

Week
10

Stories To Read From FNArena

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Marketing Costs Confront Bega Cheese

Heightened costs in transitioning the Mondelez Grocery business have muddled the outlook for Bega Cheese in FY18/19.

-Heightened competition for milk supply mitigated by a 25% increase in milk intake -Bega Foods business performing below investment case, requiring expenditure to stabilise market share -Earnings drivers likely to be dependent on returns exceeding farm gate milk prices

By Eva Brocklehurst

A setback to targets for FY18 put Bega Cheese ((BGA)) on the back foot at its first half result release, although brokers expect the strong position of most of the company's brands will help maintain momentum.

First half results may have been stronger than many expected, but full year guidance was weaker. The company is targeting underlying EBITDA (operating earnings) of \$105-115m, below consensus expectations prior to the first half result.

Guidance incorporates all expenses relating to the integration of the Mondelez Grocery (now Bega Foods) business and the transition to the Bega brand from Kraft in the spreads business. This is expected to be more material in FY18-19 than many brokers previously allowed for.

UBS suggests the performance of Bega Cheese and Bega Foods is not as bad as it looks and upgrades to Buy from Neutral. The broker's target falls to \$7.90 from \$8.30. Brand positioning is now stronger and the broker suspects material legal costs which may have occurred have not been removed from normalised earnings.

Heightened competition for milk supply is mitigated by the company's 25% increase in milk intake, allowing Bega Cheese to choose supply without materially affecting estimates for earnings.

The acquisition of Murray Goulburn by Saputo also signals a more rational pricing environment for milk, UBS asserts, which supports a long-term earnings profile and dairy earnings margin expansion of 150 basis points by FY20.

The loss of the Coles ((WES)) private-label cheese contract and pressures on margins in consumer packaged goods affected the base business. However, the broker estimates that if the contribution from Bega Foods is excluded, the fall in related revenue in the first half was partly offset by the gain from the smaller Woolworths ((WOW)) contract.

Following the result, Bell Potter downgrades forecasts by -3% for FY18 and by -6% for FY19. Major changes include an uplift in milk intake, countered by higher milk costs.

Bega Foods

The Mondelez Grocery business acquisition is not expected to deliver its original FY18 earnings target until FY20. Segment reporting is under review and the newly labelled Bega Foods business is likely to report alongside other company branded products.

Morgans observes the division was impacted by "channel stuffing" from the vendors and an increase in competitive pressure, particularly in peanut butter, which then required significant marketing to maintain share. Consolidation of the acquisition is highly dependent on the returns of the peanut butter segment.

Yet the Bega Foods business is performing below the original investment case and will require a pulling forward of expenditure to stabilise market share.

UBS estimates the peanut butter business will contribute around \$10m in earnings in FY20, or 7% of group earnings, after significant investment to protect the brand's position in major retailers. The broker's proprietary survey is highly supportive of the view that an informed Australian consumer would prefer Bega peanut butter over Kraft.

Given the company paid a large price for the acquisition - \$452.7m - and it is underperforming, Morgans suggests an impairment to goodwill cannot be ruled out with the full year result. The broker has a Hold rating and \$6.50 target.

The cost to transition and defend the market position of the Mondelez business is now front loaded and likely to extend beyond FY18 and Kraft also intends to re-launch in Australia. Hence, Bell Potter includes higher up-front brand investment costs for the business and, while retaining a Buy rating, lowers the target to \$7.85 from \$8.24.

Milk Supply

UBS estimates dairy intake can lift operating earnings by \$16m, yet Morgans points out the dairy business is skewed to the first half and suspects earnings will be affected by reduced milk supply growth.

Bell Potter considers the drivers of earnings for FY18-20 will be the extent to which returns exceed movements in farm gate milk prices, as well as the extent to which the company can sustain its milk supply.

The company's nutritionals business has stabilised because of a more supportive regulatory environment in China. The company expects infant formula canning volumes to recover and has started to invest in additional capacity. For the first time, Bega Cheese has secured commercial volumes of domestic organic milk for use in infant formula.

Bell Potter also observes that the company has already secured shareholder approval for the issue of stock, effectively allowing it to take advantage should an acquisition opportunity emerge.

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Global AI Boom Boosts Appen's Potential

Impressive growth achieved in 2017 leaves analysts positive and enthusiastic about Appen's growth potential on the back of a global boom in artificial intelligence.

-20 years of private growth delivers bonanza for public investors -Business needs to diversify client base for broad-based growth -US buy positions Appen to dominate global market for content relevance services

By Nicki Bourlioufas

ASX-listed Appen Ltd ((APX)) is a major player in the global language services industry, selling annotated data sets for use in e-commerce and machine-learning applications.

One of its claims to fame is that the annotation is done by actual humans - about 400,000 linguistics experts and content evaluators working, largely from home, in 130 countries and using more than 180 languages and dialects. Appen has two operating divisions - its foundation business in Language Resources and the rapidly growing area of Content Relevance.

Language Resources provides training data for speech-recognition technologies in devices such as mobile phones, computer games and TV consoles. Content relevance provides smart data to improve online discovery by search engines and social media platforms.

As Artificial Intelligence technologies explode, Appen is also expanding into fields such as fraud detection, risk management, medical imaging and in-car navigation.

From spare room to much more than spare change

Appen was established in 1996 by linguist Dr Julie Vonwiller, a researcher at the University of Sydney, and her engineer husband Chris Vonwiller, who was inaugural chairman of Telstra's Bigpond before he retired to join the family business in 1999.

Starting in the spare room of their home in Gordon, Sydney, the Vonwillers expanded the business privately, developing long-term relationships with clients including Microsoft and the US government. The company now employs 374 staff in seven offices across the US, UK, Australia, China and Philippines.

Appen went public in January 2015 at 50 cents a share, and quadrupled its share price in two years. Since early 2017, the company's impressive record of revenue growth and strong margins has pushed the stock from \$2 to a high of \$10.60, which it hit after the release of full-year results on February 21.

At the end of November, the company announced the US\$80m acquisition of Leapforce Inc, a Silicon Valley provider of search relevance services with what Appen describes as "a highly automated and proprietary end-to-end technology platform".

Acquisition and organic growth augur well for 2018

Brokers are positive on Appen's prospects for the current financial year. Canaccord Genuity, UBS and Citi all maintain their Buy recommendation, with price targets of \$10.80, \$12 and \$12.19 respectively.

Bell Potter sets a middle course, raising its 12-month price target by 22% to \$11, post the financial report release in February, but also downgrading its recommendation to Hold from Buy as the new target is only about 5% above the share price.

Overall, the broad based enthusiasm is based on Appen's "impressive results" for the year ending December 2017, in which it posted 50% growth in revenue to \$166.6m and 62% growth in EBITDA (Earnings Before Interest, Tax, Depreciation and Amortisation) to \$28.1m.

Canaccord Genuity says Leapforce is expected to contribute around one-third of group revenue. According to the analysts, the acquisition of Leapforce highlights Appen's increasing focus on its Content Relevance division, where revenue grew by 75% in the second half of 2017, including a one-month contribution of \$6m from Leapforce.

Language Resources revenue was softer than expected, growing only 7% over the year, but the division is expanding into image and video annotation, which is expected to accelerate growth at higher margins.

Appen stakes claim to global leadership in its field

Bell Potter sees Appen's key competitive advantage as its long-standing relationships with customers such as Microsoft Research, with which the company has been working with for more than 21 years. Further, the majority of revenue is from repeat customers as they update and upgrade their products.

Bell Potter concedes this strength could also be a weakness, saying Appen's customer base is relatively concentrated, with the largest five clients representing more than 75% of revenue. Canaccord Genuity is more optimistic, saying the concentration of revenue is easing and a full year contribution from Leapforce should assist this diversification further.

Bell Potter also points out that Appen generates most of its revenue from individual projects rather than long-term contracts, which can be lumpy and unpredictable. Moreover, the global Language Services industry is fragmented, with around 18,000 service providers, and consolidation or vertical integration could increase competition.

But Citi backs up its confident call of \$12.19 by saying that the acquisition of Leapforce makes Appen the clear global leader in development of high-quality, human annotated data for machine learning programs.

Citi says the winner in Content Relevance will likely be the company that can analyse the "most amount of data", with the "highest quality of analytics", in the "shortest amount of time" at a "competitive price". The broker believes Appen is well placed to be that winner over the near term.

FNArena's database shows two Buy ratings from two covering brokers, UBS and Citi. The consensus target is \$12.10, suggesting 24.7% upside to the last share price. On current forecasts, updated post FY17 financials, earnings per share are projected to grow by 92% this year and by 39% in 2019. Dividends are expected to increase by 70% and 37% respectively.

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Brighter Outlook Emerges For Nufarm

Seasonal headwinds confront agricultural chemical supplier Nufarm in some jurisdictions but several brokers retain a positive view based on acquisitions and cost savings.

-Caution prevails re Latin America crop yields -Omega-3 canola potential may be under estimated -Changes to earnings drivers may not be fully recognised in share price

By Eva Brocklehurst

Agricultural chemical supplier Nufarm ((NUF)) is facing seasonal headwinds, as usual, but several brokers brush this aside, instead favouring a positive view based on the company's transformation program and acquisitions. Geographical diversity also provides support.

Argentina's worst drought in decades has ensured a poor crop, although Citi believes this should help reduce stockpiles and farmers may increase plantings, given a rally in grain prices. The broker believes the downside to Nufarm's business is minimal.

Bell Potter adopts a more cautious approach to earnings from the Argentinian crop because of low yields. Argentina accounts for over 15-20% of the company's Latin American business.

The broker is also careful about forecasts for Europe in light of recent inclement weather, as well as the drier-than-average finish to the Australian summer crop. These conditions suggest the focus will shift to the earnings growth profile through FY19-21 as this year progresses.

Yet, Bell Potter retains a favourable view on the stock based on the integration of the Century and FMC portfolios, as well as the cost savings to be delivered from back-office consolidation in Europe. Omega-3 canola is also expected to be profitable by FY21.

Citi, too, has a favourable view, upgrading to Buy from Neutral. The broker believes Nufarm is entering a period of double-digit growth calculated as a three-year CAGR of 11%. Recent acquisitions will introduce higher margins and the broker also flags the launch of Omega-3 canola.

The broker considers the shares oversold and offering a compelling buying opportunity, despite the weak first half guidance which has weighed on the shares recently, and anticipates a strong second half rebound.

Bell Potter reduces net profit forecast by -18% in FY18 and -3% in FY19. This is based on changes to the broker's settlement timeline for the Century acquisition and the contributions from FMC, which have a combined \$110-115m pro forma in operating earnings (EBITDA).

The assumption for the close of the Century transaction is pushed out to the September quarter from the end of the first half, but forecasts for both assets in FY19-20 are unchanged.

Changed Earnings Drivers

Credit Suisse upgraded in early February to Outperform, believing the market is under-appreciating the long-term benefits of the company's transformation program.

The market may be struggling with the changes to earnings drivers, the broker also suggests. This view is based on improvements that emerge from a larger scale European position, a rebuilding of Australian market share and growth in the seeds business.

Moreover, Credit Suisse suggests a successful development of Omega-3 canola has not been factored into the share price and, while this contribution may not be completely certain, potential material upside exists.

There are five Buy ratings, one Hold (Ord Minnett) and one Sell (Deutsche Bank) on the FNArena database. The consensus target is \$9.46, signalling 19.3% upside to the last share price. Targets range from \$6.85 (Deutsche Bank) to \$11.20 (Morgan Stanley).

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Iron Ore And The US Steel Tariff

The iron ore market is unlikely to be affected by US tariffs on imported steel, while the focus remains on the sustainability of low-grade supply.

-ROW should be able to absorb excess supply of steel if US imposes tariffs -Development expenditure on iron ore in China declines significantly -Cost inflation creeping back into iron ore market

By Eva Brocklehurst

Will the imposition of US tariffs on imported steel weigh on global steel demand and, by default, iron ore? US president Donald Trump has said he prefers global tariffs on both steel and aluminium imports of 25% and 10% respectively. Macquarie notes, if these were the actual tariffs imposed, they would exceed the most severe option presented by the Commerce Department. The president has until April 11 to decide on steel.

Actually, Commonwealth Bank analysts don't expect the tariffs to be that disruptive to either steel or iron ore markets. US steel prices are expected to increase but the rest of the world should be able to absorb the excess supply of steel, particularly Southeast Asia. If this is the case, iron ore markets can also absorb the tariff changes.

Nevertheless, the analysts point out that stronger US steel output at the expense of production elsewhere would be more negative for iron ore consumption, because US steel is predominantly produced via electric arc furnace and this uses less iron ore than the basic oxygen furnace process. The basic process accounts for around 75% of global steel production and is the primary driver of iron ore consumption.

Global steel production rose just 0.8% for the year to January, with China's output declining -0.9% because of reductions during the winter. This was offset by the rest of the world growing at 2.5%. Meanwhile, Citi notes, the iron ore price has displayed resilience in the mid-to-high US\$70/t range.

China

Capital expenditure on iron ore mining in China dropped -23% in 2017, despite a recovery in the iron ore price. Citi points out the absolute peak in iron ore mining expenditure occurred in 2014 in China, and since then the growth rate has slowed to 5% per annum.

The broker also observes that most of the small domestic iron ore mines did not produce proper mine plans during the boom years and development expenditure has declined significantly over the last couple of years. Moreover, credit availability for re-starts is likely to be constrained because of China's fiscal tightening. Hence, it could take some time for iron ore mine operating rates to resume the levels of previous years.

Nevertheless, globally, iron ore supplies are plentiful, and while prices continue to surprise on the upside, incentive pricing is not sustainable, Ord Minnett believes. Major producers have shown discipline when it comes to supply, the broker acknowledges, but the likelihood of marginal supply returning, and the risk of de-stocking, should take away some of the pricing tension.

Ord Minnett maintains a declining price profile for iron ore and expects US\$65/t over 2018 for a December quarter target of US\$60/t.

Productivity

Macquarie notes cost inflation is slowly creeping back to the iron ore market, although miners are countering this fiercely with productivity measures. Virtually all producers are in the money, the broker adds, as prices are well above the seaborne marginal cost.

With the exception of high-cost magnetite operations in Australia, miners selling lower grade sinter fines are still the marginal suppliers in the seaborne market. Some of these operators have come under pressure, as both Atlas Iron ((AGO)) and the Asia-Pacific division of Cliffs, which account for 20mt of low-grade Australian supply, reported small losses in the December quarter.

Macquarie believes, if low-grade discounts stay at current levels throughout 2018, a benchmark price in the high US\$60/t range is required to keep 92mt of low-grade supply in the market.

Meanwhile, widening discounts have now become visible in trade flows and low-grade supply has started to exit the market. The broker suggests this is offsetting the expected growth from the major suppliers. The break-even price for iron ore majors is expected to slip slightly in the March quarter because of lower freight rates, although Macquarie observes the underlying trend is clearly one of rising costs.

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Material Matters: Oil, Diesel, Lithium & Steel

A glance through the latest expert views and predictions about commodities. US shale oil; diesel; lithium; and China steel.

-Infrastructure constraints may impede growth in US shale oil production
-Outlook for diesel usage remains strong despite decline in diesel cars
-Morgan Stanley underscores its call for downward pressure on lithium price
-Chinese steel mills closely following their order books

By Eva Brocklehurst

US Shale Oil

Attractive oil prices have stimulated the US shale industry while the recent jump in US drilling activity has raised concerns about the impact on US output. ANZ analysts suggest actual growth in production will be lower than the drill rig numbers indicate, given rising infrastructure constraints and crew shortages.

The US rig count has risen sharply over the past couple of months and the upward trend is expected to continue, particularly if West Texas Intermediate crude remains above US\$60/bbl.

Yet the list of constraints to production is growing, as investors are pressuring producers to focus on profitability and returns. The analysts note many producers are struggling to attract people back to the industry after the job losses in the past couple of years.

Pipeline capacity is also likely to constrain the growth in completed wells. In the past, the industry has been highly sensitive to price, as even small changes have a considerable effect on the economics, and output, of an operation.

The analysts sense some hesitancy in bringing wells on line until prices are well established above US\$60/bbl. Still, they revise up forecasts for US shale oil output to 6.2mb/d by the end of 2018.

Diesel

Despite the passing of the "golden age" of diesel as a passenger car fuel in Europe, Morgan Stanley suggests the strong outlook for global road freight and higher industrial usage remain supportive of the product. Global oil demand was just under 98m bpd in 2017 of which passenger cars made up 26%.

Europe, where diesel cars have had the highest penetration, constituted just 1.6% of global demand. This is the market that is at risk from the clamp-down on diesel emissions. Yet global road freight is 18% of global oil demand, second only to passenger cars, and in this environment diesel dominates.

Moreover, industrial activity, powering tractors, trucks and generators at construction and mine sites, also makes diesel more linked to GDP and less linked to price than petrol demand. As global GDP growth is expected to be strong and synchronised in 2018 diesel demand is likely to be supported.

The other issue pertains to the displacement of some fuel oils as, in 2020, the sulphur content in bunker fuel for shipping will be capped at 0.5% versus 3.5% currently. Morgan Stanley suggest most shippers will likely switch to compliant fuels rather than install scrubbers to clean emissions or switch to LNG. Hence, refiners will need to pull on their middle distillate products to meet the estimated demand.

Lithium

Morgan Stanley addresses some of the key points raised in opposition to its recent bearish call on lithium. Regarding the view it is underestimating the penetration of electric vehicles, the broker suggests any forecast above its 9.2% penetration rate for battery electric vehicles by 2025 is highly ambitious.

This is based on the requirements for building supportive infrastructure, the rolling back of subsidies and the cost of implementation and capital investment that is required by automobile producers. While accepting China and Europe will lead the way and may reach 15-20% penetration by 2025, Morgan Stanley suggests other regions will lag and lower the global average.

On the other side of the demand/supply equation, the broker suggests the focus on 2025 also ignores the near-term surplus in the lithium market. Moreover, accepting that lithium brine deposits have long lead times to develop and

many underperform market expectations, the broker suggests it is still taking a conservative view of the supply pipeline.

The vast premiums currently occurring in some areas will normalise as the market moves into oversupply, Morgan Stanley suggests, and the current arbitrage is already encouraging China's battery makers to seek supply from lower-cost sources.

The broker concedes China's privately-owned lithium industry is difficult to track but has heard that domestic lithium supply is coming on strongly and battery makers expect to be able to reduce their dependence on imported material in the near future.

China Steel

Macquarie observes sentiment in China's steel market is positive and while orders continue to decline because of subdued construction activity, a recovery is expected after Chinese New Year.

The rate of increase in trader steel inventory has begun to slow. While steel mills intend to boost inventory, the rate of re-stocking is tied closely to growth in order books, Macquarie suggests. Orders have fallen over the past month or so and only the automotive sector has grown.

Chinese steel exports are expected to remain soft in the near term but if domestic supply recovers strongly from April, when there may be some downside pressure on demand growth, exports may lift from current low levels.

The broker notes the industry's average profit margin remains substantial and steel mills are incentivised to maximise output, providing there is no policy disruption. The mills, reportedly, plan to commence re-stocking of raw materials soon, but Macquarie suggests the scale and duration of this depends on the demand and price outlook for steel.

The broker believes the mills will wait for the order books to improve before engaging in the raw materials trade, so the near-term re-stocking momentum may not be very strong.

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Material Matters: Oil, Natgas And Nickel

A glance through the latest expert views and predictions about commodities. Crude; natural gas; and nickel.

-Oil prices likely to remain range-bound, as shale production remains robust
-Natural gas market has potential for price gains amid very low inventories
-Stainless steel demand still the major driver of the nickel price

By Eva Brocklehurst

Crude

PIMCO observes the growth in shale production that sparked a bear market in natural gas seven years ago, ultimately spreading to oil, remains intact as a theme for the industry. Oil, the largest component in nearly every commodity index, is therefore expected to remain range-bound. Oil prices briefly touched US\$70 a barrel early this year amid a combination of production outages, global growth and OPEC discipline.

PIMCO expects inventory drawdown in the second half to support prices after a period of seasonal build. Yet several factors should keep the curve anchored and limit the upside. The main, but not the sole, driver of this is US shale production growth.

US shale production is expected to grow by 1.25m b/d for crude and 1.5m b/d including natural gas liquids. The analysts envisage incremental investments and some non-shale conventional resources, such as offshore, as efforts to drive down costs make these economical. Furthermore, when oil prices move higher, alternative energy sources become even more viable, and this dents demand.

Positive returns from oil are still likely, PIMCO suggests, given investors' ability to roll the higher-priced, short-term contracts into lower-priced, long-term contracts. These opportunities are expected to be important contributors to returns on oil.

In the latest US data, crude output has been revised up to a new high while imports have surged. Weekly estimates of crude production have risen to 10.37m b/d. Citi notes the build-up in crude inventory has more than offset the small draw-down in a number of petroleum product categories.

Natural Gas

The natural gas market is the area of the complex with the greatest potential for price gains, PIMCO believes. Inventories are expected to end the US winter at the second-lowest level for the past 10 years, owing to strong demand and export growth. Strong production growth will be required to rebuild inventory to normal levels and provide supplies for next winter.

PIMCO is sceptical that this growth can happen at current prices, particularly given that several of the largest gas-focused E&P companies are guiding to lower capital expenditure and slower investment growth.

Nickel

Nickel prices have risen over the last few months because of a weaker US dollar, hopes for global demand and a view that lithium ion batteries will increase the consumption of nickel. Moreover, China's nickel ore imports nearly doubled in annualised terms in January, as imports from Indonesia surged. This more than offset the decline in imports from the Philippines.

Whilst Commonwealth Bank analysts believe nickel sulphate demand will lift in response to advances in battery demand and technology, any shortage is likely to be the story for the next decade. Nickel prices are expected to be driven by developments in the stainless steel market because this accounts for around two thirds of nickel consumption.

The analysts envisage downside pressure on nickel prices this year because of the surplus building in the nickel ore and nickel pig iron market. Around 2% of global nickel supply was probably added last year. The analysts believe Filipino nickel ore exports should also recover this year, although it may take longer than previously expected.

Macquarie also suggests that ascribing the rise in LME nickel prices to the speculation regarding electric vehicles is incorrect. The market has moved into a significant deficit because of booming stainless production, in Indonesia particularly, amid shortfalls in nickel production from conventional producers.

In addition to the stainless market, non-stainless applications such as alloy steel, plating and non-ferrous alloys and batteries are also growing strongly. Physical market premiums for all nickel products, with the exception of nickel pig iron, have risen to record levels. Plating products have also risen strongly as have standard cathodes and briquettes, indicating a shortage in specialised areas.

Macquarie believes there could be a short sharp correction in the nickel price although overall demand conditions in 2018 remain positive. Despite the growth in nickel pig iron, the broker notes the rest of the world is struggling to produce nickel and major producers are all guiding to lower 2018 production than would have been the case a year ago.

Macquarie assumes global nickel production growth of 6.5% this year, but also some potential upside from the re-starting of idle capacity if prices maintain recent strength. However, this would have more of an impact in 2019 than 2018.

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Weekly Ratings, Targets, Forecast Changes

By Rudi Filapek-Vandyck, Editor FNArena

Guide:

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

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

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

Summary

Period: Monday February 26 to Friday March 2, 2018 Total Upgrades: 20 Total Downgrades: 14 Net Ratings Breakdown: Buy 42.69%; Hold 42.17%; Sell 15.14%

The final week of the February local reporting season continued to reveal a true frenzy among stockbroking analysts, with FNArena registering 20 upgrades and 14 downgrades for individual ASX-listed entities for the week ending Friday, 2 March 2018.

Among those receiving upgrades, Costa Group received two, as did Spark Infrastructure. Among the downgrades, Caltex received two, and was the sole recipient of more than one downgrade (both went to Neutral from Buy).

When it comes to target prices, the resurrecting Nine Entertainment claimed prime glory for the week enjoying a gain of 21%, followed by NextDC, ERM Power and Costa Group. On the flipside, the largest reduction (-5%) was for bling retailer Michael Hill, followed by Ramsay Health Care, HT&E and Domain Holdings.

Average increases to consensus price targets are significantly higher than average reductions.

Earnings estimates saw some ginormous increases with Perseus Mining, QBE Insurance and Iluka Resources all enjoying increases in excess of 100%, followed by Speedcast International, BlueScope Steel and Reliance Worldwide. Here consensus reductions are equally firm with Macquarie Atlas Group suffering most (-44%), followed by Virgin Australia, Orocobre and Alumina Ltd.

The week ahead will be considerably quieter representing the traditional lull post an eventful month.

Upgrade

ARDENT LEISURE GROUP ((AAD)) Upgrade to Hold from Lighten by Ord Minnett .B/H/S: 2/4/1

First half results were significantly below forecasts, largely related to one-off charges in theme parks. Ord Minnett is encouraged by the trends in theme parks and Main Event, with some early signs that the turnaround effort is working.

The broker upgrades to Hold from Lighten based on valuation. Target is raised to \$1.95 from \$1.73.

BEADELL RESOURCES LIMITED ((BDR)) Upgrade to Buy from Neutral by Citi .B/H/S: 1/2/0

2017 results were weaker than expected but the headline loss included a non-cash write-down of low-grade stockpiles.

Citi upgrades to Buy/High Risk from Neutral/High Risk, as the share price has been slapped down and the Tucano upgrade is now funded, but stresses that debt and high operating expenditure makes the stock high risk. Target is reduced to 15c from 21c.

BEGA CHEESE LIMITED ((BGA)) Upgrade to Buy from Neutral by UBS .B/H/S: 1/1/0

First half results were ahead of estimates. UBS found the market's reaction to the strong result was tempered by lower-than-expected guidance for FY18 earnings and commentary regarding margin pressure.

The broker believes this provides an attractive entry point and upgrades to Buy from Neutral. Target is reduced to \$7.90 from \$8.30.

CAPITOL HEALTH LIMITED ((CAJ)) Upgrade to Buy from Accumulate by Ord Minnett .B/H/S: 1/0/0

First half results were in line with expectations. Ord Minnett believes the company is set to participate in strong industry growth rates and its balance sheet offers opportunities for acquisitions.

Meanwhile, attention is on the proposed takeover of Integral Diagnostics ((IDX)) as successful completion is far from certain. Regardless of the outcome, the broker believes the stock presents good value and upgrades to Buy from Accumulate. Target is \$0.32.

COSTA GROUP HOLDINGS LIMITED ((CGC)) Upgrade to Buy from Neutral by UBS and Upgrade to Accumulate from Hold by Ord Minnett .B/H/S: 3/0/0

First half results were ahead of estimates. The produce result was the highlight for UBS, beating forecasts by around 31% and driven by citrus and tomatoes. Berry revenue was flat, reflecting heavy deflation over the half.

UBS upgrades estimates for earnings per share by 3-5% across FY18-20. The broker believes the company is well placed to outperform and the valuation is attractive. Rating is upgraded to Buy from Neutral. Target is raised to \$7.50 from \$6.80.

First half results were ahead of forecasts and show significant progress, Ord Minnett observes. Citrus underpinned the result and the broker expects citrus to decline next year, although positive export prices should restrict the impact.

Ord Minnett increases earnings forecasts by 16% for FY19, noting management is building its growth options, driven by berries, avocados, mushrooms and expansion overseas. Rating is upgraded to Accumulate from Hold. Target is raised to \$7.52 from \$6.03.

HARVEY NORMAN HOLDINGS LIMITED ((HVN)) Upgrade to Neutral from Underperform by Credit Suisse .B/H/S: 1/3/2

In case of any doubt (which we very much doubt), Harvey Norman's interim report was a disappointment. Credit Suisse analysts point at the Australian franchisee segment where earnings reflected increasing costs and increasing competition.

CS is forecasting more of the same with a cooling housing market in Sydney and Melbourne. Also, the first defense against online competition is investing in online sales, and this weighs on margin, explain the analysts. This is an industry-wide burden.

Target price falls to \$4 from \$4.03. Upgrade to Neutral from Underperform post sharp sell-off post results release.

See also HVN downgrade.

ILUKA RESOURCES LIMITED ((ILU)) Upgrade to Neutral from Underperform by Macquarie .B/H/S: 3/3/1

A solid result from Iluka beat Macquarie on both earnings and free cash flow. The dividend increase is a surprise given the step-up in capex planned for 2018. The highlight was a positive outlook for zircon and rutile prices.

Macquarie has materially upgraded earnings forecasts to reflect price guidance, noting Iluka's current rutile contract price is well below spot.

Nevertheless, valuation remains limited at this level. Upgrade to Neutral from Underperform. Target rises to \$10.50 from \$8.80.

MIRVAC GROUP ((MGR)) Upgrade to Buy from Sell by Citi .B/H/S: 4/2/1

Citi has double upgraded to Buy from Sell, while bumping up the share price target to \$2.35 from \$2.16. Despite softer residential conditions, the analysts believe earnings certainty is improving with 90% of major apartment projects due for completion through to FY20 having been pre-sold.

Earnings estimates have lifted by 9% and the analysts note Mirvac shares are now the cheapest among peers, despite "robust" growth prospects and with the company implementing a share buyback.

MACQUARIE ATLAS ROADS GROUP ((MQA)) Upgrade to Overweight from Equal-weight by Morgan Stanley .B/H/S: 6/0/0

2017 results were a little better than expected. Morgan Stanley suggests the year ahead will be complex but ultimately worthwhile for investors. APRR is expected to perform well.

Should the board negotiate internalisation the broker expects this to be a positive, via reduced corporate costs.

Rating is upgraded to Overweight from Equal-weight. Target is raised to \$6.26 from \$5.86. Industry view: Cautious.

MYOB LIMITED ((MYO)) Upgrade to Outperform from Neutral by Credit Suisse .B/H/S: 4/2/0

Full year results were in line with Credit Suisse but at the low end of the company's guidance range. 2018 guidance was largely as expected.

The broker makes minor changes to revenue forecasts following guidance for "8-10% organic growth". The broker also adjusts numbers for the Reckon deal, lowering 2018 EPS forecast by -3% on higher costs.

MYOB faces a challenging competitive environment and a period of higher investment but its valuation is compelling, the broker notes, and moves to Outperform from Neutral. Target price rises to \$3.75 from \$3.60.

OCEANAGOLD CORPORATION ((OGC)) Upgrade to Buy from Neutral by UBS .B/H/S: 6/0/0

In the wake of the recent production downgrade, and increased capex forecast, UBS believes the worst is now behind Oceana. The broker's key concern has been the Didipio ramp-up but revised guidance, that sees the project reaching nameplate production by end-2019, increases confidence.

The broker suggests production guidance may prove conservative and downside risk has abated. Upgrade to Buy. Target rises to \$4.00 from \$3.40.

OROCOBRE LIMITED ((ORE)) Upgrade to Buy from Hold by Deutsche Bank .B/H/S: 5/1/1

Orocobre's first half results were well ahead of Deutsche Bank forecasts, driven by a higher profit from the Olaroz JV.

The broker expects production from Olaroz to lift in the March quarter to 4,250t LCE at a cost of US\$3,600/t, generating a 70% margin. Along side this, Deutsche Bank believes the new Chinese EV subsidy scheme for electric vehicles will result in less demand disruption than the market previously feared.

This leads the broker to upgrade to Buy from Hold. Target is raised to \$7.70 from \$7.40.

QBE INSURANCE GROUP LIMITED ((QBE)) Upgrade to Neutral from Underperform by Credit Suisse .B/H/S: 4/3/1

QBE's full year results were in line with expectations, having been pre-reported in January. GWP and NEP was slightly weaker but the balance sheet deteriorated a little less than Credit Suisse had forecast.

The company has retained the \$1bn buyback despite the fall in earnings. The broker believes that with the company sitting at the low end of the capital target and a debt to equity position above 40%, management should focus on repairing the damaged balance sheet in the near-term.

With QBE underperforming the market by -21% in the last twelve months the broker upgrades to Neutral from Underperform and raises the target to \$10.20 from \$9.85.

QUBE HOLDINGS LIMITED ((QUB)) Upgrade to Neutral from Underperform by Credit Suisse .B/H/S: 2/5/0

First half results were ahead of estimates. Credit Suisse raises FY18 estimates for earnings per share by 11% and FY19 by 17% because of a stronger performance in ports & bulk.

Logistics remains challenged but the broker expects management to deliver improvements.

Rating is upgraded to Neutral from Underperform. Target is raised to \$2.35 from \$2.30.

RAMSAY HEALTH CARE LIMITED ((RHC)) Upgrade to Buy from Neutral by Citi .B/H/S: 2/5/0

Post interim report release and subsequent sell-off, Citi analysts have upgraded to Buy from Neutral, pointing out the shares have not been this "cheap" over the past five years. FY18-20 EPS forecasts have been lifted by 1%.

The analysts acknowledge growth is now happening at a slower pace than historically, but there will still be growth with an anticipated positive momentum shift in the Australian operations expected to outweigh weak offshore performance (UK and France).

Citi suggests the specific PHI affordability issues plaguing the sector is now well understood by investors, and this has been priced in accordingly. Price target moves to \$78.50 from \$74.50. DPS estimates have been reduced.

See also RHC downgrade.

SPARK INFRASTRUCTURE GROUP ((SKI)) Upgrade to Neutral from Underperform by Credit Suisse and Upgrade to Accumulate from Hold by Ord Minnett .B/H/S: 3/4/0

Full year results were ahead of Credit Suisse. The broker notes the company's cash flow outlook continues to deteriorate for a number of reasons.

Guidance for growth in distributions was given as "at least CPI" through 2018-2020, in line with consensus forecasts but below the 4-5% plus delivered since 2011.

With the stock now trading in line with DCF based valuation the broker upgrades to Neutral from Underperform and raises the price target to \$2.45 from \$2.40.

2017 net profit was slightly ahead of estimates. Ord Minnett observes the result was characterised by strong cash flow and cash has been retained to fund growth opportunities.

The broker upgrades to Accumulate from Hold on the basis of valuation, raising the target to \$2.60 from \$2.55. Growth from unregulated assets potentially provides further upside.

See also SKI downgrade.

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

For UBS, the negative surprise in the Southern Cross result was costs to be flat in FY18 from FY17 despite the Northern NSW TV divestment, given investments elsewhere and higher revenue-related costs. The stock is trading on a similar valuation to FTATV peers despite growing radio audiences.

Which makes it look cheap, the broker suggests. 2018 should be the year the industry sees consolidation activity post the relaxation of media laws, and while Southern Cross wants to focus on organic initiatives, it is positioned to exploit M&A opportunities if they arise.

Upgrade to Buy. Target falls to \$1.20 from \$1.25.

WOODSIDE PETROLEUM LIMITED ((WPL)) Upgrade to Hold from Lighten by Ord Minnett .B/H/S: 2/3/3

Ord Minnett believes the biggest downside risk for the company is cash flow but the stock is looking more attractive on a valuation basis.

The broker suggests the stock price is not factoring in much growth and approximately 10% of estimated value comes from growth projects that are valued on a risk-weighted basis.

These include small near-term projects such as Senegal and Myanmar and larger longer-term projects such as Scarborough and Browse.

Ord Minnett upgrades to Hold from Lighten and raises the target to \$29.70 from \$29.00.

Downgrade

ADELAIDE BRIGHTON LIMITED ((ABC)) Downgrade to Underweight from Equal-weight by Morgan Stanley .B/H/S: 1/3/2

It was a result that came out in-line, comment the analysts, including the 4c in special dividend, but given the share price had rallied pre-results release, it simply wasn't good enough. Morgan Stanley continues to have a problem with the valuation, and thus downgrades to Underweight from Equal-weight rating.

While management remaining bullish on the basis of continued strength in East Coast construction markets, Morgan Stanley cautions there remains the niggling factor of rising costs (energy). Volumes of lime imports are another factor that can spoil this party, the analysts point out.

Target remains unchanged at \$6.00. Industry view: Cautious.

ADAIRS LIMITED ((ADH)) Downgrade to Hold from Add by Morgans .B/H/S: 1/1/0

First half results marked a strong return to growth, although slightly missed upgraded guidance, which Morgans notes was provided post balance date.

FY18 EBIT guidance of \$40-44m is reiterated. Morgans suggests the second half growth rates required to achieve this are not demanding.

The broker downgrades to Hold from Add, believing the company is not far away from cycling very strong comparables. Catalyst also owns a 30% stake which is out of escrow. Target is \$2.28.

AUTOMOTIVE HOLDINGS GROUP LIMITED ((AHG)) Downgrade to Neutral from Outperform by Credit Suisse .B/H/S: 3/3/0

First half results suggest to Credit Suisse that, while the trajectory of the business has improved, much is dependent on the success of the sale of refrigerated logistics to HNA.

The risk that the deal falls over is higher than would typically be the case, as HNA is currently undertaking asset sales to reduce debt.

If the deal does not go ahead the company will be stuck with a capital-hungry refrigerated logistics business, the broker observes. Pending confirmation of the deal the rating is downgraded to Neutral from Outperform. Target is raised to \$3.85 from \$3.60.

APOLLO TOURISM & LEISURE LTD ((ATL)) Downgrade to Hold from Add by Morgans .B/H/S: 0/2/0

First half results were in line with expectations. Forward bookings are strong in New Zealand and North America while Australia is in line with the company's expectations.

Management remains comfortable with current FY18 consensus net profit forecasts of around \$19-19.5m.

Morgans observes the stock screens attractively but, as it is now trading within 10% of the new target, downgrades to Hold from Add. Target is reduced to \$1.93 from \$2.03.

CALTEX AUSTRALIA LIMITED ((CTX)) Downgrade to Neutral from Buy by Citi and Downgrade to Hold from Accumulate by Ord Minnett .B/H/S: 2/4/1

Full year results were broadly in line with December's guidance and a little above Citi.

The company has announced plans to more than double own-operated stores by transitioning the 496 owned but franchised sites to Caltex operation stores by mid 2020. Management aims to deliver 10-15% EPS growth within 5 years.

Citi downgrades to Neutral from Buy and increases the target price to \$39.71 from \$37.66.

2017 net profit was ahead of estimates. Ord Minnett notes the retail operating model is changing to corporate from franchise, with costs that will weigh on the earnings in the near term. The broker notes many options are being pursued to improve shareholder returns and the retention of Woolworths ((WOW)) petrol volumes are now more likely.

Recent share price appreciation has reduced the size of the multiple uplift and Ord Minnett is also less confident regarding significant divestments. Rating is downgraded to Hold from Accumulate. Target is \$37.50.

EUREKA GROUP HOLDINGS LIMITED ((EGH)) Downgrade to Hold from Add by Morgans .B/H/S: 0/1/0

First half results were mixed, Morgans observes, but on track. FY18 guidance implies a flat full year with a strong second half skew because of the contribution from three new villages as well as the divestment of underperforming villages.

Morgans applies a -35% discount to peers to reflect the ongoing market discontent with Terranora strata approval issues and downgrades to Hold from Add. Target is lowered to \$0.34 from \$0.41.

GALAXY RESOURCES LIMITED ((GXY)) Downgrade to Equal-weight from Overweight by Morgan Stanley .B/H/S: 2/2/1

A revised lithium price forecast has reduced the stock's valuation and Morgan Stanley also moves to a balanced bull versus bear case weighting.

The latest price deck refreshes the broker's base case view and now incorporates the risks of increased supply from Chile.

Rating is downgraded to Equal-weight from Overweight. Target is reduced to \$3.05 from \$3.50. Industry View: Attractive.

HARVEY NORMAN HOLDINGS LIMITED ((HVN)) Downgrade to Neutral from Buy by UBS .B/H/S: 1/3/2

UBS found little to like in the first half result, which was softer than expected. Net debt was higher and the dividend disappointed. Comments regarding capital management suggest this is less likely in the near term.

The broker believes earnings risk is now to the downside for the franchisee segment and downgrades to Neutral from Buy. Target is reduced to \$4.10 from \$5.77.

See also HVN upgrade.

MONASH IVF GROUP LIMITED ((MVF)) Downgrade to Hold from Add by Morgans .B/H/S: 1/1/0

First half results were in line with guidance. Margins were affected by competition from Primary Healthcare's ((PRY)) low-cost operation and the transition of a Sydney-based facility to a premium offering, Morgans notes.

The broker was surprised by FY18 guidance, which has called for a net profit to be -25% lower than FY17. The broker adjusts forecasts accordingly. As a result, valuation falls significantly.

Rating is downgraded to Hold from Add as the broker believes competitive pressures will continue to suppress earnings over the next few years. Target is reduced to \$1.25 from \$1.52.

NEXTDC LIMITED ((NXT)) Downgrade to Hold from Add by Morgans .B/H/S: 3/3/0

First half results were ahead of expectations. Morgans upgrades EBITDA forecasts by 4% for FY18 and 6% for FY19.

The broker notes generation 2 sales are moving along at a healthy rate. S2 impresses, with 18% of capacity already sold despite not being built.

Rating is downgraded to Hold from Add, after the strong run up in the share price. Target rises to \$7.01 from \$6.39.

RANGE INTERNATIONAL LIMITED ((RAN)) Downgrade to Reduce from Hold by Morgans .B/H/S: 0/0/1

2017 earnings were broadly in line. While management is working hard to reduce costs Morgans remains concerned about the cash burn, suspecting another capital raising may occur over the next 6-9 months.

For this to be successful, the broker suggests the company needs to allay concerns around sales execution and instability at board level.

Rating is downgraded to Reduce from Hold. Target is reduced to 3c from 7c.

RAMSAY HEALTH CARE LIMITED ((RHC)) Downgrade to Hold from Accumulate by Ord Minnett .B/H/S: 2/5/0

First half results were ahead of Ord Minnett's forecast, mainly due to lower interest and tax expenses. The 57.5c dividend was 3% above the broker's estimate.

The broker estimates the company will have to boost its second half domestic EBIT by more than 11% to deliver the bottom end of its guidance range.

Ord Minnett downgrades the stock to Hold from Accumulate. Target drops substantially to \$67.50 from \$80.

See also RHC upgrade.

SPARK INFRASTRUCTURE GROUP ((SKI)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 3/4/0

Spark Infrastructure's profit came in slightly ahead of Macquarie although composition was not as expected. While 2018 dividend guidance did not surprise, 2019-20 dividend growth guidance of "at least CPI" is well below the 5%+ pace of growth seen in the last seven years, the broker notes.

This is a concern. Macquarie has lifted its ten-year bond rate assumption to 4.25% from 3.25% although this only impacts Spark's valuation until the next price reset for 2021-25. But slowing dividend growth means Spark Infrastructure is no longer differentiated from other regulated assets, and market concern over rising rates leads to the broker to downgrade to Neutral from Outperform.

Target rises to 2.67 from \$2.65.

See also SKI upgrade.

Total Recommendations Recommendation Changes

Broker Recommendation Breakup

Broker Rating Order Company New Rating Old Rating Broker Upgrade 1 ARDENT LEISURE GROUP Neutral Sell Ord Minnett 2 BEADELL RESOURCES LIMITED Buy Neutral Citi 3 BEGA CHEESE LIMITED Buy Neutral UBS 4 CAPITOL HEALTH LIMITED Buy Buy Ord Minnett 5 COSTA GROUP HOLDINGS LIMITED Buy Neutral UBS 6 COSTA GROUP HOLDINGS LIMITED Buy Neutral Ord Minnett 7 HARVEY NORMAN HOLDINGS LIMITED Neutral Sell Credit Suisse 8 ILUKA RESOURCES LIMITED Neutral Sell Macquarie 9 MACQUARIE ATLAS ROADS GROUP Buy Neutral Morgan Stanley 10 MIRVAC GROUP Buy Sell Citi 11 MYOB LIMITED Buy Neutral Credit Suisse 12 OCEANAGOLD CORPORATION Buy Neutral UBS 13 OROCOBRE LIMITED Buy Neutral Deutsche Bank 14 QBE INSURANCE GROUP LIMITED Neutral Sell Credit Suisse 15 QUBE HOLDINGS LIMITED Neutral Sell Credit Suisse 16 RAMSAY HEALTH CARE LIMITED Buy Neutral Citi 17 SOUTHERN CROSS MEDIA GROUP Buy Neutral UBS 18 SPARK INFRASTRUCTURE GROUP Neutral Sell Credit Suisse 19 SPARK INFRASTRUCTURE GROUP Buy Neutral Ord Minnett 20 WOODSIDE PETROLEUM LIMITED Neutral Sell Ord Minnett Downgrade 21 ADAIRS LIMITED Neutral Buy Morgans 22 ADELAIDE BRIGHTON LIMITED Sell Neutral Morgan Stanley 23 APOLLO TOURISM & LEISURE LTD Neutral Buy Morgans 24 AUTOMOTIVE HOLDINGS GROUP LIMITED Neutral Buy Credit Suisse 25 CALTEX AUSTRALIA LIMITED Neutral Buy Citi 26 CALTEX AUSTRALIA LIMITED Neutral Buy Ord Minnett 27 EUREKA GROUP HOLDINGS LIMITED Neutral Buy Morgans 28 GALAXY RESOURCES LIMITED Neutral Buy Morgan Stanley 29 HARVEY NORMAN HOLDINGS LIMITED Neutral Buy UBS 30 MONASH IVF GROUP LIMITED Neutral Buy Morgans 31 NEXTDC LIMITED Neutral Buy Morgans 32 RAMSAY HEALTH CARE LIMITED Neutral Buy Ord Minnett 33 RANGE INTERNATIONAL LIMITED Sell Neutral Morgans 34 SPARK INFRASTRUCTURE GROUP Neutral Buy Macquarie Recommendation Positive Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 CGC COSTA GROUP HOLDINGS LIMITED 83.0% 33.0% 50.0% 3 2 NEC NINE ENTERTAINMENT CO. HOLDINGS LIMITED 60.0% 17.0% 43.0% 5 3 EPW ERM POWER LIMITED 67.0% 33.0% 34.0% 3 4 MGR MIRVAC GROUP 43.0% 14.0% 29.0% 7 5 WFD WESTFIELD CORPORATION 60.0% 33.0% 27.0% 5 6 MHJ MICHAEL HILL INTERNATIONAL LIMITED 75.0% 50.0% 25.0% 4 7 GWA GWA GROUP LIMITED 40.0% 17.0% 23.0% 5 8 RHC RAMSAY HEALTH CARE LIMITED 29.0% 7.0% 22.0% 7 9 FMG FORTESCUE METALS GROUP LTD 71.0% 50.0% 21.0% 7 10 WEB WEBJET LIMITED 60.0% 40.0% 20.0% 5 Negative Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 LNK LINK ADMINISTRATION HOLDINGS LIMITED 60.0% 83.0% -23.0% 5 2 CTX CALTEX AUSTRALIA LIMITED 14.0% 36.0% -22.0% 7 3 AHG AUTOMOTIVE HOLDINGS GROUP LIMITED 42.0% 64.0% -22.0% 6 4 NXT NEXTDC LIMITED 50.0% 71.0% -21.0% 6 5 GXY GALAXY RESOURCES LIMITED 20.0% 40.0% -20.0% 5 6 PPT PERPETUAL LIMITED -21.0% -7.0% -14.0% 7 7 DHG DOMAIN HOLDINGS AUSTRALIA LIMITED 17.0% 29.0% -12.0% 6 8 GPT GPT 17.0% 29.0% -12.0% 6 9 AWC ALUMINA LIMITED 10.0% 21.0% -11.0% 5 10 NWS NEWS CORPORATION 50.0% 60.0% -10.0% 4 Target Price Positive Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 NEC NINE ENTERTAINMENT CO. HOLDINGS LIMITED 1.860 1.533 21.33% 5 2 NXT NEXTDC LIMITED 7.155 6.030 18.66% 6 3 EPW ERM POWER LIMITED 1.730 1.490 16.11% 3 4 CGC COSTA GROUP HOLDINGS LIMITED 7.540 6.743 11.82% 3 5 AQG ALACER GOLD CORP 4.050 3.700 9.46% 4 6 WTC WISETECH GLOBAL LIMITED 10.373 9.530 8.85% 3 7 WEB WEBJET LIMITED 13.180 12.130 8.66% 5 8 ILU ILUKA RESOURCES LIMITED 10.514 9.850 6.74% 7 9 ARB ARB CORPORATION LIMITED 19.333 18.188 6.30% 4 10 MND MONADELPHOUS GROUP LIMITED 15.886 15.125 5.03% 5 Negative Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 MHJ MICHAEL HILL INTERNATIONAL LIMITED 1.350 1.433 -5.79% 4 2 RHC RAMSAY HEALTH CARE LIMITED 69.840 73.259 -4.67% 7 3 HT1 HT&E LIMITED 2.184 2.278 -4.13% 5 4 DHG DOMAIN HOLDINGS AUSTRALIA LIMITED 3.152 3.287 -4.11% 6 5 MYO MYOB LIMITED 3.957 4.082 -3.06% 6 6 GXY GALAXY RESOURCES LIMITED 3.650 3.740 -2.41% 5 7 QUB QUBE HOLDINGS LIMITED 2.759 2.810 -1.81% 7 8 NST NORTHERN STAR RESOURCES LTD 5.317 5.369 -0.97% 6 9 MQA MACQUARIE ATLAS ROADS GROUP 6.483 6.545 -0.95% 6 10 AWC ALUMINA LIMITED 2.330 2.350 -0.85% 5 Earning Forecast Positive Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 PRU PERSEUS MINING LIMITED 0.850 0.075 1033.33% 5 2 QBE QBE INSURANCE GROUP LIMITED 70.537 -40.572 273.86% 8 3 ILU ILUKA RESOURCES LIMITED 64.601 21.759 196.89% 7 4 SDA SPEEDCAST INTERNATIONAL LIMITED 36.230 24.626 47.12% 4 5 BSL BLUESCOPE STEEL LIMITED 141.117 118.067 19.52% 6 6 RWC RELIANCE WORLDWIDE CORPORATION LIMITED 15.825 14.475 9.33% 4 7 GEM G8 EDUCATION LIMITED 24.440 22.520 8.53% 5 8 NXT NEXTDC LIMITED 4.065 3.770 7.82% 6 9 CGC COSTA GROUP HOLDINGS LIMITED 25.100 24.000 4.58% 3 10 MND MONADELPHOUS GROUP LIMITED 76.698 73.415 4.47% 5 Negative Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 MQA MACQUARIE ATLAS ROADS GROUP 34.433 61.940 -44.41% 6 2 VAH VIRGIN AUSTRALIA HOLDINGS LIMITED 0.195 0.273 -28.57% 4 3 ORE OROCOBRE LIMITED 14.172 16.458 -13.89% 7 4 AWC ALUMINA LIMITED 16.789 18.239 -7.95% 5 5 AHG AUTOMOTIVE HOLDINGS GROUP LIMITED 27.065 29.099 -6.99% 6 6 ISD ISENTIA GROUP LIMITED 8.267 8.767 -5.70% 3 7 AAD ARDENT LEISURE GROUP 0.206 0.216 -4.63% 7 8 HVN HARVEY NORMAN HOLDINGS LIMITED 33.923 35.204 -3.64% 7 9 NWL NETWEALTH GROUP LIMITED 10.733 11.100 -3.31% 3 10 OSH OIL SEARCH LIMITED 34.047 35.185 -3.23% 8 Technical limitations

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

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Uranium Week: The Power Of 232

Uncertainty continues in the uranium industry as the US president exercises section 232 with regard steel and aluminium.

-Uncertainty grips US market -Utilities mostly absent in February -Deliver point disparity evident in March

By Greg Peel

For the uranium industry, February was a month of ongoing uncertainty. Aside from trying to assess, still, what impact will be felt from big production cutbacks announced last year by the likes of Kazakhstan and Cameco, the market continues to dwell upon what the outcome of the US section 232 petition filed earlier this year will be.

Note that pending US tariffs of 25% on steel imports and 10% on aluminium imports, announced by President Trump last week but yet to be confirmed, are an example of section 232 at work - the protection of domestic industry for security purposes.

While one might be drawing a long bow to connect steel and aluminium imports with national security, one might agree that a country's energy security is indeed a matter of "national security" hence in the case of uranium, import tariffs can be justified. Except that the resultant increase in uranium prices would force the closure of US nuclear plants already rendered uneconomic by cheap natural gas.

Which would undermine energy security. Which way Trump swings in this one is anyone's guess. And it may take some time to find out.

In the meantime, utilities are mostly absent from the uranium spot market, given the uncertainty. There was some utility activity on the buy-side over the month of February, but most material was acquired by traders and intermediaries, with traders and producers on the sell-side.

Industry consultant TradeTech reports 23 transactions were concluded in the spot market in February totalling 3.2mlbs U3O8, which was up from a very quiet January. TradeTech's spot price indicator ended the month at US\$21.50/lb, down -US25c from end-January.

Term markets also saw 3.2mlbs change hands, through ten transactions, with intermediaries and traders again the main buyers. TradeTech's mid-term price indicator has fallen -US25c to US\$25.75/lb and the long-term indicator has fallen -US1.00 to US\$29.00/lb.

Geographic Disparity

While the month of February ended on a weak note, the beginning of March saw a notable rebound. TradeTech reports five transactions were concluded in the spot market over the week ending Friday, totalling 500,000lbs U3O8 equivalent. TradeTech's weekly spot price indicator rose US30c over the week to US\$22.25/lb, bearing in mind the price dipped to US\$21.50/lb mid-week.

The lift in price was not so much a factor of demand/supply but of delivery location, TradeTech notes. Material at the European market's delivery point in France is limited compared to that available at the North American market's delivery point in the US. Buyers in Europe are therefore being forced to pay higher prices, and this is dragging up prices in a relatively quiet US market.

The market is not totally devoid of utility buying interest - there are several near-term delivery transactions currently under negotiation, TradeTech reports, but these were not concluded by week's end.

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

The 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 March 1, 2018

Last week saw the recovery rally that began earlier in the month in the wake of the US inflation scare, at 5793, peak out at 6080 before Donald Trump dumped a bucket of cold water on proceedings. It was also the final week of the local reporting season.

There's a little bit of movement in the short table below but only three moves represent one percentage point or more.

I highlighted toiletry/cosmetics company BWX ((BWX)) last week, which suffered a -20% share price fall following its result release, along with a short position increase to 6.3% from below 5% prior.

Last week BWX shorts increased to 7.6%.

Nanosonics ((NAN)) saw its shorts jump to 8.7% from 7.0%, while NextDC ((NXT)) dropped off the 55 plus table altogether, from 7.5% shorted the week before. See below.

We can also make another special mention of Myer ((MYR)), which having tanked the week earlier on yet another profit warnings, mysteriously bounced 16% on Monday for reasons no one could quite ascertain. There was no news from the company, nor from major stakeholder Premier Investments ((PMV)).

Nor is there anything on the ASX website. I was assuming a "speeding ticket" would be issued by the exchange - a "please explain" - but that appears not to be the case. Either way, we might safely assume the fact the stock is over 10% shorted that short-covering played its part in that 16% move.

Weekly short positions as a percentage of market cap:

10%+

SYR 22.0 IGO 16.9 DMP 16.1 JBH 15.9 RFG 13.8 HSO 13.7 GXY 13.1 HT1 12.3 VOC 12.0 MYX 11.2 FLT 10.6 MYR 10.2

No changes

9.0-9.9

AAD, AAC, HVN, APO In: APO

8.0-8.9%

PLS, NWS, NAN, GXL, MTS, TGR

In: NAN Out: APO

7.0-7.9%

BAP, ORE, BWX, BEN, GMA

In: ORE, BWX Out: NAN, NXT, TPM

6.0-6.9%

TPM, SHV, APT, WEB, KAR

In: TPM, APT Out: ORE, BWX, GTY, AHG

5.0-5.9%

CCP, SUL, QUB, SEK, AHG, WOW, RIO, NSR, GTY, JHC, WSA, IFL, IVC, CSR, BGA, ABC, IMF, ISD

In: AHG, GTY, IFL, IVC, ABC Out: APT, IMF, ISD

Movers & Shakers

Nanosonics engages in the research, development, and commercialisation of infection control and decontamination products and related technologies. In other words it is a biotech, and biotechs are notoriously volatile if success hangs on trials and approvals in various jurisdictions of key products. They often display "binary" tendencies on this basis, meaning potential big ups or downs.

In this case however, it was Nanosonics' profit result that sparked a -16% plunge in the stock price on the day. The result fell short of Morgan's forecast, being the only FNArena database broker covering the stock, leading to a rebasing of earnings expectations.

Morgans nevertheless suggested the big share price drop provided a buying opportunity, and retained an Add rating.

Nanosonics shorts have risen to 8.7% from 7.0%.

Data centre operator NextDC posted a strong beat of broker forecasts with its earnings results and received rave reviews. The share price jumped 20%. Brokers agree that while there may be some risk around emerging competition, and execution on new centres under construction, the underlying "new world" thematic of Big Data, The Cloud, and storage necessities make NextDC a story for the age.

Only a stretched valuation leads three of six covering FNArena database brokers to rate the stock a Hold as opposed to Buy, or equivalent. From 7.5% shorted the week before, NextDC shorts fell below 5% last week.

ASX20 Short Positions (%)

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

IMPORTANT INFORMATION ABOUT THIS REPORT

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

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

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

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

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

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

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

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

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The Wrap: Telcos, Banks, Insurance & Fish

Weekly Broker Wrap: Telcos; banks; insurance; and aquaculture.

-Launching unlimited mobile data plans may be difficult for Telstra -Valuations for banks may get worse before they get better -Less earnings risk posed in current half-year for insurers -New aquafeed additives flagged for both Nufarm and Ridley

By Eva Brocklehurst

Telcos

Optus is now trialling unlimited mobile data plans in Australia. UBS notes the plans are only available to select Optus fixed broadband customers that have no existing mobile products, and will be at limited speeds. These speeds will support only certain applications. Optus is targeting a small percentage of the user base with the aim of lifting mobile penetration.

UBS, using the US as a precedent, expects any move to unlimited mobile data could be value destructive. Telstra ((TLS)) is considered unlikely to launch unlimited mobile data plans unless competitors force its hand.

The broker believes launching unlimited mobile data plans could be more difficult for Telstra, given its network premium. Telstra may also be unable to throttle speeds to the same extent as Optus while still commanding its current price premium.

Banks

Credit Suisse suspects the valuations of banks are likely to get worse before they get better. This will happen as the market speculates on further negative outcomes for the sector. The sector is currently trading at a -27% discount to non-banks and the broker notes history shows a further -10-15% relative downside is possible.

If the sector achieves this level of valuation, and/or regulatory probes and slowing top-line growth are substantially ameliorated, Credit Suisse will re-visit its cautious view. Opportunity may present later in the year, the broker adds.

Bank of America Merrill Lynch upgrades Commonwealth Bank ((CBA)) to Buy from Underperform and downgrades Westpac ((WBC)) to Underperform from Buy. The broker's valuation analysis suggests that the sector is closer to oversold than overbought territory.

Particular appeal is still envisaged for investors that seek quality, dividends or domestic interest rate exposure. CBA has underperformed both National Australia Bank ((NAB)) and ANZ Bank ((ANZ)) by around 7% since June last year, the broker observes.

The market's concerns regarding AUSTRAC allegations and expensive valuations are considered reflected in CBA's share price. The broker has no major concerns regarding Westpac and the downgrade is driven by valuation.

Insurance

For short-term investors, Credit Suisse observes the current half-year poses less earnings risk from peril events than the prior half. The second half of the financial year is typically riskier for Insurance Australia Group ((IAG)) but this time there is a buffer from rolling forward a more benign first half. Suncorp ((SUN)) has used over half of its natural peril retention, providing earnings protection in the second half.

The company was unable to renew its reinsurance in FY18 on the same terms as FY17 and Credit Suisse suggests the current cover arguably needs a higher natural hazard allowance. QBE Insurance ((QBE)) has, similarly, exceeded its allowance in seven of the last 10 years and has the same reinsurance cover in place for FY18 as it did in FY17.

While the market appears willing to look through QBE's perils risk, Credit Suisse believes this has downside potential again in FY18. The broker prefers Suncorp, as it offers valuation support and a recovery in earnings, driven by positive premium rates and cost reduction initiatives. Valuation at present prevents the broker from being positive on IAG while it remains negative on QBE.

Aquaculture

Ridley ((RIC)) and Nufarm ((NUF)) are both developing new aqua feed additives that improve the efficiency of growth rates and/or the general health of seafood. Consumption of seafood globally is projected to increase by 1.8% in the decade to 2025, below the increase of 3.1% witnessed in the decade to 2015. Wilsons assesses the market for new aquafeed additives and the products that Nufarm and Ridley will offer.

The broker is more attracted to the Ridley program as while visibility on profitability is arguably lower, it faces less direct competition. Wilsons, which has a Buy rating and \$1.81 target on the stock, considers the risk valuation provides for more significant upside relative to the current share price. The broker retains a Hold rating and \$8.75 target for Nufarm.

Ridley's additive acts as a metabolic stimulant and the primary benefits are stated as increased survival and growth. Commercial scale sales are expected in FY19. Nufarm's additive, derived from GM canola, called Aquaterra has the primary benefit of sustainability. Commercial scale sales are expected in FY20.

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Stakes Are High As BWX Expands Its Reach

BWX is expanding its personal care business and in the wake of substantial acquisitions, the stakes are high in the US.

-Marketing expenditure needs increase significantly -Slump in the share price provides corporate appeal -Integrating acquired businesses critical to growth

By Eva Brocklehurst

Personal care product manufacturer and distributor BWX ((BWX)) continues to expand its business both domestically and offshore, but several brokers have raised concerns about elevated risk stemming from US acquisitions.

The company has provided a guidance range for the first time and FY18 operating earnings (EBITDA) are forecast to be \$42-46m which, at the mid point, represent a -10% downgrade to Moelis' estimates. Excluding the impact from US assets Mineral Fusion, Nourished Life and Andalou Naturals, organic growth was broadly flat.

Marketing expenditure increased significantly in the first half, representing around 20% of sales. Given an entrance into Coles ((WES)) and the traditional skew to the first half, Moelis accepts this, and understands second half expenditure will reduce to 13% of sales.

Factoring in new distribution channels, which require a one-off investment, the broker suggests around 15% of sales is a more reasonable level of advertising expenditure. On the back of the longer-term opportunities, Moelis retains a Buy rating with a \$5.60 target.

Shaw and Partners believes the slump after the first half result has left the stock with corporate appeal. For the first time in a while the broker believes the valuation is compelling, pointing out the business is not just about the Sukin brand but a North American footprint that, through Mineral Fusion and Andalou, is equivalent to the existing business.

The broker downgrade earnings estimates, primarily because of a reduction in assumptions around the growth for the acquisitions in the US as well as a moderation of growth for Sukin in the pharmacy channel. The broker believes the market has over-reacted and considers the stock an opportunity, maintaining a Buy rating and \$6.22 target.

Bell Potter is less enthusiastic. Both sales for Sukin and earnings margins were below forecasts. Guidance is also below forecasts, partly because of the impact from the company's decision to discontinue third-party manufacturing and distribution while focusing on core brands.

For Canaccord Genuity the company will need to prove it is generating reasonable organic growth. The broker has a growing list of concerns, although the strong organic growth has largely mitigated the issues to date. Now that growth has slowed, a further multiple de-rating could be nigh, the broker suggests.

Concerns highlighted include increasing competition, margin pressure and marketing expenditure. The company is also integrating three acquisitions in essentially new markets. On the positive side, cash flow was reasonable in the half-year, as was the valuation. Canaccord Genuity maintains a Hold rating and reduces the target to \$5.31 from \$6.40.

Sukin

Domestic Sukin sales were up 9.5% but, eliminating revenue from Coles, Moelis calculates growth in the pharmacy channel has dropped to 3%. Going forward, the broker expects minimal growth in the pharmacy channel and expansion in grocery will support domestic growth.

The sales growth rate for Sukin offshore also appears to be slowing. Moelis is disappointed that the roll-out in Malaysia and expansion in Canada is taking longer than previously expected.

Ranging of the product in the US should be beneficial in the second half but the broker remains cautious about uptake because this is new product in a highly competitive market.

Moelis asserts the company will need to differentiate the Sukin brand, which will require a heightened level of investment, while execution risk remains high. That said, if successful, the offshore expansion can provide a long period of growth.

US Acquisitions

US acquisitions underperformed, with the weakness at Mineral Fusion attributed to one-off channel stocking by the previous owners. Moelis is encouraged by evidence that the business continues to grow yet, despite integration with Andalou Naturals, remains disappointed that the outlook for growth is not stronger.

Integrating the acquired businesses is critical to the growth outlook, as Bell Potter estimates Mineral Fusion, Andalou and Nourished Life will account for around 55% of revenue in FY19. Hence, the broker is concerned that the first six months contribution from Mineral Fusion missed revenue estimates by around -20%.

The stock may appear cheaper but the broker believes, at this point in time, the risks around the growth outlook are elevated. Bell Potter maintains a Hold rating and lowers the target to \$5.30 from \$7.10.

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Michael Hill Revamps Emma & Roe

Jeweller Michael Hill has identified a major opportunity in the demi-fine jewellery segment for its troubled Emma & Roe brand.

-Smaller, concentrated store footprint will be retained -Concerns linger regarding consumer attitudes -Improving trend and diminished losses expected from FY19

By Eva Brocklehurst

Jeweller Michael Hill International ((MHJ)) plans to add some sparkle to its underperforming Emma & Roe division, identifying a brand positioning opportunity, and will proceed with a small trial footprint for the next 15 months or so.

The company has identified an opportunity in the "demi-fine" jewellery segment, which is a segment combining fine jewellery with a fashion statement, supplying customers with both style and affordability. Michael Hill will create a smaller, concentrated store footprint during an initial trial period for the remainder of FY18 and FY19.

Of the current 30 Emma & Roe stores, 24 will be closed. The remaining six stores will be in a single market area. Emma & Roe employees will be redeployed to Michael Hill stores where circumstances allow. Total one-off cash costs for lease terminations and employee severance are currently estimated at \$5.8-7.9m. The company is also negotiating the exit of the nine operating US stores, and has signalled a sale, or partial sale, is now less likely.

Citi expects the jeweller to benefit from a greater focus on its core business and the Emma & Roe turnaround. The stock has been trading at an undemanding PE on FY19 estimates of 9.8x and a -30% discount to listed retail peers, which the broker considers excessive. This is based on the business being relatively less exposed to a housing slowdown and the impact of Amazon.

The broker supports the decision to reposition Emma & Roe and target the demi-fine segment, envisaging material upside if the brand is successful going forward. Nevertheless, Citi is conscious the company remains in the planning phase and will have to ensure the brand does not get caught between fine and fashion jewellery without a clear market position.

The strategy to reduce discounting and improve the brand through increased marketing also makes sense but the broker remains concerned about consumers being conditioned to buy on promotions and losing share to competitors that continue to discount. Regardless, the repositioning will take time and the broker believes the short-term risks to margins are skewed to the downside.

Messy Turnaround

The outcome of the turnaround strategy for FY18 earnings will be "messy", Macquarie believes. The exit from the US should be completed by the end of FY18 and all trading losses eliminated by FY19.

Henceforth, the broker expects an improving trend from core geographies that sets a solid basis for trading in FY19. Macquarie envisages value in the restructured business and maintains an Outperform rating.

Morgans prefers a Hold rating during what continues to be a period of significant restructuring and underlying business weakness. The broker concurs that the removal of losses after the exit from the US and diminished losses from a materially lower store base at Emma & Roe should mean a better FY19/20.

In the wake of the first half results and on the back of the significant decline in the share price, Credit Suisse upgraded to Outperform from Neutral. The broker welcomes the exit of the US business and the repositioning of Emma & Roe but remains cautious about the near-term earnings profile and the potential for greater-than-forecast losses during the repositioning.

FNArena's database shows three Buy ratings and one Hold. The consensus target is \$1.32, signalling 16.5% upside to the last share price.

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February 2018 Reporting Season Review

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

-The Battlegrounds Are Drawn -February 2018 Reporting Season Review -Conviction Calls

[Note the non-highlighted items appear in part two on the website on Thursday]

February 2018 Reporting Season Review

By Rudi Filapek-Vandyck, Editor FNArena

What is the most important focus for share market portfolios? Is it growth? Is it disruption?

Most commentators and professional investors have argued the former since the middle of 2016. I have been advocating the latter since 2015.

Maybe it's not a case of either this or that. Warren Buffett, in his recent annual missive to Berkshire Hathaway shareholders, and to investors across the globe, tried his best to dismiss rather simplistic labeling such as "value" and "growth". Good investing, Buffett argues, implies both are connected at the hip.

I'd argue the same applies to growth and technological innovation, which is what causes the disruption in many of today's industries. If the February reporting season in Australia has proved one thing, it is that for successful investing in the Australian share market, growth and disruption are best seen as co-joined twins connected at the hip.

"Value", as defined by forward looking Price Earnings (PE) multiples, more often than not confused investors, and proved them terribly wrong on numerous occasions. February 2018 was the reporting season in which High PE market darlings significantly outperformed their lower priced peers, with their financial results outperforming market expectations, forcing analysts to increase forecasts, and share price valuations - often by double digit percentages.

The pain for shorters, and for many other investors who found themselves on the wrong side of the trade, was extra confronting since it had become a popular view that inflation is coming, interest rates and bond yields are on the way up, and high PE stocks should be avoided for risk of de-rating.

Yet the exact opposite happened in February, despite the fact the month opened with increased volatility and selling pressure as the world watched US bond yields lift and anti-volatility derivatives implode. Best performing sector for the month, by a long stretch? Healthcare, led by High PE outperformers CSL ((CSL)) and Cochlear ((COH)). Information Technology (IT) also proved a stand-out, equally led by High PE outperformers Computershare ((CPU)), REA Group ((REA)), NextDC ((NXT)), Altium ((ALU)), and numerous others.

[Note: I do not agree with the inclusion of Computershare, REA Group and NextDC, but the IT sector index promoted by the ASX does include these names, as well as Domain Holdings. Hence for the sake of simplicity, I'll just stick by it for the purpose of this review].

On the other end of the spectrum, cheap looking out-of-favour stalwarts such as Harvey Norman ((HVN)), QBE Insurance ((QBE)), Myer Holdings ((MYR)), Vocus Communications ((VOC)), IPH Ltd ((IPH)), Asaleo Care ((AHY)) and iSentia ((ISD)) simply continued their bad news cycle, and share prices are sharply lower in the aftermath of yet more disappointing financial results.

One should never forget, in the short term, reporting season is all about market expectations and how the financial performances that are being released compare to those expectations. Hence, immediate share price responses are not always an accurate indicator of what follows next.

One relationship is direct and undeniable: if analysts are forced to upgrade or downgrade their forecasts and valuations, the share price virtually always follows suit, unless the price is already accounting for it. The stand-out example this February was delivered by a2 Milk ((A2M)) with many an expert adopting a cautious approach beforehand given the share price had quadrupled over the prior twelve months. But since January 1st, a2 Milk

shares are up more than 40% (not a typo) and most of these gains have occurred on the day the company released its interim financials.

FNArena subscribers can observe via Stock Analysis on the website how earnings forecasts and stockbroker valuations equally jumped higher since that day. Today, consensus target sits double digit percentage above a sideways moving share price.

Seen through the prism of stockbroking analysts expectations, February 2018 delivered one of the best reporting seasons for corporate Australia over the past five years. FNArena statistics are not definitive as yet, but on our assessment some 37% of 318 reporting companies throughout the season have clearly beaten market expectations. This is equal the highest percentage with February 2016.

Back then, 21% of reporting companies disappointed. This time around profit misses represent 25% of all released results. The average increase in price target of 4% is well above average, but still beaten by two 5%+ increases respectively in February 2014 and February 2015. Changes in recommendations throughout the season favoured upgrades above downgrades; 87 versus 54. Only one other reporting season had more upgrades than downgrades. In August 2015 the ratio stood at 116 up versus 40 down.

Other factors worth mentioning:

-Earnings estimates usually decline by the end of most reporting seasons, but most brokers report the opposite happened this February. Average profit growth sits around 6-7%, which is reasonable yet below double digit growth in 2017, as well as double digit growth internationally.

On a relative basis, Australia remains a laggard, as illustrated by the table below taken from a recent market update by UBS.

-Positive surprises include capital management and dividends, with the added observation that a lot remains dependent on mining companies enjoying higher for longer prices, while boards remains hesitant to start investing in new production capacity. Analysts have noted a renewed appetite for corporate action, but also that cost growth is making a come-back. This kept numerous market updates by resources companies rather underwhelming, despite the apparent buoyant global conditions.

-Margins are near cyclical peaks, and now coming under pressure as costs are rising, but top line growth in general is positive and companies seem to be positioning for additional investment, backed by positive outlooks and guidances. Note all of Woodside Petroleum ((WPL)), Newcrest Mining ((NCM)), South32 ((S32)), Evolution Mining ((EVN)), OZ Minerals ((OZL)), Sandfire Resources ((SFR)) either announced new transactions during the season, or their management teams indicated they are ready to pounce whenever opportunity presents itself.

-Stand-out performances were delivered by a2 Milk, Altium ((ALU)), Appen ((APX)), BlueScope Steel ((BSL)), Bravura Solutions ((BVS)), Breville Group ((BRG)), Corporate Travel ((CTD)), Costa Group ((CGC)), CSL, Flight Centre ((FLT)), Hansen Technologies ((HSN)), Insurance Australia Group ((IAG)), Kogan ((KGN)), Moelis Australia ((MOE)), NextDC ((NXT)), Nine Entertainment ((NEC)), Orora ((ORA)), Qantas ((QAN)), Reliance Worldwide ((RWC)), ResMed ((RMD)), Seven West Media ((SVW)), Smartgroup Corp ((SIQ)), and Webjet ((WEB)).

-Notable disappointments include Blackmores ((BKL)), BWX Ltd ((BWX)), Domino's Pizza ((DMP)), Harvey Norman ((HVN)), InvoCare ((IVC)), IPH Ltd, iSentia, JB Hi-Fi ((JBH)), Mayne Pharma ((MYX)), QBE Insurance, Vocus Communications, Ramsay Health Care ((RHC)), Silver Chef ((SIV)), Star Entertainment ((SGR)), Suncorp ((SUN)), Super Retail ((SUL)), Tabcorp ((TAH)), and WiseTech Global ((WTC)).

-Resources' report card was rather mixed, as illustrated by the fact BHP ((BHP)) disappointed and Rio Tinto ((RIO)) broadly met expectations, including extra capital for shareholders through additional buyback and higher dividend. But Origin Energy ((ORG)) is oft cited as one notable outperformer for the sector, as is Mineral Resources ((MIN)). Notable disappointments for the sector include Beadell Resources ((BDR)), Dacian Gold ((DCN)), Northern Star ((NST)), Perseus Mining ((PRU)), Santos ((STO)), Senex Energy ((SXY)), South32, and Western Areas ((WSA)).

Earnings forecasts for resources stocks have fallen after rising strongly late in 2017, but they remain negative for 2019.

-Travel stocks, from Corporate Travel to Qantas, including Flight Centre, Helloworld ((HLO)) and Webjet, defied market scepticism about lower prices and margin pressure in Asia and a direct link to consumer spending in Australia.

-The retail sector proved a hotch-potch of solid momentum and sorry disappointments, mixed with plain disasters. AfterPay Touch ((APT)), Kogan, Breville Group, Lovisa ((LOV)) and Noni B ((NBL)) are clearly performing well. Harvey Norman, JB Hi-Fi, Myer, Michael Hill, and many others not so. The jury remains out for Accent Group ((AX1)) which

might have benefited from expectations having fallen too low. A factor that might also have benefited Coca-Cola Amatil ((CCL)), as well as The Reject Shop ((TRS)).

A weak result was delivered by Westfield ((WFD)), with questions being raised as to how this might potentially impact on the proposed acquisition by Unibail-Rodamco.

For investors here lies a much broader question waiting to be answered: how does Westfield's rapid deterioration impact on Scentre Group ((SCG)) and other supermarket owners elsewhere? What does it tell us about changing patterns for consumer spending in general?

-February also marked a come-back for traditional media on the back of advertising dollars flowing away from the Internet and from social media platforms. If sustained, this would mark an important reversal which should have the attention of all investors.

Amongst those jumping back to life, after a prolonged period in the penalty corner, are 3P Learning ((3PL)), Ardent Leisure ((AAD)), and Village Roadshow ((VRL)).

-In terms of ongoing potential for capital management, Qantas and resources giants BHP and Rio Tinto remain prime candidates, as are Crown Resorts ((CWN)), GWA Group ((GWA)), Inghams Group ((ING)), Investa Office Fund ((IOF)), Stockland ((SGP)), Wesfarmers ((WES)) and Woolworths ((WOW)).

Analysis of past reporting seasons suggests those who manage to deliver a positive market beat are most likely to continue enjoying positive momentum for up to three months after their results. Whether this also applies post February is an intriguing proposition given many a fund manager is afraid of equities de-rating on the back of rising bond yields, and is positioned in accordance with this concern.

Similarly, those who fail to meet market expectations might find a lack of buyer's appetite for a while longer.

In broad terms, the Australian share market outperformed international markets in February, but it still clocked a small net loss for the second month in a row. Investors with exposure to outperforming small and mid-cap companies (see above) might have had a different experience. FNArena's All-Weather Model Portfolio experienced its best reporting season since inception in late 2014.

In terms of profit expectations, large cap companies ex-banks and ex-resources are expected to grow by between 5-8% in both FY18 and FY19. Expectations for small and midcap industrials are twice as high. While some might argue this is already reflected in relative valuations, the February reporting season has shown that PE ratios, when judged at face value and in a static format, can be quite the misleading tool.

In terms of "growth" versus "disruption", I think the connection is there for everyone to see. While growth might falter or slow down, I don't think disruption will.

February has shown even long-time reliable growth stocks Ramsay Health Care and InvoCare are now finding the going a lot tougher than used to be the case. Whether this fundamentally changes the outlook for the years ahead remains to be seen.

Investors looking for cheap value among the downtrodden might want to reconsider before jumping on board the likes of Retail Food Group ((RFG)) and Silver Chef with February updates revealing risks are plenty and elevated with a cheap looking share price not necessarily the best gauge available.

Rudi Talks

Last week's audio interview on Reporting Season and pending index changes:

<http://boardroom.media/broadcast/?eid=5a94bb4b271b41638bdc5c42>

Rudi On TV

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

-Tuesday, 11.15am Skype-link to discuss broker calls -Thursday, noon-2pm -Friday, 11am Skype-link to discuss broker calls

Rudi On Tour

-An Evening With Rudi, Paddington, 11 April -Presentations to ASA members and guests Gold Coast and Brisbane (2x), on 12 & 13 June -ATAA members presentation Newcastle, 15 July -Presentation to ASA members and guests

Wollongong, in September

(This story was written on Monday 5th March and the second part on Wednesday 7th March. This first part was published on the Monday in the form of an email to paying subscribers at FNArena, and will be published again on Wednesday as a story on the website. Part two shall be published on Thursday).

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

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

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Rudi's View: CSL, Melbourne IT, Origin Energy

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

-The Battlelines Are Drawn -February 2018 Reporting Season Review -Conviction Calls

[Note the non-highlighted item appeared in part one on the website on Wednesday]

The Battlelines Are Drawn

By Rudi Filapek-Vandyck, Editor FNArena

According to the ruling view that is on display daily on Finance TV and in mainstream newspapers, not to mention the many blogs and other forms of finance commentary on the Internet and on social platforms, inflation is back and the world needs to prepare for much higher bond yields.

In the share market, according to the same view, the risk is that higher valued growth stocks will de-rate and thus trigger losses for investors whose portfolios are not yet in tune with the new environment.

Very few are willing to stand up against the general opinion, which is supported by scary warnings from the likes of Kenneth Rogoff, Professor of Economics at Harvard University and pretty much seen as the Ubermensch Economist of his time, and from Magellan CIO Hamish Douglas.

If Rogoff's prediction proves correct, global bond yields will be significantly higher in a year's time, and financial markets are not positioned for it today. Douglas wagers a significant sell-off for equities sometime in 2018 is now a 50/50 proposition, which is why Magellan has been upping the cash component in the investment portfolio in recent months.

Forget about Trump's erratic deal making strategies, this is all about rising bond yields on the back of returning inflation and backtracking central bankers.

The irony here is that, apart from defenseless bond proxies which have all been de-rated mercilessly, there is very little signaling from actual share prices action that such portfolio re-directing is the most accurate course to follow. Take the so-called reflation trade. Back in late 2016 it was all about reflation and buying up on miners, energy companies and banks.

But in 2018 those same sectors are finding the going a lot tougher, despite the same commentary from the sidelines, over and over, and over, and over, again.

In fact, as we are now in the third month of the calendar year, energy stocks, as a group, are well down for the year-to-date, and so are the financials, and to a lesser extent the miners. But what is most striking is that the two sectors in the Australian share market that have significantly outperformed are the two that should have been sold according to the (apparent) consensus view; healthcare and technology.

Never underestimate the potential for markets to surprise?

ASX-listed Janus Hendersons ((JHG)) has been touring main Australian cities in recent weeks, with presentations to the local investor community also including the out-of-consensus in-house view that investors should be bracing for an economic slow down, which will eventually impact on the Fed's policy, as well as on inflation readings, bond markets and equities.

According to some market watchers, there is an argument to be made this slowing down is already happening as suggested, for example, by Citi's global economic surprise index. It's early days yet, the signs are at best inconclusive, and definitely not everybody agrees with this view/observation.

At Janus Henderson the view is the Fed policy shift is already impacting on global liquidity and whereas most see the world as still swimming in cash, and the Fed merely normalising, Janus Henderson suggests "tightening" is the operative word, with most experts underestimating what is occurring below the surface of seemingly buoyant economic data and indicators.

At the very least, it's quite refreshing to know one of the successful investors listed on the ASX is not singing from the same hymn sheet as many of the worry beads and reflation trade proponents are. This, of course, doesn't mean

equity markets won't remain volatile or they won't have a correction this year.

There is an argument to be made here that if the world is truly slowing down, and the Fed remains intent to stay on course, the chances for a correction will definitely increase.

And that just about sums up 2018: widely diverging views and predictions, price action that surprises, lots of risk from known unknowns and from unknown unknowns. President Trump's economic advisor Gary Cohn resigning is simply the latest of such events.

Only one certainty stands tall for the year ahead: volatility is back. Better get used to it.

Conviction Calls

Bell Potter analyst TS Lim has updated his selection of most preferred technology stocks listed on the ASX. His current top three "Key Picks" are The Citadel Group ((CGL)), Infomedia ((IFM)) and TechnologyOne ((TME)). WiseTech Global ((WTC)), nominated as Key Sell for the sector in December, remains a Key Sell, despite the sharp fall in share price on the back of a disappointing result in February.

Altium ((ALU)) was also nominated as a Key Sell in December, but that proved the wrong call (no mention of it in the sector update, though) with the share price today substantially higher on a quality "beat" in February and with Bell Potter having moved the rating back to Hold from Sell. Begrudgingly.

No one wants to take the telephone calls from clients who sold on the December recommendation and are asking questions today.

Bell Potter maintains the future is bright for The Citadel Group, while Infomedia released yet another set of weak financials in February, but the thinking here is that things can only get better. Bell Potter is forecasting much better performance from the perennial underperformer.

TechnologyOne remains a Key Pick because, simply put, the business model remains robust and healthy, with the outlook for strong growth and the share price languishing, which means a valuation gap has opened up with other technology stocks, such as WiseTech Global and Altium.

I, of course, concur with the latter assessment and TechnologyOne remains a core holding in the All-Weather Model Portfolio.

Senetas ((SEN)) and Appen ((APX)) both lost their spot on the Key Picks selection, with both downgraded to Hold since December. Appen's share price has performed splendidly, Senetas' not so as investors try to figure out what exactly is the future for distributor Gemalto in Europe, and how might it impact on the relationship with the Australian encryptor.

One technology company that impressed analysts at Wilsons is Melbourne IT ((MLB)), one of few local remnants from the dotcom mania years. Growth should be a lot lower than the dazzling 106% and 55% recorded in the two years past, but there should still be double digits on offer and that makes the share price rather attractive, according to Wilsons.

Melbourne IT has been elevated to Wilsons' list of Conviction Calls with the added observation the yield doesn't look too bad, given the PE ratio remains relatively benign.

Bell Potter also covers the stock and rates it a Buy with a \$3.50 price target. Wilsons' Buy rating is accompanied by a \$3.59 target.

Strategists David Cassidy and Jim Xu at UBS have, post February reporting season, stuck with their year-end target for the ASX200 of 6275, implying double digit return can still be achieved if one includes dividends and franking. The strategists have added BlueScope Steel ((BSL)) and Webjet ((WEB)) to their preferred list of stocks, labeled 'Key Portfolio Overweights'.

Other stocks on the preferred list are Origin Energy ((ORG)), Janus Henderson ((JHG)), BHP ((BHP)), Aristocrat Leisure ((ALL)), AGL Energy ((AGL)), Star Entertainment ((SGR)), Qantas ((QAN)), Link Administration ((LNK)) and Woodside Petroleum ((WPL)).

In terms of interesting observations, I picked up the following in UBS' strategy commentary:

"It is interesting that the growth segment has not been hampered by the recent rise in bond yields albeit the Australian 10 year has been more subdued. In the growth area we continue to overweight the US focussed Aristocrat, Resmed as well as small cap IT play Next DC. We see attractive GARP in AGL Energy, Brambles, Star Entertainment Group, Tabcorp and Woolworths. We concede some of these results were underwhelming but we still see the attractive medium-term growth thesis at a reasonable price as intact in each case."

Macquarie analysts, reviewing the February reporting season for the local healthcare sector, observed most companies reaffirmed their guidance, but CSL ((CSL)) once again stood out by lifting its previous range for the year. Growth inside the sector is becoming more divergent with more subdued growth rates for service-based businesses with domestic exposure.

CSL, Cochlear ((COH)) and ResMed ((RMD)) remain the proud owners of prime valuations vis-a-vis their peers and there's no coincidence here as these remain the proud owners of prime growth prospects.

Taking a three-year horizon, and then reflecting back on today's share price valuations, Macquarie finds CSL and Ramsay Health Care ((RHC)) do not look expensive, but Cochlear does. Least preferred exposure: Primary Health Care ((PRY)). Most preferred: CSL.

Healthcare analysts at Credit Suisse also retained CSL as most preferred long term exposure, even though the sector overall looks expensive trading on meaty premia against other segments of the Australian share market. Least preferred exposures according to CS are Healthscope ((HSO)), Primary Health Care and Ansell ((ANN)).

The four unit team of retail analysts at Citi dared to stick their neck out, post February reporting season, and nominated Accent Group ((AX1)), Beacon Lighting ((BLX)) and Michael Hill ((MHJ)) as their highest ranked, most preferred exposures to the domestic small cap retailers segment.

Elsewhere, Citi strategists removed Caltex Australia ((CTX)) from the Focus List Australia/New Zealand, though they emphasised the company's fundamentals remain sound. The roll-up of the franchise model will be weighing down earnings growth in the short term. Against this sits an undemanding valuation, suggest the strategists.

Stocks that retained their inclusion are Aristocrat Leisure, ALS Ltd ((ALQ)), Goodman Group ((GMG)), Lend Lease ((LLC)), Newcrest Mining ((NCM)), NextDC ((NXT)), Qantas ((QAN)), Rio Tinto ((RIO)), Star Entertainment Group, and Trade Me ((TME)).

The list of High Conviction Stocks at stockbroker Morgans also saw two changes post the February reporting season. Morgans added BHP ((BHP)) and removed Corporate Travel Management ((CTD)) justifying the latter by referencing the strong share price rally that has occurred since the financial result.

Remain on the list: ResMed ((RMD)), Link Administration, Westpac ((WBC)), Oil Search ((OSH)), Senex Energy ((SXY)), and PWR Holdings ((PWR)).

UBS analysts argue there is opportunity for investors amidst tough market dynamics for companies exposed to consumer spending in Australia. The broker's Key Picks are Flight Centre ((FLT)), Woolworths ((WOW)) and Costa Group ((CGC)).

UBS has an outspoken negative view on Myer ((MYR)) and Coca-Cola Amatil ((CCL)).

Rudi Talks

Audio interview earlier in the week on Reporting Season and what is happening in the share market:

<http://boardroom.media/broadcast/?eid=5a9e01ec271b41638bdc6302>

Rudi On TV

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

-Tuesday, 11.15am Skype-link to discuss broker calls -Thursday, noon-2pm -Friday, 11am Skype-link to discuss broker calls

Rudi On Tour

-An Evening With Rudi, Paddington, 11 April -Presentations to ASA members and guests Gold Coast and Brisbane (2x), on 12 & 13 June -ATAA members presentation Newcastle, 15 July -Presentation to ASA members and guests Wollongong, in September

(This story was written on Monday 5th March and the second part on Wednesday 7th March. This first part was published on the Monday in the form of an email to paying subscribers at FNArena, and again on Wednesday as a story on the website. This is Part two).

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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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