Week
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# Stories To Read From FNArena

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## Contents

# Upgrades Happening Again At Appen

Appen is establishing a trend in guidance upgrades, while indicating revenue has become more evenly spread throughout the year.

-Content relevance, LeapForce driving earnings growth -Operating cash flow offers flexibility -Currency tailwind probable

By Eva Brocklehurst

It's all happening for Appen ((APX)), the search data service provider, which has upgraded 2018 earnings guidance because of a sharp increase in monthly revenue. The company has established a trend of earnings upgrades, and this is the second in three months.

Canaccord Genuity notes little detail around the drivers of the upgrade, save for the observation there was a sharp increase in orders from existing customers. The broker estimates the top two customers represented around 80% of revenue in the first half and increases revenue forecasts by 10% for 2018.

This upgrade is another example, in Citi's opinion, where both new and existing customers are using the company's expertise to develop new products and enhance existing capabilities. Appen enables companies to expand into new markets by improving search engines, social media platforms and e-commerce sites.

2018 operating earnings (EBITDA) guidance has been upgraded to $62-65m, which represents a 12% upgrade at the mid point from prior guidance. Citi reiterates a Buy rating and raises forecasts by 7-11% for 2018-20 and upgrades its target to $17.31 from $17.13.

The broker is positive about the company's ability to win work over the short to medium term, in particular after the US LeapForce acquisition. Canaccord Genuity agrees that content relevance, including LeapForce, have provided earnings bridges in 2018 and will remain the drivers of earnings growth.

For 2019 Canaccord Genuity assumes modest underlying growth rates in language resources but eases back on its margin assumptions, to 18% from 21%. Underlying growth rates in content relevance have been increased, with the operating earnings margin forecast to be flat at 22%.

The upgrade to guidance indicates that, on the broker's calculations, orders are now becoming more evenly spread throughout the year, with the order book of $250m in August 2018 representing around 67% of the full year revenue forecast. This compares with 2016 when the August order book represented 90% of the full year, and 2017 when that figure fell to 84%.

Canaccord Genuity is impressed with the return on equity and invested capital of 37% and 26%, respectively, on 2018 forecasts. The stock warrants a premium valuation, in the broker's view, given the track record of consistently increasing earnings estimates, while operating cash flow offers flexibility for management.

Currency

Despite the US dollar having appreciated in recent months, the company left its FX assumption at US80c, which signals to brokers that currency could be a tailwind. UBS estimates the impact on 2018 earnings is around $200,000 for every US1c move in the exchange rate. Therefore, should the spot rate of US72c continue for the remainder of the year, this would add $1.6m or 2% to the top end of guidance. UBS maintains a Neutral rating and $15.65 target.

Canaccord Genuity also suggests a US80c exchange rate is increasingly unlikely for 2018 and incorporates a flat exchange rate of US75c for 2019, which allows for some appreciation in the Australian dollar from its current rate. This results in a 23% increase in the broker's 2019 revenue forecasts and a 16% increase in operating earnings estimates, to $84.5m. Canaccord Genuity retains a Hold rating, nudging the target up to $16.00 from $15.60.

# Medibank Soldiers On Despite Garrison Loss

Medibank Private has lost its Garrison Health Services contract, a setback in terms of diversifying away from the private health insurance business.

-Target of doubling health services contribution now challenged -Excess capital still positions Medibank Private for acquisitions -Is the market too complacent about medium-term risks?

By Eva Brocklehurst

Medibank Private ((MPL)) has suffered a setback, having lost its contract with the Australian Defence Force, called Garrison Health Services. Garrison formed part of the company's health services division and Medibank provided the ADF with access to medical professionals, specialists and medical facilities.

The company expects -$5m in one-off exit costs in the second half of FY19. Subsequently, Morgan Stanley's estimate of the FY20 operating profit contribution from non-regulated health services falls to around 6% from around 11%.

Ord Minnett suspects the contract may have been won by BUPA, which also operates in this segment, noting that in 2014 Medibank Private also lost the Department of Immigration contract to BUPA. Medibank claims to have provided a competitive offer in the tender process, with no apparent reason for the loss.

The contract was most likely "lost" by Medibank rather than "won" by another insurer, Morgan Stanley asserts, which raises questions around relationship management. Garrison contributed around $30m to operating profit in FY18, out of a total of $47.3m across the health services division.

Ord Minnett believes margins for the Garrison business were better than those for the remaining health services, which it estimates are around 10%. The loss of the contract leaves an even less diversified business, Citi agrees, with regulated Australian resident health insurance now making up more than 90% of operating earnings.

Morgans is annoyed at the loss of the contract. While losing Garrison is not overly material to the main business it does represent a large hit to the operating profits of the smaller "health" segment.

Moreover, despite management stating there is no lost IP from the termination, the broker believes concerns will linger over whether this will affect the roll-out of other health services such as home treatments. Morgans acknowledges commentary that the Garrison contract was run separately and, after six years, the IP from the contract has largely been applied.

Deutsche Bank acknowledges the loss of the contract is a negative, having assumed the ADF would not want the health records of service personnel to be held and managed by a foreign entity, and that Medibank Private had met its contract obligations and expectations. Despite the setback, the broker retains a Buy rating on valuation grounds.

Medibank had a target of doubling the contribution of non-health insurance operating profits by 2020, from the 4.6% reflected in FY16 results, and Morgan Stanley suspects this aspiration is now challenged. The company remains committed to growing the division through acquisitions of in-home care.

Medibank Private guided to two further acquisitions at its FY18 result, which Macquarie calculates could contribute around 2.5% to group operating earnings in FY19. The broker believes further acquisitions are needed to soften the earnings impact of the loss of the Garrison contract as well as the impact of just 2% increases in average prices. Nevertheless, the company has $143m in excess capital which positions it well to acquire businesses and manage claims cost inflation.

Uncertainties

In the medium-term multiples appear expensive, given peak margins and the outlook for lower premium rate hikes, in Morgan Stanley's view. While a prolonged benign claims environment provides some support, the broker suggests the market is too complacent about the medium-term risks.

Ord Minnett agrees that significant political risk overshadows the stock, with the upcoming health insurance price renegotiation and potential for government claw-back of recent margin expansion, as well as the likelihood of higher capital requirements. Therefore, it is difficult to envisage the stock outperforming based on these risks and the broker maintains a Lighten rating.

Progress is being made in turning around the business, but Morgans acknowledges the investment thesis is difficult amid the risks to industry pricing from a potential Labor government.

Citi concurs that value in the stock appears to be emerging. Still, given the uncertainty surrounding the impact of Labor's proposed 2% price cap, should it win government, the broker introduces a -10% discount to its target.

Extras

Medibank Private generates earnings from a number of related activities that use its expertise in the private health segment. These earnings are bundled into the "health" division and contributed around 8.1% to operating earnings in FY18.

Incorporating the loss of the Garrison Health Services contract from July 1, 2019 and potential headwinds for the insurance business, Macquarie forecasts a 9.3% contribution to operating earnings from this division in FY19. The broker notes only three of the health business units that existed when the company listed in 2014 will remain in FY20. These include travel/pet/life insurance, telehealth services and the health advice line.

Additional units in the segment now include CareComplete, Medibank at Home, Health Concierge, HealthStrong and Home Support Services. Home Support Services is a recently acquired South Australian business for chronic disease management which will be rolled out to the east coast.

FNArena's database show three Sell ratings, four Hold and one Buy (Deutsche Bank). The consensus target is $2.71, suggesting 7.1% upside to the last share price. This compares with $2.95 ahead of the announcement. Targets range from $3.10 (Credit Suisse, yet to comment on the contract) to $2.30 (Morgan Stanley). The dividend yield on FY19 and FY20 forecasts is 5.1% and 4.7% respectively.

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# Better 2019 Expected From G8 Education

Brokers are looking forward to a better performance from G8 Education in 2019 as occupancy levels stabilise and supply pressures ease.

-Market moves closer to equilibrium -Risk of further downside greatly diminished -Self-help initiatives gaining traction

By Eva Brocklehurst

The government Child Care Subsidy (CCS) has had a positive impact on demand for G8 Education ((GEM)), resulting in improved occupancy, and brokers believe the outlook for 2019 enrolments is now much better.

The company expects to deliver operating earnings (EBIT) of $136-139m in 2018, versus the $141.5m forecast at the August result. Yet, brokers are now looking beyond this for evidence that improvements to the operations are gaining traction. The most pleasing aspect of the trading update, Canaccord Genuity asserts, is the trend in occupancy in September and October that points to the CCS having a positive influence on demand.

The revised guidance, which implies a -2-4% downgrade to prior expectations, was driven by the Oxanda centres, that were acquired in 2017. Still, that business has been re-branded and, as a result, the issues are now considered behind the company while the outlook has improved considerably. Canaccord Genuity, not one of the eight monitored daily on the FNArena database, retains a Buy rating and $2.90 target.

The stock may have rallied of its lows and, hence, the discount has been removed but Deutsche Bank remains unconvinced that the industry dynamics/structure have changed enough to become more positive, maintaining a Hold rating.

With a similar view, Moelis downgrades to Hold from Buy, with a $3.12 target, noting the market appears to have moved closer towards equilibrium. Market conditions and strategic initiatives have supported a modest increase in the broker's earnings estimates. While supportive of the business strategy, the broker, also not one of the eight, deems a downgrade prudent, given supply risks leading up to the January re-enrolments.

Morgan Stanley, on the other hand, is convinced the company has turned the corner and trading multiples should expand. The broker upgrades to Overweight from Equal-weight. The main concerns stem from M&A, as those centres operating with scale have now stabilised occupancy levels and, therefore, acquisition multiples are subdued.

Moreover, G8 Education lags its peers in terms of its ability to participate in consolidation. Gearing is now expected to peak mid 2019 but the broker does not envisage a material risk of additional capital being required, although this in turn limits the scope for M&A.

Macquarie upgrades to Outperform from Neutral as the risks to the balance sheet have eased with debt having being refinanced. The broker believes the opportunity for a further re-rating exists, particularly in the context of broader equity market conditions.

Occupancy

Occupancy in the second half showed seasonal improvement above the trend. Growth over the recent months has been driven by operating initiatives and the CCS. Occupancy is now the same level versus 2017 on a like-for-like basis. Re-enrolments also appear to be trending positively, Canaccord Genuity suggests, consistent with industry feedback.

As there are no industry regulatory changes on the horizon a number of the recent risks have eased. Morgan Stanley agrees higher occupancy now mean higher earnings and the risk of further downside is greatly diminished. The broker expects further improvements in 2019 amid moderating supply.

Supply

The lagged effect of new supply is the main risk for enrolments in 2019, Macquarie suspects, although management still anticipates earnings growth in 2019 will be underpinned by the incremental contribution from greenfield additions, plus better centre management retention.

Quality initiatives are also likely to feature, as a number of centres have been refurbished in the year to date and those of higher quality are less susceptible to competing supply. Macquarie calculates 22% of the centres are still at risk.

UBS agrees self-help initiatives are starting to gain traction. This should more than offset the subdued operating environment. Wage pressures also appear to have stabilised and the positives now outweigh the risks.

Pricing increases have been stronger than expected and, while supply remains an issue, it has not caused further deterioration. Funding costs are expected to reduce and the roll-out strategy appears fully funded. The valuation looks appealing to UBS and a 5.5% price increase is incorporated in the second half of 2018.

There are four Buy ratings on the database and one Hold (Deutsche Bank). The consensus target is $3.05, signalling 8.1% upside to the last share price the dividend yield on 2018 and 2019 forecasts is 5.8% and 5.2% respectively.

# Confidence Grows In TechnologyOne

TechnologyOne is confident in the outlook for FY19, expecting robust growth in annualised recurring revenue and profit.

-Increasingly confident in achieving 1000 cloud customers by FY22 -Cloud business expected to enhance the quality of revenue -UK expected to break even in FY19

By Eva Brocklehurst

TechnologyOne ((TNE)) surprised most brokers with a very solid FY18 performance and growth ahead of expectations. Net profit increased 15% to $51m. Margins improved around 100 basis points, supported by operating leverage in the cloud and more appropriate cost bases in consulting.

The company assesses the work outlook for 2019 will remain robust and growth should occur in annualised recurring revenue and profit. The operating earnings margin (EBITDA) of 22.3% was the highest level reported in a decade, signalling the benefits of scale.

Operating cash flow was slightly weaker than several brokers expected, largely because contracts in Australia and the UK were signed late in the period. Growth in annual licence fees accelerated, which is considered to well for FY19. Software-as-a-service (SaaS) platform revenues grew 56%.

Wilsons likes the increasing quality in revenue, as recurring revenue, which grew by 22% over FY18, supports around 50% of its FY19 estimates. UBS points out the stock's valuation has not de-rated in line with global peers and evidence of an acceleration in operating momentum is required to support a more positive view at current levels.

Industry feedback supports a strong profile for the medium to longer term, Macquarie asserts, across the core government and education verticals in the Asia-Pacific region. FY18 licence fees were mainly attributed to local government (45%), education (20%) and government (17%).

The company's leading position in local government continues to interest brokers, as 11 new major deals have been signed worth $80m in contract revenue. TechnologyOne has over 300 councils as customers.

Cloud Future

Management appears increasingly confident about the momentum in its cloud business, as well as its ability to deliver on the step change required to reach 1000 customers by FY22. Migration of new and existing customers to the cloud underpins Ord Minnett's positive investment view. The cloud should expand the addressable market and improve the quality of revenue, and the broker reiterates a Buy rating.

UBS asserts the company is well-positioned to take a goodly share of the transition to the cloud because its product is modular and able to be configured. The benefits from the shift to the cloud include stickier revenues and improved margins. The broker believes growth can continue at over 15% for the next three years. The company is estimating $143m in recurring cloud services fee revenue by FY22.

UK

The UK business was the main drag, with a -$3.8m loss in FY18. Losses were edging lower in the second half and the company expects a turnaround over FY19, targeting break-even. Higher UK consulting losses were offset by a turnaround in the Asia-Pacific consulting business but success in the UK market would provide brokers with more confidence that the company can succeed in large offshore jurisdictions.

Wilsons, not one of the eight brokers monitored daily on the FNArena database, acknowledges costs in the UK are being managed well and the business is on a path towards profitability, but finds the valuation and overall market backdrop prevents a more constructive stance. The broker has a Hold rating and $5.00 target.

As more customers purchase or move to the company's SaaS product the up-selling opportunity increases, Macquarie suggests. Growth in SaaS and the UK business remain the key catalysts, in the broker's view, with the stock considered fairly valued at present.

Morgans suggests the risk for TechnologyOne is not necessarily operational, but rather lies with the potential for investor sentiment to swing back and forth, pointing to the rapid de-rating of technology stocks over the last month.

The database has three Hold ratings and one Buy (Ord Minnett). The consensus target is $5.59, signalling 1.0% upside to the last share price. Targets range from $5.01 to $6.00.

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# Difficulties In Life Sciences Still Plague ALS

While life sciences margins surprised to the upside in the first half, brokers are unsure whether ALS Ltd can sustain these comfortably over the longer term.

-Growth of 8-10% is expected in geochemistry sample volumes in second half -Leverage observed mid cycle via the raising of geochemistry prices -Competitive volume and price pressures continue in life sciences, particularly the US

By Eva Brocklehurst

A surprise rebound in margins for life sciences spurred earnings growth for ALS Ltd ((ALQ)), along with continued share gains and price rises in commodities sampling in the first half.

However, geochemical volumes appear to be softening and brokers are unsure whether margins can be sustained over the longer term for life sciences. The rebound in margins to 15.1% was key to allaying market fears after disappointing numbers for life sciences in the prior half.

FY19 earnings guidance is for net profit of $170-175m. Earnings are typically affected by the Christmas closure of the mineral exploration sector, yet the company still expects 8-10% growth in sample volumes in geochemistry in the second half.

First half results were ahead of guidance with commodities generating 25% growth in revenue and 36% growth in operating earnings (EBITDA). There was 14% uplift in geochemistry volumes and an 8% improvement in prices. While revenue growth and pricing in the commodities division were significantly above Deutsche Bank's expectations, the life sciences and industrial divisions continued to underperform.

Geochemistry sample volume growth is easing and the broker expects this to slow even further, while life sciences seems to perennially disappoint. Deutsche Bank does not believe the stock deserves to trade on FY20 PE of 22x and maintains a Sell rating.

Conversely, Macquarie has an Outperform rating, believing there is good earnings growth in prospect, and prices will step up as volume growth slows in geochemistry. The broker considers life sciences is back on a growth trajectory, albeit off a low base.

Macquarie notes the UK business performed well, including the UK water acquisition, AlControl. Restructuring benefits also helped results in Canada and Latin America. A competitive US market and lack of infrastructure expenditure ensured US life sciences profits were lower.

The outlook now appears more upbeat than it did back at the September update and Credit Suisse also expects higher geochemical sample volumes and price increases will drive earnings, partially offset by the more subdued performance from life sciences and industrials.

Commodities

Successful price increases in the first half confirm to Morgans that activity and demand are robust, supported by an increase in market share as customers seek out the company's advantage in service and turnaround times. Sample growth may moderate but the broker believes the cycle has simply matured.

Importantly, Macquarie points out the company is showing leverage mid cycle in raising geochemical prices, which reflects a tightening market and positive effect from more greenfield work. While pricing/mix lagged volume growth over the last two years, the broker observes this is now showing a better trajectory along with improved volumes.

Life Sciences

Life sciences operating earnings of $61m exceeded Macquarie's expectations for the first time in a number of years. The division, nevertheless, endures ongoing competitive and volume pressures, particularly in the US, and a more gradual recovery in margins is now considered more likely.

ALS is becoming increasingly reliant on growth via the acquisition strategy in food and pharmaceuticals, in what Morgans observes is an increasingly challenged market.

Pricing pressure persists in the US because of overcapacity and apparent political impediments to new project approvals, the broker adds. The company's view on the long-term sustainable margin in the segment has eroded over recent years and 16-17% is now considered "possible" versus an 18% target just 12 months ago.

Credit Suisse suggests management is being cautious in guiding to a lower FY20 margin. A contribution of acquisitions and cost rationalisation could provide some relief, although competitive pressure is likely to persist.

The company continues to flag complimentary acquisitions in the segment and expects to deploy $60m for M&A in the second half, in addition to the $18m in acquisitions completed to date in FY19. The company has also confirmed the buyback will be increased to $225m and extended to December 2019.

FNArena's database shows two Buy ratings four Hold and one Sell (Deutsche Bank). The consensus target is $8.12, suggesting 10.8% upside to the last share price targets range from $6.85 (Deutsche Bank) to $8.70 (UBS).

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# Global Lithium Spotlight Falls On Wodgina

Wodgina, the hard rock lithium project, has found the global spotlight as Mineral Resources announces a JV proposal from Albemarle.

-JV plans to develop lithium hydroxide production at Wodgina -Fully unrisked the proposal offers around 90% of Morgan Stanley's valuation -FY19 earnings guidance below forecasts

By Eva Brocklehurst

Mineral Resources ((MIN)) has sparked considerable interest, announcing a joint venture proposal from Albemarle. The deal pushes the Wodgina hard rock lithium project into the global spotlight.

Albemarle is offering US$1.15bn for 50% of a joint venture at Wodgina, in the north west of Western Australia. The JV will own and operate the mine and develop an integrated lithium hydroxide operation on-site. The deal could close mid-December.

Mineral Resources had flagged a sell-down of Wodgina in May, but initially aimed for a 49% sale, without infrastructure, in order to maintain control of the asset. It appears, at first blush, this deal will include the associated infrastructure and joint ownership and operator status. Regardless, Morgan Stanley believes a deal with Albemarle enhances the credibility of Wodgina and supports the continued relevance of hard rock lithium in the future.

Deutsche Bank values the combined asset at $2.0bn and, reading through the deal, calculates the valuation at $3.17bn (based on an AUD value of US73c), 57% above its valuation. Yet the broker has only been factoring in 56,000tpa of the proposed 113,000tpa hydroxide facility, given the early nature of the strategy downstream.

Albemarle intends to produce at least 100,000tpa, which Deutsche Bank suggests is an indication it may replicate the design of the proposed Kemerton facility.

The broker upgrades Mineral Resources to Buy on valuation and believes there are implications for spodumene, hydroxide and the structure of the lithium market following this deal. The deal bodes well for an Overweight call on the stock, Morgan Stanley agrees.

The broker includes $8.30 per share in its current target of $20 for Wodgina upstream and $2.20 per share for downstream processing. Albemarle has offered an enterprise value equating to $17 a share for Wodgina in the deal, on the broker's calculation.

Even on a fully unrisked basis the value offered is around 90% of the valuation, Morgan Stanley assesses, a significant feature, particularly considering the project has not yet commenced production upstream or constructed the downstream facility.

Ord Minnett had valued Wodgina at $2.3bn, or US$1.64bn, but this included only 50,000tpa of lithium hydroxide capacity, not the 100,000tpa target which has been flagged. Adding another 50,000tpa of downstream capacity lifts the broker's valuation in line with the agreed price. Ord Minnett suggests the deal is clean, and fair, noting both parties plan for binding documents by December 14.

Albemarle

Albemarle Corp is based and listed in the US, supplying specialty chemicals globally and producing lithium carbonate at La Negra, Chile, and in Nevada, US. The company produces lithium hydroxide technical grade in the US and Germany with a plant in the US and two in China.

By this partnership, Mineral Resources has cemented Wodgina as a tier-1 strategic asset and placed the downstream option firmly on the table, in Ord Minnett's estimation. Not only does the transaction deliver a cash windfall, it also confirms the strategic value of the upstream lithium assets, which can be developed into long-term, ex-China, sources of battery-grade lithium.

Albemarle should bring significant intellectual property and engineering expertise to the JV. The construction of a 50,000tpa lithium hydroxide facility will begin as soon as necessary licenses and approvals are in place and a second stage will be subject to market conditions but would add another 50,000tpa of capacity and consume all of the concentrate output from Wodgina.

Earnings Guidance

Mineral Resources also released FY19 earnings guidance at its recent AGM, which was below both Morgan Stanley's and Macquarie's forecasts. Group guidance is $280-320m versus Macquarie's estimate of $520m. Mining service guidance is 80-85% of the total, also lower than both brokers expected.

The variation, overall, stems from reduced shipment guidance, as Mount Marion is expected to ship -17% less spodumene than Macquarie had forecast, while spodumene shipments from Wodgina are in line with estimates. DSO shipments have ceased, but Macquarie had assumed a further 220,000t in the second quarter of FY19. Iron ore shipments are broadly in line with expectations, as lower volumes at Iron Valley are offset by higher outcomes forecast for Koolyanobbing.

Mining services guidance missed expectations because of wider discounting in iron ore fines, higher operating costs at Mount Marion and higher start-up costs at Koolyanobbing.

FNArena's database shows three Buy ratings for Mineral Resources (Macquarie is restricted on rating and target). The consensus target is $19.83, suggesting 28.2% upside to the last share price. This compares with $17.83 ahead of the announcement. The dividend yield on FY19 and FY20 forecasts is 3.7% and 5.1% respectively.

# A Beautiful Mine

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.

At the Beijing Auto Show this year, 7 out of 10 "new energy vehicles" (NEVs) on display were by Chinese automakers. While EVs only accounted for 17% of the 1,022 models showcased, 124 of the 174 NEVs were made by domestic (Chinese) manufacturers. New energy vehicles in China refers to both battery-operated vehicles and plug-in hybrids.

The numbers are proof of the trend towards electrification of transportation in China, whereas in North America, we're being left behind choking on diesel and gasoline fumes. Here are some more startling stats. In 2017 less than 200,000 EVs were sold in the US, versus 777,000 in China. That's up 53% in China compared to 2016, and down 13% in the US. EVs are still a minuscule part of the massive US auto industry, accounting for just 1.2% of the 17 million vehicles sold last year. (Numbers courtesy of the South China Morning Post.)

There are a few reasons why EVs have achieved so much greater market penetration in China versus the United States. The first, unsurprisingly, is cost. The most popular range of EVs sold in China can be purchased for between USD$11,500 and $14,500 - around the cost of a used Subaru in North America. Most EVs for sale in China are produced domestically, which keeps costs down. The price tag is also considerably less than a North American model due to subsidies. The Chinese government - which wants EVs to account for 12% of all sales by 2020 - offers buyers a subsidy of up to 100,000 yuan per unit, or nearly USD$16,000. The subsidy increases, the longer the EV's range.

US News ranked the 9 cheapest electric cars in the United States, and found the least expensive model was the 2017 Smart Electric Drive, at $23,800 before tax credits. Still a considerable sum for the average wage earner. If you want to go high-end, the 2018 Tesla S can be mortgaged for between $74,500 and $135,000+.

The second reason is infrastructure. In the US they have 48,000 charging outlets with most, 15,000, in California. China has 213,903, according to the Environmental and Energy Study Institute. The Chinese government plans to build 120,000 public charging stations by 2020.

The last reason is government support. Tax credits in the US range from $2,500 to $7,500 depending on battery capacity. While the US is using tax credits, tax exemptions and rebates to encourage EV buying (and the Trump administration wants to discontinue most), in China the subsidies are much more aggressive. Since 2014, Chinese EV buyers haven't had to pay any tax. And local governments are supportive. Beijing and Shenzhen for example match the subsidy amount provided by the central government. The Zuzhou municipal government partnered with Singulato Motor to establish a 10 billion yuan (about USD$1.5B) fund for investing in EV research, according to the South China Morning Post.

All of this has resulted in China being the undisputed leader in the electric-vehicle market. The country currently accounts for half of the world's EV production and sales.

Why the big push to electric vehicles in China? Beijing sees EVs as the key to unlocking the pollution dilemma that has plagued its car-choked cities. In many ways, China is a victim of its own success. The phenomenal growth of the middle class over the last 30 years has led to urbanization and new-found wealth. It's no different from the US in the 1950s. Cars are status symbols. Thirty years ago in China it was a bicycle; today it's a Mercedes Benz.

If you look at the mine to battery supply chain, China is the leader, or is working hard at doing so. This includes the mining of materials needed for electric vehicles (copper, lithium, rare earths), processing capability and lining up battery makers to sell batteries to car companies.

But the supply of lithium is limited China already owns half of the world's production.

Countries that produce lithium are becoming alarmed that they're giving away the farm to China without saving enough for themselves. Resource nationalism is taking hold in Chile and Argentina, two main producers of what some are calling "the white gasoline." This article will trace the push and pull of the major lithium producers as they battle for market share for what is becoming an extremely sought-after ingredient in the switch to the electrification of our global transportation system.

China's lithium dominance

China has signed lithium off-take agreements with mines in Australia, Canada and Africa. Tianqi Lithium - which owns 51% of Talison's Greenbushes mine in Australia, the largest hard rock lithium mine in the world – is on its way to acquiring a 24% stake in SQM currently owned by Canada's Nutrien Inc. SQM's majority shareholder, Julio Ponce Lerou, tried to scuttle the deal by filing an anti-trust lawsuit, but it was rejected last Thursday by Chile's Constitutional Court.

Other Asian companies, such as Japan's Panasonic and Korean conglomerate Samsung, are also looking to ink deals. Lithium X Energy accepted a buyout offer from NextView, a Chinese investor consortium, for its flagship lithium property in Argentina. NextView also acquired a 20% stake in Bacanora Minerals' Sonora lithium project in Mexico.

China has a stake in Argentina's Cauchari-Olaroz lithium project - a 50/50 JV between SQM and Lithium Americas. Having financed $172 million, Ganfeng Lithium is Lithium America's largest shareholder with a 19.7% stake. Chinese and South Korean companies are among the bidders to construct the giant Salar de Uyuni lithium carbonate plant in Bolivia - which currently produces no lithium.

The two main players in China are Tianqi Lithium and Ganfeng Lithium. Together they control around 29% of the lithium market. Ganfeng is fast growing into a lithium superpower. In 2013 the company controlled just 6% of production, five years later it's nearly doubled, to 11%. Despite a disappointing IPO earlier this year where its shares closed almost $5 lower than its offer price on the Hong Kong Stock Exchange, Ganfeng plans to use the $421 million raised to expand its production capacity of lithium and lithium compounds, batteries and recycling.

Since August Genfeng has signed agreements with Tesla, BMW and battery producer LG Chem, the largest chemical company in South Korea. The company's growth has put it on track to outpace US-based FMC Corp and replace SQM as the second largest lithium producer in the world. Its expertise lies in processing raw lithium into lithium carbonate and lithium hydroxide needed for batteries.

For its part, Tianqi is building the largest lithium processor in Western Australia and looks to have wrested a near one-quarter stake of SQM from Nutrien, the world's largest potash producer and second largest maker of fertilizer.

Lithium giants spar

Tianqi-SQM vs Nutrien

Tianqi, based in Sichuan province, has been trying to access Chile's Salar de Atacama, from which brine lithium is produced at lower costs than hard rock (pegamite) mines like Greenbushes in Australia. It figured the best way to do that was to take a share in SQM, Chile's state lithium miner.

But the $4.1 billion deal went off the rails in September when SQM voiced anti-trust objections in a Chilean court. The problem was two-fold. First, because Tianqi partners with Albemarle, SQM's competitor, at the Greenbushes mine, there were concerns that Tianqi might share trade secrets with Albemarle. But Nutrien's executive vice president was quoted saying that he thinks the real reason Lerou wanted to block the deal was to keep his dominant shareholder position at SQM.

Second, critics said the tie-up would create an OPEC-like cartel that could influence prices and access to lithium when demand for it is soaring. The Chilean government piled on, saying the agreement would distort the lithium market.

Chile's competition regulator approved the stake sale, but a further wrinkle was introduced when SQM's largest shareholder, Julio Ponce Lerou, the former son-in-law of late Chilean dictator Augusto Pinochet, prepared a lawsuit. Chile's Constitutional Court however dismissed the case last week, clearing the way for the transaction to close.

SQM vs Albemarle

The row between SQM and Albemarle, the two biggest lithium producers, goes back to 2013 when government inspectors at SQM's operation found that Algarrobo trees - a native species - were dying. The inspectors deemed the dead trees to be a canary in the coal mine that there could be water problems.

The companies operate a mere 3 miles apart in the Salar de Atacama, which produces about a third of global lithium output. Keep in mind SQM and Albemarle are pumping lithium-rich brines (saltwater) from the same source. It's like sticking two straws into the same water glass; sharing the same salar is bound to cause friction.

They both got permission to increase their outputs from the Salar de Atacama earlier this year, and were confident they had enough water to do so.

Reuters however uncovered in filings with Chile's environmental regulator, that Albemarle complained in 2016 about SQM sucking up more brine than its permits allowed, for several years. SQM said the same thing of Albemarle, that it was overdrawing brine at its mine.

The problem seems to be that neither the companies nor Chilean authorities have a clear picture of how much lithium brine, or water, is left in the Salar de Atacama. To be on the safe side, Chile in August ordered its regulators to stop issuing new permits to extract water in the southern section of the Salar's watershed. The restrictions affect not only lithium miners but the world's largest copper mine (BHP's Escondida) and Antofagasta's Zaldivar mine.

The argument between SQM and Albemarle is about more than water, it's also about production bragging rights. It started in August with a daring challenge by SQM. The Chilean state lithium miner said it would overtake Albemarle by 2022, when it predicted it would control 28% of market share versus Albemarle's 16%. The current proportions are 29% for Albemarle and 23% for SQM.

Both boasted of plans to increase production, with SQM planning a $450 million expansion of its lithium carbonate plant (70,000 to 180,00 tons a year), and Albemarle claiming it has secured permits to boost its production to an annual 145,000 tons.

Things went from bad to worse in October, when the Chilean government said Albemarle failed to live up to a 2016 contract. The company was supposed to offer a quarter of its annual production at a discount to battery makers - a stipulation put in to help build a mine-to-battery industry in Chile. The country's nuclear regulator then refused to increase the company's lithium production quota.

Argentina: Taxing miners

While the top lithium dogs in Chile are squabbling over water and production rights, next door in Argentina things aren't any better. The country is in the midst of an economic crisis due to, among other factors, a falling peso, low economic growth and inflation grinding above 30%.

The government recently imposed an export tax on lithium and other commodities as part of a package of austerity measures. The tax, an 8% duty on sales, is supposed to only be for two years but taxes have a way of staying in place indefinitely. It is likely to curb lithium production and the big companies are already feeling the effects. Orocobre, which trades on the ASX, TSX and European exchanges, has seen its stock price nearly cut in half over the past six months. Its Salar de Olaroz project in northern Argentina has been operating since 2015.

Battery makers competing too

Producers aren't the only entities trying to put a lock on lithium. Battery makers are also in on the game. As the main buyers of lithium carbonate and hydroxide, these companies need to ensure they have security of supply, as do the automakers that buy the batteries.

Tesla's Gigafactory in Nevada is emblematic of EVs in North America, but it's only one of many battery-making facilities in the works. According to Benchmark Intelligence there will be a 399% increase in lithium-ion battery production capacity over the next 10 years - the equivalent of 10 Tesla Gigafactories as pointed out recently by Visual Capitalist. Unsurprisingly, 5 of the 7 largest Gigafactories will be in China, or 57% of the total.

The London-based research firm notes that prices for lithium-ion battery cells have fallen around 16% annually since 2014, putting the technology almost on par with internal combustion engines. EV market share is expected to surpass the share of the market held by traditional vehicles by 2038.

The largest battery maker in the world is Contemporary Amperex Technology Ltd. (CATL), a Chinese company. Among its clients are Volkswagen, BMW, Hyundai and Nissan. CATL is trying to get financing to build a new 24-gigawatt-hour factory in its home province of Fujian, and is supplying its cells to a number of number of major automakers in China who are rolling out new EV models including Toyota's ix4, a rebranded EV being developed by its Chinese partner, Guangzhou Automobile Group, a plug-in version of Hyundai's Sonata, and BMW's 530Le sedan. CATL opened an office in Yokohama, Japan, and is looking to build plants in Europe. Adding the plant in Japan would mean that CATL surpasses the output of Tesla's Gigafactory in Nevada, BYD Co., backed by Warren Buffet, and South Korea's LG Chem Ltd., making it the world's largest EV battery supplier, according to Bloomberg New Energy Finance.

CATL already supplies batteries for BAIC Motor Corp, the biggest EV seller in China, and Zhengzhou Yutong Group, the world's largest bus maker, states Bloomberg. CATL IPO'd in June and started trading on the Shenzhen stock exchange with a market cap of $12.3 billion.

Panasonic, Tesla's supplier, is the largest maker of batteries for regular-sized electric cars, also known as highway capable passenger electric vehicles. The other two major EV battery players are Samsung SDI Co. and LG Chem, both based in Korea.

Europe gets in on the action

Lately we have seen a flurry of action in Europe, with battery companies partnering with firms and facilities that can amp up their gigawatt hours. Two examples are Lithium Werks BV, a Dutch company that is investing $1.8 billion in a huge lithium-ion factory in China; and Swedish battery manufacturer Northvolt, which will set up a plant in Poland with Tesla supplier South Bay Solutions. The facility will reportedly make battery systems for energy storage companies and the mining industry, as part of an effort to compete with its Asian rivals - like Samsung SDI and LG Chem which are looking to build plants in Europe and Hungary.

Meanwhile European battery companies are expected to receive government support. The European Union said recently that it will allow state aid for electric vehicle battery research and offer billions as incentives for companies to build lithium-ion battery plants, according to a report in MINING.com.

Global trends: Big cities, no more fossil fuels

Given the importance of lithium, it's no wonder that the big producers and battery companies are fighting for market share and access to customers, while provisioning for expansions wherever possible. In the long-term, demand is sure to outstrip supply. The current market of about 230,000 tonnes a year is simply not sustainable. A market outlook report by Roskill states that demand will reach 1 million tonnes in the next 9 years - almost five times current supply.

Demand, of course, will be driven by an expected dramatic increase in the penetration rate of electric vehicles. The latest numbers by Bloomberg Energy Finance shows the EV percentage of total vehicle sales increasing from 3% in 2020 to 28% in 2030, and climbing to 55% in 2040. (see chart below). Battery-powered electric vehicles (the purple bars) grow the most by far.

Another graphic by Visual Capitalist supports global trends that support the need for electrification. #6 on the list of "8 Major Forces Shaping the Global Economy" is all about the green economy and the shift from fossil fuels to more sustainable energy sources. An impressive stat is the one at the bottom of the section by Morgan Stanley, stating that by 2047 there will be a billion electric cars on the road. That's 1,000 times greater than the just over 1 million units sold in 2017.

#7 talks about population trends. The big news here is Africa. The Global Cities Institute shows populations in Western countries and China stabilizing, but exploding in Africa. The animation shows that by the end of this century, Africa could contain at least 13 "megacities" bigger than New York. None of the biggest cities at this time will be in North America, Europe, South America or China.

The question is, where are these huge new cities going to get their energy? In China and India one of the spoils of a budding middle class, driven by urbanization, was for everyone (well, not everyone, but many people) to afford a car. But we have seen what that got China: an insatiable hunger for energy that meant the continuation of coal-fired power plants, with the inevitable smog that came with them. China is now trying to find a way out of this dilemma and sees EVs as a big part of the solution. Are these new African cities going to burn fossil fuels too as they continue to expand? Not likely.

A telling report by the UN's climate change panel states that we only have 12 years left to keep global warming to 1.5 degrees C, "beyond which even half a degree will significantly worsen the risks of drought, floods, extreme heat and poverty for hundreds of millions of people," the Guardian reported. No, the only way to prevent a teeming mass of humanity from choking to death on their own car fumes is to go electric.

Conclusion: A beautiful American mine?

So how will all this posturing by lithium companies affect the United States, which still sees EVs as a niche market representing a mere 1% of total vehicle sales? The only game in town for lithium production in the US is Albemarle and its Silver Peak Mine in Nevada. But lithium grades are declining at the long-running mine and Albemarle will soon have to do something about it. Either find more lithium in the Clayton Valley, shut the mine and concentrate on South America and Australia, or partner with a junior to keep it going. Cypress Development Corp (TSX-V:CYP) is the obvious answer to the third option. Its neighboring property to Silver Peak hosts 3.287 million tonnes LCE in the indicated category and 2.916 MT LCE inferred - more than enough to supply America's current lithium needs, and then some.

Its claystone lithium operation is pegged at around 24,000 tonnes a year and could provide battery-grade lithium carbonate and hydroxide to Silver Peak at low cost. Or Cypress could forget about Albemarle and go it alone; it doesn't need them.

At Ahead of the Herd, we did some calculations to put the size of the deposit in perspective. In comparison to some of the world's largest lithium deposits, Cypress is right up there, around the same size as Orocobre's Salar de Oroz lithium facility (the fifth largest deposit in the world) in Argentina which has a measured and indicated resource of 6.4 million tonnes LCE.

The irony is this: as lithium giants like SQM and Albemarle tangle with one another like gladiators in the Roman Coliseum, over scarce lithium brines and water, a beautiful lithium mine in Nevada's Clayton Valley is taking shape. Cypress' mine has no issues with water, is lower cost than brine or hard-rock lithium operations, and has rare earths and other by-product credits to boot.

The detailed PEA released in October shows an attractive net present value of $1.45 billion at an 8% discount rate, yielding an internal rate of return (after tax) of 32.7%. Payback is just under three years. The IRR is based on a lithium carbonate price of $13,000 a tonne, what we here at Ahead of the Herd think is a conservative estimate. The proposed mine would produce an average of 24,042 tonnes of lithium carbonate per year and have a mine-life of 40 years. The mine would be neither a hard-rock nor a lithium brine operation, but rather, would process the lithium from clays in Nevada's Clayton Valley by leaching with sulfuric acid.

Now, leaching lithium from claystones is relatively new, and more testing will have be done before institutional investors pile in. This is still early stage. Cypress needs to prove they can make saleable lithium products economically, as they say they can in the PEA. The hard numbers will come in the prefeasibility study expected early next year. We expect them to be solid.

In terms of risk, a company like Cypress, in the United States in an established jurisdiction, without the threat of import tariffs the US could still slap on China or other lithium-producing countries to protect US market share, has less black swans to worry about than companies operating in Chile or Argentina, where the governments are either taxing miners or making it difficult for them to get water permits and to increase production quotas. It's a no-brainer.

I'm somewhat bemused as I watch the big lithium companies fight amongst themselves when a huge supply of lithium is sitting right beside the only producing lithium mine in the United States. Eventually EVs will take off in America, and when that happens, US automakers will be crying for lithium. Without a reliable US supplier, where will they get it? If nothing happens, they'll have to keep importing it, at higher costs, and greater risks to their supply chains. Why not bet on the local horse instead?

I'm watching what's happening in the lithium market closely, and there's only one company I think has the property and the ability to compete with the big boys. That's Cypress Development Corp, which is why I own shares.

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

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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

# 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 November 12 to Friday November 16, 2018 Total Upgrades: 10 Total Downgrades: 12 Net Ratings Breakdown: Buy 44.77%; Hold 41.88%; Sell 13.36%

Perhaps the most important observation is that underlying momentum for Australian companies listed on the ASX seems to have turned for the worst. Irrespective of a share market struggling to keep upward momentum going, with indices in negative territory year-to-date, stockbroking analysts are issuing more downgrades than upgrades, and this picture becomes decisively negative when we look at valuations & price targets, and at earnings forecasts.

Sticking to recommendations, for now, total tally for the week ending Friday, 16th November 2018 accumulated to ten upgrades (of which Lend Lease accounted for two) and twelve downgrades (with Lend Lease accounting for three). The good news here is that seven out of ten upgrades went to Buy (or an equivalent).

On the negative side, five out of twelve downgrades shifted to Sell with Aveo Group, Elders, Factor Therapeutics, Platinum Management and Shopping Centres Australasia all receiving one. Aveo Group, having issued yet another profit warning, also received a second downgrade to Neutral.

Very little happened during the week in terms of positive revisions to valuations and price targets, with the week's table consisting of three names only, led by QBE Insurance, followed by Corporate Travel Management and WorleyParsons.

There is, however, plenty to witness on the flipside where downward adjustments are large and plenty. Aveo Group suffered a blow of -27%, worse than Lend Lease's -25%. Others on the week's receiving side include McMillan Shakespeare, Steadfast Group, Lovisa Holdings and NextDC.

The picture looks even worse for earnings estimates. None of the positive adjustments is worth pointing out, as all really are minor adjustments in the margin, but when it comes to negative revisions.... Xero's forecasts have been adjusted by -190%. For Graincorp the adjustment was -78%. Lend Lease is only third with its forward estimates dropping by -45%. Then comes NextDC with -35%.

No second guessing as to why share prices remain under pressure from both macro-economic and micro perspectives. The out-of-season financial reports continue to drip-drop in this week. When it comes to negative news, however, it's the June-seasoned companies that are doing most of the damage, led by the likes of Lend Lease, Pact Holdings, Aveo Holdings, and numerous retailers.

Upgrade

AGL ENERGY LIMITED ((AGL)) Upgrade to Buy from Neutral by Citi .B/H/S: 3/2/3

Citi analysts had been absent since April (last rating Neutral). They made a come-back by going against the grain, upgrading to Buy on the argument that investor concerns about political intervention risks are by now well and truly priced in, and possibly with too much emphasis on potential downside.

There is one caveat, in that the reintroduction of a carbon price if Labor is reelected could still materially impact on the valuation of the business. Price target $20.27.

AUSNET SERVICES ((AST)) Upgrade to Equal-weight from Underweight by Morgan Stanley .B/H/S: 1/6/0

First half results were in line with Morgan Stanley's estimates. The broker believes regulatory risks are factored into the price and this raises the defensive appeal of the stock.

The broker lifts growth estimates for the contracted asset base to around $1.2bn by FY21, 20% above the current level but considered achievable based on the large pipeline of new generation projects.

Rating is upgraded to Equal-weight from Underweight. Target is raised to $1.72 from $1.71. Industry view: Cautious.

See also AST downgrade.

CALTEX AUSTRALIA LIMITED ((CTX)) Upgrade to Outperform from Neutral by Credit Suisse .B/H/S: 5/1/1

While uncertainties exist, Credit Suisse believes Caltex is on an undemanding multiple and there is increasing exposure to the convenience retail segment. The broker downgrades 2018 estimates to reflect guidance on retail margins and downtime at Lytton, while outer-year upgrades are spread across fuel distribution and convenience.

An alliance with Woolworths ((WOW)) reduces sourcing complexity and participation in the rewards program adds to the company's market position. Credit Suisse upgrades to Outperform from Neutral and raises the target to $33.07 from $32.55. Without the distractions of contracts/M&A, better optimisation of fuels and infrastructure appears likely.

LEND LEASE CORPORATION LIMITED ((LLC)) Upgrade to Outperform from Neutral by Credit Suisse and Upgrade to Accumulate from Hold by Ord Minnett .B/H/S: 3/3/0

Lend Lease has announced an additional cost overrun of around $500m on NorthConnex and some other engineering construction projects. While there is heightened risk in the shares, Credit Suisse believes they are oversold and it may be attractive to buy ahead of the AGM on November 16.

Rating is upgraded to Outperform from Neutral. Target is steady at $16.20. The broker suspects there could be significant upside from a more aggressive focus on costs across the business.

Ord Minnett has assumed a worst-case scenario for Lend Lease, including another material impairment and the engineering & services business being subjected to an orderly winding down. In such a scenario the broker believes the company can return to a comfortable gearing position and avoid issuing dilutive equity.

The broker forecasts Lend Lease will release $1.65bn in capital by divesting $550m of fund co-investments at the Barangaroo International towers and bring in a joint venture partner to One Sydney Harbour, its largest development project over the next five years.

Ord Minnett upgrades to Accumulate from Hold and reduces the target to $15 from $16.

See also LLC downgrade.

NORTHERN STAR RESOURCES LTD ((NST)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 1/3/3

Northern Star has made a $150m cash offer to acquire the 49% interest in East Kundana it does not already own. Macquarie believes consolidating the venture is a compelling option, and the offer represents a discount to its valuation of the company's 51% stake.

The broker believes Northern Star is well-positioned to drive through a deal. Should the offer be successful, Northern Star will assume financial benefit from January 1 2019.

Rating is upgraded to Outperform from Neutral. Target is steady at $9.80.

ORIGIN ENERGY LIMITED ((ORG)) Upgrade to Buy from Neutral by Citi .B/H/S: 5/2/0

Citi analysts have upgraded to Buy on the argument that investor concerns about political intervention risks are by now well and truly priced in, and possibly with too much emphasis on potential downside.

There is one caveat, in that the reintroduction of a carbon price if Labor is reelected could still materially impact on the valuation of the business. Excluding this scenario, Citi thinks there is enough upside potential for an upgrade to Buy from Neutral. Price target $8.52 (was $8.74).

The analysts also point out, were they to use a US$70/bbl long term oil price then the target price would increase to $/9.62shr.

SEEK LIMITED ((SEK)) Upgrade to Neutral from Sell by UBS .B/H/S: 2/4/1

After the latest ANZ job advertising series and UBS proprietary data the broker concludes that FY19 guidance, which indicates net profit of around $200m, should be secure. This view is held despite the softening macro conditions and the slowing in domestic job growth.

The broker believes the company still has cost levers to pull even if the top line were to slow materially. Against revised estimates the broker believes the stock is fairly valued. UBS upgrades to Neutral from Sell. Target is reduced to $18.50 from $19.50.

SEVEN WEST MEDIA LIMITED ((SWM)) Upgrade to Neutral from Sell by UBS .B/H/S: 0/3/2

Seven West has underperformed the market, UBS notes, since rival Nine Entertainment's ((NEC)) October update which suggested a weaker metro TV market in which Nine was gaining share. Seven West's own update confirmed such headwinds but the broker believes this could be a low watermark, given key programming lies ahead such as the cricket and My Kitchen Rules.

Guidance has been left unchanged on the assumption cost controls can offset weak TV, but UBS appears to have a lot of faith in the cricket and MKR and flags a typical election boost next year. The broker thus upgrades to Neutral from Sell while cutting its target to 80c from 85c.

WORLEYPARSONS LIMITED ((WOR)) Upgrade to Buy from Hold by Deutsche Bank .B/H/S: 5/2/0

Deutsche Bank likes the exposure to the recovery in oil & gas capital expenditure. The share price could be negatively affected by concerns regarding global growth and declines in the oil price, but the company is still expected to find significant opportunities for revenue and margin expansion.

Deutsche Bank forecasts 20% growth in earnings per share between FY18-21. Rating is upgraded to Buy from Hold and the target is raised to $20.15 from $19.10.

Downgrade

AVEO GROUP ((AOG)) Downgrade to Underperform from Neutral by Macquarie and Downgrade to Hold from Add by Morgans .B/H/S: 1/1/1

The trading update from the AGM signals to Macquarie that management is backtracking from FY19 guidance, with sales rates below expectations because of a weak residential market.

Given price deflation and lower sales across the retirement sector, the broker suspects conditions will remain tough and pressure margins in FY19.

Macquarie downgrades to Underperform from Neutral and struggles to envisage operating conditions improving. Target is reduced to $1.54 from $2.74.

The company's AGM update revealed weaker sales/settlements because of a softer housing market. The company has, prudently in Morgan's view, pulled back its FY20 development deliveries to around 200 from 500 previously.

The broker downgrades forecasts by -21% and -34% for FY19 and FY20 respectively. The broker downgrades to Hold from Add, until there is further evidence sales rates are holding at current levels. Target is reduced to $2.09 from $3.37.

AUSNET SERVICES ((AST)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 1/6/0

The interim result was stronger than Macquarie expected, reflecting a better customer contribution. Macquarie believes the stock has performed well but the potential for growth is now factored in.

While the yield provides a floor, it is considered unlikely to be a catalyst for re-rating. A more coordinated government policy that accelerates growth and renewables is likely to be the driver of a re-rating, in the broker's opinion. This is unlikely before May 2019.

Rating is downgraded to Neutral from Outperform. Target is lowered to $1.72 from $1.74.

See also AST upgrade.

ELDERS LIMITED ((ELD)) Downgrade to Reduce from Hold by Morgans .B/H/S: 0/0/1

Full year results beat expectations with underlying operating earnings 3.6% ahead of Morgans' forecasts. The company has proven, in the broker's view, it can still grow earnings despite the drought and a decline in cattle price.

Management remains confident of delivering 5-10% earnings growth out to FY20, organically, through acquisitions and via cost control measures.

Still, Morgans believes the stock is fully valued and downgrades to Reduce from Hold. Target is raised to $7.80 from $7.05.

FACTOR THERAPEUTICS LIMITED ((FTT)) Downgrade to Reduce from Add by Morgans .B/H/S: 0/0/1

The phase 2 trial for Factor Therapeutics' treatment for venous leg ulcers failed at all levels. Ongoing development has been halted and the company will now look for ways to reduce costs and preserve cash and intellectual property.

Morgans downgrades to Reduce from Add. Target falls to 0.6c from 0.093c

LEND LEASE CORPORATION LIMITED ((LLC)) Downgrade to Neutral from Outperform by Credit Suisse and Downgrade to Neutral from Outperform by Macquarie and Downgrade to Neutral from Buy by Citi .B/H/S: 3/3/0

Lend Lease has announced additional provisions on problem projects in its engineering division. Credit Suisse believes the shares have likely been oversold but the catalysts that will restore confidence in the business are some way off.

The broker reduces FY19 estimates for operating earnings by -37%. A quick solution is likely to be a sale of the engineering business but the broker acknowledges this may not maximise shareholder value.

Credit Suisse downgrades to Neutral from Outperform and lowers the target to $16.20 from $19.30.

The company has announced a $350m post-tax provision relating to engineering projects. Macquarie is disappointed with the outcome, which proves Lend Lease has not resolved the issues at NorthConnex.

Given the uncertainty in engineering and despite the good medium-term prospects in global urban regeneration Macquarie downgrades to Neutral from Outperform. This is the third provision that has been taken for NorthConnex, the broker suspects.

The total impairment predominantly relates to projects that were previously identified, nevertheless, with major tunnelling projects still to be completed, the market will now assign a higher risk premium to these earnings, Macquarie points out. Target is reduced to $15.08 from $21.81.

Lend Lease has announced a $350m after-tax provision for engineering projects. Citi lowers forecasts for FY19 earnings per share by -40% to reflect the downgrade. FY20 estimates are lowered by -14%.

The broker is not sure the worst is behind the company, noting the engineering track record of Lend Lease is abysmal, with a loss of -$500m over the past five years.

The broker reiterates a view that engineering should be spun off and any path to a recovery in the share price is now dependent on the company divesting the division in one form or another.

Rating is downgraded to Neutral from Buy. Target is reduced to $15.06 from $22.36.

See also LLC upgrade.

PRIMARY HEALTH CARE LIMITED ((PRY)) Downgrade to Neutral from Buy by Citi .B/H/S: 1/4/3

Citi suspects FY19 net profit will be down on the prior year. At a macro level, the broker notes Medicare statistics for the September quarter were soft and the company has also found an issue in October with its payroll system which resulted in medical centre staff being underpaid for the last seven years with a -$18m underpayment likely to be paid out in cash.

The Dorevitch Fair Work Commission determination has also indicated a post-tax impact on underlying net profit guidance of -$4.5m. The company hopes to offset this through cost reductions.

Guidance is expected to be updated at the AGM on November 22. Citi downgrades to Neutral from Buy and reduces the target to $2.90 from $3.20.

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

The company has reported a -5.5% fall in funds under management for October. Negative market movements drove the decline despite a modest outperformance in the international fund and Asia fund.

Inflows were slightly positive and largely from the retail channel. Factoring in the weaker market movements Credit Suisse downgrades earnings by -6% for FY19 and -8% for FY20-21.

Rating is downgraded to Underperform from Neutral as the weak fund performance is likely to hamper flows. Target is reduced to $5.00 from $5.25.

SHOPPING CENTRES AUSTRALASIA PROPERTY GROUP ((SCP)) Downgrade to Underperform from Neutral by Credit Suisse .B/H/S: 0/2/3

Since the acquisition of the Vicinity Centres ((VCX)) in early October Credit Suisse observes the share price is now trading at a 13% premium to the last stated net tangible assets.

While the broker commends management on its ability to execute on its corporate strategy, the hefty premium to valuation is considered a stretch.

Rating is downgraded to Underperform from Neutral. Target is steady at $2.25.

STEADFAST GROUP LIMITED ((SDF)) Downgrade to Hold from Accumulate by Ord Minnett .B/H/S: 2/1/0

The Australian Securities and Investments Commission has submitted a recommendation to the Hayne Royal Commission recommending the removal of commissions for all insurance products.

Ord Minnett calculates, if this recommendation ultimately worked its way into legislation, it would have an adverse effect on Steadfast. The submission intends to fix problems related to products that provide little or no value to consumers such as add-on insurance products and it is still too early to know if the recommendations will be accepted or become policy.

Ord Minnett does not change earnings forecasts for Steadfast but increases its discount rate on valuation. The broker downgrades to Hold from Accumulate and reduces the target to $2.88 from $3.35.

Total Recommendations Recommendation Changes

Broker Recommendation Breakup

Broker Rating Order Company New Rating Old Rating Broker Upgrade 1 AGL ENERGY LIMITED Buy Neutral Citi 2 AUSNET SERVICES Neutral Sell Morgan Stanley 3 CALTEX AUSTRALIA LIMITED Buy Neutral Credit Suisse 4 LEND LEASE CORPORATION LIMITED Buy Neutral Credit Suisse 5 LEND LEASE CORPORATION LIMITED Buy Neutral Ord Minnett 6 NORTHERN STAR RESOURCES LTD Buy Neutral Macquarie 7 ORIGIN ENERGY LIMITED Buy Neutral Citi 8 SEEK LIMITED Neutral Sell UBS 9 SEVEN WEST MEDIA LIMITED Neutral Sell UBS 10 WORLEYPARSONS LIMITED Buy Neutral Deutsche Bank Downgrade 11 AUSNET SERVICES Neutral N/A Macquarie 12 AVEO GROUP Neutral Buy Morgans 13 AVEO GROUP Sell Neutral Macquarie 14 ELDERS LIMITED Sell Neutral Morgans 15 FACTOR THERAPEUTICS LIMITED Sell Buy Morgans 16 LEND LEASE CORPORATION LIMITED Neutral Buy Macquarie 17 LEND LEASE CORPORATION LIMITED Neutral Buy Citi 18 LEND LEASE CORPORATION LIMITED Neutral Neutral Credit Suisse 19 PLATINUM ASSET MANAGEMENT LIMITED Sell Neutral Credit Suisse 20 PRIMARY HEALTH CARE LIMITED Neutral Buy Citi 21 SHOPPING CENTRES AUSTRALASIA PROPERTY GROUP Sell Neutral Credit Suisse 22 STEADFAST GROUP LIMITED Neutral Buy Ord Minnett Recommendation Positive Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 WOR WORLEYPARSONS LIMITED 71.0% 33.0% 38.0% 7 2 LOV LOVISA HOLDINGS LIMITED 75.0% 50.0% 25.0% 4 3 MMS MCMILLAN SHAKESPEARE LIMITED 60.0% 40.0% 20.0% 5 4 SWM SEVEN WEST MEDIA LIMITED -40.0% -60.0% 20.0% 5 5 CTD CORPORATE TRAVEL MANAGEMENT LIMITED 60.0% 40.0% 20.0% 5 6 AGL AGL ENERGY LIMITED -6.0% -21.0% 15.0% 8 7 ORG ORIGIN ENERGY LIMITED 64.0% 50.0% 14.0% 7 8 SEK SEEK LIMITED 7.0% -7.0% 14.0% 7 9 NST NORTHERN STAR RESOURCES LTD -29.0% -43.0% 14.0% 7 10 QBE QBE INSURANCE GROUP LIMITED 69.0% 56.0% 13.0% 8 Negative Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 AOG AVEO GROUP -17.0% 50.0% -67.0% 3 2 PTM PLATINUM ASSET MANAGEMENT LIMITED -50.0% -25.0% -25.0% 4 3 SCP SHOPPING CENTRES AUSTRALASIA PROPERTY GROUP -60.0% -40.0% -20.0% 5 4 LLC LEND LEASE CORPORATION LIMITED 42.0% 60.0% -18.0% 6 5 SDF STEADFAST GROUP LIMITED 67.0% 83.0% -16.0% 3 6 DMP DOMINO'S PIZZA ENTERPRISES LIMITED -31.0% -19.0% -12.0% 8 7 PRY PRIMARY HEALTH CARE LIMITED -31.0% -19.0% -12.0% 8 8 NXT NEXTDC LIMITED 40.0% 50.0% -10.0% 5 9 AST AUSNET SERVICES 14.0% 17.0% -3.0% 7 Target Price Positive Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 QBE QBE INSURANCE GROUP LIMITED 12.304 11.858 3.76% 8 2 CTD CORPORATE TRAVEL MANAGEMENT LIMITED 28.144 27.460 2.49% 5 3 WOR WORLEYPARSONS LIMITED 19.761 19.338 2.19% 7 Negative Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 AOG AVEO GROUP 2.243 3.103 -27.72% 3 2 LLC LEND LEASE CORPORATION LIMITED 15.748 21.044 -25.17% 6 3 MMS MCMILLAN SHAKESPEARE LIMITED 17.380 18.286 -4.95% 5 4 SDF STEADFAST GROUP LIMITED 3.310 3.467 -4.53% 3 5 LOV LOVISA HOLDINGS LIMITED 9.678 9.953 -2.76% 4 6 NXT NEXTDC LIMITED 7.768 7.912 -1.82% 5 7 CTX CALTEX AUSTRALIA LIMITED 32.080 32.507 -1.31% 7 8 SWM SEVEN WEST MEDIA LIMITED 0.790 0.800 -1.25% 5 9 PRY PRIMARY HEALTH CARE LIMITED 2.994 3.031 -1.22% 8 10 PTM PLATINUM ASSET MANAGEMENT LIMITED 5.218 5.280 -1.17% 4 Earning Forecast Positive Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 S32 SOUTH32 LIMITED 39.111 39.084 0.07% 7 2 AMC AMCOR LIMITED 82.569 82.512 0.07% 7

3 RMD RESMED INC 48.938 48.905 0.07% 8 4 CPU COMPUTERSHARE LIMITED 90.317 90.263 0.06% 8 5 ANN ANSELL LIMITED 144.841 144.779 0.04% 8 6 URW UNIBAIL-RODAMCO-WESTFIELD 101.090 101.047 0.04% 3 7 FPH FISHER & PAYKEL HEALTHCARE CORPORATION LIMITED 33.542 33.528 0.04% 5 8 KMD KATHMANDU HOLDINGS LIMITED 23.884 23.877 0.03% 4 9 AIZ AIR NEW ZEALAND LIMITED 26.465 26.458 0.03% 4 10 A2M THE A2 MILK COMPANY LIMITED 33.843 33.836 0.02% 6 Negative Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 XRO XERO LIMITED -7.231 7.967 -190.76% 6 2 GNC GRAINCORP LIMITED 6.010 27.580 -78.21% 5 3 LLC LEND LEASE CORPORATION LIMITED 80.760 147.940 -45.41% 6 4 NXT NEXTDC LIMITED -1.300 -0.960 -35.42% 5 5 AOG AVEO GROUP 15.500 19.333 -19.83% 3 6 PGH PACT GROUP HOLDINGS LTD 25.818 30.140 -14.34% 5 7 JHX JAMES HARDIE INDUSTRIES N.V. 93.029 98.922 -5.96% 7 8 WOR WORLEYPARSONS LIMITED 67.648 71.718 -5.68% 7 9 MMS MCMILLAN SHAKESPEARE LIMITED 115.840 120.100 -3.55% 5 10 FSF FONTERRA SHAREHOLDERS' FUND 29.227 30.197 -3.21% 3 Technical limitations

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# Uranium Week: Kazakhstan Capitalism

The long awaited IPO of a stake of Kazakhstan's state-owned uranium producer went ahead last week, pending listing in London.

-Kazatomprom IPO oversubscribed -Spain to phase out nuclear power -Spot price ticks up again

By Greg Peel

Last week the annual United Nations' Economic Commission for Europe's Ministerial Conference of the International Forum of Energy for Sustainable Development, typically abbreviated to the much simpler UNECEMCIFESD, was held. This year's event provided a milestone.

For the first time, nuclear power was included in the program.

World Nuclear Association Director General Agneta Rising said in Kiev, "Substituting energy supplied by fossil fuels with electricity generated from nuclear energy and other low-carbon sources is a practical proposition to deliver a clean energy transition".

The Spanish minister clearly nodded off, given last week Spain announced the country would shut down its last coal-fired and nuclear power plants before 2030. By then the world's fifth largest economy hopes to be sourcing 70% of its electricity from renewable sources, and by 2050 the plan is for solar, wind and hydro-power to account for 100%.

Another Milestone

Kazatomprom last week became the first ever Kazakh national company to be listed on an international stock exchange. The uranium miner was previously fully owned by the Kazakh sovereign wealth fund, Samruk-Kazyna, but an IPO saw 15% of the company placed at a value of US$451m, implying a total market cap valuation of US$3bn.

According to Kazatomprom, the IPO was 70% oversubscribed, but one third of the IPO was snapped up by Kazakhstan's state-run pension fund. The stock will list on the local Astana Exchange, the strategic partners of which are the Shanghai Stock Exchange and the Nasdaq, but also on the London Stock Exchange.

The week before last saw the launch of an IPO for investment fund Uranium Trading Corp, but so far the company has not made its debut appearance on the Nasdaq. Back in July the world's first listed uranium investment company, Yellow Cake, made its debut on the London Stock Exchange.

For many, notes industry consultant TradeTech, initial results of these IPOs serve as a measure of confidence in the potential upside of the uranium market.

Onward, Ever Upward

Last week saw 700,000lbs U3O8 equivalent change hands in five transactions on the uranium spot market, TradeTech reports. The consultant's spot price indicator ticked up another US5c to US$29.15/lb.

No transactions were reported in term markets, and TradeTech's term market indicators remain at US$30.00/lb (mid) and US$31.00/lb (long).

While utility interest is quietly rebuilding, TradeTech notes a marked preference for sellers with a demonstrated ability to deliver from primary production and strong financial backing. Perhaps this is a nod to ongoing purchases of uranium in the spot market in order to satisfy contract obligations by produces who have shut down their own production.

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

# The Short Report

Guide:

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

Please take note of the Important Information provided at the end of this report. Percentage UIKeyInputLeftArrowamounts 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 November 15, 2018

Last week the ASX200 rallied earlier in the week before falling off a cliff once more.

Things were seemingly back to normal last week following a period of dubious ASIC reporting. Indeed to the extent that of the movements below, no change in short position in the 5%-plus shorted group exceeded one percentage point other than that of Nine Entertainment ((NEC)), which fell to 7.2% from 8.6%.

We might note, however, that shorts in Rio Tinto ((RIO)) rose to 3.7% from 2.6% (see top 20 table below) assuming, of course, the ASIC data are accurate. Rio was for quite a while at the bottom of the 5%-plus table, so it's no real stretch.

Otherwise, we note Greencross ((GXL)), under takeover, has now dropped off the bottom of the table while Domain Group ((DHG)), impacted by merger, has made its debut.

There may be a clue in the Nine and Domain moves. See below.

Weekly short positions as a percentage of market cap:

10%+

JBH 19.3 SYR 16.4 GXY 15.5 ORE 14.7 ING 13.0 MTS 12.5 BWX 12.3 IVC 11.9 DMP 11.7 MYR 11.0 NXT 10.9 IFL 10.7 CSR 10.0

No changes

9.0-9.9

GEM, SUL, SDA

In: SDA 8.0-8.9%

HVN, NUF, NWS, NAN, BAL

In: NUF, NAN Out: SDA, NEC

7.0-7.9%

KDR, PLS, NEC, FLT

In: NEC, PLS Out: MND

6.0-6.9%

MND, AMC, BOQ, APT, AMP, MSB, BKL, AAC, MLX, GMA, HT1, KAR, CGF

In: MND, APT, KAR, CGF

5.0-5.9%

A2M, CCP, LYC, SEK, RCR, SIG, BIN, BGA, RWC, CLQ, MOC, PTM, CAB, RSG, IGO, AHG, DHG, SGM, VOC

In: RWC, MOC, DHG, SGM

Out: APT, KAR, CGF, GXL

Movers & Shakers

The combination of Domain appearing on the 5%-plus table as Nine shorts fall suggests some connection to the Fairfax Media ((FXJ))-Nine Entertainment merger, confirmed this week, given Fairfax is Domain's majority shareholder and Domain is arguably the real target for Nine in the merger.

The merger will become official by year's end so in the meantime we might be seeing some sort of arbitrage play among three share prices or an attempt to strip out Domain from the merged entity – various possibilities come to mind other than just a simple naked short on Domain.?

ASX20 Short Positions (%)

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

IMPORTANT INFORMATION ABOUT THIS REPORT

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

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

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

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

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

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

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

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

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# The Wrap: Demergers And The Oz Economy

Weekly Broker Wrap: demergers; Oz economy; housing; rates; Aussie dollar; media; and automotive.

-Spin-offs tend to perform better over the medium-longer term -Adjustment of housing supply to lower demand likely to extend into FY20 -Rate hike expectations continue to be pushed into late 2019 -US dollar nearing cyclical peak suggests downside limit for Oz dollar -Citi expects AP Eagers to be the best automotive performer in 2018

By Eva Brocklehurst

De-mergers

Since 2000 there have been a number of demergers, enabling some businesses to flourish after being overshadowed by their larger listed parents. Of the 17 de-mergers that took place since 2000, DJ Carmichael Research calculates that, after two years, 73% of the spin-offs were trading higher, a similar percentage to the parent. The parents, however, recorded a median return of 9% versus the spin-offs with a median return of 28%.

DJ Carmichael notes, in the short term, spin-offs tend to underperform, as investors with small holdings offload positions, particularly where the pro rata allocation is small. The new entity also frequently requires capital that has not been previously forthcoming from the parent.

Still, the research shows that, over the medium-longer term, these businesses perform well. Also these spin-offs tend to be preferred by investors versus initial public offerings, as there is usually an established track record.

Newly listed Coles ((COL)) is expected to be a stable and defensive business, generating strong free cash flow and likely to attract income-seeking investors, in the analysts view, as management has a pay-out target of 80-90%.

Parent Wesfarmers ((WES)) is likely to become more cyclical and growth-oriented with Bunnings, Officeworks, department stores such as Kmart and Target ,as well as the industrial businesses, although now more exposed to the housing downturn on the east coast. DJ Carmichael expects both companies will perform reasonably well over time.

Oz Economy

Australia's economy for the year to June, 2018 grew 3.4%. This was the fastest pace of GDP growth since September 2012 and above the 20-year average of 3.1%. St George Bank economists expect this will slow to trend in 2019. Business investment growth has also lifted following a period of weakness and the drag from the unwinding of the mining investment boom is easing.

Government spending has supported growth and this should continue in the year ahead, with a focus on health and education. Public infrastructure investment is also expected to be a driver of growth. Meanwhile domestic inflation is subdued, with conditions similar to other advanced economies.

Without a significant pick up in wages growth, the economists find it difficult to foresee inflation rising convincingly. Inflation is not expected to reach the middle of the Reserve Bank's 2-3% target over the medium term.

Housing

The main theme to Australia's economy is a slowing housing market. A gradual but persistent decline in house prices is expected in 2018 and 2019, concentrated in Sydney and Melbourne. Heavy demand for dwellings is also fading, as regulatory measures and tighter lending conditions reduce foreign buyers.

Citi expects the adjustment of housing supply to the reduced demand will extend into FY20, and house prices will remain under pressure for another 12 months. The housing situation will be a drag on economic growth for the next two years, in the broker's opinion.

Citi has Neutral ratings for Mirvac ((MGR)) and Stockland ((SGP)) as both have been sold off on housing concerns. The broker forecasts a -20% decline in volumes for both Lendlease ((LLC)) and Mirvac and -13% for Stockland from FY18-21.

Rates

Financial markets have continued to push out expectations for a rate rise. Markets are estimated to be incorporating an 80.2% probability of a rate hike by the end of 2019. US dollar Libor rates have also lifted sharply over recent months, increasing funding costs for Australian financial institutions that are borrowing abroad.

Citi suggests a correction in housing is likely to make the RBA more cautious about acting on a tightening bias and the first tightening of rates is unlikely until the end of 2019. The broker considers the current policy mix runs the risk of prolonged house price deflation, and remains on the look-out for trading opportunities in Australian dollar short/intermediate rates.

St George economists observe household consumption is lacklustre and the savings rate indicates households may struggle to sustain expenditure without ongoing robust jobs growth. Moreover, high household debt and the slowing housing market will mean consumers remain reluctant to spend.

Citi also expects retail sales growth will deteriorate as the positive wealth affect fades. The broker expects like-for-like sales growth to slow for the likes of Bunnings and turned negative in electronics. Citi retains Sell ratings on JB Hi-Fi ((JBH)) and Harvey Norman ((HVN)).

Aussie Dollar

Downside risks to the global economy continue, amid trade tensions between the US and China. The direct effect of tariffs is not expected to have a material impact on economic growth but rather dent global confidence. The robust US economy has been a major prop to the US dollar and yield differentials have widened as US long-term bond yields have increased rapidly.

In February, the US 10-year yield rose above the Australian equivalent for the first time since the 1990s. This has weighed on the Australian dollar. Yet, St George economists expect momentum in the US economy will slow as the positive impact of fiscal stimulus wanes. This indicates the US dollar may not be far from its cyclical peak, signalling a limit in Australian dollar depreciation.

The economists expect that, over the course of the next year, trade developments will be the major uncertainty for Australian dollar forecasts. The Australian dollar is expected to end 2018 at US72c and 2019 at US70c.

Media

UBS observes advertising booking data for October was very soft, partly because previous Octobers were particularly tough comparable periods. In 2016 AFL and NRL finals fell in October rather than September and in 2017 advertising expenditure benefited from the same-sex marriage debate.

In October 2018 all media declined. Metro TV declined -6.5%, regional TV -1.7% and digital -26.1%, although late bookings are still to come in the latter and could turn this number positive. The broker also cautions that the correlation of the data to reported revenue growth is loose outside metro TV.

A number of advertising sectors were also weak, with food and produce down -27%, banks down -33%, insurance down -18% and restaurants down -19%. Meanwhile, Nine Entertainment ((NEC)) enjoyed a share of more than 40% of the TV advertising market in the first quarter, a share which has continued into October.

Automotive

The latest VFACTS data shows domestic new vehicle sales remain under pressure. Since June 30, 2018 national new vehicle sales are down -5%, with NSW the weakest state. Morgans believes the full impact from recent risk-based finance pricing, following the ban on flex financing, is yet to be felt.

AP Eagers ((APE)) has guided to net profit of $126-130m in 2018 and the broker is pleased the results from its automotive and truck retailing businesses are forecast to be slightly ahead of FY17, given current industry pressures.

Morgans expects the company's automotive result is likely to be the best from the segment in the current year. Automotive Holdings ((AHG)) is expected to provide a weak trading update at its AGM.

Morgans believes the company is being battered by headwinds because of its stronger exposure to the NSW market and the capital intensive refrigerated logistics business. The broker retains Hold ratings on both stocks but maintains a preference for AP Eagers.

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# SMSFundamentals: Is Your Super Adequate?

SMSFundamentals is an ongoing feature series dedicated to providing SMSF trustees with valuable news, investment ideas and services, in line with SMSF requirements and obligations.

For an introduction and story archive please visit FNArena's SMSFundamentals website.

Is Your Super Adequate?

Research from Roy Morgan shows Australians' level of super contribution is dropping, leading to a risk of insufficient retirement funding.

-Level of additional contribution falling -Women outpacing men -Australian budgets strained

By Greg Peel

It is generally recognised, research house Roy Morgan notes, that Australia's level of compulsory superannuation contribution – 9.5% of income – will not on its own provide in retirement for most workers to be self-funded. Additional contributions are required.

After having conducted face-to-face at-home interviews with 50,000 Australians each year, including 23,000 with super, Roy Morgan has found that in the twelve months to October only 18% of those interviewed are currently contributing beyond 9.5%. That figure in 2009 was 23%.

On a gender split, that's 18.0% of men and 18.1% of women in 2018. In 2009, 24.5% of men and 21.1% of women were making additional contributions. Both are lower, and women are now outpacing men.

Older workers, unsurprisingly, comprise the bulk of those ramping up contributions, with retirement looming. The greatest contributors are the 55-64 age bracket, of which 35.2% over-contribute. This compares with 24.4% for the 45-54 bracket. Beyond retirement age the figure falls again, with 30.7% of 65+ year-olds over-contributing.

Among younger workers, the numbers dwindle, again not so surprisingly. For the 35-44s it's 14.9%, for the 25-34s it's 9.0%, and for the 14-24s it's 4.0%.

But of greatest concern is the rate at which those numbers are dropping. Since 2009, the number of 35-44s over-contributing has dropped by 6.0 percentage points. For the 45-54s it's 7.9 percentage points.

Norman Morris, Industry Communications Director with Roy Morgan suggests:

"The low level of above compulsory superannuation contributions presents a major retirement funding problem for workers and the government.

"In addition to the problem relating to the low level of additional contributions, there is the adverse trend that less workers across all age groups are now making additional contributions compared to nine years ago. One of the reasons for this decline is the difficulty of engaging workers in what for most has a very long term time horizon and as a result is likely to involve many rule changes.

"Other financial issues are obviously negatively impacting and are related to competing priorities such as housing affordability, leisure activities, rising household expenses, all in an environment of low wages growth and political uncertainty. It is also likely that the many negative issues coming out of the Finance Royal Commission are contributing to the potential for lower levels of engagement in this market."

It has long been an issue for Australians that successive new governments, and boy haven't we had a few lately, will yet again move the goal posts on super investors and completely upset retirement strategies. A case in point will be whether or not Labor will win next year and whether or not it will remove franking credits paid as cash-backs, for example.

In 2009 Australians were reeling from the GFC, many having seen retirement savings invested in the stock market halved. Subsequent low interest rates drove the housing investment boom, and pushed up mortgage commitments for average families. Power bills have risen exponentially in the interim. And as Norman Morris duly noted, in the wake of the bank Royal Commission, why would you trust additional funds to that lot?

It's a tough call for Australians to have to take additional funds out of the household budget and use them to top up super. But the population is ageing, meaning an ever-increasing draw on the government's pension pool.

Technical limitations

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# Look! It Quacks Like A Duck!

In this week's Weekly Insights:

-Look! It Quacks Like A Duck! -Rudi On TV -Rudi On Tour

Look! It Quacks Like A Duck!

By Rudi Filapek-Vandyck, Editor FNArena

"If it Looks like a Bear and Trades Like a Bear, Stop Trading it Like a Bull." (Morgan Stanley strategists in a recent market update)

It may take a while yet before the general commentariat is willing to accept that dynamics for global equities have now irrevocably changed. However, on my observation, today's equity markets are increasingly showcasing the main characteristics of a bear market.

Does this mean we are guaranteed staring at losses of -20% and more?

No. But we might.

What is not well understood by many a market participant is that downturns, trend reversals (or call it whatever you want) like the one we are experiencing right now are not an outcome that is already set in stone. It is a process consisting of multiple stages, and the ultimate outcome will be decided by what comes next, and how we as a global community respond to it.

Take the opening months of 2016, for example. Declining global growth, falling oil prices and a Federal Reserve intent on continuing tightening created a poisonous cocktail that was similarly pushing equities into a downward spiral. That only stopped from the moment the Fed gave in.

This time around the Fed pausing its tightening might act as the necessary circuit breaker, as would be a genuine agreement between the Trump administration and China, or a much stronger economic background; but so far none of these scenarios have emerged, and financial markets clearly are not going to sit around, waiting for Godot.

In the meantime, and I am not the only one making this observation, trading activity inside the Australian share market very much resembles that of a genuine bear market. Bad news is being punished without recourse. Good news might trigger a share price rally, but that subsequently becomes a source for taking profits and raising more cash. No news can mean anything, but most likely the stock is being sold off on flimsy correlations and spurious projections.

On some days, nothing really matters. If your stock is listed, and widely owned, it will be sold, simply because other shares are too. No room for exceptions.

All of a sudden, risk is everywhere; better not to take any chances.

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One recent example of how market dynamics, and investors' attitude, has changed is REA Group ((REA)). Prior to the release of its quarterly trading update, which proved significantly better than what worried investors had been expecting given the downturn in the local housing market, the share price was trading in the low $70s.

Following the release of the quarterly update, REA Group shares jumped as high as $80.50 (and even higher intra-day) but they have subsequently retreated back to the low $70s again. Stockbroking analysts did respond positively to the better-than-expected operational performance, but nobody cares. Clearly, investors prefer safe profits and cash. Besides: this housing downturn is going to last a while yet. REA Group might not be able to stay immune.

And so the narrative goes.

What happened to REA Group equally happened to a2 Milk ((A2M)), Altium ((ALU)), Appen ((APX)), Brickworks ((BKW)), Elders ((ELD)), Xero ((XRO)), and others. Good news is no longer being rewarded and if it is, it won't stick.

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One of the major worries for investors globally is that it may yet be a little early to call for an economic recession soon, but it appears growth in corporate profits is not holding up, which means consensus forecasts will have to come down, and this means share prices need to reset at a lower level, irrespective of any movement in bond markets.

Australian companies are currently making plenty of contributions in support of this thesis. Witness the negative announcements from Medibank Private ((MPL)), Fletcher Building ((FBU)), Viva Energy ((VEA)) and Myer ((MYR)), to name but a few from recent days.

As highlighted in Monday's "Weekly Ratings, Targets, Forecast Changes" (see FNArena website), earnings estimates for ASX-listed companies are currently under negative pressure, and they are trending south as more and more triggers are being provided by companies including Pact Group ((PGH)), Aveo Holdings ((AOG)), Lendlease ((LLC)), James Hardie ((JHX)), and numerous others.

There may not be an economic recession on the horizon, but an earnings growth recession is definitely a real possibility. Further developments need to be watched closely.

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In terms of general market momentum, analysts at Morgan Stanley report for the first time since the year 2002, buying the dips is no longer working in 2018. My first thought after reading this was: so it worked in 2008 then? Apparently it did. But not so this year. The team of Quantitative Derivatives Strategies is now recommending investors/traders stop acting like it's still a bull market; time to sell the rallies instead.

We can all be certain this is the new momentum trade already adopted by automated trading strategies.

Equally worth pointing out is most equity indices, including the S&P500 and Nasdaq, are now trading below the 200 day moving average; and that average has started trending south. History suggests under such circumstances the highest virtue for any investor is: having cash at hand plus patience.

Morgan Stanley research shows when "Buying the Dip" strategies no longer work, equities are either in the middle of a bear market, or about to commence one. Years prior to 2018 when "Buying the Dip" stopped working include 2002, 2000, 1990, and 1982.

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Another observation that can be seen as an ominous signal is most equity markets the world around are showing a double peak pattern on price charts this year. Again, history suggests such a classic "double top" formation can be a harbinger of a much tougher environment ahead.

Consider, for example, the year 2007 equally shows two share market peaks, as does the year 2000 as well as, further into the past, the years 1990, 1980, and 1960.

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The first thing that comes to mind when someone mentions "bear market" are the savage sell-offs that occurred in 2008-March 2009 and post the Nasdaq meltdown of 2000 with share markets losing more than half of their value before a bottom was ultimately found, not mentioning the fact that individual share prices can incur a lot more damage than the market average during such testing times.

But a bear market doesn't need to be of such grandeur. Since 2009, equities have experienced two extended periods that offered lots of pain and very little gain outside of steady dividends and a small selection of exceptions. First, between April 2010 and June 2012, the Australian share market went up and down a lot, but ultimately lost -19% over more than two years. Secondly, after peaking in May 2015 equities kept on losing momentum until a capitulation sell-off in early 2016 took the market down -21% from nine months prior.

The positive news is that in both cases there was no economic recession on the horizon, and thus market losses never went the way of 2008-2009 or 2000-2003, but investors had still been better off by not trying to be a hero, instead opting for plenty of cash and timing their re-allocations with lots of patience.

Within this context I note it is quite remarkable strategists at Morgan Stanley, who have been predicting the scenario for equity markets in 2018 quite accurately, are suggesting investors could be facing something similarly relatively benign in the greater scheme of things, assuming consensus forecasts will be coming down soon, thus becoming more aligned with what is happening with corporate profits sometime during Q1 next year.

On this assumption, and assuming no further negative developments elsewhere, Morgan Stanley is taking the view US equities might be -90% through their downward re-valuation ("de-rating"), which could translate into higher volatility for longer, but maybe without a lot of additional downside from the index lows posted in October.

Equity markets, of course, still have to deal with slowing global growth, retreating liquidity, and lots of geopolitical threats and uncertainties (the bond market has been relegated to the background, for now).

I was of the intention to share some of my observations and portfolio experiences from the past two months, but I'll leave this for next week, maybe. Suffice to say: cash on the sidelines has been the only asset allocation that has made a genuine difference over the past eight weeks or so.

That too is one big message for investors. Make sure you sleep well at night.

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Thus far, November has delivered nothing but disappointment for investors hoping for a swift recovery post an unusually savage October sell-off. The local share market is down -3.1% with eight trading sessions left before December begins. Remember, October saw the index down -6.1%, but well off its lows, and September also proved a market negative: -1.77%.

The good news here is share markets are heavily oversold and historically this has always triggered a rally; it might just be sufficient that downward pressure abates, if only for a while. This, of course, keeps hopes alive we might see a broad rally into year-end, in particular with shares looking "cheap" after two months of selling pressure.

Further feeding into investor optimism is the seasonal pattern for Australian bank shares to first weaken post financial results while paying out dividends, and then put in a recovery move upwards into the new calendar year. Two weeks ago (see also below) I wrote the historical pattern for these sizable share market sell-offs is a rally first, and a likely re-test of the low point next.

It may well be that the local share market is testing the October low this week, creating the platform for this year's Santa rally take-off.

That remains the missing ingredient in this bear market; violent rallies to the upside.

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More recent writings about the changing share market:

-Autumn Has Arrived

-When Uncertainty Is The Only Certainty

-What Beyond The Rally

-Could This Be The Start Of Something Different

-Out With The Garbage

-Investing Used To Be So Much Easier

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Rudi On Tour In 2019

-ASA Inner West chapter, Concord, Sydney, March 12 -ASA Sydney Investor Hour, March 21 -ASA Toowoomba, Qld, May 20 -U3A Investor Group Toowoomba, Qld, May 22

(This story was written on Tuesday 20th November 2018. It was published on the Tuesday in the form of an email to paying subscribers at FNArena, and again on Thursday as a story on the website).

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