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Will The Banks Cut Dividends?

Brokers weigh up a subdued outlook for major banks ahead of interim reports in early May. Dividend reductions are considered highly probable, particularly at National Australia Bank.

-Rising credit losses should be monitored, Citi advises -Trading income and banking fees likely to remain under pressure -Modest dividend reductions could be forthcoming, particularly at NAB

By Eva Brocklehurst

Yields on banking stocks are in the sights of brokers, as interim results reporting nears and another major bank discloses further remediation costs. National Australia Bank ((NAB)) has advised it will review its dividend at the first half result, after reporting remediation-related charges of $525m after-tax for the first half. Of the charges, around 91% relate to the wealth business.

The three major banks, National Australia Bank, ANZ Bank ((ANZ)) and Westpac ((WBC)) will report interim results in early May. Macquarie Group ((MQG)) will also report FY19 results on May 3.

Credit Suisse believes the sector is exposed to earnings downgrades, amid lower asset growth and continued margin pressure. Moreover, asset quality will provide little in the way of protection from the headwinds.

JPMorgan expects the results to be messy, because of significant remediation costs, while net interest margins should reflect ongoing competition for mortgages. National Australia Bank is expected to show the best cash profit growth while ANZ Bank is likely to lag.

RBNZ Uncertainty

Benign asset quality trends are expected and capital positions remain solid, as major banks all should be above the 10.5% CET1 ratio. Still, the broker suspects further capital management plans are likely to be tempered by the proposed capital rules outlined by the Reserve Bank of New Zealand.

Concerns were raised about the stance of the RBNZ and its proposed new capital rules, but these concerns have now softened as has the potential for adverse capital or a dividend event, Citi suggests.

Credit Suisse expects ANZ Bank to provide a disappointing first half result, with a subdued balance sheet and continued margin pressure. The banks are expected to improve their expense verification while mortgage re-pricing should allow net interest margins to recover, although this may be competed away or affected by mix and switching.

Meanwhile, trading income and banking fees are likely to remain under pressure. Alarm bells will ring for the broker if there is any weakness in the upcoming first half reports in terms of mortgages and the automotive, small-medium enterprise (SME) and consumer segments.

For Macquarie Group, Credit Suisse believes it will be about maiden guidance for FY20 from the new CEO. A conservative statement is considered the likely starting point and key to this will be the proportion of performance fees from recent transactions that appear in FY19 or FY20.

Dividends

Dividend forecasts are starting to diverge and Citi notes an increasing propensity to cuts to dividend forecasts in outer years on the basis of tight capital positions, remediation costs and potential macro concerns across the sector.

Yet the broker assumes dividends remain flat. Citi notes National Australia Bank faced a similar dilemma when its dividend pay-out ratios were in excess of 90% at times in 2014, 2015 and also 2018. The bank chose to hold the dividend steady and look through the one-off items.

However, in the midst of a leadership transition, the board may take a different approach this time, the broker acknowledges. Major banks have, historically, only cut their dividends during times of credit stress. This occurred in the early 1990s, 2009 and 2016 in the case of ANZ Bank, driven by deteriorating asset quality.

Only in a broad-based economic downturn or recession would dividends be expected to be cut dramatically. The broker calculates that a credit loss scenario where losses peaked at 60 basis points (2008/09 peaked at 80bps) would result in reductions to Commonwealth Bank's dividend of -30% and the remaining three major banks around -15%.

More significantly, a credit stress event would affect ANZ Bank and Commonwealth Bank ((CBA)) to a lesser extent than National Australia Bank and Westpac, and Citi's current order of preference in the banks would reverse in favour of the former two if that was the case.

UBS expects all banks to maintain their dividends, given pressure to release franking credits before a potential change in government. Still, reductions are not completely discounted because of the NZ environment, remediation costs and asset quality.

Morgans takes the recent statement from National Australia Bank - that the dividend will be reviewed at the first half - to mean that it will be cut. While the bank is sticking with first half guidance for expenses growth to be broadly flat, Morgans expects it will underperform the other majors on costs over the next two years. This is because the transformation strategy and productivity savings target laid out by the former CEO Andrew Thorburn have been jeopardised by his departure.

Ord Minnett is increasingly confident National Australia Bank will cut its first half dividend to $0.90 a share, down 9c, yet notes it is still trading on a healthy 7% dividend yield. Credit Suisse and JPMorgan agree with a cut to $0.90 per share for the half year, returning pay-out to a more sustainable level around 82%. JPMorgan expects a flat dividend of $0.94 per share for Westpac, representing a pay-out ratio of 95%.

Yet Citi believes investors are unnecessarily concerned about the high pay-out ratios. The emergence of small dividend adjustments because of high remediation and regulatory costs does not explain the underperformance in the sector versus other yield sectors.

Citi asserts a relatively benign environment for asset quality and credit losses remains key. If there is a meaningful step up in credit losses then the outlook may change, but until dividends are reduced significantly, and capital is called on, the banking sector will remain defensive and offer relative outperformance.

See also Bank Woes Unlikely To Abate Soon on April 5, 2019.

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Manganese Lights The Outlook For South32

The main positive from the South 32 quarterly production numbers was the performance of manganese assets while thermal coal was a key point of weakness.

-Raw material prices still adversely affecting aluminium smelter costs -Guidance reduced for both alumina and thermal coal production -Illawarra Coal production expected to lift in the June quarter

By Eva Brocklehurst

The outlook for diversified miner, South32 ((S32)), is mixed. A recent fall in the alumina price has emerged as a headwind just as the company lowers alumina production guidance, and thermal coal was a key point of weakness in the March quarter.

The main positive in the quarterly report was the performance of the manganese assets. In one of its few upgrades to forecasts, Macquarie upgrades the production outlook for both GEMCO (Groote Eylandt) and Hotazel (South Africa) to match guidance for FY19. Manganese assets in South Africa also benefited from a slight reduction in cash costs.

Otherwise, Credit Suisse finds some comfort in the fact there were no changes to unit costs guidance and suggests there are plenty of catalysts for the stock over the next 3-6 months, including the potential for more capital management. UBS notes the company returned US$37m via an on-market buyback in the March quarter and still has around US$75m left to return as part of a US$1bn capital management program that should be completed by September.

While cost guidance is unchanged, Macquarie remains sceptical and believes a miss on cost targets is now likely for a number of assets, with Worsley alumina (Western Australia) and Cerro Matoso multi-metal (Colombia) production most at risk. The company has also highlighted that raw material prices are still adversely affecting aluminium smelter costs.

Silver and lead sales from Cannington (Queensland) were materially lower in the quarter, reflecting the impact of flooding and a lack of rail availability. The company remains confident the shipments can be made up in the June quarter.

Alumina

Guidance has been reduced for two of the company's key cash-generating assets. Alumina production has been reduced by -4-5% and thermal coal by -6%. The lower production and higher costs have translated to -14-22% reductions to Macquarie's earnings forecasts for the next four years. As upgrade momentum has vanished the broker downgrades to Neutral from Outperform.

However, the stock appears fairly valued to Ord Minnett, based on a 4% forecast dividend yield on a one-year forward enterprise value/operating earnings (EV/EBITDA) multiple of 5.3x. The broker suspects, given the recent history of production downgrades, that this may weigh on market sentiment towards the stock.

Outages from maintenance at Worsley caused a reduction in alumina production in the quarter, while power outages and a poor boiler performance at Alumar (Brazil) also meant production was lower than expected. Guidance for both assets in FY19 have been reduced by -4% and -5% respectively.

Both Hillside (South Africa) and Mozal (Mozambique) aluminium smelters continue to experience elevated alumina prices while power availability is a growing issue. There was significant damage to power lines in Mozambique from Cyclone Idai.

Coal

Production of metallurgical (coking) coal at Illawarra (NSW) improved, although production guidance is unchanged, which suggests to Macquarie that assumptions of a recovery post the longwall move are likely to be to optimistic. UBS is more positive, looking for Illawarra production to lift by around 30% in the June quarter.

Meanwhile, South African energy coal shipments and production were weak, attributed to community protests, delays and a slower ramping up of the dragline at Klipspruit. A formal sale of the asset is expected to be completed

in the first half of 2020. The company continues to expect binding bids in the June quarter and once these have been received the asset will be classified as a discontinued operation.

FNArena's database shows four Buy ratings and three Hold for South32. The consensus target is $3.91, suggesting 12.6% upside to the last share price. The dividend yield on FY19 and FY20 forecasts is 4.8%.

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Growth Strategies Still Critical For Sandfire

The high-grade Monty copper-gold mine has made its first contribution to Sandfire Resources' production in the March quarter but exploration remains critical to the medium-term outlook.

-Monty ramps up, with first contribution to the DeGrussa mill -Clarifying growth strategies critically important -Formal approval of Black Butte could occur in next six months

By Eva Brocklehurst

Improved copper and gold recovery enhance the outlook for Sandfire Resources ((SFR)) after a strong performance in the March quarter, and brokers highlight the company's consistent track record of beating or meeting guidance from better grade reconciliation.

Monty made its first contribution from stope ore in the March quarter, supplying 38,519t of copper at 3.74% grade to the DeGrussa (Western Australia) mill. The initial schedule involves projects that are less than the copper reserve of 8.7%.

The high-grade Monty orebody should lift production in FY20, although it comes with higher mining and haulage costs. The company has upgraded FY19 production guidance by 3% for copper, to 66-68,000 tonnes, and by 6% for gold, to 40-42,000 ounces. UBS suggests guidance is conservative, as Monty is ramping up and this mine has a higher grade profile compared with DeGrussa, at 8-9% versus 4%.

Moreover, Credit Suisse points out diesel and gold prices have moved favourably for Sandfire Resources versus original expectations, while grade recovery at DeGrussa has also outperformed.

March quarter production of copper and gold was ahead of Macquarie's estimates by 5% and 15% respectively. Higher throughput at the mill was the main driver of the stronger result and costs were also lower than the broker had estimated.

Higher average grades should also be forthcoming as mining progresses to the core of the Monty orebody, providing a better grade mix at the DeGrussa mill, and supporting an increase in recovery to 93-94% on Credit Suisse estimates.

Yet, the broker also points out, as Monty ramps up and the DeGrussa mine reduces its contribution to the mill, unit costs will rise, potentially exacerbated by increased average depth and declining average grade. Sandfire Resources generates strong cash flow from DeGrussa and Monty will contribute, but the mine life is short, at just under four years. Hence, brokers believe new discoveries are urgently required.

The company continues its exploration in the Doolgunna region with most of the focus on Morck's Well to test geochemical anomalies. Canaccord Genuity also flags further news flow potential from the phase 1 of the farm-in with Alchemy Resources ((ALY)), which has copper sediments analogous to the DeGrussa deposit.

The broker, not one of the eight monitored daily on the FNArena database, believes Sandfire Resources is entering a period of strong cash flow but clarifying growth strategies is the next critical step. The broker maintains a Hold rating and $7.65 target.

Black Butte

The Black Butte copper project in the US could represent the next stage for Sandfire Resources. Work on the Black Butte feasibility study is in progress and due for completion in mid 2019 and the company could be in a position to formally approve the project in the next six months. The environmental impact study has been completed and an updated mineral resource and mine design are being undertaken along with a maiden ore reserve estimate.

Ord Minnett looks forward to the release of the feasibility study to gain a better insight into the growth outlook beyond current operations at DeGrussa. A development could take 2-2.5 years to first production and UBS, therefore, does not include development of Black Butte in forecasts at this stage.

FNArena's database shows two Buy ratings, four Hold and two Sell. The consensus target is $7.50, suggesting 0.8% upside to the last share price. The dividend yield on FY19 and FY20 forecasts is 3.6% and 5.9% respectively.

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Northern Star Pins Hope On Pogo Recovery

Gold miner Northern Star Resources had a less-than-stellar March quarter, largely because of delays to the arrival of new mining equipment at Pogo.

-Access to higher grade gold expected in the June quarter -Recent weakness in the share price has improved the risk/reward balance -Pogo remains key to several brokers' longer-term view on Northern Star

By Eva Brocklehurst

The March quarter went awry for Northern Star Resources ((NST)), as a change from contract mining to owner operations at the newly-acquired Pogo mine in Alaska meant a delay in getting equipment to site and training operators. As a result, costs spiralled upwards.

Pogo produced just 33,000 ounces in the March quarter and all-in sustaining costs (AISC) were $2062/oz, which meant that the asset was negative on cash flow in the quarter. This has forced Northern Star to increase FY19 cost guidance to $1225-1275/oz.

Australian assets delivered quarterly improvements, as expected, and the company is targeting 235-260,000 ounces at AISC of $1075-1175/oz in the June quarter. This target includes 50,000 ounces from Pogo, based on the equipment already at site.

Production guidance for the quarter is up 26-40% from the March quarter. While this is substantially higher, UBS believes it is credible. Northern Star traditionally reports a very strong June quarter because of a lack of maintenance, ahead of access to high grade ore. The investment in development during the first to the third quarters means access to higher grade stopes is greater in the fourth quarter.

Credit Suisse suspects the company will use Kalgoorlie toll milling capacity to improve Australian production, by accessing 50,000 ounces of stockpiled ore in order to cover for the Pogo shortfall. The March quarter delivered only 21% of the full year guidance at the mid point and Pogo provided only 13%. FY19 production guidance has been maintained for 850-900,000 ounces of gold.

The stock has had a premium rating, driven by consistently beating expectations and guidance. UBS suspects a repeat of the last couple of quarters may put this premium at risk. Nevertheless, recent weakness in the share price has improved the risk/reward balance and the stock is now at narrow discount to the broker's valuation.

Canaccord Genuity considers the pullback in the share price offers an attractive entry point for a well-established gold producer. The broker, not one of the eight monitored daily on the FNArena database, retains a Buy rating and $9.55 target. Credit Suisse asserts the company's reputation and that of management is firmly hitched to the performance at Pogo.

Pogo

Only five of a planned 16 new items of underground equipment arrived in the March quarter at Pogo. It will take several quarters for the higher grade ore from stoping to reach the 60% of feed that is anticipated. The company is guiding towards a 60:40 stoping to development ratio in coming quarters. UBS is confident the new mining method is already improving the cost base of the mine.

While the quarter was negative, the broker believes it will be ultimately immaterial if the turnaround at Pogo is successful. Management has only controlled Pogo for six months and believes it will take 18 months for the full benefits of the mine plan to occur.

Canaccord Genuity agrees and foresees a bright future for Pogo, as the issues can be comfortably addressed over the next 6-12 months. The broker forecasts Pogo at a steady state run rate of 300,000 ounces per annum by FY21.

Credit Suisse notes the underlying potential of Pogo is based on geology and the company has assessed it as a repeat of the Jundee story, requiring infill and extension drilling to support higher production and longer mine life.

UBS is also confident the new equipment at Pogo should lift productivity. A maiden JORC reserve is expected from Pogo as well as updates to resources and reserves and other assets at the results in August.

UBS remodels Pogo where forecasts were too optimistic on throughput and grade, but suspects that the next catalysts for the company will be positive. Pogo also remains key to Macquarie's longer-term outlook for Northern Star. The broker awaits FY20 production guidance and the long-term outlook as well as the maiden resource/reserve statement.

Incorporating the soft March quarter result and a lift in production expectations towards the fourth quarter guidance means Macquarie lowers FY19 estimates for earnings per share by -21%. Reducing grade growth expectations at Pogo means FY20 estimates are lowered by -8%.

Kalgoorlie

Credit Suisse also points out the much vaunted South Kalgoorlie operation is opaque and the promises for the near term cannot be assessed adequately. There is no visibility on production or cost sustainability, as the depletion rate of ore sources is unknown.

Management had previously indicated that FY19 guidance was conservative, particularly with respect to the assumed negligible contribution for the Jubilee mill. This 'conservative' description now appears to Credit Suisse to be less likely.

However, Kalgoorlie and Jundee are expected, in combination, to deliver the top end of guidance and provide a very strong June quarter. Management has stressed that guidance comes from deferred grade and not the pulling forward of grade from FY20.

FNArena's database has two Buy ratings, two Hold and three Sell. The consensus target is $8.30, signalling 0.5% upside to the last share price. Targets range from $6.60 (Morgan Stanley) to $10.30 (Macquarie).

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Palladium Shifting Into Higher Gear

Richard (Rick) Mills Ahead of the Herd

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

Palladium, darling of the PGEs, shifting into high gear

The platinum group elements (PGEs) consist of six metallic elements found in the Periodic Table: iridium (Ir), osmium (Os), palladium (Pd), platinum (Pt), rhodium (Rh) and ruthenium (Ru). Platinum and palladium are the most well-known of the PGEs due to their industrial applications in diesel and gasoline engines. The market for palladium has become especially interesting of late, with the price of the silvery-white metal gaining 18% in 2018, an otherwise down year for metals. Scaling an uncharted $1,600 per ounce in March, palladium is up 70% from a year ago.

We'll get into the reasons for that in this article, and much more, as we dig deep into the world of PGEs.

Characteristics

PGEs share similar physical and chemical properties, and they usually occur together in the same orebodies. The similarities include a resistance to corrosion, high melting points, and catalytic qualities, meaning they speed up chemical reactions without themselves being chemically altered.

PGEs are the densest of the metallic elements, and they are highly durable. This, along with their high value because of their rarity, make them ideal candidates for recycling.

The first known mining of platinum and palladium alloys is thought to have occurred in pre-Columbian South America (Colombia and Ecuador), where indigenous people mined them from stream sediments and shaped them into jewelry. According to the US Geological Survey (USGS), after 1500 the Spaniards, upon finding platinum grains mixed with gold nuggets in stream deposits, named the metal "platina" meaning "small silver". However it was considered to be a worthless impurity. Platinum was named a new metal in 1750, followed by the rest of the PGE group, in the early 1800s.

Geology

PGEs are among the rarest of elements in the Earth's crust. The crust has just 0.0005 parts per million (ppm) platinum for example, compared to 60 million ppm copper and 0.075 Mppm silver and 0.004 Mppm gold.

Over 100 minerals contain components of PGEs, but they are too small to see with the naked eye. Their presence must generally be confirmed by lab analysis. Most PGEs are concentrated in magmatic ore deposits, formed millions of years ago when magma flowed up from Earth's mantle, cooled and crystallized. Through this process, PGE-rich sulfides accumulated to form PGE deposits. When PGE-enriched rocks eroded, through the movement of water, PGE-enriched placer deposits formed.

Uses of PGEs

The leading use of PGEs is in catalytic converters. These essential automobile components scrub tailpipe emissions in gas or diesel-fueled vehicles.

Palladium is an ingredient in catalytic converters for gasoline-powered cars, vans and trucks; platinum is in the catalytic converters of diesel vehicles. Autocatalyst demand accounts for three-quarters of palladium demand. Twenty-five to 50% of palladium is routinely substituted for platinum in catalytic converters, due to its normally lower price. However that is now reversed, with the price of palladium about double that of platinum. If that dynamic stays the same, carmakers will substitute platinum for higher-priced palladium.

I was surprised to read that, according to the International Platinum Group Metals Association (IPA), one-quarter of all manufactured goods either contain a PGE, or a PGE played a key role in its production. That makes PGEs indispensable for industrial applications.

The chemical industry for example needs platinum or platinum-rhodium alloys to make specialty silicones and nitric oxide - the raw material in fertilizers, explosives and nitric acid. Platinum-supported catalysts are used to refine crude oil and to produce high-octane gasoline. They are also heavily applied in electronics, with PGE components

utilized to increase storage capacities in computer hard disk drives, in multilayer ceramic capacitors, and hybridized integrated circuits. PGEs are needed to produce fiberglass, liquid-crystal and flat-panel displays.

Platinum and iridium's non-corrosive qualities make them ideal for medical implants such as pacemakers, and surgical tools. Palladium, platinum and rhodium are also investment metals, bought and sold as bars, coins or ETFs.

An emerging market for platinum is in the manufacture of hydrogen fuel cells. Platinum is used to spur the chemical reaction of hydrogen with oxygen. Recognized as powering NASA's 1969-72 moon landers, the process produces electricity and water. In the case of a fuel-cell electric vehicle, hydrogen is stored in a fuel tank before it is mixed with oxygen from the air.

Platinum demand for hydrogen fuel cells is set to increase into the 2020s, according to a report from Heraeus Precious Metals:

"Several thousand ounces of platinum are used annually and this will grow as the technology is rolled out, potentially exceeding 100,000 ounces per year in the late 2020s."

Market for PGEs

Out of 69 million tonnes of PGEs found worldwide, South Africa's Bushveld Complex has the largest reserves of platinum and palladium - 63 million tonnes as of 2018, according to the USGS. Russia and Zimbabwe are a respective second and third. The US Geological Survey notes that about 104,000 tonnes of PGEs could be developed throughout the world.

South Africa is also far and away the largest Pt and Pd producer in the world, outputting 178,000 tonnes combined last year. Canada is a significant producer of PGEs, mining and processing 17,000 tonnes of palladium and 9,500 tonnes of platinum in 2018.

Up until 1920, nearly all PGE production came from placer deposits in Russia and Colombia. PGE mining now takes place mostly in Siberia and South Africa.

PGE supply insecurity

The United States is heavily dependent on external sources for PGEs, importing about 90% of the PGE metals it consumes.

Platinum group metals were included among a 2018 list of 37 mineral commodities the United States considers critical to its economic security and national security. North America only has two producing platinum and palladium mines - Stillwater in Montana and North American Palladium's Lac des Iles mine northwest of Thunder Bay, Ontario.

Canadian PGEs are also recovered as a by-product of nickel mining, mostly from the Sudbury Basin, as well as northern Quebec and Manitoba. About three-quarters of Canadian PGE production is sold to the United States.

The United States gets 31% of its palladium and 44% of its platinum from South Africa; Russia supplies 28% of US palladium needs.

According to the US Geological Survey, the supply of PGEs from South Africa, the number one producer, is anything but guaranteed. Last year production there fell compared to 2017, owing to jobs cuts and mine shaft closures - a trend that is likely to continue.

"Production was expected to continue decreasing as the world's third-leading PGM-mining company, by production volume, announced plans to cut 13,000 jobs over the next two years at some of its mines in South Africa," states USGS.

Another key factor affecting supply: Platinum mining in South Africa is frequently interrupted by labour unrest. In 2014 workers at the country's three major producers - Lonmin, Anglo American Platinum and Impala Platinum - downed tools for five months demanding that wages be doubled. The strike was the longest and most expensive in South African history, shutting down about 40% of the world's platinum production.

The industry was bracing for another shutdown this year but won a reprieve in February after a court reserved judgment on whether to block a scheduled week-long strike. Bloomberg reported the Minerals Council lobby group saying that producers could lose 1.3 tons of PGE production equal to $36 million, every day the workers stay off the job. Impala Platinum would be "devastated" by a labor disruption, its CEO said in a statement, as it tries to restructure its Rustenburg operations to stem losses.

The country's platinum miners are under constant pressure to contain costs, because their mines are some of the deepest and most labor-intensive in the world. High temperatures are also a serious issue. Platinum is being mined in reefs up to two kilometers deep, where virgin rock temperatures have been measured at 70 degrees C. Anglo

American considers 75 degrees to be the limit for mining, taking into account the metals prices, energy costs and available technology needed in such an operating environment.

There are significant infrastructure constraints, too. The country has limited processing capacity and water is a constant concern. Last summer Cape Town came dangerously close to running out of water and was only saved from "Day Zero" by stringent restrictions on water usage. In early 2018 officials in Cape Town warned that unless drastic conservation measures were taken, by summer the city's 4 million residents would be forced to cue up for drinking water surrounded by armed guards. "Day Zero", when taps would be turned off due to perilously low reservoir levels, was originally predicted for July 2018 but has now been pushed back to 2019.

Power in South Africa is notoriously unreliable - blackouts are frequent. In 2008 the country's electricity grid nearly collapsed due to a shortage of coal for power stations and system faults. Eskom, the main utility, ordered all mining operations to evacuate underground staff and to stop mining for five days, then cut electricity supply across South Africa to minimum levels; the mining industry uses about 15% of Eskom's output. The stoppage, affecting roughly a quarter of generating capacity, cost the industry billions in lost output.

In February, Reuters reported that Eskom imposed the worst power cuts in years on homes and businesses, as the utility grappled with another crisis within its crumbling power infrastructure.

While the prices of platinum, palladium and rhodium have all gained in recent months (platinum has risen 13.7% since the beginning of February, to $886.80/oz) thus helping the bottom lines of South African producers, Anglo American Platinum's CEO has gone on record as saying that doesn't mean the industry will boost supply.

CEO Chris Griffith told Bloomberg it takes between five and seven years to open a new mine, and while some expansions are underway (like Rustenburg), the increased output is likely to just replace supply declines elsewhere; the end result will be a flat supply curve over the next decade.

"We can bring metal to the market probably faster than anyone can, and that's four to five years away," Griffith said. "Very few companies in South Africa have the ability and real estate they can develop new mines on."

Platinum

The platinum market is currently oversupplied, with prices trailing both gold and palladium.

In January the precious metal dropped to a near 14-year low. According to a recent report from the World Platinum Investment Council, the market is predicted to move further into surplus this year, to 680,000 ounces compared to the 645,000-ounce surplus in 2018. The main problem is mined supply outstripping consumption. Platinum is flowing into the market from mine stockpiles and smelters in South Africa, that accumulated during upgrades and maintenance over 2017 and 2018, states WPIC. US platinum production is expected to expand eight-fold, from 50,000 ounces to 210,000 oz.

However, the precious metal that is a popular material for jewelry, has fought back since the beginning of February, rising from $780 an ounce to $886.80/oz as of April 10 - a gain of 13.7%.

Palladium

Discovered by William Wollaston in 1803, palladium was named after the asteroid ‘Pallas'. Demand for the metallic element has surged since 2016 with the movement away from more polluting diesel-fueled vehicles. The price has more than doubled over the last three years (+124%) and ran up 18% in 2018. That compares to declines in spot gold, platinum and silver last year.

As drivers shift from diesel to gas-powered cars or hybrids, the market for palladium used in gasoline engines has buoyed the price. In 2017 palladium raced past $1,700 an ounce for the first time since 2001.

Despite automobile demand slumping in China last year, palladium finished 2018 at $1,262 an ounce - almost catching gold's year-end close of $1,282/oz.

The increasing use of palladium in hybrid vehicles deserves more fleshing out. An executive at Russian nickel and palladium miner Norilsk Nickel PJSC said recently that the combined use of palladium in hybrid and plug-in hybrid/rechargeable vehicles is set to triple this year compared to 2016. A 2018 report by JP Morgan Chase & Co. predicts hybrids are expected to grow from 3% of global marketshare to 23% by 2025.

Like platinum, palladium is facing constricted supply.

According to a report from Sprott Asset Management, "Supply shortages continue to support palladium's performance, with strong multi-year growth in palladium demand now straining a fixed supply." The Sprott report also notes that supply for palladium is inelastic because it's usually a by-product of other ores like platinum and rhodium.

South African palladium is a by-product of platinum mining and palladium from Russia is a by-product of nickel. Between them, the two countries control almost 90% of the palladium market.

On March 19, 2019, palladium prices rocketed past $1,600 an ounce, the market's reaction to news that top producer Russia is considering banning the export of precious metals scrap, refining it domestically instead.

That was on top of an announcement that Fiat Chrysler has been ordered to recall almost a million vehicles over failed emissions testing. In conjunction with that recall, prices for rhodium, which also go into catalytic converters, traded above $3,000 an ounce in March, MINING.com reported. The recall is expected to strip out 25,000 ounces of rhodium demand.

Conclusion

Platinum group metals are extremely advantageous for exploration or mining companies to have in their deposits because PGEs provide a "kick" to lower-value base metals. Consider for example a VMS deposit that is rich in copper and zinc, but also has platinum and palladium by-products. When base metals prices are up, those PGEs are a nice extra to have, and if copper and zinc prices slump, that miner will be thankful for the PGEs, whose prices normally rise when base metals fall.

PGEs also fit in with the electrification trend I continue to follow and invest in. Palladium, platinum and rhodium are not only used in catalytic converters required for diesel/gas-powered vehicles, but cleaner and greener hybrids. Platinum also has an emerging use in fuel-cell vehicles.

I like PGEs because they're rare, and the market is in no danger of oversupply. The leading platinum producers are saying there's no way we're looking at a glut anytime soon, for all the above-mentioned factors: labor disruptions at South African platinum mines, power outages, expansion problems due to constrained water supplies and processing capacity, not to mention the fact that platinum mining is difficult and expensive - it's not easy to increase production even if prices rise considerably. And it takes five to seven years to open a new mine.

We also need to emphasize that PGEs are critical metals. A relatively small amount is mined in the US and Canada - the most friendly country to the United States in the event of a supply disruption. Who are the alternatives? Russia, Zimbabwe and South Africa. Russia is the target of US sanctions and a constant thorn in its side, Zimbabwe has a basket-case economy, and South Africa can't be counted on for a reliable supply of PGEs, due to the factors I've outlined.

For all these reasons I have PGEs and PGE explorers on my radar screen. At Ahead of the Herd we know investable, palladium pure play juniors are as scarce as the metal itself. Stay tuned, we'll be rolling out our top choice very soon.

Richard (Rick) Mills

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

WallStreetJournal, USAToday, NationalPost, Lewrockwell, MontrealGazette, VancouverSun, CBSnews, HuffingtonPost, Londonthenews, Wealthwire, CalgaryHerald, Forbes, Dallasnews, SGTReport, Vantagewire, Indiatimes, ninemsn, ibtimes and the Association of Mining Analysts.

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

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

ESG Focus: Coal Showdown At The ESG Corral - Part Two

FNArena's dedicated ESG Focus news section zooms in on matters Environmental, Social & Governance (ESG) that are increasingly guiding investors preferences and decisions globally. For more news updates, past and future: https://www.fnarena.com/index.php/financial-news/daily-financial-news/category/esg-focus/

Consensus is that it's not a matter of 'if' for coal's decline but 'when'. In this second part, FNArena reviews direct impacts from regulators, court cases, new taxes and changing public opinion.

-RBA has now identified climate change as an important factor for its policies - Rocky Hill coalmine refusal in NSW court a global first -Nearly 1,000 climate change related cases have been filed globally across 25 countries - adoption of global carbon tax will change the economics of coal generation

By Sarah Mills

Regulations and legal precedents start to bite

The global economic-political scene is beginning to be marked by a weird schizophrenia, as governments, investors, and companies try to conduct business as usual and promote trade, while palming off billion-dollar carbon risks to each other – all while sidestepping the not insubstantial political risk – in a dangerous game of musical chairs.

Earlier in March, Western Australia's Environmental Protection Authority announced new unlegislated guidelines for carbon dioxide emissions at all new LNG projects emitting more than 100ktpa of carbon dioxide. The government has since quashed guidelines, responding to pressure from miners.

But what was interesting about the EPA announcement is that it gave the WA Labor Premier Mark McGowan an opportunity to call for a national solution to the issue. Heading into a Federal election, this is significant. Federal Labor plans to create a Federal Environmental Protection Authority and Climate Change Action Plan with a legal cap on pollution and carbon offsets.

On March 12, the Australian Reserve Bank Deputy Governor Guy Debelle, speaking at the Centre for Policy Development, issued a warning about the risks that climate change posed to the economy.

Debelle initially focused on drought and weather risks, but he eventually got to the elephant in the room and singled out energy, pointing to the transition to renewables under way in the energy sector now that they have become a "cost-effective source of generation".

See also: https://www.fnarena.com/index.php/2019/03/22/esg-focus-changing-climate-has-rbas-attention/

Domestic court cases

The other major front to heat up in 2019 domestically and globally was that of legal precedent.

Last month, Australia's most senior environmental judicial officer Justice Brian Preston declared the Rocky Hill coalmine near the picturesque NSW tourist town of Gloucester to be unlawful on two counts: that it contributed to global warming; and that it is too close to Gloucester.

The company can appeal but even if a higher court ruled against the climate ruling, there is a strong chance the court would uphold the point that the mine is too close to Gloucester, which will have major ramifications for other mines.

It is the first time an Australian court has ruled on a mine's contribution to carbon dioxide emissions. It is also the first time that evidence of a global budget of carbon dioxide emissions to avoid climate change to justify the refusal of a new coalmine has been brought before an Australian court.

The implications of this landmark ruling are far reaching. It will set a precedent with domestic and international reach and elevates the risk of stranded assets.

To date, most overseas coal-mine closures or refusals have largely been regulated by governments rather than the courts. Germany has been particularly active on this front, closing and compensating miners.

The Australian legal precedent may affect such payments – particularly for projects such as Adani's in Queensland – which many surmise are aimed solely at gaining compensation, or saddling sovereign nations with hefty carbon bills.

In a separate fracking case, a court found this month that it is material to consider scientific evidence, including the effects on climate change, in deciding fracking policy, and that the government could do so, ruling key aspects of national planning policy to be unlawful, and opening the doors to climate-change based rejections to planning permission for fracking sites.

International climate change litigation

These cases are just two of almost 1,000 climate change related cases that have been filed globally, across 25 countries. Overall, corporations and industrials are the most common plaintiffs, with governments the most common defendants.

For example, in Urgenda Foundation v. The State of the Netherlands, 2015, the court accepted that the Dutch government had a constitutional duty to protect its citizens from climate change. Similar cases have been brought against the Irish government, and the British Government.

Then there is the long-standing US suit brought by the youth of the United States in Juliana v. United States of America and its sister cases in Europe and Colombia, the latter being designed to protect the Amazon.

US West Coast fishers are also suing 30 fossil fuel companies for contributing to climate change which they say has devastated the region's fishing industry.

Recently, the Philippine Commission on Human Rights started investigating 47 oil, gas, coal, cement and power companies that they dubbed the "Carbon Majors".

Carbon tax bills

The adoption of a global carbon tax will also change the economics of coal generation.

Most European countries have a carbon tax of some sort and the EU's Emissions Trading System is the world's first and largest carbon market, trading EUAs. One EU Allowance Unit equates to 1 ton of carbon dioxide.

The likely end price of 1 ton of carbon dioxide varies according to whom you talk to. The Carbon Pricing Leadership Coalition estimates carbon prices will range between US$50 and US$100 per metric ton by 2030.

The United Nations Global Market has called on companies to set an internal price on carbon at a minimum of US$100 per metric ton over time to spur innovation and unlock investment.

However, IEEFA's Buckley notes that the carbon price is trading at roughly US$20 a ton and believes US$20-US$50 will be sufficient to turn the economic argument against coal.

Buckley says that events to date have made it clear consumers will not tolerate anything near US$100 a ton.

Reporting technology raises the stakes

It has long been tacitly understood among corporations that corporate social responsibility ESG is generally not an issue unless a disaster happens. But this assumption may no longer hold true.

Increased disclosure and scrutiny means there is now more chance of getting caught simply because more people are looking; they have more to look at; and the stakes are rising.

CEO of the Responsible Investment Association, Simon O'Connor, notes that while it is very hard to divest one's way out of climate change, the organisation is seeing a rise in the numbers of investors trying to divest.

"Investors want to know at what point and how are climate change risks going to hit," says O'Connor. "They want to know the physical risks, the transitional risks and the regulatory risks. The whole area of responsible investing is getting better at identifying future movements of share prices, so increasingly investors are looking for indicators from companies that are actively managing these things.

"Technology is helping ESG reporting, making data more available and easily accessible. It is becoming embodied in the core investment infrastructure, such as on Bloomberg terminals, and more sophisticated tools for rankings. Investing is complex and interpreting good data is as important as the fund manager's ability to report."

A recent Morgan Stanley survey of 118 asset owners showed that fewer than half felt they had adequate tools and resources to assess ESG issues. But this extremely complex area is becoming simpler by the day.

Aided by reporting systems, analysts now include ESG as part of their fundamental research offering. For example, Hermes Investment Management has created a carbon tool to help fund managers assess their carbon performance, carbon risk and improve reporting.

Research firms such as Macquarie, Morgan Stanley, Credit Suisse and Citi have invested heavily in ESG impacts research.

The court of public opinion

Another front is the arena of public opinion. This is the arena in which the role of stranded assets will meet its litmus test.

CEO of Balance Impact Emily Hollingham notes the risks surrounding stranded assets is high but it will be stranded energy infrastructure assets that are likely to sway public opinion.

“If power becomes increasingly expensive and unreliable, there is a risk that more people move off-grid,” says Hollingham, “meaning that the infrastructure charge on a bill becomes higher as there are less people to share the cost; more people move off grid, and the cycle continues. If we move out of coal too quickly this could exacerbate the unreliability of power and speed up this process, however I think that is a risk that can be managed and isn't a reason to stick with coal long term.”

The public has already shown marked resistance globally to the impost of a carbon tax. It contributed to the defeat of Labor Prime Minister Julia Gillard, and nearly sparked a revolution in France as the Gilets Jaunes (yellow jackets) movement took to the street, making it very clear that they expected the super wealthy to fund the carbon transition.

Germany has had better luck. Electricity prices have risen sharply in the country. About 56% of the German retail price is tax. About 20% of that goes to the renewable energy surcharge and then the balance of the excess was sheeted back to compensation for coal and nuclear companies and other costs.

At one stage, it appeared that the gilets jaunes protests would spread to Germany but the movement evaporated when the French President retreated on the carbon issue.

Given the political unpopularity of the carbon tax, it may end up being that the ESG framework and institutional pressure may prove the more subtle means to transitioning to a low-carbon world – something of a carrot and stick orchestra. It spreads the risks away from solely the taxpayer, to include investors and corporations. But it also incentivises investment in new technologies and mobilises funds for innovation.

If the institutional pressure brought to bear on thermal coal is any example, then the ESG framework may prove a formidable tool for change.

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

Weekly Ratings, Targets, Forecast Changes

By Rudi Filapek-Vandyck, Editor FNArena

Guide:

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

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

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

Summary

Period: Monday April 15 to Friday April 19, 2019 Total Upgrades: 9 Total Downgrades: 8 Net Ratings Breakdown: Buy 41.98%; Hold 42.71%; Sell 15.31%

Finally! The week ending Friday, 19th April 2019 saw stockbroking analysts issue more upgrades than downgrades for ASX-listed stocks, but investors should not get too excited just yet as takeover target DuluxGroup played a major role in the week's tally.

Exluding DuluxGroup, upgrades and downgrades for the week are in perfect balance. Still better than prior weeks when downgrades continued to outnumber total upgrades.

Looking closer into the downgrades (most went to Sell, which is equally remarkable) it seems but a fair conclusion analysts are turning less accommodative towards highly valued bonds movements driven yield stocks, and towards wealth managers.

Outside of DuluxGroup, Mirvac is the only receiver of a downgrade that did not move to Sell during the week.

Resources companies continue to feature among the stocks receiving upgrades, still.

Not much is happening in terms of positive revisions to valuations and price targets with Magellan Financial and Telstra the only ones worth mentioning. The negative side looks equally barren with Asaleo Care and Bank of Queensland suffering sizeable cuts, followed by Whitehaven Coal.

Resources companies dominate the table for positive amendments to earnings estimated, led by Galaxy Resources and OZ Minerals. On the negative side, Perseus Mining and Orocobre take care of the week's heaviest reductions in a field that is less dominated by their peers, also including Blaclmores, Michael Hill, and others.

One observation continues to stand out: average reductions to forecasts remain larger than increases, while affecting more industrials and financials.

Upgrade

AUTOMOTIVE HOLDINGS GROUP LIMITED ((AHG)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 1/5/1

Macquarie believes Automotive Holdings will be a strong strategic fit with AP Eagers ((APE)), which has announced an all-scrip merger for the remaining shares it does not hold.

The broker believes the merger is compelling for shareholders of Automotive Holdings, providing a tactical opportunity. Automotive comparables ease materially after June suggesting a bottom in the industry may be approaching.

The broker upgrades to Outperform from Neutral and raises the target to $2.65 from $1.95.

DULUXGROUP LIMITED ((DLX)) Upgrade to Neutral from Sell by UBS and Upgrade to Hold from Sell by Deutsche Bank .B/H/S: 0/5/1

The Dulux board has unanimously approved a takeover by Nippon Paint at $9.80, representing a 35% premium over the three-month volume weighted average price.

UBS does not see an issue with FIRB and, given the current housing downturn, suggests shareholder approval (July vote) should not be a problem.

The broker moves its rating to Neutral and its target to the offer price from $6.30.

Nippon Paint proposes to acquire DuluxGroup for $9.80 a share cash, inclusive of dividends up to $0.41 per share. Deutsche Bank believes the potential for a competing offer is relatively low as the price is full and the housing market is slowing.

The broker does not believe regulatory approvals will be a problem as Nippon operated in this market during 2008-10. The broker is also of the view that the upcoming interim result will disappoint the market.

Target is raised to $9.80 to match the offer and rating is upgraded to Hold from Sell.

See also DLX downgrade.

DEXUS PROPERTY GROUP ((DXS)) Upgrade to Hold from Lighten by Ord Minnett .B/H/S: 0/5/0

The company is undertaking due diligence to acquire 80 Collins Street Melbourne, a major mixed-use development project. Ord Minnett believes this represents an opportunity for the company to materially re-rate its portfolio to Melbourne, where it is currently under-represented.

Dexus has indicated the potential for capital partners to be involved but the broker assesses it could still acquire 100% on balance sheet. Ord Minnett upgrades to Hold from Lighten and raises the target to $13.00 from $10.80.

PEET & COMPANY LIMITED ((PPC)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 1/1/0

Macquarie suspects a potential re-rating as conditions continue to level out, and upgrades to Outperform from Neutral. While residential markets remain difficult and a turnaround in earnings is some way off, the broker believes the multiple may soon start to react to better news.

The rate of decline in house prices has slowed and clearance rates have stabilised. While the company does not have exposure to Sydney, improving sentiment more broadly is likely to be positive. The target is raised to $1.11 from $1.01.

PLATINUM ASSET MANAGEMENT LIMITED ((PTM)) Upgrade to Neutral from Underperform by Macquarie .B/H/S: 0/2/2

Macquarie continues to envisage near-term risk to flows, absent a turn in performance. However, the broker upgrades to Neutral from Underperform following the recent weakness in the share price.

Consistent with peers, market movements for the March quarter broadly offset the reduction experienced in the prior quarter. Target is raised to $4.85 from $4.60.

REGIS RESOURCES LIMITED ((RRL)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 1/2/4

The company has a pre-feasibility study and maiden reserve for the Rosemont underground mine. The new mine plan envisages 246,000 ounces at 3.9g/t over a five-year period.

Macquarie upgrades to Outperform from Neutral. Target is $5.60, unchanged. The broker expects further incremental resource and reserve growth as the company continues to drill the underground.

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

UBS notes Telstra is a "divisive" stock, for which one should still be wary of internal risks while at the same time acknowledging external tailwinds are building, namely NBN/5G upside, a dissipating mobile threat from TPG Telecom ((TPM)) and a more rational Optus (in terms of price discounts) ahead of the 5G launch. The broker does not believe those tailwinds are currently priced in.

UBS has increased its earnings forecasts and its target to $3.60, and suggests the current dividend now looks sustainable and 5G offers upside. Rating upgraded to Buy.

WHITEHAVEN COAL LIMITED ((WHC)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 8/0/0

Macquarie expects a strong finish to FY19. Forward curves for gas and coal imply both commodities have found the bottom and the broker believes the stock now offers an attractive entry point. The picture is also clearer regarding capital expenditure.

As there is little expenditure required in the next eight months Macquarie suspects the company will pay above the 25-50% dividend guidance at the FY19 result.

The broker also suggests the dividend may stay high in FY20, with franked dividends to commence and the potential for greater cost reductions at Maules Creek. Rating is upgraded to Outperform from Neutral and the target raised to $4.20 from $4.10.

Downgrade

DULUXGROUP LIMITED ((DLX)) Downgrade to Hold from Add by Morgans .B/H/S: 0/5/1

Nippon Paint proposes to acquire the company for $9.80 a share. Morgans believes the transaction multiple is reasonable in the context of other global paint and coatings deals over the past nine years.

The offer values DuluxGroup on an enterprise value of $4.2bn. The deal has been unanimously recommended by the board. Morgans downgrades to Hold from Add and increases the target to $9.80 from $7.67. The broker does not expect regulatory approval to be an issue.

See also DLX upgrade.

G8 EDUCATION LIMITED ((GEM)) Downgrade to Sell from Hold by Deutsche Bank .B/H/S: 4/1/1

Deutsche Bank believes the business may be underperforming peers. The company's competitive position is a bigger driver of profitability than the macro environment.

Occupancy growth at the start of 2019 appears lower than peers and could represent a slowing of momentum from the December half, the broker suggests.

Deutsche Bank downgrades to Sell from Hold, suspecting that consensus is giving the company the benefit of the doubt on improvements in occupancy and assuming around 10% growth in revenue. Target is $2.70.

MIRVAC GROUP ((MGR)) Downgrade to Hold from Buy by Deutsche Bank .B/H/S: 1/4/1

Deutsche Bank downgrades to Hold from Buy, noting retail leasing conditions are forecast to get worse for landlords. In addition to slowing income growth, the broker believes balance sheets will come under pressure as cap rates are forecast to expand.

The broker assesses over $10m in shopping centre assets are currently available for sale in the market.

OROCOBRE LIMITED ((ORE)) Downgrade to Underperform from Neutral by Macquarie .B/H/S: 6/1/1

Lower production, sales and higher costs characterised the March quarter. The company has guided to much weaker pricing of US$8200-8400/t in the fourth quarter.

Production is expected to be slightly better than previously anticipated and approximate FY18 tonnage. Macquarie downgrades to Underperform from Neutral, expecting challenges ahead with the impending Chinese EV subsidy cuts.

Oversupply in the lithium market has finally become a reality and the company appears unable to lock in longer-term contracts to protect from price falls. Target is reduced to $3.30 from $3.50.

PENDAL GROUP LIMITED ((PDL)) Downgrade to Sell from Neutral by UBS .B/H/S: 2/3/2

UBS has downgraded Pendal Group to Sell from Neutral on the observation that the previous engine of growth -JO Hambro in the UK- is increasingly looking challenged, which then puts into question the outlook for funds flows and performance fees for the group as a whole.

March 2019 marked the sixth consecutive quarter of net outflows for JOHCM, point out the analysts. UBS has reduced EPS forecasts by -4%-5% and now finds itself some -10% below market consensus. The analysts nevertheless maintain the bias remains to the downside.

Price target drops to $8.70 from $9.05. DPS forecasts have been cut too.

PERPETUAL LIMITED ((PPT)) Downgrade to Underperform from Neutral by Macquarie .B/H/S: 0/6/1

Macquarie envisages downside risk to flows and downgrades to Underperform from Neutral. The stock is currently trading at an 8% premium to the sector.

Outflows have largely been driven from institutional channels, but there was also a continuation of broad-based outflows in recent quarters in the intermediary and retail channels.

Market conditions remain supportive, in the broker's view. Target is raised to $38 from $36.

SCENTRE GROUP ((SCG)) Downgrade to Sell from Hold by Deutsche Bank .B/H/S: 1/2/3

Deutsche Bank downgrades to Sell from Hold, noting retail leasing conditions are forecast to get worse for landlords. In addition to slowing income growth, the broker believes balance sheets will come under pressure as cap rates are forecast to expand.

The broker assesses over $10m in shopping centre assets are currently available for sale in the market.

TRANSURBAN GROUP ((TCL)) Downgrade to Underperform from Neutral by Credit Suisse .B/H/S: 3/3/2

March quarter traffic was ahead of Credit Suisse estimates. The broker increases FY19 proportional earnings estimates by 1%, based on higher traffic growth assumptions.

The broker raises the target to $12.20 from $11.80 and downgrades to Underperform from Neutral on valuation grounds.

Credit Suisse expects management will provide updates on the delivery of WestConnex and debt raisings on Queensland roads at its investor briefing on April 29.

Total Recommendations Recommendation Changes

Broker Recommendation Breakup

Broker Rating Order Company New Rating Old Rating Broker Upgrade 1 AUTOMOTIVE HOLDINGS GROUP LIMITED Buy Neutral Macquarie 2 DEXUS PROPERTY GROUP Neutral Sell Ord Minnett 3 DULUXGROUP LIMITED Neutral Sell UBS 4 DULUXGROUP LIMITED Neutral Sell Deutsche Bank 5 PEET & COMPANY LIMITED Buy Neutral Macquarie 6 PLATINUM ASSET MANAGEMENT LIMITED Neutral Sell Macquarie 7 REGIS RESOURCES LIMITED Buy Neutral Macquarie 8 TELSTRA CORPORATION LIMITED Buy Neutral UBS 9 WHITEHAVEN COAL LIMITED Buy Neutral Macquarie Downgrade 10 DULUXGROUP LIMITED Neutral Buy Morgans 11 G8 EDUCATION LIMITED Sell Neutral Deutsche Bank 12 MIRVAC GROUP Neutral Buy Deutsche Bank 13 OROCOBRE LIMITED Sell Neutral Macquarie 14 PENDAL GROUP LIMITED Sell Neutral UBS 15 PERPETUAL LIMITED Sell Neutral Macquarie 16 SCENTRE GROUP Sell Neutral Deutsche Bank 17 TRANSURBAN GROUP Sell Neutral Credit Suisse Recommendation Positive Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 CYB CYBG PLC 100.0% 67.0% 33.0% 3 2 PTM PLATINUM ASSET MANAGEMENT LIMITED -50.0% -75.0% 25.0% 4 3 WHC WHITEHAVEN COAL LIMITED 94.0% 81.0% 13.0% 8 4 RRL REGIS RESOURCES LIMITED -44.0% -56.0% 12.0% 8 5 TLS TELSTRA CORPORATION LIMITED 6.0% -6.0% 12.0% 8 Negative Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 AHY ASALEO CARE LIMITED 67.0% 100.0% -33.0% 3 2 BPT BEACH ENERGY LIMITED 40.0% 60.0% -20.0% 5 3 GEM G8 EDUCATION LIMITED 50.0% 67.0% -17.0% 6 4 SCG SCENTRE GROUP -33.0% -17.0% -16.0% 6 5 MFG MAGELLAN FINANCIAL GROUP LIMITED 14.0% 29.0% -15.0% 7 6 STO SANTOS LIMITED 25.0% 38.0% -13.0% 8 7 ORE OROCOBRE LIMITED 63.0% 75.0% -12.0% 8 8 TCL TRANSURBAN GROUP 13.0% 25.0% -12.0% 8 9 TAH TABCORP HOLDINGS LIMITED 64.0% 75.0% -11.0% 7 10 BOQ BANK OF QUEENSLAND LIMITED -44.0% -38.0% -6.0% 8 Target Price Positive Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 MFG MAGELLAN FINANCIAL GROUP LIMITED 35.770 34.091 4.93% 7 2 TLS TELSTRA CORPORATION LIMITED 3.240 3.165 2.37% 8 3 TCL TRANSURBAN GROUP 12.528 12.313 1.75% 8 4 PTM PLATINUM ASSET MANAGEMENT LIMITED 4.418 4.355 1.45% 4 5 BPT BEACH ENERGY LIMITED 2.038 2.016 1.09% 5 6 STO SANTOS LIMITED 6.978 6.938 0.58% 8 7 TAH TABCORP HOLDINGS LIMITED 5.050 5.025 0.50% 7 8 SCG SCENTRE GROUP 3.948 3.947 0.03% 6 Negative Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 AHY ASALEO CARE LIMITED 1.047 1.150 -8.96% 3 2 BOQ BANK OF QUEENSLAND LIMITED 8.731 9.193 -5.03% 8 3 WHC WHITEHAVEN COAL LIMITED 5.063 5.181 -2.28% 8 4 ORE OROCOBRE LIMITED 4.718 4.780 -1.30% 8 5 GEM G8 EDUCATION LIMITED 3.418 3.457 -1.13% 6 Earning Forecast Positive Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 GXY GALAXY RESOURCES LIMITED 1.822 1.587 14.81% 5 2 OZL OZ MINERALS LIMITED 62.497 60.313 3.62% 8 3 AHY ASALEO CARE LIMITED 5.967 5.800 2.88% 3 4 RIO RIO TINTO LIMITED 936.746 910.864 2.84% 8 5 STO SANTOS LIMITED 55.424 53.934 2.76% 8 6 TAH TABCORP HOLDINGS LIMITED 19.483 19.000 2.54% 7 7 OSH OIL SEARCH LIMITED 43.818 43.150 1.55% 8 8 JHG JANUS HENDERSON GROUP PLC. 349.398 345.965 0.99% 5 9 WPL WOODSIDE PETROLEUM LIMITED 228.936 226.866 0.91% 8 10 TCL TRANSURBAN GROUP 21.140 20.950 0.91% 8 Negative Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 PRU PERSEUS MINING LIMITED -4.233 -0.163 -2496.93% 3 2 ORE OROCOBRE LIMITED 10.125 11.673 -13.26% 8 3 BKL BLACKMORES LIMITED 346.583 378.400 -8.41% 6 4 MHJ MICHAEL HILL INTERNATIONAL LIMITED 6.000 6.367 -5.76% 4 5 SXY SENEX ENERGY LIMITED 1.180 1.240 -4.84% 5 6 COL COLES GROUP LIMITED 64.157 66.929 -4.14% 8 7 BOQ BANK OF QUEENSLAND LIMITED 79.071 82.457 -4.11% 8 8 CYB CYBG PLC 46.328 48.284 -4.05% 3 9 WHC WHITEHAVEN COAL LIMITED 58.524 60.370 -3.06% 8 10 EVN EVOLUTION MINING LIMITED 13.051 13.293 -1.82% 8 Technical limitations

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Uranium Week: All Quiet

The uranium market went quiet last week ahead of the Easter break, with section 232 still in the balance.

-Unchanged prices -Nuclear power winning subsidies in the US -Increased output from Australian producers

By Greg Peel

With the US Department of Commerce’s confidential recommendations regarding section 232 now in the hands of President Trump, who has a little under 90 days to respond, the uranium market has again gone quiet. Notwithstanding last week was a short week.

Limited action in the spot market has left industry consultant TradeTech’s weekly price indicator unchanged at US$25.85/lb.

TradeTech’s term price indicators remain at US$28.00/lb (mid) and US$32.00/lb (long).

Demand

There was encouraging news for the US nuclear power industry last week, which has struggled to remain commercial in the face of cheap gas-fired power and subsidised renewable power. The State of New Jersey voted to allow Zero Emission Certificates for two power plants which provide the state with 90% of its emission-free electricity, amounting to US$300m in subsidies.

In a statement, the operator of the plants, PSEG, said "We are pleased with the decision to award ZECs to PSEG to help support New Jersey's primary supply of zero-carbon electricity. The [Board of Public Utilities] just saved the people of the State hundreds of millions of dollars in what would have been higher energy costs, thousands of jobs lost, and tons of environmentally damaging air emissions”.

New Jersey has now joined New York, Illinois and Connecticut in approving subsidies for the challenged nuclear power industry, with Ohio currently considering such a move.

Non-nuclear power companies in Illinois and New York challenged the granting of subsidies in the US Supreme Court, but the court refused to hear their case. Hence the subsidies stand.

Supply

Rio Tinto produced 1.6mlbs U3O8 in the March quarter – up 5% from the previous March quarter but down -15% on the December quarter.

Energy Resources of Australia ((ERA)), of which Rio Tinto owns two thirds, increased its production from stockpiles by 19% year on year thanks to better mill throughput, grade and recoveries. ERA is not currently mining new ore.

Rio’s Rossing mine in Namibia saw its production fall -6%. Late last year Rio sold 68.2% of Rossing to the China National Uranium Corp at a price dependent of the profitability of the mine between now and 2025. The sale still requires approval from the Namibian Competition Commission.

BHP Group’s ((BHP)) Olympic Dam mine in South Australia increased uranium production in the March quarter by 16% year on year and 19% from the December quarter. Olympic Dam produces uranium as a by-product of copper production, which increased by 22% following smelter maintenance in the prior quarter.

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Galaxy Resources Opts For Grade Vs Recovery

Lithium sales were significantly lower in the March quarter for Galaxy Resources, while the sell-down process for Sal de Vida has been formally closed without a deal.

-Priority at Mount Cattlin shifts to better lithium concentrate grades versus recovery -Unlikely to conclude a Sal de Vida sell down as attractive as the POSCO sale -Mount Cattlin may need to ship increased volumes in H2 to clear inventory

By Eva Brocklehurst

Galaxy Resources ((GXY)) is faced with finely balancing recovery and grade at its Mount Cattlin lithium mine and has conceded its yield optimisation target may have been optimistic.

Concentrate production of 42,000t at cash costs of US$453/t was reported for the quarter and 2019 production guidance is 180-210,000t. While mined grades improved at Mount Cattlin, the yield optimisation project is yet to deliver benefits, as recoveries have only increase to 51%, from 47% in the December quarter.

Meanwhile, concentrate grades actually decreased to 5.6% lithium oxide. Sales was significantly lower in the quarter, attributed to a second half weighting for deliveries. Shipment volumes are expected to increase in the second half but, brokers suspect, any catch up from the first half may attract lower prices.

The company has cited a lag between production and agreed delivery schedules. Three shipments are expected over the second quarter of 2019, of 15,000t each. Larger vessels are expected to be used over the second half to enable inventory drawdown to broadly match production.

No realised pricing was provided. UBS estimates US$630/t in the March quarter, likely affected by lower-than-anticipated grades. The broker forecasts a US$653/t average price over 2019, which compares with over US$900/t in 2018. The broker also notes the Chinese government has lowered subsidies on lower-range new electric vehicles and raised the eligibility requirements, which has affected sentiment adversely.

Macquarie remains concerned about weak recovery. The yield optimisation project at Mount Cattlin was designed to lift recovery to over 70% but the company has conceded this optimistic as its priority shifts to better concentrate grades.

Macquarie slows its expectations for a ramp-up in recovery over 2019 and reduces long-term assumptions to 67% from 72%. Product grade assumptions are lifted to 5.8% from 5.7%. Credit Suisse suspects the revised recovery target from the yield optimisation project may have implications for the next reserve revision. Canaccord Genuity agrees the 70% recovery rate may never be achieved.

Credit Suisse found several negatives in the report and struggles to identify a near-term catalyst for the stock given the issues at Mount Cattlin, the lack of a sale of Sal de Vida and a deteriorating macro environment.

Sal de Vida

The company has closed the process of selling down Sal de Vida, unable to agree on a transaction structure or value. Discussions still continue with some parties. Given a stronger pricing environment has passed, Canaccord Genuity believes this is a missed opportunity.

Galaxy Resources will continue to develop the project but has not presented a timeline or a firm funding strategy. The lack of a transaction on Sal de Vida means there is no catalyst in a difficult market for lithium equities. Yet Canaccord Genuity, not one of the eight stockbrokers monitored daily on the FNArena database, suggests the shares have been oversold and maintains a Buy rating and $2.75 target.

UBS had been expecting a further sell down in Sal de Vida and, while noting negotiations continue, does not expect a deal as attractive as the POSCO sale can be concluded. During the quarter POSCO's consideration of US$272m was released from escrow.

A strong cash position should support the development, UBS asserts. Macquarie considers Sal de Vida is increasingly uncertain, because of recent muted pricing and longer development times for brine resources.

Sourcing funding could also be difficult. The broker lifts the estimated cost of capital for the project to 14% from 10% and this reduces valuation to $90m from $395m. Still, post the sale of the northern tenements to POSCO, the company has entered the quarter with no debt.

Uncertain Pricing

Macquarie reduces its long-term outlook, lowering estimates for earnings per share in 2019 by -31% and by -9% in 2020-21. A higher debt loading for Sal de Vida means 2022 estimates are lowered by -27% and the broker downgrades to Underperform from Neutral.

Credit Suisse carries only 50% of its valuation of Sal de Vida in the stock's valuation to account for the uncertainties. Crystallising value through a partial sale and finding the finance to develop would offer opportunities but this appears of the table at present. The read-through price from the POSCO sale is US$700-850m and achieving a sale price near that level would add considerably to valuing the stock.

Achieving a sale is the principal re-rating opportunity, Credit Suisse believes but also points out that a progressive reduction in reporting disclosure, particularly around prices or margins, entails a risk to estimates, particular given the fact peers openly provide this information.

The broker assumes a spodumene price of US$740/t for the March and June quarters and reduces second half estimates to US$650/t. This remains a risk given recent declines and spot prices and the fact Mount Cattlin may need to ship increased volumes in the second half to clear the inventory build up, and this may lead to discounting.

FNArena's database shows four Buy ratings and one Sell (Macquarie). The consensus target is $2.45, signalling 51.2% upside to the last share price. Targets range from $1.50 (Macquarie) to $3.20 (Citi, yet to comment on the quarterly).

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Treasure Chest: Oil Search Set For Re-Rate?

Oil Search has underperformed LNG peers recently but with the company moving into a heavy expansion phase, Morgan Stanley believes a multi-year re-rating could be nigh.

-PNG LNG exceeding expectations -Several growth projects provide for potential catalysts -Confirmation of new PNG LNG trains critical

By Greg Peel

Oil Search ((OSH)) posted a disappointing March quarter production report last week admidst upside surprises from its big LNG peers. The quarterly run-rate suggested a full-year production only reaching the bottom of guidance and sales volumes and prices were below forecasts.

But analysts were quick to give the company the benefit of the doubt.

Production was affected by the lingering impact of last year's PNG earthquake, which saw some equipment yet to come back on line. The miss on sales volumes owed a lot to timing and should swing back in the June quarter. LNG spot prices were indeed lower, but Oil Search sales are only 10% exposed to spot.

On the positive side, production at PNG LNG exceeded both nameplate capacity and analyst forecasts. And a deal with the PNG government will allow the Papua LNG project, which is separate to PNG LNG and of which Oil Search's stake is 17.7%, to proceed.

All brokers agree the company's poor March quarter performance can be overlooked at a time Oil Search is, as Macquarie (Outperform) puts it, "on a path to growth". Expansion and greenfield projects are informing analyst valuations more so than current performance.

First Papua LNG gas is expected in 2024. Having signed the agreement with the PNG government for Papua LNG, the next step is a similar agreement on the P'nyang licence. The Murak discovery appears to be large and is close to the existing PNG LNG operation, so further appraisal there is awaited.

An appraisal is also pending for the company's Alaskan asset, with an option over the project expiring mid-year.

All of the above are considered by Morgan Stanley to be key catalysts over the next few months. The broker also suggests the potential of a farm-in of peer Santos ((STO)), which has a stake in PNG PNG, into P'nyang. A farm-down of Alaska is another possibility.

But most critical is a decision on expanding the two-train PNG LNG operation to five trains, confirmation of which appears close. "Confirmation of expansion could lead to a multi-year re-rate" in Morgan Stanley's view, "upon successful delivery".

While Oil Search is currently carrying some US$1.5bn of spare liquidity, gearing levels are on the move up as the expansion phase plays out, and the balance sheet remains beholden to volatile oil prices (to which LNG prices are indexed). This provides some concern for Morgan Stanley, who ponders what gearing would look like after a US$1bn equity injection.

Balance sheet issues may limit performance, the broker concedes, but after years of underperforming peers due to expansion delays, Oil Search's performance should improve once the company confirms expansion is underway, the broker believes.

Morgan Stanley views the next few months as a critical juncture for Oil Search, setting up performance for the next one to two years. To that end the broker retains an Equal-weight rating as opposed to Overweight, awaiting successful delivery on aforementioned catalysts.

UBS has a similar rating (Neutral), agreeing the stock is all about growth opportunities but seeing those as largely priced in. Citi held the same view in March when it downgraded to Sell.

All up there are three Buy or equivalent ratings in the FNArena database, four Holds and a Sell.

The average target price among the brokers is $8.71 – around 7% up from the current trading price, but as is so often the case with resources sector companies, valuations are very much a function of analyst forecasts for relevant commodity prices, and this leads to disparities.

Thus Oil Search target prices range from $7.60 (Credit Suisse) to $10.62 (Morgans). Morgan Stanley sits at $8.60.

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