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Convenience Retail Seen Oiling Caltex Growth

The renewed alliance between Viva Energy and Coles is making life more difficult for Caltex, although brokers still envisage the long-term opportunity from convenience retailing is substantial.

-Further pressure forecast for Caltex volumes and margins -Retail margins expected to normalise in the second half amid US crude supply growth -Is the market adequately valuing the Caltex convenience offer

By Eva Brocklehurst

While a rebound in oil prices has likely contributed to margin weakness for Caltex ((CTX)) recently, a rise in competitor discounting remains the biggest concern for brokers over 2019. This has been caused by the re-setting of the alliance between Viva Energy ((VEA)) and Coles ((COL)), with aggressive pricing in January materialising ahead of the change.

Deutsche Bank suspects this dynamic is not going to ease off any time soon, as the alliance has a clear mandate to grow volumes. Hence, further pressure is forecast for Caltex volumes and margins. The broker believes this makes the company's retail uplift target even less achievable.

Ord Minnett agrees the new competitor alliance will make gross margin expansion more difficult. Market share losses are expected at Caltex customer Woolworths ((WOW)) and to a lesser extent at Caltex itself.

Underlying fuel and infrastructure growth has also slowed, as international business moderates, and Woolworths is considered to be a long-term contract burden. Ord Minnett expects earnings from the Lytton refinery to fall because of lower volumes and volatile refining margins.

A plant shutdown at Lytton is expected to reduce production by 200-250m litres while 2019 production guidance for 5.8bn litres has been reaffirmed. Fuel retail margins were lower at the end of February, affected by diesel pricing and competition in petrol retailing. The negative impact from diesel is likely to reverse at some stage during the year, Credit Suisse assesses.

Credit Suisse takes a positive view on the company's market share, which appears to have stabilised. The increased competition in petrol retailing appears to the broker to be a tactical move by Caltex to stabilise market share ahead of changes in the Viva Energy/Coles contract and the transition of Woolworths fuel to EG Group.

Morgan Stanley retains an Underweight rating and expects the new pricing strategy from Viva Energy will affect margins in the second quarter, although there may be some offset from the oil price after the large increase in the first quarter.

UBS reduces 2019-21 estimates for earnings per share by -5-18%, largely because of lower refining margins, the Lytton shutdown and retail margin and volume weakness. Retail margins are expected to normalise in the second half as crude prices are impacted by supply growth in the US.

Convenience

Ord Minnett has reduced confidence in the execution of the convenience retail strategy, as earnings targets are being pushed back and not reiterated. However, longer-term, the convenience business remains an opportunity. Credit Suisse agrees the main levers for growth continue to revolve around developing convenience formats and fuel infrastructure.

The broker assumes price competition continues throughout the first half, partially offset by a recovery in refining margins. The Caltex refining margin has improved from the January low, averaging US$7.00/bbl over the two months to February. The broker increases forecasts for margin to US$7.50/bbl in the first half, resulting in an earnings upgrade for Lytton.

UBS believes pressures from competition are likely to continue and reduces retail earnings estimates by -3-10%. Despite the near-term earnings risk, the broker considers there is medium-term upside via the successful execution of the convenience business.

UBS assesses the market as attractive, as there are high barriers to entry amid growth across convenience and commercial business. Industry profitability is seen improving as fuel sites increase their share of sales of higher

margin, higher returning convenience and food. The broker does not believe the market is adequately valuing the convenience offer.

FNArena's database shows four Buy ratings, two Hold and one Sell (Morgan Stanley). The consensus target is $29.16, signalling 7.4% upside to the last share price. Targets range from $25 (Morgan Stanley) to $33 (Macquarie, yet to comment on the update). The dividend yield on 2019 and 2020 forecasts is 4.0% and 4.9% respectively.

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TPG Telecom Wired For ACCC Decision

TPG Telecom is in the line of fire as it awaits the decision from the ACCC on its merger with Vodafone Australia. Brokers suspect downside risk to the share price is considerable if the merger is disallowed.

-Revenue uplift from Vodafone Australia backhaul benefits corporate margins -Downside risk if Singapore mobile fails to attract sufficient consumer interest -If the merger does not proceed what becomes of the 5G spectrum?

By Eva Brocklehurst

Margin pressure stemming from the NBN will step up for TPG Telecom ((TPM)) as promotional discounts unwind and migration to the NBN increases. Hence, Citi believes it will be strong growth in the company's corporate division that will stand out from FY20 and offset the NBN impact. This is the main attribute that TPG Telecom brings to the proposed merger with Vodafone Australia.

NBN margins are set to narrow because of rising CVC (network capacity) charges, although Macquarie suggests there is scope for a better outcome if either NBN wholesale pricing changes or TPG Telecom increases its prices. The company has indicated that it may become uneconomic to sell a $60 NBN product if there is no change to pricing.

Guidance for operating earnings (EBITDA) of $800-820m in FY19 is maintained, largely because of an expected increase in NBN access costs in the second half. Excluding $22m in revenue from the Vodafone Australia backhaul contract, corporate data and internet revenue grew by less than 1% in the first half, as management decided to exit the NBN wholesale business.

Ord Minnett calculates this poses a -5% headwind to the growth rate. Meanwhile, corporate margins have benefited from the uplift in revenue from the Vodafone Australia fibre contract as well as the winding back of NBN low-margin wholesale business.

Morgan Stanley welcomes further cost reductions and better-than-expected corporate earnings. Revenue and operating earnings grew by 2.5% and 15.0%, respectively, in the first half, the primary impetus being the scaling up of revenue from Vodafone. The broker estimates the company now needs second half operating earnings of $376-396m to achieve its full year guidance.

First half results were supported by a benign Singapore mobile division, as the company has reached 99% outdoor coverage, amid lower finance costs. Commercial launch in Singapore is expected in December and the company continues to run free trial services.

Ord Minnett pushes out its commercial estimates for Singapore to the second half of FY20. The broker forecasts break-even by FY20 in operating earnings and calculates the venture will require $180m in capital to become positive on free cash flow.

Morgan Stanley acknowledges downside risks include the new business launches in Australia and Singapore mobile, if they fail to attract sufficient consumer interest and remain unprofitable.

Merger

The ACCC (Australian Competition and Consumer Commission) review of the merger with Vodafone Australia is in train, with a decision now expected in May. Several brokers envisage significant downside potential if the merger does not eventuate.

Citi's earnings forecasts currently assume the merger is blocked and that the company's Australian mobile network roll-out ceases. Even if the merger does not proceed, UBS suspects TPG Telecom has a Plan B. The broker asserts the cessation of the company's mobile network roll-out adds complexity and may have created an impasse, as the ACCC will need to form a view on what a stand-alone entity would do with its mobile spectrum and network assets.

UBS values a merged business at $7.50 and TPG Telecom at $5.00 on a stand-alone basis. Morgans believes the deal should be allowed to proceed, as having a stronger and better-funded third operator is better for consumers in the medium term. This remains key to the share price and an investment driver going forward. The broker suggests the share price will rally if approval is granted.

Mobile Network Future

Credit Suisse assesses any upside is more than factored into current trading prices. The broker includes higher depreciation & amortisation in its forecasts, to reflect spectrum not previously factored in, given the decision by TPG Telecom to cease its Australian mobile network roll out following the ban on the use of Huawei equipment in 5G mobile networks.

Morgans suggests, if the merger does not proceed, TPG Telecom will need to liquidate its spectrum or find another use by possibly working out how to reinstate the mobile network. Selling the spectrum to a third party would presumably be at a loss as the company paid a very full price for 4G. Building out a 4G/5G network would also be difficult and more costly than originally expected because of the Huawei ban.

FNArena's database has one Buy (Morgan Stanley), two Hold and three Sell ratings. The consensus target is $6.50, signalling -10.1% downside to the last share price. Targets range from $5.60 (Credit Suisse) to $7.15 (Morgan Stanley).

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Season, Supply, Safety Issues Plague Nufarm

Adverse seasonal conditions, supply issues and glyphosate safety concerns plagued Nufarm in the first half and continue to affect the company's outlook.

-Working capital worsens and net debt rises, no interim dividend -Potential for an equity raising increases -Chinese supply chain risk materialises, reflecting poorly on transition planning

By Eva Brocklehurst

Several issues of concern were raised after Nufarm ((NUF)) reported a disappointing first half. Cash flow was significantly worse than expected and European acquisitions are not expected to achieve original earnings guidance until FY20. Adverse seasonal conditions continue to plague the company's performance in FY19 amid supply issues, glyphosate safety concerns and poor execution.

The company now expects FY19 operating earnings (EBITDA) of $440-470m versus $500-530m previously, a -12% downgrade at the mid point. The reduction to estimates is attributed to Australia and Europe while expectations for North and Latin America are unchanged.

Working capital was significantly worse than brokers expected, increasing around $450m. Net debt has risen to uncomfortable levels, at $1.58bn, and caused the board to temporarily suspend the dividend.

Credit Suisse sums up the reaction to the results as a mismatch between market expectations in relation to the risks for the balance sheet and the ability/willingness of the company to effectively manage working capital fluctuations.

The drivers of a second half improvement in working capital stem from Australia, where the company will sell existing inventory and wind back production, amid expectations the drought will continue.

In Latin America Nufarm expects to convert receivables to cash in line with normal practice and strong sales are expected in North America, albeit with some risk for receivables if the US season is late. European seasonal conditions are noted to be reasonable.

Morgan Stanley asserts the share price has capitalised the short-term/seasonal headwinds and generating cash in the second half is key to a re-rating. The broker continues to believe the stock is oversold, as it is trading at a -29% discount to the industrials ex financials. A partial recovery in Europe is assumed amid a more gradual normalisation of conditions in Australia.

Deutsche Bank, while retaining a Buy rating, is cautious and highlights the reasonable amount of risk for the next 4.5 months. The company has estimated average net leverage at the end of the year will be "well below 3x", while the broker estimates it will be 3.0x, which does not leave much headroom.

Ord Minnett downgrades to Hold from Buy after reducing earnings forecast by -30% for FY19 and -26% for FY20. The broker assesses the balance sheet leverage target of 2x net debt for the medium term is challenged, and the business remains heavily dependent on the weather outlook. There is also potential for an equity raising.

Morgans, on the other hand, upgrades to Add from Hold, assessing the stock has been oversold. The broker expects a tough second half and acknowledges short-term catalysts are limited, but with the return to average seasons and a range of growth initiatives there should be an eventual recovery in earnings growth. The main downside risk, Morgans agrees, is if Nufarm cannot restore the balance sheet and requires another equity raising.

Supply Chain

The main issue contributing to the reduction in guidance, outside of the drought in Australia, is the problems with the transition of acquired product portfolios in Europe. Macquarie was not expecting anything extraordinary from the first half results but the extent of the reduction to guidance was worse than envisaged. Europe was disappointing as the Chinese supply chain risk has materialised.

The company has previously flagged uncertainty regarding Prochloraz sourced from China, which is sold by its Century business in Europe. The supplier of Prochloraz, Adama, has declared force majeure based on increased Chinese environmental compliance. This meant the partial or complete closure of a number of Chinese chemical facilities.

While the affected Chinese plant has now resumed production, this is at lower levels. Nufarm is pursuing other potential supply options and expects a -$30m shortfall should be recovered in FY20.

Credit Suisse questions how transitional supply arrangements with the vendors of Century and FMC were allowed to disintegrate to the extent they did, and believes it reflects poorly on transition planning and execution. Even so, and despite the -$30m impact, Credit Suisse considers Europe is a large opportunity once the acquisitions are bedded down.

Meanwhile, brokers agree the Omega-3 seed development is a winner, which Credit Suisse values of $750m. US FDA approval is expected in the next six months and Canadian approvals over 2019. First commercial contracts are likely by the end of FY19 and an earnings contribution is expected in FY21. Nufarm has reaffirmed guidance for Omega-3 operating earnings of $8.5m for each 1% share of the market by 2028.

Litigation

There are several glyphosate-related lawsuits underway, with brokers noting stage I of the Hardeman-Bayer trial going against Bayer, a key competitor to Nufarm. Credit Suisse believes it will be important for investors to separately consider litigation and regulatory risks as the regulatory position has been supported by Brazil and Canada reaffirming the use of glyphosate. Ord Minnett estimates glyphosate accounts for 25% of the company's Brazilian portfolio.

FNArena's database shows six Buy ratings and one Hold (Ord Minnett). The consensus target is $6.44, suggesting 47.0% upside to the last share price. This compares with $7.43 ahead of the results. Targets range from $4.50 (Ord Minnett) to $8.90 (Credit Suisse).

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Material Matters: Coal, Iron Ore & Oil

A glance through the latest expert views and predictions about commodities. Oz miners; coal; iron ore; and oil.

-Credit Suisse ascertains Oz miners are trading close to fair value -Gap between high and lower quality thermal coal prices increasing -Citi expects Chinese demand for iron units to decline over the next five years -New cheaper oil projects creating dilemma for OPEC

By Eva Brocklehurst

Oz Miners

Credit Suisse expects commodity prices and steel production in China could move lower throughout 2019. The broker's modelling of risk appetite suggests this has now normalised. All up, when running a mid-cycle earnings approach, the broker considers large capitalised companies are trading broadly in line with historical multiples, although BHP Group ((BHP)) is slightly expensive. Iluka Resources ((ILU)) appears the cheapest.

The broker ascertains the sector is, in general, trading close to fair value and struggles to visualise a positive shock outside of stimulus in Chinese infrastructure. The main risk is that Chinese policy diverges from its current rhetoric. On this basis, Credit Suisse would not be overweight on the sector and would consider moderating its position slightly. The key pick on a relative basis is Whitehaven Coal ((WHC)) followed by Iluka Resources and Alumina Ltd ((AWC)).

Coal

Credit Suisse observes the price of Australian thermal coal being sold to China is being hit relative to competitors, at odds with assurances by the Chinese and Australian governments. Whether there is a ban or just restrictions, the price suggests importers are avoiding Australian thermal coal. The sharp improvement in the Indonesian price signals to the broker where Australia's market share may be headed.

National Australia Bank strategists point to Platts data, which has indicated that Chinese coal buyers are seeking increased volumes from Indonesia and Russia, which could lead to greater volatility for prices in the short term because of supply constraints. The analysts expect thermal coal prices to ease gradually to US$90/t in 2020.

However, 5500kcal coal is now looking so cheap it could attract Indian buyers, Credit Suisse believes. Most high-ash coal in Australia is produced by Glencore, Yancoal and BHP Group. The former two have options to blend up some of their high-ash coal while BHP has few options from Mt Arthur because of insufficient washing capacity.

Morgan Stanley also notes the frequently-quoted 6000 kcal thermal coal price on an F.O.B. Australia basis has dropped from its 2018 peak, but at US$92.60/t remains largely in line with expectations for 2019.

The broker observes the difference between high-quality benchmarks and lower-energy alternatives has started to increase, and one of the drivers is the controls in place in China on import of low-energy coal. Morgan Stanley agrees this, in particular, affects BHP and Glencore.

Meanwhile, Credit Suisse points out, metallurgical (coking) coal prices have remain strong and Chinese buying is continuing. Ultimately, steel mills have little choice as China is short of premium-grade, low-sulphur coking coal. National Australia Bank analysts expect hard coking coal prices to decline to US$158/t in 2020 amid weaker steel output in China.

Iron Ore

The risks around iron ore price forecasts are finely balanced, in Citi's view. The broker expects only a modest lift in global steel production in 2019-20 and continues to believe the market will lose around -80mtpa of supply in 2019 because of a net reduction of -40mt in Brazilian exports. The broker assumes the mine at the site of the tailings dam tragedy in Brazil will be off line for all of 2019.

2020 is considered more difficult to predict, although the three-year ramp up of capacity by Vale should enable exports from Brazil to regain some ground and reach around 370mt. The broker considers the downside case for iron ore prices at US$80/t in 2019 versus upside of US$95/t.

Citi notes Australian iron ore miners have been quick to point out there will be no change to their production targets, and they do not plan to bring forward production as a result of the exit of Brazilian supply. Given uncertainty around the longer-term demand for iron ore in China, Citi is glad this has been confirmed. The broker assumes China's demand for iron units will decline over the next five years as steel production rates peak and more scrap is utilised.

Macquarie observes shipments from Brazil have started to decline but this appears more related to the weather than expected capacity reductions from Vale. Meanwhile, shipping rates from key Western Australian miners have recovered and are now broadly in line with expectations for the March quarter, although down -3% sequentially and -1% year-on-year.

Spot iron ore prices for all products have increased since the tailings dam tragedy but the gap between higher grades and lower grades has narrowed significantly. Macquarie notes high-grade premiums have fallen to 15% from 40% while discounts for lower grades have narrowed to -20% from -50%. The broker maintains Outperform ratings on all three major Australian iron producers, Rio Tinto ((RIO)), BHP and Fortescue Metals ((FMG)).

National Australia Bank analysts have noted spot iron ore prices have eased from recent peaks, although acknowledge these are still high by recent standards. The analysts expect a relatively balanced market over the short term, with a limit to downward pressure until output can be boosted from other sources besides Vale, along with an easing of Chinese demand. Forecasts are unchanged, with spot prices expected to ease across 2019 and average US$80/t before dropping to US$70/t in 2020.

Oil

OPEC (Organisation of Petroleum Exporting Countries) has a dilemma, Citi points out, as the cartel is trying to cut production to support prices but is losing market share to shale and deepwater oil. Citi highlights the outperformance of liquids production by the US and a strong pipeline of non-OPEC non-shale supply projects. New discoveries have accelerated and resource bases are being revised higher.

Citi also assesses offshore projects are becoming cheaper and faster to implement. The International Energy Agency estimates that upstream oil and gas investment will hit around US$500bn in 2019, up 4%. This remains around -US$300bn lower than the 2014 peak but costs are also down -30-40%.

Saudi Arabia appears to believe it can reduce price volatility by preventing global oil inventory from moving too high or too low. However, Citi suggests this reaction to observable stocks, and efforts to mobilise support on output cuts or additions, sparks volatility rather than suppresses it.

The broker suggests Saudi Arabia needs to act like a central bank to be more effective, and announce a target price range while acting on it rather than searching for elusive data on inventory. Still, the broker concedes the targeting of a price above the market equilibrium would lead to a loss of share to shale and other non-OPEC producers. National Australia Bank analysts envisage a very gradual uptrend for oil prices amid a range of geopolitical risks. Brent is forecast to reach US$70/bbl by the end of the year.

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ESG Focus: Coke; You Can't Beat The Real Thing - Or Can You?

Part One of FNArena's deep dive into the future of coking coal in an increasingly carbon sensitive world.

-Future of steel production directly linked to availability of scrap -Governments and private sector investing in new technologies -Chinese policies remain key for global demand, with uncertainty post 2023 -Demand for coking coal supported in short term; looks capped further out

By Sarah Mills

If thermal coal is public enemy No. 1 in an ESG world, then metallurgical (coking) coal is running neck and neck with single-use plastics for the position of public enemy No. 2.

Thermal coal represents about 80% of the world's coal use and coking coal represents 20%.

Coking coal is used in blast-furnace steel making. It is widely accepted there is no at-scale substitute for coking coal in steel manufacture, although this is only partly true.

More Scrap Equals Less Coking Coal

Electric arc furnaces produce steel from scrap metal and represent about 30% of the world's steel production. Coking coal is only needed for steel produced from scratch. So, like thermal coal, coking coal is a tale of two hemispheres.

In the West, which has huge reserves of scrap metal, demand for coking coal is expected to ease over the next five years. In Asia, which is industrialising and urbanising, and has relatively low reserves of scrap metal, demand is expected to remain reasonably steady.

The timeframe after 2023 is anything but certain and will depend on the rate of technological advances and the rate at which carbon imposts flow through.

The race to find a substitute for coking coal in steel making very much resembles that to discover longitude in the 1700s, when the British government offered a huge purse to the one who could provide a solution to save the massive losses of cargo at sea.

Except it is more intense.

Some governments are not just offering prizes, they are co-funding projects – many of which are already quite advanced. Steel companies are nearly as keen to invest, seeking any technological advance that will help them cut costs, emissions, slag pollution and labour, and enable them to establish competitive dominance in a post-carbon tax and post-ESG world.

Direct threats to coking coal demand include: new generation blast furnaces: electric arc furnaces; substitutes for coking coal; a likely carbon tax; and ESG capital withdrawals.

Indirect Threats To Coking Coal

There are also indirect threats. Coking coal prices are very sensitive to steel demand, and steel faces its own battles with alternative materials and carbon targets.

Asia is coking coal's best friend but China, the world's largest consumer of coking coal, is committed to reforming the industry, has an ageing population, and is starting to build its own scrap-metal reserves.

India, in contrast, is on the rise. But with ESG penalties on supply chains starting to bite within the next few years, improvements in technology and the likely introduction of the carbon tax, it will be unlikely that an industrialising India will be able to fill China's shoes.

This, apart from the fact that China's steel manufacture is by far the largest in history, currently equal to output from all other producers elsewhere combined. A large slowdown in China would thus leave too big a foot print for any single country to fill, including fast growing India.

Beyond 2023 Looks Uncertain

While coking coal seems safe for the near term, its future beyond 2023 is less certain. Coking coal is essential to steel making. It is used as a reducing agent in a chemical reaction called reduction that turns iron ore into pig iron. Carbon dioxide is the by-product.

Coking coal has a higher carbon content than thermal coal, and is needed to generate the high temperatures required for the blast furnaces.

The International Energy Agency estimates that about 7% of the world's carbon dioxide emissions come from steel production. The production of 1 tonne of steel yields about 0.8 tonnes of carbon dioxide, not including energy costs.

According to the journal Nature, primary sources of greenhouse gas emissions (those arising from blast furnaces) represent 43% of the industry's total footprint, miscellaneous combustion sources (gases) 30%, other process units 15%, and indirect emissions (energy use) represent 12%.

The Paris Accord has set a target of a -27% reduction in emissions for manufacturing (excluding energy which has its own targets) in the medium term. This will affect all industries, ranging from automotive to aviation to shipping.

With its high carbon-dioxide-emission profile, steel faces serious challenges as a material in a carbon-weaning world, ipso-facto coking coal. Steel companies fortunes are very sensitive to demand, which translates to volatile coking coal prices, which in turn requires investors with nerves of steel, excuse the pun.

The introduction of a carbon tax and ESG penalties will exacerbate this situation.

The Pressure Is On

As a result, the pressure to reduce the reliance on coking coal used in blast furnaces is intense. Blast furnaces are expensive and have a life of about 10 years before they need relining, and an average overall life of 25 years (which is not that long in the greater scheme of things and provides an incentive to cycle quickly to new technology).

They emit about 12 times the carbon dioxide of their scrap-metal rival; electric arc furnaces. They need large-scale production to achieve economies of scale and are not as flexible as electric arc furnaces, which can produce steel runs on demand – an attractive quality in the world of just-in-time manufacturing, reduced inventories and short lead times.

They also use huge amounts of thermal coal for energy. They must be shut down for relining and restarting is costly. They also have huge waste issues, producing slag; plus they are labour intensive.

These factors mean that blast furnaces can lead to big losses in tight years. Blast furnace numbers have declined sharply in the United States and Australia over the past two decades. The last blast furnace to be built in the US was in 1995.

Australia has two remaining blast furnaces – one in Whyalla (ex OneSteel and Arrium, now owned by GFG Alliance) and one in Port Kembla (owned by BlueScope Steel ((BSL)).

Europe is still heavily invested and only recently authorised steel producers to continue using blast furnaces until 2026 – and only after extreme lobbying from the steel and automotive industries.

China is still dependent on coking coal but is widely perceived to be in a declining megatrend. India and Russia are expected to expand. The global blast furnace market is forecast to rise at a compound annual growth rate of more than 4% between 2019-2023 according to Business Wire, including capacity additions.

But the degree to which this will support coke prices will depend very much on the type of blast-furnace technology deployed.

The Next Generation

Many of the new blast furnaces to be built in the West, and most likely China and possibly India, will be next-generation furnaces as producers scramble to meet ESG and carbon-tax demands.

These are similar to traditional blast furnaces but use renewables, recycled gas, pumped hydro and grid scale batteries, for thermal energy; reducing overall emissions by 12%.

Old generation furnaces use up to 950kg THM (although the majority have better scores), while the new furnaces use 70kg/THM and produce carbon dioxide ready to store.

The efficiency of blast furnaces differs markedly. According to Science Direct, global best practice for using coking coal as the energy source for blast furnaces (it is also used in other functions) requires 250kg of coking coal to produce a ton (1.1 tonnes) of hot metal; but many of India's blast furnaces require 507kg.

Similar disparities are recorded in other components of the steelmaking process. ESG capital flows and the likely adoption of the carbon tax by 2023 are likely to make inefficient furnaces uncompetitive.

As global best practices in blast furnaces become the standard, the demand for coking coal seems poised to fall. Given nearly all major consumers of coking coal have energy targets, and given ESG tracking extends to the supply chain of retailer and manufacturers, the likely introduction of a carbon tax, and the relatively short life of blast furnaces before upgrading, the pressure to upgrade is likely.

So, even if demand for steel increases, the demand for coking coal should be kept in check.

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ESG Focus: Changing Climate Has RBA's Attention

The story was originally published as part of Weekly Insights on March 21, 2019. It has now been re-published to include it as a stand-alone item in FNArena's ESG Focus section.

By Rudi Filapek-Vandyck, Editor FNArena

Central bankers like to operate on a low public profile. They in particular don't like to be pulled into the messy processes of domestic politics, which is why last week's public speech by Guy Debelle, Deputy Governor at the RBA, should have every investor's attention.

The speech is titled "Climate Change and the Economy". Given everybody inside and around the RBA would have been well aware of the potential for becoming implicated in local politics, with NSW elections this coming weekend and Federal elections not far off after, the brazen and candid manner in which this "hot topic" has been addressed by the number two at the most important financial institution in the country..., well, need I really spell it out?

The RBA is sending a clear and powerful message to everybody who is paying attention.

I hope this includes you too.

For good measure: the RBA is not playing local politics, and neither should Australian investors (not when it concerns their investment portfolio). This is not about whether you are a conservative, a hardliner, somewhere in the middle, or at the extreme left. This is about taking responsibility in the management of your investment portfolio by acknowledging there is a new type of risk, and you need to address it.

In the words spoken by Guy Debelle, what we are dealing with today can no longer be viewed as "cyclical"; long term trends are changing. This means any impact can no longer be interpreted as "temporary". Instead, investors have to start thinking in terms of long term impacts, if not permanent changes.

The implications are broad and varied, affecting the way businesses structure and run their operations, to how investors treat and value these businesses, to how governments prepare and respond, and to how central banks set interest rates and inflation/unemployment targets.

Ultimately, Debelle's speech makes it very clear, this is no longer a problem specifically for grape growers and milk farms and other types of agricultural companies and their suppliers and insurers; this is now a major change affecting whole economies and everybody who lives and works and operates in it.

Be smart. Deal with it.

The RBA is far from a front runner when it comes to putting the changing climate on its policy and analysis radar. Put APRA and climate in Google search and you'll find the local regulator for the financial sector has been addressing the topic for at least two years now, and with multiple repeats.

Debelle's speech can be downloaded from the RBA website:

https://www.rba.gov.au/speeches/2019/sp-dg-2019-03-12.html

I highly recommend you do. Read it multiple times. Observe the implications of the chart on page eight. China is less and less reliant on coal for its energy usage, and more and more on renewables. To borrow from the RBA's core message: while these are long-winded processes, this is not cyclical. This is a long term trend changing.

FNArena started its own ESG Focus section on the website in 2018:

https://www.fnarena.com/index.php/financial-news/daily-financial-news/category/esg-focus/

If you are truly interested in what is happening in the world of coal, I highly recommend reading the stories FNArena has published thus far (including one on Tuesday morning). I cannot speak highly enough of the research and analysis done by journalist Sarah Mills, with more follow-ups in the offing. I think Sarah is doing a fan-tas-tic job.

Ultimately, for investors, this is not about making a political statement. This is about adapting to a rapidly changing world. FNArena, the RBA, and APRA, are merely providing tools and a framework. The rest is up to you.

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

Weekly Ratings, Targets, Forecast Changes

By Rudi Filapek-Vandyck, Editor FNArena

Guide:

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

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

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

Summary

Period: Monday March 11 to Friday March 15, 2019 Total Upgrades: 3 Total Downgrades: 8 Net Ratings Breakdown: Buy 42.12%; Hold 43.11%; Sell 14.77%

The end of a busy February reporting season has significantly reduced the research output by stockbrokers, but this has not prevented sell-side analysts from continuing to issue more downgrades than upgrades for ASX-listed stocks. The fact the ASX200 might be hovering near 6200 might have something to do with it.

For the week ending Friday, 15th March 2019, FNArena registered eight downgrades versus only three upgrades. All upgrades shifted to Buy or an equivalent of Buy.

The stand-out observation, perhaps, is that ANZ Bank received two downgrades during the week, of which one went to Sell. See also the news story on ANZ Bank's queue of downgrades we published on Friday.

Changes to valuations and price targets remain benign, with only IPH ltd, EclipX Group and Hotel Property Investments worth mentioning. Virtually nothing seems to be happening on the negative side with Origin Energy's -2.2% reduction the week's largest, followed by ANZ Bank.

There is more action in the week's tables for changes to earnings forecasts, with the underlying trend remaining positive, albeit largely carried by resources companies. Notable exceptions are Fisher & Paykel Healthcare and Megaport.

On the negative side, Western Areas is experiencing significant pull back in analysts' forward projections, but otherwise energy producers, clearly, are suffering from falling oil price forecasts, while TPG Telecom, Nufarm, InvoCare and OZ Minerals are all experiencing small declines in forecasts.

There are a handful of companies reporting this week, and there always remains plenty of macro to keep investors' attention firmly focused in March.

Upgrade

APPEN LIMITED ((APX)) Upgrade to Buy from Neutral by Citi .B/H/S: 1/1/0

Following the proposed acquisition of Figure Eight Citi upgrades to Buy from Neutral. The broker believes this is a complementary acquisition that will provide the technology, platform and expertise to enable material scale and improved productivity.

The Figure Eight business was loss-making in FY18 and the broker's estimates for FY19 operating earnings (EBITDA) drop -8%. although FY20 and FY21 estimates are increased by 6% and 30% respectively. Citi raises the target to $28.04 from $23.29.

IPH LIMITED ((IPH)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 2/1/0

Macquarie believes IPH is well-positioned in the three-way merger tussle, as the Qantm ((QIP)) merger deal with Xenith ((XIP)) remains subject to a number of hurdles.

Importantly, there is the opportunity for a competing proposal should it emerge and Macquarie calculates there is material accretion potential.

The broker upgrades to Outperform from Neutral and raises the target to $7.10 from $6.00. The broker factors in earnings upgrades driven by FX and a multiple re-rating, with M&A risk skewed to the upside.

THE STAR ENTERTAINMENT GROUP LIMITED ((SGR)) Upgrade to Outperform from Neutral by Credit Suisse .B/H/S: 7/0/0

Credit Suisse believes the stock could soon break out of its trading range. The broker upgrades FY21 estimates for operating earnings (EBITDA) by 2% and FY22 by 5%.

The stock has been trading at a discount to fair value because of the impending opening of Crown Sydney.

Credit Suisse also believes Star Entertainment's multiple will expand to 9.0x from 8.5x for its domestic casinos, including Brisbane, as investor confidence in the prospects of new capacity grows.

The broker believes the stock is inexpensive and upgrades to Outperform from Neutral. Target is raised to $5.50 from $5.15.

Downgrade

AUSTRALIA & NEW ZEALAND BANKING GROUP ((ANZ)) Downgrade to Underweight from Equal-weight by Morgan Stanley and Downgrade to Neutral from Outperform by Credit Suisse .B/H/S: 2/5/1

Morgan Stanley believes pressure on the bank's revenue is growing and positive surprises on costs are unlikely.

While ANZ's business mix should have scope to adapt to an increasingly difficult operating environment, the broker believes the bank is currently facing execution challenges in Australian retail & business banking, with housing loan and deposit growth below system.

Recent results have enhanced the bank's credibility on cost management but the broker suggests it is unlikely to beat forecasts for a -1% decline in underlying expenses this year.

Morgan Stanley downgrades to Underweight from Equal-weight and reduces the target to $25 from $26. Industry view: In-Line.

Credit Suisse points out ANZ's recent announcement, that it may have been too conservative in its approach to mortgage lending, has been interpreted by some that this is an inflection point for growth.

The broker suggests this is not the case and the earliest there is likely to be a change is at the end of FY19.

The broker also suspects the bank may pause capital management, and it may be less than expected. Credit Suisse assesses the next initiative is not likely until FY20 and decreases buyback estimates by $1.5bn.

Earnings estimates are downgraded by -3-8% over the forecast period and the target reduced to $28 from $30. Rating is downgraded to Neutral from Outperform.

AUSNET SERVICES ((AST)) Downgrade to Hold from Add by Morgans .B/H/S: 0/6/0

Morgans downgrades to Hold from Add following the outperformance of the share price. Target is $1.73, up from $1.71. The next event is the FY19 results release on May 13, and the broker expects a reduction to earnings.

This should also include first time FY20 distribution guidance, which the broker assumes will be flat.

Morgans believes the share price has been driven by falling government bond rates and a switching to Ausnet from Spark infrastructure ((SKI)) because of the latter's tax issues and reduction in its distribution outlook.

HOTEL PROPERTY INVESTMENTS ((HPI)) Downgrade to Hold from Accumulate by Ord Minnett .B/H/S: 1/2/0

The company's major tenant, Coles ((COL)) has entered a joint venture with Australian Venue Co in relation to its hotel operations.

Ord Minnett expects that bringing in an experienced venue operator should drive an stronger operating performance and, in turn, reduce the risk around the exercise of options, while improving the revaluation outcomes.

The broker also believes Australian Venue Co will be more willing to partner with Hotel Property in exploring growth opportunities in hotels and accommodation compared with Coles.

As the stock is trading in line with the broker's unchanged $3.20 target the rating is downgraded to Hold from Accumulate.

MEDIBANK PRIVATE LIMITED ((MPL)) Downgrade to Underperform from Neutral by Credit Suisse .B/H/S: 1/3/3

Credit Suisse finds considerable uncertainty prevails for FY20 and FY21 earnings and does not envisage much upside for the share price. The broker finds listed health insurers expensive.

Private health insurance profit growth has been slowing recently, driven by a slowdown in premium growth and a stabilising of the margin.

Hence, the broker downgrades to Underperform from Neutral. The main risks to the negative view are acquisitions, funded from the debt-free balance sheet. Target is steady at $2.50.

ORIGIN ENERGY LIMITED ((ORG)) Downgrade to Equal-weight from Overweight by Morgan Stanley .B/H/S: 5/3/0

Morgan Stanley downgrades energy market earnings estimates and the company's valuation multiple. The broker revises its renewable power purchase agreement forecasts, deferring an FY20 earnings tailwind of around $65m.

Morgan Stanley is also more cautious about FY21 gas margins. The broker downgrades to Equal-weight from Overweight as the stock is up 11% so far this year.

The broker believes de-leveraging is now factored into the share price. Target is reduced to $7.67 from $8.43. Industry view is Cautious.

SANTOS LIMITED ((STO)) Downgrade to Neutral from Buy by UBS .B/H/S: 3/5/0

As the stock is up 24% in the year to date, UBS downgrades to Neutral from Buy. The fact the company operates around 80% of its forecast production growth provides confidence that it will achieve a target of over 100mmboe by the end of 2025.

However, the broker believes the risk/return profile is now largely reflected in the current price. Estimates for earnings per share through 2019-21 are reduced to reflect a lower oil price outlook. Target is reduced to $7.00 from $7.20.

WOODSIDE PETROLEUM LIMITED ((WPL)) Downgrade to Neutral from Buy by UBS .B/H/S: 3/5/0

UBS downgrades Woodside to Neutral from Buy, believing growth in a more subdued oil price environment is now factored into the share price.

The broker forecasts oil prices to remain at US$70/bbl to the end of 2024.

The broker reduces net asset valuation by -5% to reflect fewer growth opportunities and lower cash flow associated with producing assets. Target is lowered to $35.25 from $37.30.

Total Recommendations Recommendation Changes

Broker Recommendation Breakup

Broker Rating Order Company New Rating Old Rating Broker Upgrade 1 APPEN LIMITED Buy Neutral Citi 2 IPH LIMITED Buy Neutral Macquarie 3 THE STAR ENTERTAINMENT GROUP LIMITED Buy Neutral Credit Suisse Downgrade 4 AUSNET SERVICES Neutral Buy Morgans 5 AUSTRALIA & NEW ZEALAND BANKING GROUP Neutral Buy Credit Suisse 6 AUSTRALIA & NEW ZEALAND BANKING GROUP Sell Neutral Morgan Stanley 7 HOTEL PROPERTY INVESTMENTS Neutral Buy Ord Minnett 8 MEDIBANK PRIVATE LIMITED Sell Neutral Credit Suisse 9 ORIGIN ENERGY LIMITED Neutral Buy Morgan Stanley 10 SANTOS LIMITED Neutral Buy UBS 11 WOODSIDE PETROLEUM LIMITED Neutral Buy UBS Recommendation Positive Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 IPH IPH LIMITED 67.0% 50.0% 17.0% 3 2 SGR THE STAR ENTERTAINMENT GROUP LIMITED 100.0% 86.0% 14.0% 7 3 HPI HOTEL PROPERTY INVESTMENTS 33.0% 25.0% 8.0% 3 4 ECX ECLIPX GROUP LIMITED 25.0% 20.0% 5.0% 4 5 NUF NUFARM LIMITED 86.0% 83.0% 3.0% 7 Negative Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 ANZ AUSTRALIA & NEW ZEALAND BANKING GROUP 6.0% 31.0% -25.0% 8 2 MPL MEDIBANK PRIVATE LIMITED -31.0% -19.0% -12.0% 8 3 WPL WOODSIDE PETROLEUM LIMITED 38.0% 50.0% -12.0% 8 4 STO SANTOS LIMITED 38.0% 50.0% -12.0% 8 5 ORG ORIGIN ENERGY LIMITED 63.0% 75.0% -12.0% 8 6 WSA WESTERN AREAS NL 67.0% 71.0% -4.0% 6 Target Price Positive Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 IPH IPH LIMITED 6.377 6.165 3.44% 3 2 ECX ECLIPX GROUP LIMITED 2.433 2.366 2.83% 4 3 HPI HOTEL PROPERTY INVESTMENTS 3.263 3.175 2.77% 3 4 SGR THE STAR ENTERTAINMENT GROUP LIMITED 5.553 5.503 0.91% 7 Negative Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 ORG ORIGIN ENERGY LIMITED 8.199 8.385 -2.22% 8 2 ANZ AUSTRALIA & NEW ZEALAND BANKING GROUP 28.288 28.663 -1.31% 8 3 WPL WOODSIDE PETROLEUM LIMITED 36.105 36.361 -0.70% 8 4 STO SANTOS LIMITED 6.900 6.925 -0.36% 8 Earning Forecast Positive Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 FMG FORTESCUE METALS GROUP LTD 82.536 76.489 7.91% 8 2 FPH FISHER & PAYKEL HEALTHCARE CORPORATION LIMITED 33.782 31.438 7.46% 5 3 MP1 MEGAPORT LIMITED -27.150 -29.000 6.38% 3 4 RIO RIO TINTO LIMITED 894.564

842.530 6.18% 8 5 NHC NEW HOPE CORPORATION LIMITED 51.300 48.967 4.76% 3 6 OGC OCEANAGOLD CORPORATION 18.770 18.034 4.08% 6 7 MHJ MICHAEL HILL INTERNATIONAL LIMITED 6.367 6.175 3.11% 4 8 BHP BHP GROUP 266.458 260.911 2.13% 8 9 SUN SUNCORP GROUP LIMITED 74.729 73.900 1.12% 8 10 CSL CSL LIMITED 573.046 570.592 0.43% 8 Negative Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 WSA WESTERN AREAS NL 2.526 6.538 -61.36% 6 2 TPM TPG TELECOM LIMITED 35.257 37.829 -6.80% 6 3 NUF NUFARM LIMITED 39.074 41.134 -5.01% 7 4 IVC INVOCARE LIMITED 53.633 54.467 -1.53% 7 5 OZL OZ MINERALS LIMITED 58.941 59.799 -1.43% 8 6 OSH OIL SEARCH LIMITED 37.312 37.756 -1.18% 8 7 STO SANTOS LIMITED 46.482 46.974 -1.05% 8 8 WPL WOODSIDE PETROLEUM LIMITED 222.199 224.068 -0.83% 8 9 PMV PREMIER INVESTMENTS LIMITED 82.512 82.852 -0.41% 6 10 ANZ AUSTRALIA & NEW ZEALAND BANKING GROUP 227.886 228.600 -0.31% 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: Lacking Buyers

The spot uranium price continues to fall as US utilities remain out of the market.

-Uranium spot price down -6% in 2019 -US utilities staying away -Spike in trading volume misleading, according to TradeTech

By Greg Peel

It was a busy week last week in the spot uranium market, with a sizeable volume of 2.6mlbs U3O8 equivalent changing hands. The volume is nevertheless misleading, industry consultant TradeTech reports.

The week featured a number of back-to-back deals tied to delivery location, timing and/or counterparty risk, such that several lots of material changed hands multiple times throughout the week.

For some months now, and as is often the case, spot prices have varied depending upon where the material is to be delivered to – US, Canada or Europe. This means a buyer can pay more in one location than a seller is prepared to sell at the other. Add in other vagaries of delivery timing and counterparty risk and what TradeTech comes up with is a weekly spot price “indicator”.

It’s not an exchange-traded market.

While utilities were involved to some extent on the buy-side last week, a majority of US utilities have withdrawn from the market as they await a section 232 decision from the Department of Commerce. The issue for uranium markets is they could be waiting for some time.

This lack of near term demand has led to a drift down in the spot uranium price in recent weeks. As we approach the end of the March quarter, sellers have become more keen to offload material. TradeTech’s spot price indicator fell -US$1.10 last week to US$27.00/lb.

The spot price is now down -6.1% in 2019 year to date but remains 24% higher year on year.

TradeTech’s term price indicators remain at US$30.00/lb (mid) and US$32.00/lb (long).

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The Short Report

Guide:

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

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

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

Summary:

Week ending March 14, 2019

Last week saw the ASX200 come tumbling down from a failed attempt to revisit recent highs, an attempt that was driven by the euphoria of the RBA dropping its “next move in rates likely up” mantra. Never mind the reasons behind the change.

In the week before it had appeared shorters had taken a bit of post-result season break but last week it was back to business, as a sea of red in the table below might suggest.

Most of the moves were only small, representing bracket creep, with a couple of exceptions.

If any stock has a Gold Pass to the elite 10%-plus shorted club it's JB Hi-Fi ((JBH)), which but for a couple of brief holidays has lived at the club for over a decade. The fact the stock has risen 770% since March 2009 highlights the fact the shorters have continued to flog a dead horse over that time, but this never seems to deter them.

JB Hi-Fi shorts rose to 15.4% last week from 13.2%, most likely, in today’s thinking, on a “short bricks & mortar” play. Will JB shorters ever see their chooks come home to roost?

Other short positions moves of one percentage point or more were noted last week for NextDC ((NXT)) and CSR ((CSR)). See below.

Weekly short positions as a percentage of market cap:

10%+ SYR 17.4 ING 17.2 GXY 16.3 JBH 15.4 NXT 12.8 ORE 12.4 BWX 11.5 MTS 11.3 SDA 10.7 MYR 10.7 BAL 10.1

Out: IVC

9.0-9.9

IVC, IFL, DMP, PLS

In: IVC, IFL, PLS 8.0-8.9%

SUL, HVN, BOQ, LYC, BKL

In: BOQ, LYC, BKL Out: IFL, PLS

7.0-7.9%

HUB, AMC, CSR, NUF, MSB, AMP, SGM, RWC

In: CSR, SGM, RWC Out: BKL, BOQ, LYC

6.0-6.9%

BEN, BIN, DHG, KGN, CCP, CGF

In: KGN, CCP , CGF Out: SGM, RWC, RSG

5.0-5.9%

APT, KDR, BGA, RSG, WSA, PPT, HT1, MLX, NSR, CAR, ARB, GMA A2B, NAN

In: RSG, PPT, HT1, MLX, NSR Out: CSR, CCP, CGF, A2B, NAN

Movers & Shakers

There's been no new news out of data centre operator NextDC since its earnings result sparked a share price plunge in February. As one of those "new world" stocks that tend to run ahead of themselves, any stumble was always going to be met with punishment.

When NextDC built its first round of capital city data centres capacity filled up very quickly, so the company spent big to build another round of larger centres, and unsurprisingly take-up has not been at the same pace as previously. Analysts aren't that concerned, although a pick-up in Melbourne would be welcomed, and NextDC's share price has plateaued ever since.

But last week the shorters moved the stock up to 12.8% from 11.1%.

Today's CSR is a far cry from the Colonial Sugar Refinery that gave the company its name. Once known as "Sugars" on the old stock exchange, CSR is now strictly a building materials company with a focus on aluminium. But a while back CSR made an ill-fated foray into glass when it acquired Viridian.

Late last month the company announced, to the great relief of the market, it had disposed of Viridian and would use the proceeds to fund a share buyback. Last week CSR shorts rose to 7.6% from 5.9%. This might seem like a gamble for a stock supported by a buyback, but analysts suggest that support will only be temporary before pressure on aluminium earnings is the primary focus.

ASX20 Short Positions (%)

Code Last Week Week Before Code Last Week Week Before AMC 7.6 7.2 RIO 4.8 4.6 ANZ 1.6 1.6 S32 0.9 0.9 BHP 4.0 3.5 SCP 0.8 0.6 BXB 0.4 0.3 SUN 0.8 0.8 CBA 2.2 2.0 TCL 1.5 1.3 COL 2.2 2.3 TLS 0.9 0.7 CSL 0.3 0.3 WBC 2.0 2.0 IAG 0.6 0.5 WES 1.9 1.8 MQG 0.5 0.4 WOW 2.8 2.7 NAB 1.7 1.4 WPL 0.6 0.6 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: Insurers, Telcos, Asset Managers

Weekly Broker Wrap: supermarkets; general insurance; health insurance; telcos; asset managers; and industrial earnings.

-Loyalty drops to fourth as a driver of shopping decisions in UBS survey -Market share of major general insurers continues to slip -Better claims performance for health insurers expected to persist -Mooted NBN changes signal disadvantage to providers with lower-tier customers -Asset managers and wholesale banks are under pressure and need to define a growth agenda - Morgan Stanley

By Eva Brocklehurst

Supermarkets

A UBS survey of 1100 shoppers in February was positive for Woolworths Group ((WOW)), slightly positive for IGA, supplied by Metcash ((MTS)), and negative for Coles Group ((COL)) & Aldi.

Convenience and price remain the driver of consumption. Woolworths performed the best across price measures, ahead of Coles, albeit slightly, for the first time since the studies began. Loyalty dropped to fourth as the driver of shopping decisions, which surprised UBS, particularly given the heightened investment in tailored offers and the use of customer data.

Woolworths appears to have accelerated its market share gains, at the expense of Coles. UBS envisages upside to second half growth estimates for Woolworths and downside for Coles.

Meanwhile, IGA market share trends were up modestly and the broker envisages accelerated store refurbishment and more consistent pricing as catalysts for future growth. UBS retains a Buy rating on Woolworths and Metcash and a Sell rating for Coles.

General Insurance

UBS finds the consistent slippage of market share for both Insurance Australia Group ((IAG)) and Suncorp Group ((SUN)) presents a confronting longer-term view. The broker has retained an overweight position on the sector, noting a high level of momentum in personal line rates across motor & home, despite overall gross written premium (GWP) growth being below the challenger brands.

This should add modest upward pressure to the widening of margins over the next 12 months that is being driven predominantly by a hardening of commercial rates. Still, obvious questions about vulnerability remain, UBS acknowledges, should a meaningful disruptor emerge at some point.

A sceptical view of challengers has been based on the probability they would not be able to sustain high growth and deliver acceptable profitability at the same time, and would have greater volatility when costs from catastrophic events were elevated. However, UBS calculates that both the absolute level of challenger loss ratios and the change relative to the first half of FY18 counter this view. Challengers have acquired 4.1% market share over the past five years and now write $2bn in GWP.

Health Insurance

Macquarie's analysis shows industry headwinds are mounting for health insurers, as participation continues to contract and the potential for a 2% cap to pricing under a Labor government nears. The broker maintains a Neutral rating for both nib Holdings ((NHF)) and Medibank Private ((MPL)) heading into the May federal election.

Current valuations remain supportive but the broker does not believe the margin risks are completely priced in. Moreover, the analysis shows that Medibank Private achieved claims growth per policyholder that was around -270 basis points below industry averages in the first half and nib Holdings was lower by -230 basis points.

Both companies are confident claims outperformance will persist in the medium term owing to chronic disease management, the acquisition of healthier lives and more facilities to take claims out of the hospital setting. Should a 2% average cap to price be imposed, Macquarie believes those insurers and hospitals with scale will outperform.

Telcos

Press reports have suggested that the NBN is preparing for further changes to wholesale pricing. Credit Suisse estimates that monthly NBN access costs for 12Mbps customers could effectively increase 8.5% following the changes, primarily because of the removal of dimension-based discounts.

The 12Mbps plan cost to the retail services provider would also be much closer to the cost of the 50Mbps wholesale bundle, despite being a lower speed tier with less bandwidth provision. The broker suggests this will disadvantage those providers that have a greater proportion of lower-tier customers and illustrates the NBN strategy of heavily pushing the adoption of 50Mbps plans.

Given both TPG Telecom ((TPM)) and Vocus Group ((VOC)) have a greater proportion of customers and lower-speed plans the broker continues to expect this dynamic will increase the access costs for these companies. Nevertheless, the proposed changes appear to be appropriately factored into Credit Suisse estimates and these are unchanged.

Asset Managers

Morgan Stanley believes the asset management sector is ex growth. Valuations are at historical lows and, globally, traditional asset managers have de-rated around -25% since the beginning of 2018. The broker envisages an alternative path to attractive pockets of growth in emerging markets/China and private markets. However, companies must be able to afford the requisite investment over a multi-year horizon.

Defining a growth agenda is now seen as imperative and is likely to become a differentiator among stocks, Morgan Stanley asserts. Asset managers and wholesale banks are under increasing investor pressure, facing falling margins. The broker believes they need to respond to the commoditisation of market/benchmark returns caused by passive investment.

The broker asserts, while costs can be higher, more possibilities now exist to restructure consistently challenged businesses. Management needs to decide on strategies in China as well, as its markets open up. A growing pool of externally managed assets under management is an opportunity for foreign asset managers.

Morgan Stanley also notes, in the battle to adapt and leverage new technology, established firms with capital, as well as new entrants, are seeking to out-compete slow-moving incumbents.

Those who become winners will have leveraged their data advantage in providing new client solutions, the broker deduces. Hence, those with the weaker starting point are increasingly being disadvantaged. They will have to balance demands to defend core markets with a need to follow the money and find long-term growth.

Morgan Stanley believes asset managers need to restructure core active business as that revenue pool is set to shrink at around -9% annually. They need to be ready to compete at a lower price point and plan to take out -30% of core costs, critical to funding growth and ensuring survival in active investment.

Industrial Earnings

As policy responses are firmly in the reactive camp, Morgan Stanley expects continued pressure on earnings for the industrial sector. When breaking down the outlook for the ASX200's three super-sectors, financials, resources and industrials, the broker's model suggests an earnings recession is likely for the non-resource sectors as domestic factors hold sway.

Prior earnings recessions have been predominantly linked to the resource/global growth cycle. However, Morgan Stanley believes the domestic-led nature of the next episode of earnings weakness will increase the depth and length of the downturn.

The broker assesses the ASX200 is heavily discounting the ultimate earnings risk linked to the current financial de-leveraging being experienced in the economy and by consumers.

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

Elders Dampens Outlook As Drought Holds

Difficult conditions in rural Australia have dampened the outlook and Elders expects first half earnings will be materially lower.

-Guidance incorporates a material improvement in the second half -Costs likely to start rising -Have agricultural stocks dropped to "buy" levels

By Eva Brocklehurst

Severe drought on the east coast, lower wool volumes and a steep fall in cattle prices have combined to drag on the outlook for rural services business Elders ((ELD)).

FY19 guidance is been revised to earnings (EBIT) of $72-75m, down -3.5% on FY18, and earnings in the first half will be materially lower than the prior corresponding half, at $45.7m. Flat retail earnings are expected, with growth initiatives such as the Titan acquisition expected to offset the reduced summer crop. First half results will be reported on May 20.

Brokers understand that guidance includes a material improvement in the second half, with better winter crop conditions and a recovery in the cattle price from current lows. However, while this can be reasonably assumed, the bias is considered to be to the downside.

Morgans expects underlying net profit of $28.3m in the first half, down -29%, and remains cautious about operating conditions, reducing FY19 and FY20 forecasts for net profit by -12.2% and -11.9%, respectively. Given the steep fall in the share price recently, the broker believes tough conditions are factored into the stock and upgrades to Hold from Reduce.

Wilsons suspects the five-year run of strong cost containment has ended. In the five years to FY18 the broker estimates cost reductions generated around $40m in improvements to operating earnings. A period of investment on IT infrastructure subsequently ensued, and the broker suspects operating expenditure has increased. Costs have also increased in personnel and marketing. Wilsons sticks with a Hold rating and has a $5.79 target.

Bell Potter had assumed there would be around $50m in new acquisitions in FY19 that would make a meaningful contribution to the results for the year. Now, the broker scales back expectations and downgrades net profit forecasts by -14% for FY19 and -9% for FY20.

Bell Potter acknowledges that achieving guidance for FY19 is dependent on a better winter season and, if this fails to materialise, this could mean a further -$10-15m risk to operating earnings (EBITDA). The broker believes the point in the cycle has been reached where seasonal downgrades for agricultural stocks can be bought, and upgrades to Buy from Hold. The broker's target is $6.70.

Corporate Activity

In terms of the recently-announced bid by Nutrien for Ruralco ((RHL)), Morgans believes, should the takeover proceed, Elders will be competing with a much larger peer group and this, potentially, removes the corporate appeal that was previously attached to the stock. At the same time, the broker suspects Elders should benefit from any downside from the merged group, although this is difficult to quantify.

Given management's comment and strict financial discipline, Morgans does not expect Elders to bid for Ruralco.

Nutrien is a US$32bn company that owns Landmark, which is the largest operator in Australia's rural services industry, and well ahead of both Elders and Ruralco. Given the ACCC did not oppose the proposed merger of Elders and Ruralco in 2013, Morgans does not believe competition concerns will impede the transaction.

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Infigen Pursues Growth Despite Volatility

Infigen Energy continues to focus on several renewable energy channels, pursuing growth amid volatility in the electricity market.

-Expected to aggressively pursue growth in firming capacity -Stock price implies value below replacement cost of generation assets -Capital management opportunities exist

By Eva Brocklehurst

Visibility of earnings for Infigen Energy ((IFN)) is improving, with a large portion of FY19 production under contract. The company, which is a developer and operator of wind and solar assets across Australia, expects growth of 14% in production in FY19, as Bodangora wind farm in NSW comes on line.

The company continues to focus on several channels amidst the volatility in the electricity market. Most recent developments are the Lake Bonney battery and Cherry Tree wind farm in South Australia. Guidance for average pricing of $125-130/megawatt-hour was provided at the first half results, around -6% below the FY18 price guidance, while realised pricing in the first half was down -5%.

Canaccord Genuity expects the company to aggressively pursue growth in firming capacity - the maintenance of committed levels of power output from renewable power plants - and apply a capital-light strategy to traditional renewable developments. This should also lead to less earnings volatility.

The company is heavily contracted over the medium term, the broker notes, which excludes any potential uplift from the ramp-up of Sydney Water's desalination plant. Energy policy continues to remain an uncertainty at a federal level, although the broker suggests a win by the Australian Labor Party should benefit the sector.

South Australian electricity futures appear robust and Canaccord Genuity's forecast is slightly ahead of the company's pricing guidance, at $131/megawatt-hour. Canaccord Genuity retains a Buy rating and $0.88 target, noting the stock trades at a discount to book value, as well as replacement costs.

Ord Minnett also has a Buy rating and $0.80 target, agreeing that the stock price implies a value that is less than the replacement cost of the generation assets. The highlight of the recent results was the strong growth in commercial and industrial (C&I) retailing.

The broker continues to take a conservative view of that side of the business, assuming no growth and lower margins. Ord Minnett estimates the C&I retailing business contributed $20m in revenue and a 50% gross margin in the first half, which shows the company's strategy has had some success.

Despite macro headwinds, the broker is largely positive about valuation, estimating the stock is implying a valuation of $1450/kilowatt installed capacity versus the capital expenditure required to build new wind farms of $2000/kilowatt.

Capital management opportunities exist post debt re-financing, Macquarie observes. The company will consider a distribution with the FY19 results and the broker expects a small pay-out, although acknowledges a buyback may emerge.

The amount of distribution will be subject to the company's capital intentions going forward, as well as the wholesale pricing environment. Macquarie believes Infigen Energy has performed strongly on costs and there is valuation support, retaining an Outperform rating and $0.78 target.

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New Freedom Foods Product Keenly Awaited

Freedom Foods is now less likely to be in the bidding for Lion Dairy & Drinks. This would be a positive signal to brokers, putting the focus squarely on new product development.

-Acceleration in FY20 earnings and margins expected -Is the growth profile captured in the share price -Full extent of Shepparton milk processing upgrade to be realised in FY20

By Eva Brocklehurst

Demand for its varied food and drink products should underpin Freedom Foods ((FNP)), as will the scaling up of new facilities and a focus on higher-margin dairy nutrition products.

Some 60 new products are being launched in the second half, which will go into retail grocery, food service and export markets, supported by increased expenditure on marketing. In the second half, the company is commercialising native whey protein isolate and lactoferrin, with a material earnings contribution expected in FY20.

Management expects an acceleration in FY20 earnings and margins, as benefits from new products and channels to market are realised. In the second half, the company is commercialising native whey protein isolate and lactoferrin, with a material earnings contribution expected in FY20.

Freedom Foods expects FY19 sales to be at the lower end of the guidance range of $500-530m. At the lower end, Morgans calculates this implies growth of 42%. The broker points out that guidance on an EBITDA basis would be preferable to sales, given the company has many products that generate different margins.

The latest climate outlook for Victoria and NSW indicates that a worsening of the current drought conditions is less likely. Average farmgate prices have risen to $6.03/kgMS for FY19 as milk production has fallen -7% in the year to January over the two states.

Citi believes Freedom Foods is somewhat spared short-term milk price movements, as it has long supply contracts and already pays higher prices to its farmers. The broker expects the operating earnings (EBITDA) margin to expand by over 282 basis points to FY20, supported by nutritionals and the dairy ramp up.

UBS agrees the company's growth trajectory is on track, estimating FY19-22 compound growth of 55% in earnings per share, which should underpin a FY19 price/earnings (PE) ratio of 54x. The broker expects higher margin branded sales growth should offset the annualisation of sales reductions from the exit of contract manufacturing.

While exiting these contracts may have a short-term impact on profitability, Morgans assesses over the medium term this is the right strategy. The company is expected to benefit from strong demand across Australia, Asia and the Middle East.

The stock may be leveraged to growth trends across the food and beverage industry but the broker considers the growth profile is captured in the share price. Morgans suspects the reported interest in the Lion Dairy & Drinks portfolio may overhang the stock until an outcome is known.

Lion Dairy & Drinks

Citi believes it is reasonable to assume that, as Coca-Cola Amatil ((CCL)) is not pursuing a bid for Lion Dairy & Drinks, a deal is also off the radar for Freedom Foods. Media speculation had indicated that Freedom Foods was considering a joint bid with Coca-Cola Amatil.

This is a positive development, the broker asserts, as a potential overhang has now been lifted from the share price. There may have been upside for Freedom Foods in gaining access to the Lion Dairy & Drinks milk supply and using Coca-Cola Amatil's extensive distribution network. However, this would require an equity raising and could delay margin expansion. The broker believes Freedom Foods has enough growth for the medium term without the acquisition.

The upside risks, Morgans considers, are further accretive organic growth and acquisition opportunities. The main risks include management of rapid growth, commissioning, and raw material supply. Morgans maintains a Hold rating, believing with the stock trading on a high PE there is no room for disappointment.

UBS does not expect the full extent of the company's capital investment program at Shepparton to be realised until FY20, foreseeing operating earnings margins of 14.8% versus 11.1% in FY19. The company is increasing processing capacity to 500m litres from 250m and will process over 250m litres in FY19.

This increased capacity will allow the company to sell other value-added product including functional and medical grade dairy-based beverages, drinking yoghurt and cream. Morgans points out the business is seasonally skewed to the second half and this may be even greater this year as new facilities scale up.

FNArena's database shows two Buy ratings and one Hold. The consensus target is $6.02, suggesting 28.6% upside to the last share price. Targets range from $6.60 (UBS) to $4.90 (Morgans).

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Central Banks Keep The Worries Away

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

-Central Banks Keep The Worries Away -BC *Extra* Puts Small Caps In Focus -Changing Climate Has RBA's Attention -Conviction Calls -February Reporting Season: Final Observations -Rudi On TV -Rudi On Tour

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

By Rudi Filapek-Vandyck, Editor FNArena

Central Banks Keep The Worries Away

One of the curious characteristics of the 2019 rally in global equities is that while most commentators have been zooming in on the AbFab V-shaped performance against all odds, in the background investors have been withdrawing their money, leading to quite large net outflows which tend to indicate widespread unease and discomfort rather than the bullish view and optimism one might infer from face value index performances.

This observation has led to at least one strategist (Citi's Robert Buckland) to conclude "Buybacks, not investor inflows, now drive the US market".

While part of the global money flows can be explained by investors preferencing passive ETFs over active fund managers (unsurprisingly given many of the latter's dismal performances in 2018), outside of the US money continues to flow out of markets in Japan, China and the rest of Asia, as well as away from equities in the UK and Europe.

Bonds are the biggest beneficiaries, believe it or not. So much for the Armageddon predictions by all too eager inflation hunters and otherwise end-of-bond-bull-market doomsayers. More stimulus from central bankers ("expectations of") means bond yields go down, thus bond prices move up.

Whereas 2018 proved a rather difficult year for global bonds, at least as far as money flows are concerned, net inflows for global bonds have been positive in each of the first three months thus far in 2019.

So where does this leave us regarding prospects for equity markets?

If we take a negative view, we could interpret the latest global industry data as a firm warning signal; investors, clearly, are sceptical about whether equity indices should be at current levels. Global economic growth is still decelerating, and Trump's USA is no longer the exception.

In Australia, it's easy to get excited by a recovery in banks share prices and ongoing strong gains by large mining stocks, but investors should not lose sight of the fact the February reporting season, underneath the apparent share price responses, wasn't good; it wasn't good at all. If anything, February exposed more headwinds and weaknesses than most of us were expecting.

However, there is also the opposite view, in that if investors now have a large chunk of their cash outside of equity markets, this can potentially provide a big boost to markets if some or most of that cash starts flowing back in.

I am rather sceptical whether a trade deal between the Trump administration and China will be the catalyst for such a move. But an unexpectedly stronger performance from major economies certainly can. To borrow from US Fed communiques since 2016: markets remain data dependent.

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It is mostly a mug's game trying to predict short term directions of equity markets, but I haven't been too worried thus far in 2019. Yes, the V-shape recovery has come very quickly, and there are more than just a few reasonable question marks behind it all, but central bank support has proved such a powerful instrument in the post-GFC environment, it is almost an art not to let complacency take over in full.

The reasoning that is currently supporting equities globally is that economic data might still be looking ugly for the time being, central bankers in China, the US, Japan, the UK, and in Europe are ready, or have already started to reverse course and offer support to economies and equities.

In Australia, as we all know now, most economists with egg on their face having predicted interest rate hikes post 2016 are now forecasting one or two cuts later this year or in 2020.

Not everyone is convinced this will stop the downtrend in low quality apartments and consumer spending, but the share market is prepared to take a rose-tinted view towards the second half of the year, and this is why bad news and a less than stellar local reporting season have nevertheless allowed the ASX200 to surge near the post-GFC high from August last year, and not sell-off in a hurry since.

In the US, there seems to be an iron-clad conviction that profit growth for American companies will accelerate again later in 2019. As long as conviction in these projections remains intact, we can but wonder how much downside risk is there in the absence of adverse developments and left-field surprises?

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A while ago, analysts at Citi devised a Bear Market Checklist for global equities, which is largely based upon the experiences from the early 1990s, 2000-2003 and 2007-2009, and we should all know history might rhyme but it never repeats in exact the same fashion. Nevertheless, updates to the Checklist are usually widely copied, republished and distributed by investors who like to add some substance to their own share market optimism.

This month Citi has launched a similar Bear Market Checklist specifically for US equities. I think we can all agree on the fact that the outlook for the local share market is very much dependent on what happens in the USA, hence the importance of this new indicator.

As it turns out, the new Bear Market indicator seems to suggest conditions are nowhere near dire enough to worry about the next bear market for US equities.

The signals from all 20 variables in this new US Equity Bear Market Checklist as at 7 March 2019 are shown in the table below. There are no variables in the Danger zone and four in the Caution zone. The total score is not even close to worrisome levels. In 1990, 69% of the factors were highlighting risk, while in 2000, the number reached 89%. In 2007, it was 55%. The current reading (4 Caution signals out of 20 variables) is only 20%.

Nothing here suggests we can take this indicator at face value and simply forget about what happens next or in the rest of the world. What has Citi strategists worried, a little at this stage, is the fact that the Fed's latest Senior Loan Officers' Survey was disappointing. If this is now setting a new trend, less availability of credit might indicate the forthcoming economic performance for the US is more likely to disappoint, irrespective of the Federal Reserve deciding to sit on its hands and stop shrinking its ginormous balance sheet.

This would place one big question mark over those optimistic projections for US corporate profits in the second half, and probably -all else remaining equal- put downward pressure on equity prices.

But we're not there yet. Far from it.

Changing Climate Has RBA's Attention

Central bankers like to operate on a low public profile. They in particular don't like to be pulled into the messy processes of domestic politics, which is why last week's public speech by Guy Debelle, Deputy Governor at the RBA, should have every investor's attention.

The speech is titled "Climate Change and the Economy". Given everybody inside and around the RBA would have been well aware of the potential for becoming implicated in local politics, with NSW elections this coming weekend and Federal elections not far off after, the brazen and candid manner in which this "hot topic" has been addressed by the number two at the most important financial institution in the country..., well, need I really spell it out?

The RBA is sending a clear and powerful message to everybody who is paying attention.

I hope this includes you too.

For good measure: the RBA is not playing local politics, and neither should Australian investors (not when it concerns their investment portfolio). This is not about whether you are a conservative, a hardliner, somewhere in the middle, or at the extreme left. This is about taking responsibility in the management of your investment portfolio by acknowledging there is a new type of risk, and you need to address it.

In the words spoken by Guy Debelle, what we are dealing with today can no longer be viewed as "cyclical"; long term trends are changing. This means any impact can no longer be interpreted as "temporary". Instead, investors have to start thinking in terms of long term impacts, if not permanent changes.

The implications are broad and varied, affecting the way businesses structure and run their operations, to how investors treat and value these businesses, to how governments prepare and respond, and to how central banks set

interest rates and inflation/unemployment targets.

Ultimately, Debelle's speech makes it very clear, this is no longer a problem specifically for grape growers and milk farms and other types of agricultural companies and their suppliers and insurers; this is now a major change affecting whole economies and everybody who lives and works and operates in it.

Be smart. Deal with it.

The RBA is far from a front runner when it comes to putting the changing climate on its policy and analysis radar. Put APRA and climate in Google search and you'll find the local regulator for the financial sector has been addressing the topic for at least two years now, and with multiple repeats.

Debelle's speech can be downloaded from the RBA website:

https://www.rba.gov.au/speeches/2019/sp-dg-2019-03-12.html

I highly recommend you do. Read it multiple times. Observe the implications of the chart on page eight. China is less and less reliant on coal for its energy usage, and more and more on renewables. To borrow from the RBA's core message: while these are long-winded processes, this is not cyclical. This is a long term trend changing.

FNArena started its own ESG Focus section on the website in 2018:

https://www.fnarena.com/index.php/financial-news/daily-financial-news/category/esg-focus/

If you are truly interested in what is happening in the world of coal, I highly recommend reading the stories FNArena has published thus far (including one on Tuesday morning). I cannot speak highly enough of the research and analysis done by journalist Sarah Mills, with more follow-ups in the offing. I think Sarah is doing a fan-tas-tic job.

Ultimately, for investors, this is not about making a political statement. This is about adapting to a rapidly changing world. FNArena, the RBA, and APRA, are merely providing tools and a framework. The rest is up to you.

Rudi On TV

My weekly appearance on Your Money is now on Mondays, midday-2pm.

Rudi On Tour In 2019

-ASA Sydney Investor Hour, March 21 -ASA Melbourne, May 1 -ASA Toowoomba, Qld, May 20 -U3A Investor Group Toowoomba, Qld, May 22 -AIA Adelaide, SA, June 11 -AIA National Conference, Gold Coast, Qld, 28-31 July -AIA and ASA, Perth, WA, October 1

(This story was written on Tuesday 19th March 2019. Part One was published on the Tuesday in the form of an email to paying subscribers at FNArena, and again on Thursday as a story on the website. Part Two will be published as a story on the website on Friday).

(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: Banks, Cimic, Coles, And PWR Group

In this week's Weekly Insights (this is Part Two):

-Central Banks Keep The Worries Away -BC *Extra* Puts Small Caps In Focus -Changing Climate Has RBA's Attention -Conviction Calls -February Reporting Season: Final Observations -Rudi On TV -Rudi On Tour

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By Rudi Filapek-Vandyck, Editor FNArena

BC *Extra* Puts Small Caps In Focus

FNArena's daily Australian Broker Call Report focuses solely on eight stockbrokerages, and so does the permanent Corporate Results Monitor we are running all-year around on the website. This can have the disadvantage that sometimes smaller cap stocks, albeit promising and/or interesting, fall through the cracks, in particular when the team of journalists is extremely busy.

This year we have tried to compensate for this through two updates of the Australian Broker Call *Extra* Report; two editions published last week that are chock-a-block filled with lesser-known ASX-listed names such as Bigtincan Holdings ((BTH)), Elanor Investors Group ((ENN)), Fluence Corp ((FLC)), and Macquarie Telecom ((MAQ)), as covered by a wider group of brokers.

The added value is now that investors can also search for these companies on the website, with share price information and price charts included. Above all, for all that are specifically interested in finding the next small cap opportunities, there's a whole new bunch to read about, consider and add to your watch list.

We are awaiting for the tech development team to introduce an easy-to-locate archive for these *Extra* editions next to the archive for daily Broker Call Reports on the website. In the meantime, I have to admit it's not easy to find where exactly are these two special editions in between all the stories we publish and update every day.

Hence why I have included two direct links:

https://www.fnarena.com/index.php/2019/03/11/australian-broker-call-extra-edition-mar-11-2019/

https://www.fnarena.com/index.php/2019/03/13/australian-broker-call-extra-edition-mar-13-2019/

One of the obvious observations to make from these two *Extra* February reporting season-inspired updates is that small cap engineers and specialist services providers to miners and energy companies are back on analyst radars. Whereas many would argue the share price for a sector stalwart such as Monadelphous ((MND)) already reflects a lot of future optimism about both sectors ramping up spending in the years ahead, judging from a whole lot of comparable companies mentioned, this doesn't seem to be the case for everyone in that sector.

That idea is further fuelled by analysis such as the one published by UBS on 11 March recently, in that infrastructure construction spending across Australia is still looking healthy, offering engineers and contractors visible growth potential at least out to 2021 from public infrastructure spending on top of the resources sector.

UBS's favourites to play the theme are Seven Group ((SVW)), Downer EDI ((DOW)), and Cimic Group ((CIM)).

The main caveat here is that this theme is by no means new, and recent years have also exposed many disappointments for investors who jumped on board the wrong stocks, believing they could benefit from what, from the outside at least, looks like a cannot-lose situation for contractors. Wagners Holding ((WGN)) comes to mind, as well as RCR Tomlinson (no longer in existence), while Adelaide Brighton ((ABC)) has been nothing but a disappointment as well.

Conviction Calls

Stockbroker Morgans has released what is possibly best described as a negative conviction list; stocks that are either too expensive, or unattractive for other reasons, with investors advised to trim holdings, or sell out completely, and seek better rewards elsewhere.

Note that Morgans is, and has been, worried about how quickly the local share market recovered from its December low, with a rather mixed and lukewarm reporting season to support current share price levels.

Stocks listed to sell include ASX ((ASX)), TechnologyOne ((TNE)), Fortescue Metals ((FMG)), Newcrest Mining ((NCM)), and AGL Energy ((AGL)).

Stocks that are better avoided, with better opportunities seen elsewhere, include Coles Group ((COL)), Pendal Group ((PDL)), JB Hi-Fi ((JBH)), Accent Group ((AX1)), Coca-Cola Amatil ((CCL)), Vocus Group ((VOC)), Freedom Foods Group ((FNP)), and Sandfire Resources ((SFR)).

Stocks for which investors are advised to trim their current ownership include Brambles ((BXB)), Medibank Private ((MPL)), Insurance Australia Group ((IAG)), APA Group ((APA)), Aurizon Holdings ((AZJ)), Atlas Arteria ((ALX)), Transurban ((TCL)), Cleanaway Waste Management ((CWY)), Centuria Industrial REIT ((CIP)), Ramsay Health Care ((RHC)), Ansell ((ANN)), and New Hope Corp ((NHC)).

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Stockbroker Morgans has also updated on its model portfolios, revealing its Balanced Model Portfolio has sold out of Link Administration ((LNK)) -disappointed with the interim result and believing the future offers headwinds- while adding Woolworths ((WOW)) in a move to strengthen the portfolio's defensive characteristics, while also trimming positions in Cleanaway Waste Management, Corporate Travel ((CTD)), and Transurban.

It should be noted, the Growth Model Portfolio has kept its shares in Link Administration, sold out of Atlas Arteria and Apollo Tourism & Leisure ((ATL)), trimmed its exposure to Corporate Travel, and bought additional shares in both Motorcycle Holdings ((MTO)) and ResMed ((RMD)).

Preferred yield plays remain, in order of preference, Viva Energy REIT ((VVR)), Centuria Metropolitan REIT ((CMA)), Centuria Industrial REIT ((CIP)), and Aventus Group ((AVN)).

Might be useful to also take into account A-REIT preferences at Ord Minnett with all of Aventus Group, Viva Energy REIT, Centuria Metropolitan REIT and APN Convenience Retail REIT ((AQR)) enjoying the broker's highest rating.

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Bell Potter's tech analysts Chris Savage and TS Lim have had to stretch the principle of what makes a tech company to compensate for TechnologyOne's strong share price performance. TechnologyOne is no longer a Key Pick at Bell Potter, not quite joining WiseTech Global ((WTC)) as yet as a Sell-rated stock, but it was decided the Top Three of Key Picks for the local technology sector needed a revamp.

Apart from Citadel Group ((CGL)) -most preferred- and Integrated Research ((IRI)), number three is now PWR Group ((PWH)). If anyone's just a little confused, I can fully understand it, as I was too upon reading the latest update. PWR Group designs and produces cooling systems for fast driving cars. Bell Potter justifies its selection by stating there is a lot of technology involved.

I have visions of queues of market commentators, and the occasional punter, to address Domino's Pizza ((DMP)) as a tech company when the share price was rallying towards $75.80 in August 2016. Remarkably, to say the least, since then the label "technology company" has seldom been used in relationship with Domino's Pizza, with its share price now in the mid-$40s.

I can sympathise somewhat. For years I have been pointing out both ResMed and Cochlear are technology stocks, and some very good ones too. They just happen to operate inside the healthcare sector and therefore carry that specific label, but they are, in essence, technology driven with all the typical characteristics that come with it.

I cannot sympathise with Domino's Pizza, though, and fail to connect with PWR Group. Maybe the true message here is that Savage and Lim have decided not to nominate either of Adacel Technologies ((ADA)), Catapult Group International ((CAT)), Empired ((EPD)) or Over The Wire Holdings ((OTW)) as their third most preferred technology sector choice, despite rating all as a Buy?

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Model portfolio operators at UBS retain an Overweight preference for Metals and Mining, Defensives and Energy, while sticking to an underweight exposure to Banks, Other Financials, and REITs.

At a stock level, report the analysts, Premier Investments ((PMV)), Brambles, Woolworths, CSL ((CSL)) and BHP Group ((BHP)) all continue to screen well, while quantitative analysis suggests an unfavourable outlook short term for stocks including Seek ((SEK)), DuluxGroup ((DLX)), TPG Telecom ((TPM)), Vocus Group, and Sims Metal Management ((SGM)).

Looking at the finer details, UBS's Model Portfolio remains heavily underweight banks at close to -30%.

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Macquarie's Model Portfolio, on the other hand, continues to see downside pressure on domestic bond yields, and thus ongoing support for yield names. Taking guidance from past research, Macquarie analysts believe healthcare and yield stocks tend to outperform in the lead-in to RBA rate cuts.

The Macquarie Model Portfolio has further reduced exposure to local banks to make room for the addition of Fortescue Metals, alongside Amcor ((AMC)). The latter replaces Orora ((ORA)), while OZ Minerals ((OZL)) is also out.

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The team of analysts covering consumer related stocks in Australia at Morgan Stanley has equally communicated their Top Favourites and Best To Avoid picks post February reporting season.

Top Picks are JB Hi-Fi ((JBH)) and Flight Centre ((FLT)). For the former, the analysts agree sales momentum is likely to continue slowing throughout the rest of the year, but this is already reflected in the share price, in their view.

For Flight Centre, the composition of sales is changing towards more corporate (rather than leisure) in the US and as investors start to acknowledge this, a higher valuation should ensue.

Two stocks to avoid are, on their assessment, Wesfarmers ((WES)) and Blackmores ((BKL)). The latter is facing a more difficult environment for longer, is the analysts' view, something that has yet to be priced into the share price.

As far as Wesfarmers goes, Morgan Stanley's deeper dive research into big box retailing (see also further below) is showing sales per square meter at Bunnings is now slowing noticeably, with negative consequences for the outlook.

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Earlier in the month, analysts at stockbroker Morgans had updated their selection of High Conviction Stocks which resulted in the removal of Cleanaway Waste Management, OZ Minerals and Lovisa Holdings ((LOV)) alongside the inclusion of Sonic Healthcare ((SHL)).

Apart from Sonic Healthcare, the selection also still includes ResMed, Reliance Worldwide ((RWC)), Westpac ((WBC)), Oil Search ((OSH)), PWR Holdings, Volpara Health Technologies ((VHT)), Kina Securities ((KSL)), Australian Finance Group ((AFG)), and Senex Energy ((SXY)).

February Reporting Season: Final Observations

If there is one conclusion for investors to draw from the recent February reporting season in Australia, suggest analysts at Morgan Stanley, it is that big box retailing is slowly dying in Australia.

Analysis by the analysts has revealed on current trends sales per square meter only grew faster than 2.5% for just three retailers in the February reporting season. This is a red alarm signal given rental costs are growing by 2.5% and labour costs are increasing at 3.5% on a like-for-like basis.

On Morgan Stanley's calculations, labour costs represent between 70%-90% of all costs for Australian retailers.

Even a child can put one and one together and conclude the squeeze is on.

Morgan Stanley's research also suggests consumers are preferring smaller box retailers, while online competition is increasingly taking market share (together with retailers' own online channel). "Should retailers cut back on staffing, opening hours or marketing we think that this likely accelerates the slowdown in sales per sqm growth", state the analysts and with that statement the sector's dilemma has been captured.

The stand-out slowing down story for Morgan Stanley is Dan Murphy's (owned by Woolworths) with the analysts noting the beer, liquor and wine chain has for a long time been the group's growth engine, but now three years in succession have disappointed. On the latest analysis, sales per sqm growth for Dan Murphy's is negative. Foot traffic, point out the analysts, fell -4% to -5% in H1.

The analysts are predicting the next 12-18 months will see stores being closed. Not helping matters, industry data presented by Nielsen suggest high rates of online growth are representative of in-store cannibalisation, with only minimal growth still occurring in in-store sales, point out the analysts.

What makes this latest piece of analysis so painful for both supermarket operators Woolworths and Coles ((COL)) is that, contrary to the trend, both have been closing down smaller locations and opening up larger sized stores in recent years.

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Staying with the local consumer stocks, UBS analysts have made the effort to trying to establish where the market over-reacted post February results, with their analysis suggesting positive share price responses may likely have been out-of-line enthusiastic for Myer ((MYR)), a2 Milk ((A2M)), Flight Centre ((FLT)), Viva Energy ((VEA)), JB Hi-Fi ((JBH)) and Wesfarmers ((WES)); the latter was downgraded to Sell post interim report.

Where investors might have over-reacted to the downside (i.e. these stocks might be worth revisiting), according to UBS, is after results released by Coles Group ((COL)), Treasury Wine Estates ((TWE)), Super Retail ((SUL)), Costa Group ((CGC)), Woolworths, and Kogan ((KGN)).

To set the sector record straight: UBS's three sector favourites are Flight Centre ((FLT)), Treasury Wine ((TWE)), and Metcash ((MTS)). Least preferred are Wesfarmers, Coca-Cola Amatil and Inghams Group ((ING)).

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Strategists at Morgan Stanley have observed a sharp discrepancy between the local share market performance in February (which was by anyone's account excellent, generating close to 6% return all-in) and the reporting season itself which, on Morgan Stanley's assessment highlighted the intensification of growth and earnings headwinds.

Meanwhile, macro data in Australia continue to weaken and there are suggestions households are deleveraging, thus creating an automatic headwind for companies dependent on consumer spending. The logical observation to add here is that investors, clearly, are drawing confidence from the prospect for one or more rate cuts by the RBA later in the year, or in 2020.

Morgan Stanley strategists are not so sure, and they would "fade such optimism". Their warning to investors: "The downturn underway could be harder to stimulate out of". Apart from a more cautious stance on the local share market in general, Morgan Stanley's Model Portfolio is not inclined to change the underweight exposure to both banks and housing-linked stocks.

If anything, Morgan Stanley thinks the divergence between housing-linked stocks and the broader share market is likely to widen further, not shrink in the months ahead.

Earlier in the month, quant analysis by UBS indicated that, not only have "value" stocks uncharacteristically outperformed during the February reporting season (usually momentum and growth are outperforming), but macro influences have been of larger impact than the actual results. Think the Hayne report and banks, for example, and production loss at Vale.

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While healthcare stocks have been prominently absent from the month's table of best performers, analysts at Morgan Stanley see further downside for shorter-term forecasts. They also point out, the main ASX healthcare names still offer circa 10% 3 year CAGR EPS growth (on market cap weighted average) compared to no more than 4% for the ASX200.

In layman's language these numbers translate into: yes, healthcare stocks failed to shoot out the lights in February, but over the next three years the key sector performers (which includes all of CSL ((CSL)), ResMed ((RMD)) and Cochlear ((COH)) should still outgrow the large majority of ASX200 constituents, so there doesn't appear to be any reason for panic or despair for investors owning these stocks.

In line with comments and views expressed elsewhere, Morgan Stanley preaches caution when it comes to owning private hospital operators.

Rudi On TV

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(This story was written on Tuesday 19th March 2019. Part One was published on the Tuesday in the form of an email to paying subscribers at FNArena, and again on Thursday as a story on the website. Part Two will be published as a story on the website on Friday).

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