMP ((AMP)), IOOF ((IFL)), and even the Big Four Banks (though I doubt whether anyone would have scored the banks accurately on ESG measures pre-Royal Commission). Since PIA does not invest in the Australian share market, there should be plenty of suitable examples on offshore exchanges.

I remember reading how the Deepwater Horizon oil spill in 2010 had been preceded by numerous indications BP was not the world's most prudent and risk-conscious operator, to put it mildly. And it certainly seems the bad news flow, and potential financial ramifications from the 737 Max plane disasters for Boeing is nowhere near its end.

Stringently applied ESG filters should keep such disasters out of the portfolio; a message that will be understood by every kind of investor, irrespective whether they have experienced portfolio disaster first hand or not.

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

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

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