Week

15

Stories To Read From FNArena

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FNArena
Financial News, Data & Analysis

GPO Box 3145
Sydney NSW 2001

info@fnarena.com

Your editor
Rudi Filapek-Vandyck

Your dedicated team of journo's
Greg Peel
Eva Brocklehurst

Contents

Gold Gleams For St Barbara In FY18

Gold miner St Barbara expects to finish FY18 with a flourish, upgrading FY18 production guidance for its two gold mines.

-Outlook improves for Simberi -High grade sections remain available at Gwalia -Cash accumulation higher than expected

By Eva Brocklehurst

Much better grades of gold were accessed at Gwalia in the March quarter, countering lower output, while St Barbara Mining ((SBM)) has upgraded FY18 guidance as the outlook for Simberi improves.

Overall production guidance has been lifted to 375-392,000 ozs from 365-385,000 ozs because of an increase in expectations for Simberi. The company expects Gwalia will finish strongly as high-grade sections of the ore body remain available.

With forecasts already ahead of guidance, the upgrade was no surprise to Credit Suisse. The March quarter preliminary update was mildly stronger than expected and, with the June quarter expected to improve at Simberi, it is likely to have been the weakest for FY18, in the broker's view.

This was largely because of lower grades, as expected, but also the lost production because of recent industrial action that has since been resolved. Year-to-date production at Simberi of 99,800ozs indicates 25,000ozs is required in the June quarter to meet the lower end of guidance.

Underground expansion affected Gwalia in the quarter while milled grades were near double the reserve grade. This went some way to offset the volume decline. There is no change to Gwalia's FY18 guidance of 250-260,000ozs.

A miss to Canaccord Genuity's estimates was primarily because of lower mining/milled volumes at Gwalia from changes in the mining sequence and waste from the bore activities affecting ore haulage. This was offset by higher grades, at over 14g/t versus Canaccord Genuity's estimates of 11.8g/t and a reserve grade of 7.8g/t.

Expectations for a strong finish on the back of high-grade and improved volumes at Gwalia should mean the company comfortably achieves upgraded guidance and the broker, not one of the eight monitored daily on the FNArena database, maintains a Buy rating and $4.35 target.

Group production of 85,885ozs of gold in the March quarter was -11% short of Macquarie's expectations on the back of softer milled tonnage at Gwalia and Simberi. The broker lowers FY18 production assumptions by -2% after incorporating the result. Expected tonnage from Gwalia is lowered while grade is lifted in line with the March quarter milled grade.

Cash Build

The company has no debt, which provides options and cash to pursue external growth, although Credit Suisse suggests high competition and elevated prices for quality assets will provide a challenge. The broker has a Neutral rating and $3.85 target.

Cash accumulation was also higher than Macquarie expected after dividend payments of $16m as well as a $4m outflow from investing in ABM Resources ((ABM)). Macquarie maintains a Outperform rating and $4.70 target. The catalysts include the Gwalia extension project and its impact on production outcomes.

FNArena's database shows two Buy, two Hold and one Sell (Citi, yet to update on the March quarter). The consensus target is $3.99, suggesting -2.4% downside to the last share price.

Macquarie Atlas Takes The Internal Route

Macquarie Atlas will pursue plans to simplify its management structure and brokers expect distributions should improve once the transition occurs.

-Main benefits to come from improved investor sentiment towards the stock -Complicated agreement regarding management of APRR yet to play out -Potential for corporate activity around Atlas Arteria made easier

By Eva Brocklehurst

Macquarie Atlas ((MQA)) is taking a new road, with plans to internalise management being submitted to its AGM on May 15 for approval. Brokers welcome the move to simplify the company's management structure and expect distributions to improve from FY20 onwards.

Macquarie Atlas will be renamed Atlas Arteria with an ASX code of ((ALX)) and will appoint a new management team. Macquarie Fund Advisers (MFA) will remain as manager for 12 months until May 15, 2019. During this time Atlas Arteria will incur one-off internalisation-related costs as well as continue to pay base fees.

MFA will be paid the third instalment of its FY17 performance fee and six months of transition services fees from May 16 2019, to allow Atlas Arteria to establish offices and a new management team.

Morgan Stanley believes the proposed transition is manageable and estimates net savings in management fees of around $15m per annum. UBS considers this a positive first step to full independence and the agreement should result in a net $8m per annum saving on costs.

The main benefits are likely to come from improved investor sentiment towards the stock, as conflicting interests and governance concerns are removed, while future performance fees will be linked to cash flow rather than the share price.

Macquarie notes the performance fees will be taken in cash and Atlas Arteria will use the Eiffarie borrowing facility to finance these fees, meaning there is no impact on the dividend, while using its surplus cash from Greenway and improved currency to repay the borrowing.

The internalisation costs are less than Morgans assumed but the base fees being paid for 12 months are more than it expected. This broker assumes around $78m in performance fees are paid in the second half of FY18, via the issue of scrip as per historical precedents.

Morgans considers the agreement detrimental to FY19 cash flows, as costs run into FY19, although positive for FY20 and beyond. Further clarity on the internalisation, however, signals that fundamental factors should drive the share price of Atlas Arteria higher henceforth.

APRR

The company's Dulles Greenway (US) management is internalised while the company's APRR (France) stake will still be managed by MFA and associated funds (MEIF2, MAF2), with ongoing performance fees.

As the management agreement remains in place this suggests a larger and more complicated negotiation between MFA and Eiffage is yet to play out. The performance fee at the asset level remains an unquantifiable contingent liability but UBS notes starting value will be agreed as of May 2019, after a material step up in APRR cash flow.

MFA will receive a base fee of EUR7.4m to manage APRR along with the performance fee of 15% of the internal cash return of 8%. The base value of APRR is yet to be determined.

Morgans remains cautious about the capital requirements related to the exit of MEIF2 from APRR and the potential internalisation of MAF2. UBS believes MFA is incentivised to resolve the next stage of internalisation, to release the MEIF2 stake in MAF2 and facilitate an orderly wind up of that fund.

The broker envisages a clear path for the cash contribution from APRR to Atlas Arteria to rise to $350m, or more, in 2020 from $150m in 2017. This would account for around $0.50 per share in cash flow before any eventual distributions from Dulles Greenway.

The broker suggests Atlas Arteria will offer strong growth over the next three years and a considerable amount of upside, given the decision to explore internalisation amid the potential to acquire a further 5% stake in APRR.

Macquarie point out that between July 2018 and May 2019 there is effectively no performance fee on the APRR value and this provides a route for co-owner Eiffage to potentially bid for the business if a negotiated outcome is not achieved.

While Macquarie considers internalisation is a good move, the path chosen highlights a need to resolve the APRR ownership structure. At this point, the broker believes the potential ahead for corporate activity in Atlas Arteria is being made easier and this should ensure the core value of $6.55 a share can be realised .

FNArena's database shows five Buy ratings. The consensus target is $6.61, suggesting 11.8% upside to the last share price. The dividend yield on FY18 and FY19 forecasts is 4.1% and 6.1% respectively.

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Risks In Hand At IAG

Insurance Australia Group is benefiting from cost reductions and hikes in premium rates which brokers expect will underpin the stock at current levels.

-Strong brand, margin tailwinds and further cost savings likely -High quality player in a sector enjoying an upturn in the commercial insurance cycle -Preference for further off-market share buybacks confirmed

By Eva Brocklehurst

Insurance Australia Group ((IAG)) is confident in its future and brokers greet the latest investor briefing positively, amid a focus on simplification, cost reductions and increased capital efficiency.

Medium-term targets of at least $250m in cost savings and 10% growth in earnings per share were reiterated and UBS notes the significance of the references to "customer" and "simplification" in the briefing.

The potential for disruptive challenges was acknowledged, but the broker asserts that the strength of the brand and margin tailwinds should mean the company can do what is necessary with its legacy systems to prepare for changes.

Despite forecast negative shareholder returns, Macquarie recognises the business is benefiting from cost reductions and hikes in premium rates and this should support the stock at current levels.

FY18 guidance for premium growth in low single digits was reaffirmed. The broker believes the consolidation of policy systems should be in focus, because of the increased trend in the industry towards automation across the supply chain and greater data collection relating to customers.

Citi incorporates the $250m in cost savings into its estimates by 2020. The broker also factors in a 2.5% reserve release in FY19 and FY20. The business looks strong but the stock's valuation is full and the broker maintains a Neutral rating.

While the company is likely to target further cost savings over and beyond those slated by 2020, Citi points out management understands the risk of re-investing such savings will then be higher and future growth initiatives will subsequently be required.

With returns on around one third of its book now locked in, IAG is envisaged as a less volatile, higher-quality play in a sector that is enjoying benefits from an upturn in the commercial insurance cycle.

Credit Suisse finds it hard to fault the management team, as growth is being delivered and opportunities assessed. Still, the external operating environment cannot be ignored. The premium rate environment is working favourably at present but the broker is cautious in terms of this unwinding by FY20.

For this reason, Credit Suisse incorporates only half of the targeted cost savings, in both FY19 and FY20. While there remains potential for an out another leg up in the share price on delivering cost reductions and capital management the broker is sceptical there will be enough confidence in the pricing environment until late 2018 or early 2019 and this would likely be the catalyst for earnings upgrades.

Autonomous Vehicles

Citi suggests the risks from other industry brands and their entry/involvement in the insurance sector may be a more immediate challenge than a longer-dated threat from autonomous vehicles. The company expects the motor insurance market to grow to 2030 with a change in mix away from personal to fleet insurance.

IAG suspects a long lead time before automated cars are approved for public roads, citing around 700 regulations that will need to be changed while the price of these vehicles is currently too prohibitive to be widely consumed.

Capital Outlook

Ord Minnett notes the company's capital position is currently very strong, above the common equity tier-1 target band, with further surplus capital to come from quota share deals, the unwinding of tax losses in New Zealand and, potentially, Asian divestments.

Management has advised it is not working on any further quotas share deals and confirmed a preference for further off-market share buybacks. Macquarie currently assumes $400m in the first half of FY19. Further capital management plans are to be provided in the second half of 2018.

FNArena's database shows two Buy ratings and six Hold. The consensus target is $7.45, signalling -1.9% downside to the last share price. Targets range from $6.45 (Macquarie) to $8.00 (Morgan Stanley, yet to comment on the update).

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GWA Expanding Market Opportunity

Bathroom & kitchen fittings supplier GWA Group has identified an opportunity to expand its market share in an important segment of its business.

-Substantial scope in residential and commercial renovations -Plans to re-position its brands in the high-end quality market -Upside risk from increased market share, cost reductions and divestments

By Eva Brocklehurst

GWA Group ((GWA)) has heightened its focus on new product development and gains in market share in the bathroom & kitchen segment. The company has identified an opportunity within this segment, which has become its core after the divestment of several other businesses.

The company is renewing its focus on secondary and end markets, rather than traditional merchant partners, and has identified a $150m revenue opportunity in the commercial and residential renovations aspect of the bathroom & kitchen segment. Collectively, this accounts for around 70% of the $1.4bn addressable market.

It has become apparent to GWA that renovations have been under penetrated. To address this, the company has expanded the number of showroom displays by 20% in the past two years.

The residential renovations market is more than three times the size of new building, but the company's share of this is less than half its share of new building. GWA plans to capture increased share by re-branding Caroma and Clark and re-position its brands into the better quality sections of the market.

Credit Suisse believes the company is at the beginning of a virtuous cycle of reinvestment in brand and product, furthered by a new FY19-21 cost reduction target of $9-12m, 50% of which is to be reinvested in growth.

Innovations that will feature in this strategy include the Cleanflush rimless toilet range, new showrooms, products for the aged care sector - which incorporate weight-bearing grab rails into functional products, and the Caroma Smart Command water management system.

The aged care segment represents around $170m in revenue across both commercial and residential building. The company is also exploring low capital entry into overseas high-end commercial markets to leverage its water-efficient products.

Morgans has a positive view on the strategy and believes that successful execution over time could mean its market share in the renovation segment increases to the levels achieved in the new building segment, also noting technological innovation will be a key factor going forward.

The broker is impressed by the Sydney flagship store that is soon to be opened and believes a move to increase the engagement with consumers will reap benefits.

Divestments And Dividends

No update was provided on the sale of the doors & access segment, aside from confirmation of a three-month timeline. Credit Suisse continues to model a special dividend of $0.10 per share with the potential for an additional 3-5% buyback.

Citi envisages upside risk over the medium term if the company continues to gain market share, reduces costs and divests doors & access. The divestment of this business would bring to a close almost a decade of divesting.

A sale of doors & access at book value would represent an FY18 enterprise value/EBIT multiple of 5.8x based on Citi's forecasts and result in net debt declining such that the company could have ample room to pursue either acquisitions or capital management initiatives. The broker notes special dividends have been a feature of the capital management strategy since FY06.

Deutsche Bank suspects that, while GWA has grown is share of the renovations market at 50 basis points per annum since December 2013, each additional point of share growth will be harder to achieve at current margins. The broker believes this is particularly true for existing markets, as Caroma and Dorf are already number 1 and 4 respectively in terms of brand awareness.

Hence, the broker expects earnings from market share growth will not be able to offset lost volumes as the housing market peels back from peak levels. Amid concerns about margin erosion Deutsche Bank retains a Hold rating. Citi is less concerned, and suggests that the additional cost savings outlined could help the company maintain margins and offset a slowing housing market.

Building Outlook

New building is still expected to remain robust, driven by population growth, and the company has pointed to a strong pipeline of projects over the next few years.

While the lag between approvals and completions in new dwellings may mean volumes remain relatively robust in the second half, the company's growth trajectory is expected to moderate as the cycle eventually softens.

Nevertheless, Citi asserts that GWA has not benefited from the material increase in apartment construction during the boom, which means it should not be materially affected when these volumes also normalise or moderate.

The company has clearly turned the corner, Wilsons believes, with a focus on leading product innovation, and is encouraged by the desire to increase exposure to the less-volatile renovation segment and positioning as a late-cycle building products supplier.

The broker also expects the impact from online competition to be minimal in the medium term because the company operates in the higher value/quality space. Wilsons, not one of the eight stockbrokers monitored daily on the FNArena database, maintains a Buy rating and $3.75 target.

The database shows one Buy (Credit Suisse) and four Hold ratings. The consensus target is $3.19, suggesting -9.3% downside to the last share price. Targets range from $2.86 (Macquarie, yet to comment on the update) to $3.40 (Credit Suisse). The dividend yield on FY18 and FY19 forecasts is 5.0%.

Weekly Ratings, Targets, Forecast Changes

By Rudi Filapek-Vandyck, Editor FNArena

Guide:

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

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

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

Summary

Period: Monday April 2 to Friday April 6, 2018 Total Upgrades: 9 Total Downgrades: 3 Net Ratings Breakdown: Buy 44.54%; Hold 39.81%; Sell 15.65%

The balance between stockbrokers downgrading and upgrading their recommendations for individual ASX-listed stocks remains overwhelmingly positive, but underneath the surface, where valuations and earnings forecasts are being assessed and recalibrated, the outlook seems more mixed.

For the week ending Friday April 6, 2018, FNArena registered nine upgrades and only three downgrades in stock ratings, with none of the downgrades sinking to Sell. Stocks receiving upgrades to Buy include ANZ Bank, BHP and CSL, while all of G8 Education, GWA Group and ResMed were downgraded once to Neutral.

Funnily enough, the balance between Buy and Neutral ratings remained steady for the week as twelve changes in total amount to six fresh Buy ratings and an equal number of new Neutrals. The gap between total Buys and Neutrals for the eight stockbrokers monitored daily remains substantial at 44.54% and 39.81% respectively.

Perseus Mining is the only stand-out among stocks receiving a boost to their valuation/price target (+14%), with Crown Resorts second for the week at significant distance (+2%). None of the negative revisions comes near Perseus' increase, but the numbers are larger for larger decreases with G8 Education (-6%) at the bottom, followed by Platinum Asset Management, Estia Health and nib Holdings.

It's a similar story for changes to earnings estimates where Newcrest Mining tops the table for positive revision (+4%), followed at a distance by QBE Insurance whose 0.89% increase would normally not be worth mentioning. The negative side of earnings forecasts sees Orocobre suffering most (-4.6%), followed by G8 Education, Navitas and Platinum Asset Management.

Luckily for Australian investors, the negative balance for the week merely affects smaller cap companies while large cap names feature prominently among the rating upgrades. Unfortunately, Trump's negotiation antics with China are currently dominating news headlines, and this is weighing upon short term prospects for equities globally.

Upgrade

AUSTRALIA & NEW ZEALAND BANKING GROUP ((ANZ)) Upgrade to Buy from Neutral by Citi .B/H/S: 4/4/0

The share price has declined around -6% in the year to date and Citi upgrades to Buy from Neutral. The broker believes ANZ, in particular, will be able to shift its dividend pay-out higher, to 80% by the second half of 2020 from the current 65%.

The CET1 ratio is forecast to remain above the 10.5% target despite around $7bn in share buybacks. Target is steady at $30.

AP EAGERS LIMITED ((APE)) Upgrade to Equal-weight from Underweight by Morgan Stanley .B/H/S: 1/3/0

New car sales growth has improved and regulatory headwinds have been factored into the stock but the valuation holds Morgan Stanley back from being more positive on AP Eagers.

There is upside relative to FY17 on the removal of trading losses at sold dealerships, while the impact from regulatory changes has largely passed.

Rating is upgraded to Equal-weight from Underweight. In-Line industry view. Target is raised to $8.50 from $6.85.

BHP BILLITON LIMITED ((BHP)) Upgrade to Buy from Neutral by Citi .B/H/S: 5/3/0

Citi has upgraded to Buy from Neutral with a higher price target, $33 versus $32 prior, on the realisation the company's shale assets, which are up for divestment, might catch a higher price than previously thought.

On Citi's present calculations, based upon recent transactions inside the US shale industry, BHP's shale assets might attract US$14bn instead of US$10bn, while global upheaval due to rising risks from economic protectionism are believed to be overdone.

CARSALES.COM LIMITED ((CAR)) Upgrade to Neutral from Underperform by Credit Suisse .B/H/S: 2/5/1

The share price has been under pressure recently, and we can blame Morgan Stanley analysts for scaring investors about potential competition impact that was purely theoretical, and Credit Suisse has now decided it's opportune to raise its recommendation to Neutral from Underperform.

Some minor adjustments have been made to the broker's modeling, but nothing to impact on valuation or price target, which remains unchanged at $13.50.

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

UBS has re-modelled earnings drivers for CSL and transferred lead analyst coverage. The broker shifts to DCF-based valuation methodology. A three-year compound growth rate for earnings per share of 16% is forecast.

The valuation implies a premium to the company's historical average relative to the market but UBS believes current plasma industry conditions are favourable. Rating is upgraded to Buy from Neutral. Target is raised to $175 from $155.

CYBG PLC ((CYB)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 2/1/1

Macquarie's investment thesis for CYBG is underpinned by expectations of improving profitability through efficiencies, market share gains, capital returns and, eventually, higher interest rates. While some factors will take time and indeed benefit all UK banks, the broker sees CYBG as a greater net beneficiary.

Given an undemanding valuation, Macquarie upgrades to Outperform from Neutral. Target rises to $6.50 from $5.27.

INFIGEN ENERGY ((IFN)) Upgrade to Buy from Hold by Ord Minnett .B/H/S: 1/1/1

Ord Minnett has had a negative outlook on the company's three traditional revenue streams. While situation has not changed that much the broker notes the stock has de-rated such that it would be now at least 10% cheaper to buy Infigen than to build new wind farms.

As the valuation looks significantly more interesting Ord Minnett upgrades to Buy from Hold. Target falls to $0.71 from $0.73.

PERSEUS MINING LIMITED ((PRU)) Upgrade to Buy from Neutral by UBS .B/H/S: 3/1/0

UBS believes the company may have turned the corner and upgrades to Buy from Neutral. Operating consistency is now being achieved at Edikan, Sissingue is being delivered on time and on budget and the outlook is de-risking.

As the company is offering growth through a third development at Yaoure UBS believes the market could eventually re-rate the stock and potentially capture a gold premium. Target is raised to $0.55 from $0.33.

SOUTH32 LIMITED ((S32)) Upgrade to Neutral from Sell by Citi .B/H/S: 1/4/2

South32 has been upgraded to Neutral from Sell, with a reduced price target; $3.40 versus $3.50 prior. Previously, Citi analysts were worried about the direction of manganese prices, but they have now concluded risk is to the upside.

Also, the analysts note cash flow generation remains strong to fund opportunities and the early stage projects that S32 has invested in, keeping potential for ongoing returns to shareholders alive.

Estimates have been slightly reduced, DPS estimate remains on 9c for as far as the eye can see beyond the 14c penciled in for the present fiscal year,

Downgrade

G8 EDUCATION LIMITED ((GEM)) Downgrade to Equal-weight from Overweight by Morgan Stanley .B/H/S: 3/3/0

Morgan Stanley has reduced occupancy forecasts for 2018 to 77.7% from 78.8% and for 2019 to 79.0% from 80.5%. This results in a -4-5% reduction to revenue forecasts.

While the valuation remains undemanding the broker envisages few catalysts in 2018. Rating is downgraded to Equal-weight from Overweight. Target is reduced to $2.80 from $4.25. Industry view is In-Line.

GWA GROUP LIMITED ((GWA)) Downgrade to Hold from Add by Morgans .B/H/S: 1/4/0

Management intends to divest its door & access systems business. Morgans values this business at $45-65m. The company maintains a strong balance sheet which could provide capital management initiatives such as a share buyback or special dividend, in the broker's opinion.

While the broker expects earnings growth to be broadly flat over the next few years the stock offers a 5.2% fully franked yield with upside from capital management initiatives post the sale of this business.

Rating is downgraded to Hold from Add as the share price is now trading above the target price of $3.30.

RESMED INC ((RMD)) Downgrade to Neutral from Buy by Citi .B/H/S: 3/3/1

The share price has performed well and on Citi's observation this has pushed valuation to a 30% premium versus the five years trading average. Too expensive conclude the analysts and they have pulled back their rating to Neutral from Buy.

In addition, Citi analysts seem a bit worried that new mask launches by competitors Philips Electronics and Fisher & Paykel Healthcare ((FPH)) will tighten competition in the high margin mask sector, which might weigh upon forward growth rates for ResMed. Target untouched at $13.60.

Adding to Citi's concern is the observation ResMed hasn't been able to grow Masks at double digit rates for more than two consecutive quarters since 2012.

Total Recommendations Recommendation Changes

Broker Recommendation Breakup

Broker Rating Order Company New Rating Old Rating Broker Upgrade 1 AP EAGERS LIMITED Neutral Sell Morgan Stanley 2 AUSTRALIA & NEW ZEALAND BANKING GROUP Buy Neutral Citi 3 BHP BILLITON LIMITED Buy Neutral Citi 4 CARSALES.COM LIMITED Neutral Sell Credit Suisse 5 CSL LIMITED Buy Neutral UBS 6 CYBG PLC Buy Neutral Macquarie 7 INFIGEN ENERGY Buy Neutral Ord Minnett 8 PERSEUS MINING LIMITED Buy Neutral UBS 9 SOUTH32 LIMITED Neutral Sell Citi Downgrade 10 G8 EDUCATION LIMITED Neutral Buy Morgan Stanley 11 GWA GROUP LIMITED Neutral Buy Morgans 12 RESMED INC Neutral Buy Citi Recommendation Positive Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 PRU PERSEUS MINING LIMITED 75.0% 50.0% 25.0% 4 2 REG REGIS HEALTHCARE LIMITED 67.0% 50.0% 17.0% 3 3 S32 SOUTH32 LIMITED -14.0% -29.0% 15.0% 7 4 CSL CSL LIMITED 64.0% 50.0% 14.0% 7 5 CWN CROWN RESORTS LIMITED 33.0% 20.0% 13.0% 6 6 BHP BHP BILLITON LIMITED 63.0% 50.0% 13.0% 8 7 ANZ AUSTRALIA & NEW ZEALAND BANKING GROUP 44.0% 31.0% 13.0% 8 Negative Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 PTM PLATINUM ASSET MANAGEMENT LIMITED -75.0% -50.0% -25.0% 4 2 NEC NINE ENTERTAINMENT CO. HOLDINGS LIMITED 17.0% 40.0% -23.0% 6 3 GWA GWA GROUP LIMITED 20.0% 40.0% -20.0% 5 4 EHE ESTIA HEALTH LIMITED 33.0% 50.0% -17.0% 3 5 GEM G8 EDUCATION LIMITED 50.0% 67.0% -17.0% 6 6 RMD RESMED INC 29.0% 43.0% -14.0% 7 7 WFD WESTFIELD CORPORATION 50.0% 60.0% -10.0% 4 8 NHF NIB HOLDINGS LIMITED -38.0% -29.0% -9.0% 8 9 JHC JAPARA HEALTHCARE LIMITED -38.0% -33.0% -5.0% 4 Target Price Positive Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 PRU PERSEUS MINING LIMITED 0.603 0.528 14.20% 4 2 CWN CROWN RESORTS LIMITED 13.150 12.880 2.10% 6 3 CSL CSL LIMITED 166.429 163.571 1.75% 7 4 BHP BHP BILLITON LIMITED 32.796 32.671 0.38% 8 5 JHC JAPARA HEALTHCARE LIMITED 1.815 1.810 0.28% 4 Negative Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 GEM G8 EDUCATION LIMITED 3.447 3.688 -6.53% 6 2 PTM PLATINUM ASSET MANAGEMENT LIMITED 6.313 6.538 -3.44% 4 3 EHE ESTIA HEALTH LIMITED 3.667 3.725 -1.56% 3 4 NHF NIB HOLDINGS LIMITED 6.304 6.390 -1.35% 8 5 NEC NINE ENTERTAINMENT CO. HOLDINGS LIMITED 1.892 1.910 -0.94% 6 6 REG REGIS HEALTHCARE LIMITED 4.500 4.525 -0.55% 3 7 S32 SOUTH32 LIMITED 3.296 3.310 -0.42% 7 8 WFD WESTFIELD CORPORATION 10.017 10.030 -0.13% 4 Earning Forecast Positive Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 NCM NEWCREST MINING LIMITED 63.553 60.656 4.78% 8 2 QBE QBE INSURANCE GROUP LIMITED 70.624 70.002 0.89% 8 3 SGR THE STAR ENTERTAINMENT GROUP LIMITED 27.506 27.293 0.78% 8 4 KMD KATHMANDU HOLDINGS LIMITED 19.643 19.552 0.47% 4 5 NHF NIB HOLDINGS LIMITED 29.213 29.114 0.34% 8 6 CSL CSL LIMITED 466.467 465.093 0.30% 7 7 BHP BHP BILLITON LIMITED 214.572 214.119 0.21% 8 8 ANZ AUSTRALIA & NEW ZEALAND BANKING GROUP 235.375 235.000 0.16% 8 9 TWE TREASURY WINE ESTATES LIMITED 48.887 48.816 0.15% 7 10 SPK SPARK NEW ZEALAND LIMITED 19.933 19.920 0.07% 4 Negative Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 ORE OROCOBRE LIMITED 13.252 13.896 -4.63% 7 2 GEM G8 EDUCATION LIMITED 23.583 24.250 -2.75% 6 3 NVT NAVITAS LIMITED 19.442 19.908 -2.34% 6 4 PTM PLATINUM ASSET MANAGEMENT LIMITED 33.575 34.075 -1.47% 4 5 CSR CSR LIMITED 41.800 42.200 -0.95% 5 6 SCG SCENTRE GROUP 24.771 24.957 -0.75% 7 7

SUN SUNCORP GROUP LIMITED 79.050 79.525 -0.60% 8 8 IAG INSURANCE AUSTRALIA GROUP LIMITED 43.688 43.938 -0.57% 8 9 BTT BT INVESTMENT MANAGEMENT LIMITED 62.000 62.333 -0.53% 6 10 S32 SOUTH32 LIMITED 29.230 29.385 -0.53% 7 Technical limitations

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Uranium Week: Low Turnover, Weak Price

The elevated level of transactions in the uranium post market in March gave way to a quiet start to April, and still prices retreat.

-Spot price down -15% year to date -US producers/end-users providing a conundrum -Two subsidiaries of Ohio-based FirstEnergy Corp filed for bankruptcy

By Greg Peel

After a month of March highlighted by the third largest number of monthly transactions on record, the spot uranium market began April in a quiet fashion. Industry consultant TradeTech reports only four transactions concluded in the week, totalling 1mlbs U3O8 equivalent.

Traded prices remained steady throughout the week up until Friday, when one late seller affected yet another dip in price. That seller remained unsatisfied at the close of trade, and TradeTech's weekly spot price indicator has fallen -US90c to US$20.10/lb.

The spot price is now down -9% in a month and -15% year to date. In the past four months, only four weeks have seen spot price increases.

TradeTech's term price indicators remain at US$25.50/lb (mid) and US$28.00/lb (long).

The uranium market remains in a state of flux, uncertain as to whether Donald Trump's trade policy upheaval will impact on the uranium production and power generation industries. No mention has yet been made of a tariff on imported uranium – China not being a uranium exporter – but in a twist to the current trade theme, US uranium producers have called for the imposition of a quota on US power companies ensuring 25% of the uranium they purchase must be US-sourced.

Power companies have in turn pointed out that US nuclear power is already on the brink of extinction in the face of cheap gas-fired power and subsidised alternative energy, and that such a quota would be the last straw. Last week's developments only serve to confirm such a declaration.

Rolling Closures

Two subsidiaries of Ohio-based FirstEnergy Corp have announced they will close their nuclear plants in Ohio and Pennsylvania in 2021-22 due to the inability to compete against gas. FirstEnergy has appealed to the respective state legislatures to consider policy solutions to keep the plants in service.

The company has also appealed to the US Energy Secretary to provide assistance under the Federal Power Act.

FirstEnergy has assured the two plants can keep operating for the time being thanks to cash at hand. But the two subsidiaries have filed for bankruptcy.

Late on Friday, after the close of the market, Donald Trump indicated the door was open to consider assistance for the plants and that the Administration is taking extraordinary steps to keep some US plants operating. The Department of Energy indicated it is reviewing FirstEnergy's request.

The Trump Administration thus finds itself between the proverbial rock and hard place. One the one hand, US uranium producers are petitioning for assistance amidst persistently weak uranium prices, via the imposition of buy-American quotas for US power companies. One might think weak uranium prices would leave US utilities sitting pretty, but no, on the other hand power companies are petitioning for assistance in the face of even cheaper gas.

No solution will appease both parties. The dilemma is it is in the interest of national security to ensure diversification of base load power supply, and it is also in the interest of national security that the US can supply its own uranium to fuel that power supply, rather than be beholden to imports.

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 April 4, 2018

What a difference a week makes.

In last week's Report I highlighted one of the dullest weeks on record in terms of short-position changes. Every change in position was an increase, which is a first in the history of this Report, but there were so few and movements were so small that it mattered not.

By contrast, this week's table looks like something Moses could part.

No fewer than eight companies have rejoined the 5% plus shorted table. Nevertheless, all bar one of the short position increases noted below represent a move of less than one percentage point, meaning it's all about bracket creep. All the new entries had been hovering in the 4% range.

It was a week which saw the ASX200 continue to slide on trade war fears, breaching its 200-day moving average before finding a bottom late in the week.

Three stocks climbed into the 10% plus club last week. For APN Outdoor ((APO)) this represented a return, rejoining outdoor advertising peer HT&E ((HT1). It was also a return for Orocobre ((ORE)), rejoining lithium mining peer Galaxy Resources ((GXY)).

The newcomer to 10% plus shorted is beef exporter Australian Agricultural Company ((AAC)). See below.

The only short position movement exceeding one percentage point last week was that of small cap medical device company Nanosonics ((NAN)). See below.

Weekly short positions as a percentage of market cap:

10%+

SYR 21.4 JBH 17.0 DMP 16.6 GXY 14.8 HSO 14.2 VOC 12.2 IGO 11.9 NAN 11.6 MYR 11.4 RFG 11.2 MYX 11.1 HT1 11.0 APO 10.5 AAC 10.2 ORE 10.2

In: APO, AAC, ORE

9.0-9.9

NWS, FLT

Out: ORE, APO, AAC

8.0-8.9%

AAD, HVN, PLS, BWX, MTS

In: MTS

7.0-7.9%

TGR, APT, GMA, BAP, IVC, BGA, GXL

In: BAP, IVC, BGA, GXL Out: MTS

6.0-6.9%

ING, TPM, IPH, GEM, WEB, IFL, CSR, QUB, KAR, BEN, MLX, SEK

In: IPH , GEM, WEB, IFL, CSR, KAR, MLX, SEK

Out: BAP, GXL, IVC, BGA, SUL

5.0-5.9%

SUL, AHG, JHC, CCP, BIN, IMF, MOC, NSR, RSG, WSA, SHV, MQA, BKL, RIO, PRY

In: SUL, CCP, BIN, IMF, NSR, WSA, SHV, MQA, BKL, PRY

Out: KAR, CSR, IFL, SEK, WEB, IPH, MLX, GEM

Movers & Shakers

Disinfection specialist Nanosonics has been undergoing a steady rise in short positions over past weeks, in line with a gradual decline in stock price. This week stockbroker Morgans noted new guidelines in Germany should boost the uptake of Nanosonics' Trophon product in that market, while at the same time slashing near term earnings forecasts to reflect a shift to a more direct sales channel.

Morgans retains an Add recommendation nonetheless. Stockbroker Wilsons continues to include the stock as one of its Conviction Calls.

Last week Australian Agricultural Company issued a profit-warning, ahead of the release of its FY18 (end-March) result. The stock fell -9% in response.

AACo warned FY18 operating earnings will be up to -73% lower than 2017, statutory earnings would represent a loss, and cash flow would be negative compared to positive a year earlier. Impairments will be taken on an onerous contract provision and on the company's Livingstone beef processing facility.

AACo's half-year result also disappointed last year, suggesting that the company's transition from a livestock company to a branded beef business has not reaped the rewards assumed. The full year result only serves to confirm this fear, and AACo is now looking to back-pedal from the questionable strategy.

ASX20 Short Positions (%)

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

IMPORTANT INFORMATION ABOUT THIS REPORT

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

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

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

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

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

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

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

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

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

The Wrap: Property, Contractors & Kaufland

Weekly Broker Wrap: property; contractors; Kaufland; Royal Commission; general insurance; and Appen.

-Sales growth at shopping centres could slow further -Ord Minnett wary of holding contractors with expensive valuations -Kaufland's fresh food credentials likely to lift competitive intensity -Bank Royal Commission: credit tightening or crunch? -QBE regains competitive position in insurance broker survey

By Eva Brocklehurst

Property

Residual sales growth at shopping centres may slow further as specialty retailers allocate capital to technology and logistics to capture online growth. On this front Morgan Stanley observes that sales at the most productive shopping centres are growing at the greatest rate, while those assets that have not been redeveloped in the past five years have experienced the greatest slowing in sales growth.

This highlights increased capital needs for maintaining a competitive position as consumers become increasingly selective. The rising proportion of maintenance capital expenditure being included in development capital expenditure will also reduce the value that is being created and put pressure on gearing.

The broker suggests demand for regional and fortress malls may not be as deep as previously expected and there may be better opportunities in offshore markets.

Vicinity Centres ((VCX)) is considered good value while the scope for self-help remains high, with the potential clarification of the strategy in May providing a positive catalyst. Stockland ((SGP)) could also unlock latent value from clarifying its strategy in May.

Meanwhile, Mirvac ((MGR)) remains the most exposed to weaker residential sentiment, in the broker's opinion. Scentre Group ((SCG)) has the highest quality but also the most rapidly ageing portfolio and remains most reliant on ongoing increases in asset values.

Contractors

Ord Minnett suggests there is a 1-2 year runway before the peak of the infrastructure cycle is likely to be reached. Expectations for stocks, nonetheless, are relatively high and many are trading at near previous peak PE valuations.

The broker remains wary of holding those stocks trading on expensive valuations, unless very confident of earnings upgrades, but acknowledges there is an argument that activity levels could remain elevated for a number of years.

In the current environment Ord Minnett prefers those stocks with lower relative valuations and/or geographic diversity. A Buy rating is maintained for RCR Tomlinson ((RCR)) while Boral ((BLD)) is rated Accumulate. Adelaide Brighton ((ABC)), CIMIC ((CIM)) and Monadelphous ((MND)) are rated Hold and ALS ((ALQ)) and Downer EDI ((DOW)) are rated Lighten.

Kaufland

Morgan Stanley suggests that high labour costs, store rentals and low competitive intensity, as well as high margin structures, enable another supermarket discounter to prosper in Australia. Kaufland is expected to enter the Australian market late in 2019/early 2020.

The business has strong fresh food credentials that the broker expects will lift the competitive intensity even further. This is likely to lead to reduced prospects for margin expansion and a sector PE de-rating.

Unlike Aldi in its initial phase, Kaufland prioritises fresh food and while there are some similarities, Morgan Stanley notes the customer proposition is also different. In recent years supermarket margins compressed as proactive price investment was undertaken to narrow the price gap to Aldi.

Near term, the broker expects food deflation to moderate because of faster cost growth for imports, and as the majors look to protect their profit pool. This should not be extrapolated long-term, Morgan Stanley warns, as the pricing gap to Aldi and Kaufland is likely to increase the potential for price investment.

The broker maintains an Overweight rating for Metcash ((MTS)) despite the increased competitive intensity in fresh food, because of a stronger performance from self-help initiatives and a lower percentage of sales generated from fresh food. Valuation is also considered attractive and the balance sheet flexible.

Royal Commission

UBS mulls plausible downside scenarios for the A-REIT sector, given the Royal Commission on Financial Services is likely to recommend higher levels of due diligence in order for banks to comply with responsible lending laws.

In one scenario, a credit tightening, the broker assesses that, as banks move to responsible lending over time, credit would be constrained and borrowing capacity reduced around 30-40% in FY19.

The implications for A-REITs in this scenario suggest retail income growth slows to 1% from 2-3% and residential settlement volumes are down around -15%. The the most affected stocks would be Mirvac and Stockland.

In the second scenario, in which income assessment is tightened materially and credit availability is sharply reduced, home loans are likely to fall -25% and -10% in FY19 and FY20 respectively, and there is large downside risk to house prices.

In this instance, where the commission creates a credit crunch, retail A-REIT income growth is forecast to slow to 0-1% and residential settlement volumes drop -40%. In such a case the broker would revise down sector earnings by -5-8% for FY20-21. Those most affected by this scenario are Lend Lease ((LLC)), Mirvac and Stockland.

Credit Suisse notes the Royal Commission will focus its next public hearings on wealth advice and platforms, with two weeks of hearings starting April 16. In May, the focus will be on business lending. The first round highlighted lapses in bank behaviour and this is expected to drag on sentiment until the final report.

Hence, increased legal and preparation expenses will be a cost headwind for the banks in FY18. Nevertheless, the broker envisages clear value in the longer term for bank stock investors as banks improve their reputation.

General Insurance

In analysing insurance broker survey data with regard satisfaction, Macquarie notes Insurance Australia Group ((IAG)) and Suncorp ((SUN)) held relatively flat positions, while QBE Insurance ((QBE)) regained its competitive position network. Broker satisfaction with the top five insurers rebounded to long-term average in November 2017 versus the five-year low recorded in May.

Macquarie believes these metrics are strong predictors of future premium growth. QBE improved on every product but had the lowest and second lowest satisfaction from brokers for the home and personal motor products respectively. Macquarie concludes that these products are non-core and should be divested.

The survey noted an increasing number of interactions were being transferred to call centres as insurers sought to streamline distribution. The report suggests this mix could be a predictor of future broker satisfaction. On average broker satisfaction is around 25% higher in correspondence with an insurer through business development management rather than a call centre.

Appen

Overall, Bell Potter makes no changes to forecasts for artificial intelligence company Appen ((APX)) but does refined the comparable used in relative valuations. As a result of this change the 10% premium has been removed and a -5% discount applied. The broker's forecasts remain consistent with the company's guidance range for 2018 EBITDA of $50-55m.

Bell Potter expects Appen to at least reiterate 2018 guidance next month at its AGM and there is some chance of narrowing the range towards a higher end, or even an upgrade. At the target price of $11 the total expected return is around 29% so the broker upgrades the recommendation to Buy from Hold.

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

Medical Developments Pain Free In Germany

Brokers welcome the news that Medical Developments has received regulatory approval to market its pain-killing device Penthrox in Germany.

-Milestone payment expected in second half of 2018 -Global expansion strategy for Penthrox on track -Catalysts include appointment of a distributor in the US

By Eva Brocklehurst

As Germany is the largest EU market, news that Medical Developments ((MVP)) has received regulatory approval to market its Penthrox product has been welcomed by brokers. This brings the total number of approvals in the EU to 15 nations.

First reimbursed sales in Germany will trigger a milestone payment of US$2m from the company's partner, Mundipharma, expected in the second half of 2018.

Bell Potter considers this approval marks an important milestone, as Germany is the largest user of opioids in Europe. The availability of Penthrox as an alternative non-opioid pain relief product should benefit patients and likely candidates are in the trauma setting.

The broker estimates that around 16m people visit accident and emergency centres in Germany in a year, with over 3m likely to be candidates for Penthrox. Bell Potter forecasts first revenue in FY19 and retains a Buy rating and $8.49 target for Medical Developments.

If Penthrox is only used to treat acute trauma pain in ambulances and emergency departments, Moelis estimates Medical Developments could achieve in excess of 1m units sold per annum.

The company expects sales to commence this month in the other EU countries which have approved Penthrox, commencing in Austria where the first order has been received.

The remaining 11 EU countries are expected to follow. Spain and Italy are the next two markets in focus after Germany. First sales in these will trigger additional milestone payments of US$3m collectively.

Moelis believes this is further evidence of the company's ability to deliver on its roll-out strategy for Penthrox and expects a total of US$5m in milestone payments will be recorded in FY19.

If Penthrox is only used to treat acute trauma pain in ambulances and emergency departments, the broker estimates Medical Developments could achieve in excess of 1m units sold per annum.

Any indications that the uptake established EU markets is progressing faster than expected will provide the evidence that Penthrox can be rolled out into the rest of the EU and later in the US.

Moelis envisages the next catalysts for the share price will be the appointment of a distributor in the US, expected in 2019. The broker retains a Hold rating and $8.08 target.

G Medical Launches Mobile Health Monitoring

G Medical Innovations is a small medical device company with two key products it intends to distribute globally. TMT Analytics initiates coverage.

-Products to become available commercially in approved markets late in the June quarter -Obtaining approval for Chinese manufacturing facilities crucial to tap into global market -Should be able to generate strong gross margins over the medium term

By Eva Brocklehurst

G Medical Innovations ((GMV)) is commercialising a range of mobile monitoring systems for vital signs that should provide major cost savings for the health system. These monitoring systems allow patients to remain mobile in hospitals and at home.

TMT Analytics, in reviewing the stock, acknowledges its financial projections are steep but believes there is actually upside risk to the forecasts, especially if the company can manufacture and assemble its products in enough volume that enable the servicing of multiple large markets.

The first two products are the Prizma medical smartphone case and the G Medical Patch (GMP), which can measure vital signs such as heart rate, blood pressure, body temperature, respiration rate, body position, blood blood oxygen saturation and ECG.

Both products can wirelessly transmit patient data to physicians using 4G or Wi-Fi. The Prizma can mostly be considered a consumer product while the GMP needs to be prescribed by medical professionals.

The Israel-based company is targeting global markets including the US, Europe, China and India and has already achieved CE status for both products in Europe as well as US FDA approval for the Prizma. The products are expected to become commercially available from late in the June quarter in countries where regulatory approval has been received.

TMT Analytics acknowledges that the Prizma solution encounters competition from a variety of players, ranging from traditional health firms and IT/app developers to pure-play companies which are disrupting the segment. This has resulted in a highly fragmented market.

While these apps provide information, the majority lack the functionality to do more in relation to health and this limits the competition in the personal health tracking space.

In the case of the GMP product, the company is likely to compete against those that offer remote patient monitoring (RPM) solutions, led by publicly-listed medical devices company such as Medtronic and Biotronik. The analysts suggest G Medical can potentially look to partner with platforms to accelerate its presence in this segment.

Milestones

TMT analytics believes obtaining FDA approval for the GMP in the US, expected in the second half of FY18, and CFDA approval for the Prizma and GMP in China are critical to the company's outlook. Obtaining approval for Chinese manufacturing and assembly facilities will be crucial for the company to scale up its production to desired levels.

An expedited approval process is already underway in China and relevant approvals are expected in the June quarter. Not only will the facilities be crucial for the global supply they will also supply a significant target market in its own right.

The company will support the roll out of GMP through its Texas-based call centre that currently sells other third-party monitoring devices. It has commercial agreements in place with around 200 health insurance companies in the US. These relationships remain critical for the company from a reimbursement perspective.

TMT Analytics believes the centre will play a role in the commercial roll out of GMP, as it provides direct support to both patients and physicians. Also, the proprietary product allows a substantially higher margins compared with the third-party products the company sells through the centre.

Financials

The analysts estimate GMP will be able to generate strong gross margins from its hardware product of between 60-80% in the medium term while the long-term operating earnings margin should level off between 40-45%.

TMT Analytics anticipates GMP will require an additional US$10-12m in funding to cover working capital and capital expenditure requirements in 2019 and 2020. A substantial part could be debt-financed on the back of incoming purchase orders, thereby avoiding dilution for existing shareholders, the analysts suggest.

TMT Analytics believes a key element in the investment case is the company's track record in building a business such as GMP. Company CEO, Yacov Geva, has brought several key staff from LifeWatch to operate at the Texas centre. Dr Geva founded LifeWatch AG and listed it before it was acquired by BioTelemetry in 2017 for US$280m.

The analysts commence research coverage with a Buy recommendation and 94c target, based on the valuation multiples of NASDAQ-listed peers.

NB: TMT Analytics is being paid by the company for the research.

Competitor Failures Bitter Sweet For Baby Bunting

The baby goods retail industry has had its share of failures recently which puts Baby Bunting in the spotlight.

-Heightened discounting creates downside risk to Baby Bunting's FY18 earnings -Pressure on gross margins evident -Stabilising of industry conditions considered unlikely

By Eva Brocklehurst

As administrators circle several of its competitors, Baby Bunting ((BBN)) has come to the fore. Further out, fewer players may provide a more solid industry structure, although brokers suspect the near-term impact could be more mixed.

Administrators have been appointed to Baby Bounce (10 stores across NSW/QLD) and Baby Savings (4 Sydney metro stores), Australia's third and fourth largest specialty baby goods retailers by store count. This comes after a series of closures of other baby goods stores in the first half.

Citi believes the news increases the downside risk to Baby Bunting's FY18 operating earnings (EBITDA) guidance of $23m, largely because of clearance activity. The broker last month downgraded the stock to Sell because of the increased risk from competitor closures.

Analysis indicates 93% of these latest two businesses to go into administration are located within a 20km radius of a Baby Bunting store. As a result, clearance sales could adversely affect the fourth quarter result and limit the potential for the company to take over store locations.

That said, same store sales grew 4.7% in the third quarter, an improvement on the 4.5% in the first six weeks of the quarter. Yet, Macquarie observes pressure on gross margins is evident, amid increased discounting.

The company's FY18 guidance is based on the stabilising of industry conditions and this appears unlikely, in the broker's opinion. Morgan Stanley also notes recent commentary surrounding pressure on margins and estimates a -20 basis points decline year-on-year in second half margins.

Risks to other operators continue, such as Babies R Us/Toys R Us in Australia following the bankruptcy of the US parent. Morgan Stanley notes Babies R Us is the only player of scale and the US parent intends to sell or close some of its international stores, which may include Australia.

Amazon

Over the medium term the exit of competitors is a positive for Baby Bunting, Citi concedes, given the prospects for market share gains. It also is likely to increase the company's bargaining power with suppliers and landlords and provide access to a greater share of exclusive products.

Still, Amazon may play an increasing part, as suppliers consider alternative channels in order to diversify customers and reduce the reliance on a major player.

Macquarie also notes Amazon's “Prime” offering is a potential de-stabiliser and will mean the baby goods category remains in focus and competition strengthens. The broker requires evidence of a sustained improvement in performance and market conditions before changing its Neutral recommendation on the stock.

FNArena's database has two Buy ratings, one Hold and one Sell. The consensus target is $1.58 signalling 20.8% upside to the last share price. The dividend yield on FY18 and FY19 forecasts is 5.2% and 5.8% respectively.

Class Outlook More Subdued

As the migration of AMP accounts continue and the easy wins in cloud conversions pass, Class is likely to experience a more subdued period over coming months.

-UBS finds little evidence to support a large downgrade to future expectations -Customer acquisition growth slows to lowest level in five years -Wilsons suggests the valuation does not reflect margin pressures

By Eva Brocklehurst

The near-term outlook for SMSF software provider, Class ((CL1)), has become a little more uncertain, although brokers disagree on the extent of any downside.

The company still has 8,800 AMP-based accounts to be migrated over 2018 and growth in the March quarter was affected by the migration of 1,000 AMP accounts off the Class Super platform. Class added more than 6,102 portfolios in the quarter, taking its total to 164,255, up 3.9%.

The company did not provide an update to the earnings guidance provided at its first half result release, which signalled margins would be flat in the second half. UBS expects higher costs and a fee holiday until July 1, 2018 will affect FY18 revenues by -2% and flow on to margins.

The broker also suspects implementation costs could exceed sales as a result of competitive intensity and the attempts to capture desktop/cloud conversions from a major competitor. The chance of another fee holiday in the second quarter of FY19 is also elevated, in the broker's opinion.

UBS expects Class to lifted share of the SMSF market to 45% from 25% over the next decade although revenue is likely to be effectively flat.

The March quarter was a tad softer than expected but Ord Minnett is attracted to the growth profile, unit economics and low customer churn of Class and expects reasonable growth in the fourth quarter.

Future Expectations Revised Down

Based on the share price performance lately the broker was rather surprised by how quickly future growth expectations were revised down, with little real evidence this was playing out to any degree. Ord Minnett just doesn't envisage a decline in the base business to justify taking the stock down further and reiterates a Buy rating.

Moelis, too, remains comfortable with the long-term view, given consistent retention rates and high cash conversion as well as a scalable platform, maintaining a Buy rating with the target reduced to $2.99 from $3.22. The broker, not one of the eight monitored daily on the FNArena database, estimates around 2,800 AMP accounts will be migrated in the coming quarter.

Moelis acknowledges customer acquisition growth also slowed, as Class brought on 25 new customers in the quarter, the lowest over the last five years. The March quarter is usually the weakest of the year so the broker suggests keeping an eye on this metric going forward.

Portfolio account growth estimates for FY19-21 are reduced by -1.8-4.2% to reflect the increased probability of slower customer acquisitions and, while FY18 is seen as a more disruptive year, Moelis expects FY19 to be more stable, with earnings-per-share growth of 30%.

Early Wins Achieved

Wilsons downgrades to Sell and remains concerned about a likely re-basing of operating margins that is not factored into consensus estimates. The broker believes the early market wins have been achieved and, with the majority having adopted the cloud, the late comers that are moving on board may prove tougher to convert, requiring more investment.

The valuation does not reflect margin pressures and, moreover, the broker suspects AMP contracts could migrate at a faster rate ahead.

The product suite may be the best in its class, and there are supportive structural drivers around the cloud, but it is not enough to convince Wilsons, also not one of the eight brokers monitored daily on the database. Forecasts are downgraded by -9% for FY19 and the target price has been adjusted down to $2.05.

The database shows two Buy ratings and one Hold (UBS). Morgans (Buy) is yet to report on the update. The consensus target is $3.20, suggesting 42.2% upside to the last share price.

See also, Class Makes Progress Despite Competition on February 13, 2018.

Looking For Answers

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

-Looking For Answers -Conviction Calls -Rudi On TV -Rudi On Tour

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

Looking For Answers

By Rudi Filapek-Vandyck, Editor

After what turned out to be an unusually low volatility and robust uptrend in 2017, at least for US equities, the outlook for calendar 2018 was always going to be less predictable, and potentially a lot tougher. But only a few would have predicted things were about to dramatically change this early into the new calendar year.

Wall Street still had a few more weeks of unabated continuation of last year's market exuberance before anti-vol derivatives and the ugly side of bond market moves announced themselves. In Australia, the ASX200 has barely had a peek into what year-to-date positive performance looks like. And now US President Donald Trump is prepared to play all-or-nothing in a public game of political poker, or so it seems.

The result to date, apart from a significant spike in day-to-day volatility which the local share market tries its best not to follow blindly nor willingly, is a negative performance for Australian shares for the first three months of the new calendar year - a rather rare occurrence outside the bear markets of 2000-2003 and late 2007-early 2009.

Making this rare event even more exceptional is the fact Australian shares booked a negative performance for each of the three months that make up the first quarter. So much for the seasonal pattern that usually implies the best share market gains are generated between mid-October and late April (i.e. right now).

The two big questions on investors minds, no doubt, are:

-What does this mean for the rest of the year? -And is this the end of the nine year long bull market?

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Let me first follow up by stating that on my observation there is no such thing as a 100% reliable blueprint guide from the past. Just like you, I regularly see "analysis" (note the quotation marks) and predictions based upon copy and paste charts from 1987, or from the sixties and thirties, and given such predictions have constantly been proved blatantly inaccurate, I am quite amazed such comparisons keep on popping up, irrespective.

If this truly is the start of something more sinister, like the next bear market or US recession in 2019, events will unfold at their own speed and in their own way rather than to copy any pre-defined pattern from the past. But, to be honest, the past is readily available and there are occasions when valuable insights can be derived from it.

As such, the first conclusion is that calendar 2018 might not be a good year for the local share market.

According to data analysis conducted by Bell Potter Director of Institutional Sales and Trading, Richard Coppleson, the past 79 years have only seen the March quarter in negative performance territory, with all three months contributing negatively, a total of five times. This didn't even happen during the past two bear markets mentioned above.

On Coppleson's data research, it happened in 1982, in 1965, in 1952, and in 1939. Only in the latter case the bad start to the new calendar year was not an omen for an overall very bad year for the share market, with double digit negative annual returns following the three more recent occurrences.

However, given this never happened during the past two bear markets, and the fact US equities only had two bad months out of the three, it's probably more helpful to look at negative March quarters without the requirement of three negative months. After all, both January and February only recorded minor losses.

Negative-returning first quarter performances are still relative rare, but they do occur more regularly: nine times in the past 25 years, including 2018. Six of those occurrences are linked to the two noted bear markets: 2000-2003 and 2008-2010.

Investors with a good memory will remember that share markets fared well in 2009, after a dreadful opening to the new year, and the same happened again in 2010. The last time a negative Q1 quarter happened was in 2016 and by the end of the year indices were clocking off on double digit percentage gains.

Making matters even more complicated, US equities often ended the above mentioned years with sizable gains.

Within this context I'd like to remind everyone about comparable data analysis conducted by the team of quant analysts at Macquarie in 2016. That piece of analysis was limited to a negative return for the month of January, but its underlying conclusion is likely to apply regardless.

Macquarie's data analysis seems to suggest that a calendar year starting on the back foot is no guarantee for a negative performance for the full year overall; it just makes it more likely the full year won't be a fantastic experience for investors. This may well be a case of simple mathematics. Including dividends, the ASX200 Accumulation index from here onwards carries a negative circa -3.5% for the remaining nine months.

Another way of looking at Macquarie's research is: a smidgen less than half of all negative January performances have proven to be a bad omen for the remainder of the year. This means more than half of all cases turns out to be a disappointing start, and nothing more.

I'd say the underlying conclusion is thus: clearly, a negative start to the new year indicates there are problems. Both the duration and the severity of these problems will determine the outlook for equities for the remainder of the year.

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One reason for short term optimism is that we now have entered April, which not only is the fourth month on the calendar, but historically the strongest month out of the twelve in terms of average share market performance, with December a close second. Also, think about it: if three consecutive negative months for Q1 are extremely rare, what are the odds the share market adds a fourth negative performance?

On my observation a number of market strategists (at Shaw and Partners, Ord Minnett, Morgans,..) are predicting a swift rebound soon as valuations for index heavyweights the Big Four Banks have now fallen near the bottom of historical valuation ranges, while a similar observation applies also to a number of other blue chip stocks.

In terms of average Price Earnings (PE) ratio for the local market overall, weakness throughout the first quarter has now pushed the number down to 14.8x (December). The average dividend yield for the ASX200 is now 4.6%. Both are near long term averages implying the share market can no longer be labeled "expensive".

Throughout 2017 the local market's PE had been consistently near or above 16x while the dividend yield has been closer to 4%.

Some strategists are also referring to rising profit forecasts at the same time as share prices remain under pressure but FNArena's observation on this account is rather mixed. Note also the US corporate reporting season is about to start while in Australia the banks are preparing for the release of interim reports.

What is not apparent from these statistics is that the gap between lowly valued, low growth companies and the highly valued, high growth companies in March had again blown out to proportions not witnessed since mid-2016, after which a major money flow rotation ensued. I don't think a similar rotation is on the cards this time around, but that gap has only narrowed a smidgen since last month, and predominantly through banks, large resources, etc falling less than the likes of Altium, Afterpay Touch, Corporate Travel Management, Cochlear, et cetera.

Don't be surprised if the period ahead sees "value" outperforming "growth". Apart from the large gap between the two groups, banks and other low growth blue chip stocks look cheap on many an investor's spread sheet, and this is likely to attract attention. Also, with fear of inflation and rising bond yields rampant, investors feel safer buying into lowly priced assets rather than joining popular trades, which carry added risk of being a crowded trade.

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Paying attention to seasonal patterns is a popular endeavour among investors and their advisors. It is likely many will welcome an April bounce as the return to normal seasonal trading, even though January, February and March have proved to be rather unseasonal.

But with April-May often marking the end of the seasonal upswing for global equities, should investors now fear they will be given only a rather limited window of opportunity?

Here I think it is important to point out seasonal patterns only manifest themselves when nothing else more powerful impacts on financial markets. Usually, when normal patterns are broken this tends to also distort the pattern thereafter. Like when the September sell-off occurs in August, it won't happen again in September.

In similar fashion, it is my observation "Sell in May" tends not to apply when share markets already started on an uncharacteristically weak note during what is usually a strong performance period at the start of the new calendar year.

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Look beyond the short term, and beyond Trump's my-bazooka-is-bigger-than-yours approach towards China, and I must point out I have seldom witnessed such a bifurcation in views and predictions about what is really going on in the world of economics, interest rates, corporate profits and central bank policies, as is in place today.

Scenarios for the future being put forward are:

-Global growth is strong and shall remain strong. Against this backdrop, the Federal Reserve might be underestimating the inflation risks building in the US economy. Some are warning of an outbreak in inflation, which will force bonds to sell-off (yields higher) pushing equities in a downward spiral. Buy gold as protection as the US dollar shall remain weak;

-Others believe the US economy stands out as a beacon of strength, but Europe, Japan, China and emerging economies are already losing momentum, and the gap is only getting larger. This creates a whole different dynamic in that the US dollar will strengthen and thus technology stocks in the US will resume market leadership while US bond yield are being tamed through lower bond yields elsewhere;

-Others believe the US economy is not as strong and healthy as economic data suggest. One major point of contention is the declining savings rate for US consumers. Some are predicting the US economy might be on course for a recession in 2019. Look out for a flattening bond curve, and for potentially significantly lower share prices;

-In Australia some experts have started talking about the RBA potentially having to support consumer spending in 2019 by cutting the cash rate, rather than starting to lift rates. There are increasing signals stress is building among investors looking to sell apartments, while luxury goods are no longer flying off the shelves, with debt collectors observing asset rich but cashflow poor Australian households seem increasingly under financial duress.

Some experts see potential for a genuine credit crunch as authorities clamp down further on the Big Four banks post Royal Commission embarrassment.

I think it remains way too early to decide which of these scenarios might get the upper hand, but the consequences of getting it wrong will be severe, if not disastrous. This is why I expect financial markets to remain on tenterhooks for much longer.

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Rudi's View: Ramsay Health Care, Xero And Computershare

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

-Looking For Answers -Conviction Calls -Rudi On TV -Rudi On Tour

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

Conviction Calls

By Rudi Filapek-Vandyck, Editor

Stockbroker Morgans has added Cleanaway Waste Management ((CWY)) to its selection of Conviction Calls in the Australian share market. Cleanaway joins Suncorp ((SUN)), Link Administration ((LNK)), BHP ((BHP)), Westpac ((WBC)) and Oil Search ((OSH)) among large caps, and Senex Energy ((SXY)), PWR Holdings ((PWH)) and CML Group ((CGR)) outside of the Top100.

Cleanaway joins the selection after a presentation by the CEO which "helped reinforce confidence" in the stockbroker's positive outlook for the company.

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Ord Minnett also has used a general update on investment matters -Investment Insights June Quarter Update- to line up its favourites among listed Australian entities.

Among so-called blue chip stocks, still considered "core" for longer term investment portfolios, Ord Minnett has selected the following nine:

AGL Energy ((AGL)), ANZ Bank ((ANZ)), CSL ((CSL)), GPT Group ((GPT)), Oil Search ((OSH)), Ramsay Health Care ((RHC)), Rio Tinto ((RIO)), Transurban ((TCL)), and Westpac ((WBC)).

For Value investors, the following selection of favourites applies:

AMP ((AMP)), APA Group ((APA)), Charter Hall ((CHC)), Event Hospitality and Entertainment ((EVT)), National Australia Bank ((NAB)), Suncorp, and Wesfarmers ((WES)).

Growth oriented investors have the following seven favourites to choose from:

Aristocrat Leisure ((ALL)), Boral ((BLD)), Caltex Australia ((CTX)), Macquarie Group ((MQG)), Magellan Financial Group ((MFG)), Orora ((ORA)), and Treasury Wine Estates ((TWE)).

Ord Minnett's selected favourites among small caps include:

Afterpay Touch ((APT)), Austal ((ASB)), Corporate Travel Management ((CTD)), Hansen Technologies ((HSN)), Hub24 ((HUB)), People Infrastructure ((PPE)), Pinnacle Investment Management ((PNI)), RCR Tomlinson ((RCR)), Service Stream ((SSM)), Steadfast Group ((SDF)), and WorleyParsons ((WOR)).

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Here's one casual observation in relationship to the list of Conviction Calls published by Wilsons; components tend to drop off not because their share price has rallied hard, but because of operational disappointment which then leads to significant weakness in the share price. The latest victim, so to speak, has been Opthea ((OPT)), small cap biotech trying to develop commercial solutions in ophthalmology (eye diseases).

With the share price down approximately by -50% over the year past, Wilsons has now kicked Opthea off its Conviction Calls list. Reason: "A lack of consistent catalysts ... could cause short-term underperformance".

Remaining on the list: Afterpay Touch, Bravura Solutions ((BVA)), Melbourne IT ((MLB)), Ruralco ((RHL)), Collins Foods ((CKF)), Ridley Corp ((RIC)), ImpediMed ((IPD)), Nanosonics ((NAN)), Citadel Group ((CGL)), and Pinnacle Investment.

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CLSA updated their local favourites through the Australia Top15 selection. The following new members have been added: Qantas ((QAN)), Transurban, Link Administration, CYBG ((CYB)), Xero ((XRO)) and Mirvac Group ((MRG)). The following names have been removed: AGL Energy, Scentre Group ((SCG)), Challenger ((CGF)), Ramsay Health Care, Sydney Airport ((SYD)), and Computershare ((CPU)).

This leaves the following components retaining their inclusion: Rio Tinto ((RIO)), a2 Milk ((A2M)), Speedcast International ((SDA)), Macquarie Group, National Australia Bank, CSL, Tabcorp Holdings ((TAH)), Treasury Wine Estates, and OZ Minerals ((OZL)).

Also, on Monday CLSA issued two 60 page reports on Incitec Pivot and Ramsay Health Care respectively. Both exercises in in-depth analysis resulted in positive revisions. Regarding Incitec Pivot, CLSA analysts note how over-supply concerns for fertilisers in Australia have kept a lid on the share price, but it is their prediction the market is migrating towards under-supply. Hence an upgrade to Buy from Outperform, with a price target of $21.

For Ramsay Health Care, investors should expect below average growth in FY19, but with momentum projected to pick up again into double digit percentage thereafter. The number of new operating theatres is expected to pick up again, while competitors are looking the other way, and current problems with regard governments in the UK and in France are expected to be resolved by then as well. On a three year horizon Ramsay shares look significantly undervalued on CLSA's projections. Hence the upgrade to Buy from Outperform, with a rise in price target to $77.80 from $74.50.

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And finally, the latest update on Citi's High Conviction list contains Aristocrat Leisure, ALS ltd ((ALQ)), BlueScope Steel ((BSL)), Computershare, Downer EDI ((DOW)), Incitec Pivot, Galaxy Resources ((GXY)), Star Entertainment Group ((SGR)), and Xero on the "long" side (positive view), with JB Hi-Fi ((JBH)) the only one listed on the "short" side (negative view).

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