Week
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Stories To Read From FNArena

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Is Netwealth Fair Value?

The market opportunity for Netwealth is substantial and brokers are prepared to look through the negative flows in the December quarter, although valuation remains a sticking point.

-Netwealth remains upbeat about transitions to its wealth management platform in the second half -Brokers struggle with valuation, despite a leading market position -Tender activity and business opportunities should provide momentum in 2019

By Eva Brocklehurst

Underlying net flows declined in the December quarter, for the first time since wealth manager Netwealth ((NWL)) listed on the ASX. This resulted in funds under administration falling short of broker expectations.

The company considers this weaker quarter to be temporary, as advisers re-appraise platform offerings. Nevertheless, the market opportunity is substantial and Netwealth expects an increasing share of the $847bn platform market.

Funds under administration were $18.9bn as of the end of December. Funds under administration were down -1% because of negative markets, partially offset by $876m in inflows. This volume of inflows was -17% lower than Citi forecast.

Nevertheless, the broker notes the increase in fee-paying funds under administration is a positive for revenue margins and expects a pick up in the second half, driven by new clients and the ongoing structural shift towards specialist platform providers.

Citi suspects there is still a risk that the transition to the company's platform could take longer than forecast and slip into FY20. Downside risk to pricing and margins is also a reality, as major platform providers fight back to maintain market share.

Credit Suisse is not too concerned about the level of flows, as the drop in net flows is likely stemming from fewer high-balance account transitions. The miss probably corresponds to very low value and mostly non-fee earning business.

The company did not adjust its guidance for net flows in FY19 and this, plus upbeat commentary on transitions in the second half, provides the broker with confidence that the miss in the December quarter was largely because of delays rather than a change in the organic flow rate.

RC Dislocation

The dislocation caused by the Hayne Royal Commission and its investigation of the financial advice sector has been the main cause of wealth stocks missing flows or sales estimates, Bell Potter believes. This is expected to pass following the RC's recommendations to the government, which are due out on February 1.

While there will be different implications for respective stocks in the sector, the broker expects Netwealth to be a key beneficiary of the pending changes. The company has already indicated it expects an uptick in flows in early 2019.

Following the quarterly update, Bell Potter, not one of the eight stockbrokers monitored daily on the FNArena database, makes minor reductions to estimates and maintains a Buy rating with a $9.77 target.

UBS continues to believe the company's technology and service will aid its leading position. Still, there are risks from competitive responses that could constrain an acceleration in flows, or reduce revenue margins, and this is not adequately reflected in the company's PE (price/earnings) ratio of 47x. Hence, UBS maintains a Sell rating.

Credit Suisse believes the company is making the most of its unique opportunity caused by the disruption in wealth management, but agrees the PE limits the upside. The broker remains comfortable with its forecasts for FY19-21, for net flows of $4.5-5.0bn.

Macquarie's view regarding specialty platform providers is largely unchanged, but limited differentiation and substitute offerings are pointing to intensifying fee margin pressure. While the growth outlook is robust, this broker also struggles from a valuation perspective and maintains a Neutral rating.

Tender activity and business opportunities remain attractive, and the pipeline is strong for new business which should provide momentum in 2019 as clients are transitioned. Yet costs are being brought forward to capitalise on the market opportunity and, Macquarie assesses, this may be a headwind for the first half result.

There are four Hold ratings and one Sell (UBS) on the database. The consensus target is $7.83, suggesting 16.3% upside to the last share price. Targets range from $7.20 (UBS) to $8.60 (Ord Minnett, yet to update on the quarter).

ResMed Judged Harshly As Costs Mount

The core sleep therapy business of ResMed remains solid but brokers and the market have judged the stock harshly as details emerge regarding the cost of acquisitions.

-Data investment provides potential to improve quality of care -US Medicare reimbursement now more favourable, less gross margin pressure -Is the sell-off in the stock overdone?

By Eva Brocklehurst

While the core sleep therapy business of ResMed ((RMD)) continues to perform well, expenditure on acquisitions dragged on earnings over the December quarter, resulting in brokers downgrading forecasts for FY19.

The top-line performance of the core sleep therapy business in the US was strong but recent investments in the software-as-a-service (SaaS) platform have led to higher costs. December quarter sales were US$651m, up 8%. Revenue growth was 9% in the US and down -2% in the rest-of-world (RoW). Sales in RoW were weaker than expected because of completion of cloud-connected device upgrades in France and Japan.

There was also a sizeable drag from Propeller Health and the Verily joint venture investments. The equity investment in Verily of -US$3.4m was a surprise to UBS, with the loss expected to increase to -US$7m per quarter in March and June.

Sales growth was weaker than Ord Minnett expected, offset by a better-than-expected gross margin. The broker remains comfortable with the company's leading position in sleep therapy, although acknowledges recent results were boosted by the one-off benefit from renewals in France and Japan.

Yet, of greater concern, is a slowdown in Brightree revenue growth as this impacts on the rationale behind the US$1.5bn investment in the SaaS business. Such challenges are likely to lead to a further de-rating of the stock and Ord Minnett downgrades to Lighten from Hold.

Focus Turns To Investments

Citi believes the impact of the various investments should have been obvious but acknowledges a focus on the underlying CPAP (continuous positive airway pressure) business underscored expectations that a high-multiple stock would justify the rally in the share price via operating leverage, resulting in strong earnings growth.

Instead, the market was forced to focus on the acquisitions and the joint venture, which will, it is now revealed, contribute an operating loss in the next 12 months. Nevertheless, excluding this impact and the downgrade to FY19-21 estimates, Citi believes ResMed remains an excellent business, albeit fairly valued.

Medium-longer term opportunities from SaaS acquisitions are well and good but Macquarie also points out near-term risks in the core sleep business, such as lower device growth in RoW and competition in terms of Fisher & Paykel's ((FPH)) new masks which are to be launched over 2019.

Credit Suisse remains upbeat about the investment in data for longer-term growth, while decreasing estimates by -8% over the forecast period, given the potential for improving the quality of care to patients in the home setting, as well as increasing penetration within the sleep and COPD (chronic obstructive pulmonary disease) markets.

The long term is still supported by growth in the installed base, stable US reimbursement and Brightree is driving higher resupply. Hence, Morgan Stanley believes the company's expertise in patient connectivity within the OSA (obstructive sleep apnoea) system has borne fruit.

Propeller Health may also open up the COPD market and lead to downstream referrals of inhaler patients and the Verily JV can lead to higher diagnosis rates for OSA sufferers and support long-term CPAP device growth.

The broker envisages less gross margin pressure than in the past five years, as US Medicare reimbursement is more favourable. There is also upside with traction from the Mobi portable oxygen concentrator as well as a recovery in RoW devices in FY20 once the high-growth period has been lapped.

ResMed is a strong franchise, CLSA accepts, but low growth and a relatively high PE (price/earnings) signals a downgrade to Underperform from Outperform. The broker, not one of the eight monitored daily on the FNArena database, reduces the target to $15.10.

The company needs to show a return on its investment in SaaS, UBS asserts, having spent around US$1bn on connected-care transactions recently. The broker believes a path to generating operating earnings (EBIT) above the cost of capital needs to be outlined in order to support the stock performance in the future.

Deutsche Bank is also cautious about the acquisitions and Verily investment until there is more transparency and a return profile can be articulated.

Meanwhile, Morgans points to the growth in patients in the RoW, outside of France and Japan, noting market share gains, stable pricing and expanding margins. The broker is not overly concerned with the additional costs from acquisitions, and considers the sell-off in the stock shortsighted and overdone. Morgans believes the slowdown in growth is not driven by fundamentals, as patient growth is solid and the company is taking share.

There are three Buy ratings, three Hold and two Sell on the database. The consensus target is $15.08, suggesting 15.5% upside to the last share price. Targets range from $13.40 (Ord Minnett) to $17.00 (Morgan Stanley).

See also, ResMed Propels Forward on December 6, 2018.

Turning Around G8 Education

By Steven Everett, Portfolio Manager, Belvedere Share Managers

G8 Education ((GEM)) operates a portfolio of just over 500 childcare centres across Australia and Singapore. An investor day was held on 15 November 2018 to report management's new strategy for the company. Presentations included a tour of one of G8's centres in Nerang, followed by a detailed briefing covering the broader market, regulatory changes and the strategy to return the company to organic growth.

The quality of the early learning centre was truly impressive, and the tour highlighted that although the industry is complex in many ways the right formula can produce consistent quality cash flows from a loyal and repeat customer base.

Management's strategy presentation was compelling and suggested that many of the legacy problems from the previous management had worked their way through the business, reducing challenges to execution.

At the right price, the yield could be attractive enough to compensate for the volatility while the strategy is executed which if done so effectively, will produce significant earnings growth.

The Tour

The G8 Investor day began with a tour of the Kool Kids Centre at Nerang on the Gold Coast. Arriving at the site, the modern façade of the building presented very well and is specifically designed to look home-like and inviting which was later explained to part of the company's marketing strategy going forward. It also contained a small coffee shop to one side which G8 leases to a third party. Parents dropping of their children simply waved at the café staff as they walked from their cars to signal they wanted a coffee, obviously regulars as the staff were confirming orders with a personalised 'good morning'.

The entrance to the centre is locked and requires a pin code to enter which is provided to the parents. Sign-in is digital and linked directly to Centrelink's network for fast facilitation of Child Care Subsidy (CSS) rebates. At first glance the facility was very impressive. It catered for children as young as newborns right up to starting pre-school. Around the centre were a variety of features to make the experience exciting for children including caged parrots, fish-tanks, water features, vegetable gardens and even a chicken coop.

Occupancy for this site averaged at 90% despite their being a total of nine centres in the area, including a Goodstart which is said by the management team to be their most dominant competitor. The outperformance of occupancy for this site versus the group (71%) was said to be a result of the location and its modern design (built in 2016).

Daily rates for this centre ranged between $105 - $111 per day. Some parents pay as little as $14 of the total daily rate after the CSS rebate, while others are required (and a reasonable proportion do) to pay the full rate. There are currently 315 children enrolled in the centre. As an example of what scale of investment is required to build a greenfield facility, the cost to build this one was $5m.

Noteworthy off-the-cuff comments made by the Centre Manager during the tour were:

• A significant amount of disruption occurred when the new CSS system was being implemented, all of which is behind them now and operations have returned to normal;

• Since the new pay structures (10% increase in wages for Early Childhood Teachers) and roll-out of the new staff benefits scheme1 the centre retention has increased significantly, and better candidates are applying for positions;

• Families have very close relationships with the centre staff and will often follow staff to other centres if they are to move; and

• There is some push-back on the plan to move to a call centre structure for incoming inquiries.

Technology is well integrated into the centres. There were interactive televisions set up in different class rooms as well as a cooking and science lab but most impressive was the iSandBox. An interactive digital display overlaid on a sand box that adjusts the vision depending on what structures the children were making with the sand.

As the kids made islands, projected on those islands were trees and animals as sharks lurked in the lower areas between them. As the sand was moved around the projected adjusted the vision to suit. A teacher stood buy with an iPad, adjusting the interactive vision to facilitate the lesson the kids were learning.

Also onsite was an industrial kitchen that prepared meals. Children received at least one hot meal per day (4 in total). The kitchen also prepares takeaway breakfasts for Mums and Dads on the go.

Recent legislative changes now require all staff breaks to be covered by another staff member so that the child to teacher ratio remains the same constantly. Centre Managers have been able to completely absorb these extra staff hours without incurring additional costs with carefully structured rosters.

The Market

CEO Gary Carrol noted in his presentation that headwinds for the sector are expected to continue and that the occupancy improvement is set to plateau post 3rd quarter 2018. Supply of new centres has yet to significantly reduce however these are said to be the result of projects already in the pipeline. Credit tightening and lack of available capital is expected to begin tightening the supply of new centres into 2020. Discounting is still occurring across the industry, some competitors even offering free iPads to attract new customers.

G8 reports not having increased any discounting offers above what has typically been the case for the past 3 years, instead offering customers a premium product at a fair price. The company's research indicates that quality of the centre is far more correlated to increased occupancy for the majority of the portfolio than price, with the exception of some regional areas like Townsville where one centre increased occupancy by 25% simply by reducing the daily rate from $95 to $75.

The Australian Government recently introduced the National Quality Framework (NQS) which is designed to benchmark early learning centres around the country. Currently 22% of G8's portfolio is classified as 'working towards the NQS and require investment in upgrades to meet the benchmark'. In terms of occupancy, their studies showed that centres classified as 'meeting' NQS reported a 10% increase in occupancy. Management aims in the near-term to have 50% of the portfolio classified as 'meeting' and 40% classified as 'exceeding' which is forecast to add 2% to overall group occupancy.

It was also reported that Australia has lower participation in early learning than most OECD countries and that every $1 that the Australian Government invests in funding for early learning, it receives a return of $1.30 in the form of higher tax revenue through increased workforce participation and higher household income.

The Strategy

In (General Manager of Operations) Jason Ball's presentation he noted a simple strategy to return the company to consistent growth. The strategy can be simply broken down into three tasks:

1. Increase new customer tours and better facilitate transition

Currently the G8 portfolio of brands is highly fragmented and each brand has their own website. Incoming phone calls go directly to the particular centre. These incoming phone calls go unanswered 20% of the time. The Company has trialled a call centre that receives all incoming calls and books the tours at the relevant centre. In the sample group this increased occupancy by 2%. This is intended to be rolled out across the group by April 2019. There are also plans to reinvent the G8 website and consolidate the brands to help potential customers more easily find a G8 centre that is convenient for them. This will also reduce marketing spend and provide better return on investment.

A marketing plan has also been developed that has identified pain points for customers including identifying available booking times at centres and transition through the various age brackets (infant, toddler, kindergarten etc.).

2. Improve staff retention and cost efficiencies

Customers are reported to be very loyal to centre staff. A quick Google review search of a couple of the centres in the G8 portfolio confirms this is important to customers.

Legislated staff ratios can be problematic and often require the company to contract ECTs on short notice through labour hire. It is estimated that these temp ECTs incur an additional cost of 20-25% to the company through uplift. Intention is to centralise the rostering process so that casual ECTs can be shared amongst the group.

A staff rewards scheme had also been designed that provides discounts to staff members and families at specific retailers. Feedback from the staff was positive about the scheme.

There is also a significant opportunity to generate cost efficiencies though centralisation of the procurement process. Currently each Centre Manager is responsible for arranging purchases or maintenance contracting. The company intends to centralise this process and leverage scale to achieve better prices.

3. Improve customer experience

The marketing team has profiled their customer base into four groups and identified specific offerings that will appeal to each individual group and the collective. This has been compiled into a newly implemented mobile application where parents can interact with the centres and also provides real-time updates to parents about their children, including photos, videos, sleep and diet reporting and if their child has an injury or isn't feeling well. This new software platform is also said to significantly decrease the administrative workload for the staff. Surprisingly the new platform had not added costs to the business and replaced a redundant system since the arrival of the new CSS legislation.

Investment Thesis

While not yet out of the woods, the new management appears to be on the right track to return the company to organic growth. There are some questions about the previous management and legacy issues that may have been left behind after their departure, however these seem to be coming to an end.

An example of such issues impacted the current year result. A brownfield acquisition was somehow allowed to take place with the vendor retaining the rights to the brand and some centres. The vendor was also allowed to retain the website and 'promised' to forward all website enquiries to G8. Needless to say, the website inquiry for those particular acquisitions significantly underperformed the group. These centres have since been rebranded and inquiry now is in-line with the group.

There are also some questions around the soon to be completed greenfield acquisitions (which have been purposefully delayed so to coincide with the busiest intake time of the year). The greenfield acquisitions and the Singapore operations were both arranged under the previous management and are essentially related party transactions. A review of the Singapore operations will occur during the year and a decision will be made by management to either expand the footprint or divest. Retaining the operations sounds onerous and risky so likely the decision will be to divest.

The balance sheet is robust enough to fund management's plans, just. Examples were produced of other centres that management made minor improvements to, and the cost of these improvements ranged from $175,000 to as little as $50,000. In all cases improvements saw ratings and occupancy increase.

Management has also identified some underperforming centres that will be divested in the near-term. Cash generated can be used to help fund the new strategy. It was also reiterated that management are comfortable with the company's debt headroom and expect debt to be brought back into line within their target of 1.5-1.7x by 2020.

The nature of the business is such that small improvements can have significant bottom line impact. Every 1% of additional occupancy across the group over a base of 75% (management's near-term forecast) adds $3-5m of EBITDA. Over 81% the additional benefit of every 1% rises to $8-9m.

Whilst not without risk, the management team compelled confidence, and the strategy is simple and clear enough to be executed effectively. Additionally, at the right entry price the yield on offer is attractive compensation for weathering any potential price volatility while the market gets comfortable with the execution and results begin to show.

[Note: As of January 30, the FNArena broker database shows five Buy and one Hold rating (or equivalent) for G8 Education. The consensus price target is $3.06, suggesting 3.65 upside.]

Disclaimer:

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Credit Corp Sets Sights On US Expansion

While the Australasian market remains benign, Credit Corp has set its sights on US expansion, where it is now buying debt ledgers from the largest seller in that market.

-Strong growth in US revenue offsets reduced purchasing of debt ledgers in Australasia -Opportunities to diversify in Australian consumer lending and automotive loans -Few risks envisaged in association with the Senate inquiry

By Eva Brocklehurst

Receivables management company Credit Corp ((CCP)) is enjoying robust conditions for purchased debt ledgers in the US, continuing to build its profile. The company has observed strong unsecured credit growth in this market and is now buying from the largest seller in the US.

Meanwhile, the Australasian industry remains competitive, with domestic credit card statistics pointing to little movement in aggregate balances over the last two years. Arrears on personal loans provided by the banking sector remain generally benign.

First half net profit was $33.6m, up 12.7%. The interim dividend of $0.36 per share was slightly ahead of broker forecasts. Net profit guidance for FY19 has been slightly upgraded to $69-70m, based on origination volumes and purchasing activity for the year to date.

The company reported strong growth in US PDL (purchased debt ledger) revenue offsetting the impact of reduced purchasing in Australasia. Credit Corp will open another collection facility in the US in the medium term.

For the past couple of years Ord Minnett has been concerned about returns in the Australian PDL market, as meaningful capital was added by a number of competitors. Credit Corp is the largest player in this market and management recognises the current dynamic, effectively guiding to a benign FY19 result in Australia.

PDL acquisition and lending guidance has been increased by 10%, supporting FY20 growth expectations. The company has a strong track record of deploying its capital accretively and Ord Minnett considers current earnings expectations are readily achievable.

However, the broker believes the risk/reward is now more balanced, particularly with the uncertain macro-economic backdrop developing in Australia, and downgrades to Hold from Accumulate with a $23 target.

Bailieu also downgrades to Hold, purely on valuation, with a $23.90 target. The broker continues to rate the stock highly, as it is on target to deliver earnings growth in what was originally expected to be a transition year, as capital is allocated towards the US and away from Australasia.

Opportunities

Still, Ord Minnett points to a number of other opportunities in which to deploy capital such as US PDLs, Australian consumer lending and automotive loans. This should enable the company to maintain return hurdles and minimise any impact by diversifying from the Australian PDL market.

Canaccord Genuity also believes the domestic banking environment presents an opportunity for shadow lenders such as Credit Corp. Automotive lending is one area where the company is under-represented as it has a loan book of less than $20m versus a $6bn annual market for used-car financing in Australia.

Canaccord Genuity maintains a Buy rating and a $23.03 target. The broker notes Credit Corp has one of the best balance sheets and lowest cost of funding in the sector, able to take market share where the returns are justified. Group profits are expected to grow at double-digit rates, despite the cyclical tightness in the domestic debt purchasing market.

Morgans suspects competitive pressure may start to erode domestic debt buying earnings but growth should come from consumer lending and US debt buying. While acknowledging the stock is relatively fair value on a short-term basis, the broker has an Add rating because of the visible earnings growth in upside potential from the US business, retaining a $24.10 target.

Risks

Risks lie in regulation and consumer advocacy within the lending division, domestic PDL competition and execution in the US, Morgans points out. The current Senate inquiry is due to report in February 22 but the broker expects the company's products will not be affected, although the implications from the review are not assured.

The company has indicated that no regulator or industry advocate has made any recommendation that would affect its current products. Bailieu agrees the Senate inquiry into consumer-facing lending, debt consolidation and deferred payment operators is most likely benign for Credit Corp.

Fears regarding changes to domestic consumer lending regulations are also fading. Still, Bailieu suspects the Hayne Royal Commission is having some impact on the behaviour of debt sellers and supply is, as a result, tighter.

Incitec Pivot Beholden To Commodity Prices

Unplanned outages at the ammonia and phosphate plants have affected sentiment toward Incitec Pivot. Fertiliser and explosives prices are key going forward.

-Lower ammonia and phosphate production signalled for FY19 -More reliant on firmer commodity prices in FY19 -Is value emerging in the stock?

By Eva Brocklehurst

Outages have plagued Incitec Pivot ((IPL)) during January, leading to reductions to earnings (EBIT) estimates in FY19. The outages, at Waggaman in Louisiana and Phosphate Hill in Queensland, have a combined impact on FY19 earnings of -$45m.

As the investment story is centred on squeezing more from the existing asset base, Credit Suisse understands why the outages can have a large impact on investor sentiment.

Still, the broker highlights US dollar earnings remain attractive, given the potential for further Australian dollar weakness. Expansion of Moranbah remains the most significant use of capital, while the next news item is likely to be a decision on Gibson Island, which the broker suspects will be closed.

Macquarie believes this is just another reminder of the variability at play in the stock, and considers the issues are operational rather than systemic. The broker expects a seasonal rebound in global fertiliser prices in the first half of 2019, reflecting solid North American demand.

The outage at the Waggaman ammonia plant is expected to reduce production by -80,000t in FY19, taking annual production to around 90% of nameplate, and stems from problems with the carbon dioxide removal system. The plant has been out of operation for 2.5 weeks and the repair timeline suggests a return to normal by mid February. This is the first material issue with production in almost 2.5 years of operations.

Meanwhile, the Phosphate Hill fertiliser plant has resumed normal operations after an outage caused by leaks at the phosphoric acid facility in early January. FY19 production is likely to be reduced by around -50,000t. The company is currently renewing its Moranbah, Queensland, ammonium nitrate contracts.

The outages disappointed Morgans because they follow gas supply problems in December. The broker now expects FY19 profit will be marginally lower than FY18. Successive manufacturing issues over the last two months signal to the broker the growth target is unlikely to be met. Incitec Pivot will also be affected by lost explosive contracts from Roy Hill and BHP Group ((BHP)).

The decline in the share price has provided a good buying opportunity, in Deutsche Bank's view, as the outages are largely one-off in nature and extensive corrective action is being taken to ensure they do not reoccur. The broker points out the market is capitalising the unplanned outages and, while reducing FY19 earnings estimates by -7%, maintains FY20 forecasts.

UBS reduces FY19 estimates by -7% but retains FY20/21 forecasts, expecting manufacturing issues will be resolved. The broker foresees a positive outlook for explosives volumes, as mining demand normalises, but expects oversupply and re-pricing of contracts in the near term will weigh on growth. Similarly, recent drought in Australia may also weigh on demand for fertilisers.

Pricing Outlook

Morgans notes, since December, ammonia and urea prices have fallen while diammonium phosphate and the AUD/USD are largely stable. Partly offsetting lower commodity prices is a reduction in the US gas price. Still, internal issues are reducing leverage to more favourable fertiliser prices and a lower Australian dollar.

Morgans asserts that restoring fertiliser earnings may eventually lead to a corporate transaction, given explosives are a less cyclical business and appear to be the company's preference.

Citi agrees this is a setback to the company's strategy on manufacturing excellence. Lost volumes and higher gas costs at Gibson Island mean Incitec Pivot is now heavily reliant on firmer commodity prices in FY19. While value is emerging in the stock, the broker believes catalysts are lacking.

Macquarie factors in a -$10m impact on earnings over the next two years because of lower contracted ammonium nitrate prices, although does not assume any loss of volume. Morgan Stanley lowers fertiliser price assumptions. Since mid November urea prices decline by around -12% while the benchmark Tampa ammonia price has declined by -20%. Diammonium phosphate has been more resilient, down -4%.

The broker notes the stock has underperformed fertiliser prices since November and therefore, as there is some seasonal support over the next two months, this should underpin the share price. Nevertheless, Morgan Stanley is cautious, pending more clarity on the impact of re-negotiated explosives contracts.

Given the recurring manufacturing issues, the broker lowers ongoing capacity utilisation rates across its forecasts. Hence, any sustainable improvement in the performance represents upside to forecasts.

There are four Buy ratings and four Hold on FNArena's database. The consensus target is $3.94, suggesting 18.2% upside to the last share price.

See also, Incitec Pivot Cleans The Slate For FY19 on November 14, 2018.

Brighter H2 Likely For GUD Holdings

GUD Holdings is confident organic growth in its automotive business will return to historical levels in the second half. Several brokers prefer to wait and see.

-NARVA catalogue and new product could mean strong recovery in the second half -High-quality automotive aftermarket brands remain potential acquisition targets -Margin is unlikely to be sustained over the next 3-5 years

By Eva Brocklehurst

A sharp deterioration in growth in the company's automotive business underscored the first half for GUD Holdings ((GUD)), as it slipped to less than 4% from an average of more than 8% over the past five years.

The company is confident organic growth will return to over 8% in the second half. Recent trading appears to have been mixed, with Christmas/New Year softer but subsequently rebounding as Ryco achieved record sales in the third and fourth weeks of January.

The company reported underlying earnings before interest and tax (EBIT) in the first half of $43.9m up 9.6%. Operating cash flow was sharply lower, at $2.2m, versus the $16.6m generated a year ago.

Historically, there has been a skew in cash flow to the second half and the Brown & Watson business, the supplier of NARVA automotive lighting and electrical accessories, has experienced a significant lift in inventory, ahead of a new product catalogue that will be launched in the second half.

Ord Minnett suspects some timing issues, such as the release of the NARVA catalogue and new products, could mean a strong recovery occurs in the second half, but prefers to wait and see. The broker acknowledges the organic growth profile is highly valued and expects the market will question the underlying growth dynamics until the second half result is delivered.

Still, accepting there may be one-off timing issues surrounding the NARVA catalogue, greater margin erosion from acquisitions and increased working capital intensity signal to Wilsons incremental returns have likely deteriorated.

Wilsons was disappointed with the first half result and the slowdown in automotive earnings. Increased working capital intensity also contributed to a diminished outlook for the core business and the broker believes the weaker sales growth implies a slowdown in volumes. Wilsons, not one of the eight stockbrokers monitored daily on the FNArena database, has a Hold rating and $11.25 target.

Macquarie finds the defensive earnings profile attractive, given current market conditions as well as organic growth and options regarding acquisitions. Valuation appears undemanding following the sell-off and, over time, the broker expects the company to extract additional synergies/margin from completed acquisitions.

The stock is now attractively priced, UBS agrees, upgrading to Buy from Neutral and suggesting the result is not as bad as the headlines indicate. The lower acquired revenue from AA Gaskets is considered to be a temporary issue. Moreover, cash flow is usually weighted to the second half anyway.

Acquisitions

UBS suggests high-quality automotive aftermarket brands that are not too reliant on sales to either Bapcor ((BAP)) or Repco are potential acquisition targets. The broker envisages mid single-digit top-line growth is achievable in the medium term, without acquisitions.

Nevertheless, UBS suspects margins are unlikely to be sustained over the next 3-5 years. Although the company is expanding its share of wallet with major customers, UBS expects the threat of private-label competition and the move away from internal combustion engine parts will soften margins in the longer term.

Citi separates the discussion into organic growth versus acquisitions. The broker estimates, at the EBIT line, half the 10% growth was organic, which is likely to be flat in the second half. Growth from acquisitions is expected to increase to around 7%, from around 5% in the first half, as AA Gaskets accelerates.

The broker reiterates a Buy rating, although lowers forecasts by -2-5%. Citi envisages several primary drivers for the automotive division, including continued growth in motor vehicle numbers, annual price rises and a positive shift towards more expensive parts over time. Growth of the independent aftermarket channel and gains in market share by the company's primary customers are also envisaged.

The company continues to flag further bolt-on acquisitions in the automotive sector. Citi estimates GUD Holdings could fund via debt up to $80m in acquisitions before reaching the upper end of its target range for net debt/operating earnings (EBITDA). An $80m acquisition at an enterprise value/EBIT multiple of 6.5x represents 9.4% upside to the broker's net profit forecast in FY19.

The database shows three Buy ratings and two Hold. The consensus target is $13.67, signalling 22.6% upside to the last share price. The dividend yield on FY19 and FY20 forecasts is 5.0% and 5.6% respectively.

Big Gold Run Ahead

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.

Gold markets were rocking on Tuesday [last], lifted by a basket of factors that included poor stock market performance earlier in the week, slow growth in China, weak earnings reports and expectations the US Federal Reserve would strike a dovish tone at its two-day meeting starting on Tuesday afternoon.

The Fed raised interest rates four times in 2018 but some officials have signaled they are not expecting to continue raising rates this year, as the US economy faces a number of pressures including the ongoing trade war with China, the US government shutdown part 2 and waning consumer and business confidence.

Indeed the doves were firmly in control on Tuesday as spot gold rocketed past $1,300 an ounce to close at $1,311.66 in New York - a 7-month high.

Strength in the precious metal was buoyed by rising US-China tensions after the Justice Department charged Chinese tech company Huawei and its chief financial officer (earlier arrested and held in Vancouver) with fraud, thus escalating trade tensions that have been ongoing for almost a year, with billions in import tariffs levied from either side. The US dollar index, which typically moves in the opposite direction of gold, was near a two-month low, Tuesday.

At Ahead of the Herd we love gold (and promising junior gold companies) because gold holds its value through time. Owning gold is a way to preserve wealth against paper currencies which are subject to inflationary pressures and over time, lose their value. In the US there was an increase in inflation for every decade except the Depression when prices shrunk nearly 20%. Between 1860 and 2015, the dollar experienced 2.6% inflation every year, meaning that US$1 in 1860 was equivalent to $27.80 in 2015. This also means that prices in 2015 were 2,828% higher than they were in 1860.

Gold investors love nothing more than a war, economic crisis or any type of geopolitical instability to watch the value of their bullion grow. Heightened global tensions such as terrorist attacks, border skirmishes or civil wars scare investors into putting their funds into safe havens like gold and stable, high-yield sovereign debt. Geopolitical tensions also drive more government spending (eg. on arms), which brings inflation, leading investors to look at precious metals as a place to park their money, short term.

We also like gold because gold companies and explore-cos are finding less of it. All the easiest gold to mine has been found, including gold found near surface and in underground veins. We are now facing “peak gold” where gold production from here-on will keep falling. The experts agree the industry is seeing a significant slowdown in the number of large deposits being discovered. It used to be that major gold miners were looking at 5-million ounce projects to buy and develop; now they’d be happy with a million ozs in the ground.

With gold production falling, combined with a lack of large gold deposits that could move the market, you have the setup for a continued rise in the gold price - irrespective of what happens to investment demand for gold or gold jewelry, affectionately known as “the fear trade and the love trade.”

Taking a run through the headlines, we find everything is in place for a big run-up in gold. The US dollar was on the rise last year, causing gold to fall, but this year the dollar is struggling, weighed down in part by the US Federal Reserve’s signal that it may stop raising interest rates and unwinding its balance sheet, put in place to keep tightening monetary policy.

The central bank since October 2017 has been decreasing the size of its $4.5 trillion debt by allowing $50 billion to run off each month.

We are also looking at slowing global growth, a worsening US economic outlook, the size of the federal debt, the Fed possibly lowering interest rates to stimulate the economy, and a rush to safe havens like gold due to escalating conflicts. Let’s take each in turn.

Sluggish growth

When economies falter, gold tends to well. The big news here is China, whose economy was booming at double-digits for most of the 2000s but is now creeping along at just 6.5% in fourth quarter 2018. This is a normal expectation from a country that moved very rapidly to becoming an export-driven economy, with a low-value currency, to a more diversified one now. However there are worrying signs in China about slack consumer spending on discretionary items like cars and phones - Chinese imports fell 7.6% in December after gaining 16.1% in 2017. Exports are also hurting, due to US tariffs on Chinese goods.

But it’s not just China. While the IMF has made a slight downward adjustment to its expected 4% global growth rate in 2019, Yale economist Stephen Roach notes that it’s worse than that, examining the longer-term trend. He writes:

Following a crisis-induced plunge of 10.4% in the volume of global trade in 2009 – a modern-day record – recovery has been muted. After a brief two-year rebound in 2010-2011, world trade growth averaged just 3.6% from 2012 to 2018 – about half the 7.1% average annual pace in the 20 years before the crisis.

That, combined with a surge in protectionism made apparent by the US-China trade war, and the anticipated negative fallout from Britain leaving the European Union, has Roach sounding a warning:

All in all, the global trade cycle is facing major stress in 2019, and markdowns have only just begun. This underscores the risks of a major shortfall in world GDP growth.

Emerging markets better hope that the Fed does move in a dovish rather than hawkish direction, by keeping rates low. According to Fitch Ratings, Latin America, the Middle East and Africa will face more downgrades than upgrades to their debt ratings this year, if interest rates and the dollar rise. That’s because these countries’ currencies have depreciated and they have a high share of their debt denominated in foreign currencies.

Examples are Turkey and Argentina. As the worst-performing emerging market currency last year, the Argentine peso has 83% of its government debt in foreign currency, Bloomberg reported, making it especially vulnerable to a dollar rise. 47% of Turkey’s debt is foreign; the lira fell 28% last year.

Not so great again

President Donald Trump took credit for the stock market run that prevailed for most of the last two years since his inauguration in January 2017. The continuation of the longest bull market in American history had even Trump’s opponents conceding things were going well, until the market encountered a serious correction last September.

December was the worst month for US stock markets since the Great Depression, and while markets are up since the start of the New Year, investor sentiment is weak and despite the economy barreling along at near full employment, and inflation at a very reasonable 2%, many economists are urging caution ahead.

One is J. Bradford DeLong, an economics professor at the University of California at Berkeley. DeLong looked at previous recessions dating from 1825, when England’s “canal-stock boom” collapsed. He found that the pattern for downturns is a flight to safety following a weakness in financial markets, such as the collapse of the sub-prime mortgage market in 2007. Writing in Project Syndicate, Prof. DeLong states:

Needless to say, the particular nature and form of the next financial shock will be unanticipated. Investors, speculators, and financial institutions are generally hedged against the foreseeable shocks, but there will always be other contingencies that have been missed.

At any rate, today’s near-inverted yield curve, low nominal and real bond yields, and equity values all suggest that US financial markets have begun to price in the likelihood of a recession. Assuming that business investment committees are thinking like investors and speculators, all it will take now to bring on a recession is an event that triggers a retrenchment of investment spending.

If there is a meltdown, like the housing market collapse that pre-dated the financial crisis, or the sudden shock of understated earnings that burst the dot-com bubble, expect gold, the time-honored safe haven, to rally.

Beyond the stock market, there are other signs that all is not well in the land of the free. As corporate earnings start to trickle in, it’s not looking good. On Monday Caterpillar, a heavy equipment manufacturer, and Nvidia, a chipmaker, both reported lower-than-expected fourth-quarter earnings due to weakness in China. Caterpillar, the world’s largest maker of construction machinery, is seen as a bellwether of US economic health.

Then there’s the debt bogeyman. According to the Congressional Budget Office, as the stimulative effects of Trump’s tax cuts wane, the increasing federal deficit - projected at nearly $900 billion - will weigh on growth. Reuters reports the CBO saying that economic growth will slow to 2.3% from 3.1% in 2018. More alarmingly, whereas in 2007 total government debt was about $9 trillion, 62% of GDP, now it is approaching $22 trillion, 100% of GDP. Corporate debt is at a record 46% of GDP.

This isn’t just an American phenomenon, though, it’s global. After the financial crisis, central banks in the US, Europe, China and Japan all lowered their interest rates in an effort to stimulate borrowing, and economic activity. They also injected massive amounts of liquidity into the system (aka printing money through quantitative easing).

Just over a year ago the Fed started removing liquidity (Treasuries and mortgages) to try to reduce the multi-trillion-dollar debt it had accumulated through QE; in 2018 it raised interest rates four times. And why not? The US economy was running hot, with no signs of problematic inflation, and a healthy stock market. China and Europe also made moves to deleverage their debt.

Central bank tightening has been blamed for killing the stock market rally last fall. The problem is, with everyone used to interest rates near zero over the last 10 years, the world is mortgaged to the hilt. Global debt has gone from $113 trillion before the financial crisis to over $186 trillion. Why is this a problem? Because if interest rates rise, even a little bit, the higher interest on loans is going to hurt – a lot. Especially the government which will have trouble servicing its own massive debt. And more people and businesses will be locked out of borrowing. As the Canberra Times describes,

The massive build up in global debt that the central government sought and encouraged developed with interest rates at unprecedented lows. That means borrowers are exceptionally sensitive to increases in interest rates and decreases in the availability of credit.

After a decade of ultra-loose monetary policies designed to encourage debt it isn't surprising that the world has gorged on it nor that, now that the central banks are starting to reverse course, markets and their participants are becoming nervous and more risk averse.

QE4?

Given its $22 trillion debt, can the United States afford to raise rates any more, with the pain that this higher cost of borrowing will entail? Long-time Fed critic Peter Schiff doesn't think so. Schiff, the CEO of Euro Pacific Capital, thinks with debt levels so high, the only way to finance it is to keep interest rates at ridiculously low levels. "Everybody thinks that quantitative easing is over. What they don't realize is it's barely begun. The next round is going to be bigger than the first three, and that's going to send gold to new highs," Schiff said at the New Orleans Investment Conference.

On Tuesday, Ronald-Peter Stoeferle, fund manager at Incrementum AG and author of the In Gold We Trust report, told Kitco News he isn't surprised to see the central banking getting more dovish; he agrees with Schiff that rates are likely to come down.

"Central banks have tried to get out of this zero-interest-rate trap but they aren't able to. The market is addicted to cheap liquidity and I don't think that is going to change anytime soon. There is no way out for central banks caught in this trap," he said. "Gold does very well in this environment."

As the rich get richer...

Another disturbing trend in the American economy that few people talk about is its growing inequality. Why is that important? Because as more people grow poorer, fewer can participate in the economy, like borrowing and spending money. A study by the Economic Policy Institute found that in 2015, five states, 30 metro areas and 78 counties exceeded the previous national record for share of income by the richest 1%, at 23.9%; the previous record was set in 1929.

Other stats showing that economic growth in the United States is benefiting only the very rich:

The incomes of the top 1% grew faster than the 99% between 2009 and 2013. The 1% in 2015 had average household income of $421,926. This was exceeded by 13 states plus Washington DC. There has been slow wage growth in almost every part of the country, over the past 45 years. The US has more poor people than Sierra Leone and Nepal. 5.3 million Americans are living under the poverty line, including several million children who live on less than $2 a day. The effects of this growing inequality in America is especially felt in urban areas, where lower-income residents and marginal businesses are being squeezed out of neighborhoods. We see the same thing in Vancouver - it's a kind of reverse gentrification, where only the top 10% can afford to live there.

If and when a recession hits, these 10%-ers will be hard hit. Businesses highly dependent on discretionary income, like expensive coffee shops, will go under. "In effect, the top 10% is ripe for the disruptions of globalization and automation that have already laid waste to the bottom 90%," writes Charles Hugh Smith, a blogger.

Venezuela in crisis

Along with the conflict over Huawei, Tuesday's gold rally was also underpinned by the return of safe-haven demand, particularly with respect to US tensions with Venezuela and Russia. On Monday the US sanctioned Venezuela's state oil company, the boldest action taken so far in the effort to isolate embattled President Nicolas Maduro. The measure blocks about $7 billion in assets. The Trump Administration last week recognized Opposition leader Juan Guaido as the interim president, and has called on the Venezuelan military to get Maduro to resign. The country has been gripped with hyperinflation, soaring unemployment and a mass exodus of refugees, CNN reported.

It also looks increasingly likely that the US will pull out of a key nuclear disarmament agreement signed in the 1980s. NATO's 29 members are urging Russia to destroy a nuclear-capable cruise missile system before Feb. 2. Failure to do so will put the US government on track for a threatened pull-out of the 1987 IMF Treaty.

We have argued the breakdown of the IMF Treaty could be the catalyst that starts a new arms race between the United States, Russia and China as each projects military power in defense of spheres of influence outside their borders. We are seeing this in the constant tension between the US and China in the South China Sea and Taiwan - which China claims as its own - and Russian expansion into the Ukraine and military support for Syria.

While no-one want to see the return of the nuclear threat, if events escalate, gold's safe-haven status will kick in and we will see upward price pressure.

Conclusion

Given that gold always pushes against the prevailing economic winds, it appears likely that we could be in for an extended up-leg in the price. We are only now seeing the rot that has begun to set into the US economy. The first clue was the stock market correction, but others are coming forward. As Trump's $1.5 trillion tax cuts announced at year-end 2017 finish percolating through the economy, growth is predicted to stall. We are already seeing disappointing corporate earnings, especially from companies that sell into China, which is also slowing down. The trade war isn't helping.

Unemployment is low, but this is misleading. Many Americans are working dead-end jobs or are employed part-time. The gap between rich and poor is widening.

Most importantly for gold, the tightening cycle appears to have stalled. With record debt on the books, the central bank has very limited leeway in how fast and far it can raise interest rates. If we are heading into a recession, as some predict, the Fed may have no choice but to once again lower rates to stimulate the economy, as it did in 2011. Bad economic times ahead means good news for gold and gold stocks.

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

Will The Spike In Iron Ore Prices Hold?

Iron ore prices are likely to remain at elevated levels for the near term as the market assesses the reliability of supply in the wake of the Vale tailings dam failure.

-Supply likely to tighten, iron ore prices stay elevated for the near term -Vale to alter iron ore production mix, less pellet and more lower-quality fines likely -A review of tailings dam construction may have long-term implications for prices

By Eva Brocklehurst

The catastrophic collapse of a tailings dam at Vale's Feijao mine, the second such failure in Brazil in three years, has triggered a spike in iron ore prices. Brokers suspect, while the impact on Brazillian iron ore operations is assessed, prices will remain at elevated levels.

Mysteel reports traders are concerned about Vale's other vast operations, which may be curtailed for safety checks. Vale is the world's largest iron ore miner. ANZ analysts expect the market should tighten because of the closure of the mine, noting 7.3mtpa of supply from the Feijao mine has already been lost in the current quarter.

While the company intends to increase production elsewhere, the analysts estimate a total loss of around -13mt net in 2019, which should, on their forecasts, push the iron ore market back into deficit. As a consequence short term forecasts are raised and spot prices are expected to breach US$80/t in the current quarter. Further upside is likely if the losses in Brazil are more than expected.

As its base case accounts for a 40mt global surplus in 2019, Morgan Stanley believes a -15mt cut to production by Vale would still leave the market in surplus, while a forecast surplus for iron ore continues to feature in Deutsche Bank's estimates too, although this has been lowered to 29mt for 2019 and 36mt in 2020.

Deutsche Bank retains its bearish view on prices, nonetheless, expecting an average of US$68/t in 2019, as declines accelerate over the rest of the year. The main driver of this bearish view is minimal steel production growth in China, while the risk lies with the reliability of supply.

Credit Suisse agrees Vale's plans add risk to the market. A pre-condition for iron ore prices to decline in the June quarter, as the broker forecasts, is China's port traders rebuilding inventory levels by the end of March.

Having assessed no significant rebuild occurred in January from the 2018 depletion, Credit Suisse believes a rebuild of at least 10mt may be needed from current levels by the end of the March quarter, in order for prices to ease in the June quarter.

The broker's base case assumes that Chinese steel demand will slow down because of weakening housing construction and, consequently, demand for iron ore should slacken off. China's imports of iron ore are likely to return to growth in 2019, the ANZ analysts assert, as domestic production falls and there is move to use higher grades.

Seaborne Mix Changes

Credit Suisse believes the mix of production from seaborne iron ore should change, with pellet capacity likely replaced with fines to the tune of 11mtpa. Vale has indicated that its mix of iron ore will be different, given mine suspensions. This replacement iron ore is likely to have higher silica and alumina levels, as it will come from lower-quality mines.

Morgan Stanley suspects the iron ore pellet premium will be affected for longer than is generally believed, as offsetting pellet production will be harder for Vale. Deutsche Bank also expects, given the current disruption, that pellet premiums will rise and this should benefit specific players such as Rio Tinto ((RIO)) and the remainder of Vale's pellet portfolio that is unaffected by the recent disaster.

The broker assesses BHP Group ((BHP)) has little scope to further boost its volumes above the rate already needed to achieve FY19 guidance. Furthermore, the lower-grade discount versus benchmark should fade as an issue for Fortescue Metals ((FMG)). High expectations are factored into the stock and long-term prices would need to be 15% higher to justify the current share price, in Deutsche Bank's view.

Credit Suisse agrees BHP does not have additional capacity, nor Rio Tinto for that matter, to compensate for the reduction in Vale's capacity and doubts Fortescue Metals will increase output. Hence, there may be no constraints to upside for prices if steel demand remains strong.

Meanwhile, the ANZ analysts expect India to become a permanent net importer of iron ore as constraints on production and exports are likely to continue. India has historically been a net exporter, having a relatively small albeit growing domestic steel market. However mining bans in India have hampered supply and, as a result, mills are topping up iron ore from the seaborne market.

Brazil

The disaster in Brazil, which Credit Suisse suspects stems from unforgiving topography and rainfall, has highlighted the fact that risky dams apparently exhibit little outward signs of a problem.

Credit Suisse expects wet tailings dam capital expenditure costs will rise as more robust designs are used, while many new operation will offer dry tailings stacking, despite the higher expenditure. This may have long-term implications for iron ore prices.

Deutsche Bank expects production reductions in Brazil will take place over many months, as decommissioning plans are reviewed. Meanwhile, the Brazilian government has decided not to punish Vale while it deals with the aftermath of the disaster and investigations begin. However, a response may be forthcoming, which brokers acknowledge could affect output.

Vale estimates the suspension of certain mines will result in production from its southern system falling by -40mt, to allow the decommissioning and removal of 10 tailings dams that were constructed using the upstream method.

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: Tuesday January 22 to Saturday January 26, 2019 Total Upgrades: 25 Total Downgrades: 24 Net Ratings Breakdown: Buy 46.75%; Hold 40.66%; Sell 12.59%

The February reporting season is still one week away, with a few early birds scheduled to report this week, and ahead of the "busy" season stockbroking analysts have started to dust off their sector views for retailers & consumer stocks, financials, gold producers and A-REITs and the result has been a long queue in recommendation upgrades and downgrades.

For the week ending Friday, 25th January 2019 FNArena registered no less than 25 upgrades in recommendations for individual ASX-listed entities on top of 24 downgrades. All the sectors mentioned are prominently represented.

Lendlease was the sole recipient of two upgrades during the week. On the flipside Dexus Property Group stands out with three downgrades, while gold producer Regis Resources was downgraded twice.

Outside of the dominant sector updates, we note upgrades to Buy for Ansell, Aristocrat Leisure and Brambles, and downgrades for Qantas, Rio Tinto and Woolworths; all to Neutral.

Target price increases remain benign with only Charter Hall, Dexus Property and Goodman Group worth mentioning. However, numerous large decreases can be observed for the likes of Challenger (profit warning), Sims Metal Management (profit warning), Unibail Rodamco Westfield, and others.

The table for positive revisions to earnings estimates is pretty much an all-miners affair, the exception is Unibail Rodamco Westfield, with junior gold producers on top of the week's table.

Again, the numbers look decisively bigger in the table for earnings estimates decreases, where nib Holdings' reduction in market consensus topples cuts for junior mining stocks including Western Areas, South32, Perseus Mining, and Galaxy Resources.

The February reporting season takes off this week with early birds Credit Corp ((CCP)), GUD Holdings ((GUD)) and Navitas ((NVT)) reporting. Gone are the days when we used to still pay attention to Energy Resources of Australia (ERA).

Meanwhile, there is plenty on the macro-calendar for investors to focus on, as well as plenty of corporate result releases in the USA.

Upgrade

ADELAIDE BRIGHTON LIMITED ((ABC)) Upgrade to Hold from Lighten by Ord Minnett .B/H/S: 1/5/1

Ord Minnett believes the building materials backdrop has turned more challenging, as residential construction in Australia has pulled back and the US housing market has softened. Moreover, activity in New Zealand appears set to moderate.

Given the underperformance of the sector as a whole the broker upgrades Adelaide Brighton to Hold from Lighten, maintaining a $4.50 target. The broker remains cautious about the stock, nevertheless, because of its exposure to the Australasian housing market.

ABACUS PROPERTY GROUP ((ABP)) Upgrade to Buy from Neutral by Citi .B/H/S: 1/1/0

Citi believes the stock has sold off on concerns relating to the delays in realising the residential project in NSW, while a slowing residential market is weighing on earnings.

The broker suspects the new strategy of moving towards a higher recurring base simplifies the business and could lead to a multiple re-rating.

The broker does not believe much has been priced in for the land bank and upgrades to Buy from Neutral. Target is raised to $3.91 from $3.80.

ARISTOCRAT LEISURE LIMITED ((ALL)) Upgrade to Buy from Accumulate by Ord Minnett .B/H/S: 6/1/0

Ord Minnett puts Aristocrat Leisure at the top of its picks for the gaming sector and raises the rating to Buy from Accumulate. Target is $32.45.

The company remains the land-based market leader in North America while Australasian slot expenditure is expected to stay weak. Nevertheless, the company's expansion into casual/social gaming puts it to the fore.

ANSELL LIMITED ((ANN)) Upgrade to Buy from Hold by Deutsche Bank .B/H/S: 4/4/0

Deutsche Bank has a mixed outlook for Australian healthcare companies and expects lower growth in Australian hospital and GP markets. The broker has a positive outlook on the global plasma, OSA and hearing implant markets.

Those with exposure to global markets have a better outlook, in the broker's view, although this is already largely priced in, as valuations are at the upper end of historical ranges.

The broker upgrades Ansell to Buy from Hold. Target price improves to $29.78 from $27.25.

BRAMBLES LIMITED ((BXB)) Upgrade to Buy from Neutral by Citi .B/H/S: 4/4/0

Citi observes the share price has been pressured in recent years by the decline in earnings for the CHEP Americas business. These headwinds are expected to fade in the second half and lead to double-digit earnings growth from FY20.

The broker upgrades to Buy from Neutral and lifts the target to $12.10 from $11.00. Citi now forecasts underlying margins to decline by -190 basis points for the CHEP Americas division in the first half, affected by cost inflation and the timing of costs recovery strategies.

COCA-COLA AMATIL LIMITED ((CCL)) Upgrade to Neutral from Underperform by Macquarie .B/H/S: 0/6/2

Macquarie believes valuation support is emerging following the underperformance in the share price recently, and upgrades to Neutral from Underperform.

Australian beverages are still under pressure and management expects 2019 to be another "transitional year". Macquarie believes more money will need to be spent to meet growth targets. Target is raised to $8.28 from $8.26.

CARINDALE PROPERTY TRUST ((CDP)) Upgrade to Hold from Lighten by Ord Minnett .B/H/S: 0/1/0

In Ord Minnett's view, the outlook for property earnings is robust while balance sheets are well positioned. Nevertheless, various asset classes are at, or approaching, peak cycle conditions.

Capitalisation rates are expected to bottom in the first half of FY19 and real estate assets to soften around -25-75 basis points, because of an excess supply of assets for sale and softening rental growth.

Office remains the stronger segment but the key market, Sydney, is at risk of reaching an inflection point in 2020.

Ord Minnett upgrades to Hold from Lighten based on valuation. Target is reduced to $7.50 from $7.80.

CHARTER HALL GROUP ((CHC)) Upgrade to Accumulate from Hold by Ord Minnett .B/H/S: 3/1/0

Ord Minnett expects the company to end FY19 with assets under management of $29bn, up 25%. The broker also forecasts 12% growth in earnings per share.

FY20 is forecast to be a strong year for earnings, expected to be up 85%. Estimates are raised and the target is lifted to $8.25 from $7.50. Rating is upgraded to Accumulate from Hold.

CROMWELL PROPERTY GROUP ((CMW)) Upgrade to Accumulate from Lighten by Ord Minnett .B/H/S: 1/1/1

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Ord Minnett upgrades Cromwell to Accumulate from Lighten because of reduced risk and M&A potential. Target is raised to $1.10 from $1.05.

DEXUS PROPERTY GROUP ((DXS)) Upgrade to Neutral from Sell by UBS .B/H/S: 0/4/0

UBS upgrades to Neutral from Sell and raises the target to $11.17 from $9.39. The broker had expected office supply would pick up more quickly and there was downside risk to bullish rental expectations.

UBS now expects supply to remain constrained amid another good year for rental growth in Sydney. UBS is also attracted to the low gearing and balance sheet flexibility of Dexus.

See also DXS downgrade.

GPT ((GPT)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 1/5/0

Macquarie assesses the growth outlook as solid, with gearing potentially declining to less than 20% and putting the business in a good position to capitalise on the next cycle.

The broker forecasts 2019 growth of around 5%. As well, a boost should be forthcoming from the sale of its 50% stake in the MLC centre (A-grade Sydney offices).

The broker upgrades to Outperform from Neutral. Target is raised to $5.95 from $5.47.

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

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Office remains the stronger segment but the key market, Sydney, is at risk of reaching an inflection point in 2020.

Ord Minnett upgrades to Accumulate from Hold. Target is steady at $3.25.

HARVEY NORMAN HOLDINGS LIMITED ((HVN)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 2/3/2

There are structural threats from online and a cyclical slowdown in housing, Macquarie acknowledges, but the international & property business, around 50% of operating earnings (EBITDA), is likely shielding the downside.

The broker upgrades to Outperform from Neutral, contending the stock is cheap. Target is steady at $4.10.

INDUSTRIA REIT ((IDR)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 1/2/0

Macquarie forecasts upside risk to valuations, noting strong re-valuations in suburban office and industrial assets over recent months. The broker also believes, with Growthpoint ((GOZ)) holding an 18% stake there is corporate support.

The broker upgrades to Outperform from Neutral and raises the target to $2.85 from $2.58.

KATHMANDU HOLDINGS LIMITED ((KMD)) Upgrade to Outperform from Neutral by Credit Suisse .B/H/S: 2/2/0

The stock sold off by -26% since its August highs, Credit Suisse observes. Disappointing Christmas trading drove a high percentage of this drop, but the broker believes the current share price overstates the impact from weak trading in a period that typically contributes only 25-30% of full year earnings.

The broker believes the stock offers attractive value for a company that is guiding towards earnings growth and has a strong balance sheet. Rating is upgraded to Outperform from Neutral and the target is reduced to NZ$2.90 from NZ$3.25.

LENDLEASE GROUP ((LLC)) Upgrade to Outperform from Neutral by Macquarie and Upgrade to Buy from Neutral by Citi .B/H/S: 4/1/0

The further provisions being undertaken in the Australian engineering business have resulted in a significant de-rating of the share price.

Macquarie observes, while risks continue to exist around completing underperforming projects, the current share price is implying negative value for the construction business.

The broker believes there is enough going on to have confidence in the company, and suspects engineering will be labelled non-core at the upcoming results.

Rating is upgraded to Outperform from Neutral. Target is raised to $15.15 from $15.08.

Citi forecasts the year ahead will be one of lower returns for A-REITs, expecting total returns of around 5% in 2019. The main risks are to the downside, in the broker's view, including falling shopping centre values and the risk that cap rates will rise in office/industrial.

A synchronised commercial property downturn is not the broker's base case but is slated as a possible occurrence if global and domestic economic growth risks recede and upward pressure resumes on global security yields.

Citi upgrades LendLease to Buy/High Risk from Neutral. Target is steady at $15.06.

METCASH LIMITED ((MTS)) Upgrade to Neutral from Underperform by Macquarie .B/H/S: 3/2/2

Macquarie accepts the outlook is still challenging and FY20 growth is hampered by the loss of the Drakes contract.

Still the recent de-rating of the share price means the broker upgrades to Neutral from Underperform, given the improving valuation. Target is steady at $2.41.

The broker notes, despite the difficult trading conditions, the company has done well on costs, although the gains in this area appear to be coming to an end.

SARACEN MINERAL HOLDINGS LIMITED ((SAR)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 1/0/1

Macquarie includes Saracen Mineral as one of its preferred producers, as the business displays organic growth prospects.

An improved earnings outlook across gold producers drives modest increase in the broker's target, to $3.20 from $2.90. Rating is upgraded to Outperform from Neutral.

SHOPPING CENTRES AUSTRALASIA PROPERTY GROUP ((SCP)) Upgrade to Accumulate from Hold by Ord Minnett .B/H/S: 1/1/3

In Ord Minnett's view, the outlook for property earnings is robust while balance sheets are well positioned. Nevertheless, various asset classes are at, or approaching, peak cycle conditions.

Capitalisation rates are expected to bottom in the first half of FY19 and real estate assets to soften around -25-75 basis points, because of an excess supply of assets for sale and softening rental growth.

Office remains the stronger segment but the key market, Sydney, is at risk of reaching an inflection point in 2020.

Ord Minnett upgrades to Accumulate from Hold. Target is steady at $2.75.

STOCKLAND ((SGP)) Upgrade to Buy from Neutral by Citi .B/H/S: 3/3/0

Citi forecasts the year ahead will be one of lower returns for A-REITs, expecting total returns of around 5% in 2019. The main risks are to the downside, in the broker's view, including falling shopping centre values and the risk that cap rates will rise in office/industrial.

A synchronised commercial property downturn is not the broker's base case but is slated as a possible occurrence if global and domestic economic growth risks recede and upward pressure resumes on global security yields.

The broker prefers fund managers and residential A-REITs in the sub-sector. Citi upgrades Stockland to Buy from Neutral and raises the target to $4.00 from $3.98.

SANTOS LIMITED ((STO)) Upgrade to Buy from Neutral by UBS .B/H/S: 4/3/0

Sales revenue in the December quarter beat estimates, largely because of higher domestic gas prices. UBS upgrades to Buy from Neutral and the stock is now its preferred pick of the Australian E&P majors.

The three-year production growth forecast is 13% and growth is expected from all core assets. UBS reduces the target to $7.20 from $7.55, setting the target based on an estimated oil price of US$65/bbl in 2019.

SUPER RETAIL GROUP LIMITED ((SUL)) Upgrade to Outperform from Neutral by Credit Suisse .B/H/S: 5/3/0

Credit Suisse analysts simply cannot believe the present share price accurately reflects the outlook for this company, suggesting things are probably a lot less bad as suggested by how low the share price has fallen.

Hence the upgrade to Outperform from Neutral. Target price does fall to $7.75 from $8.39 on downgraded forecasts. The announcement that Anthony Heraghty is the new CEO is considered a potential circuit breaker to negative sentiment.

SUNCORP GROUP LIMITED ((SUN)) Upgrade to Buy from Neutral by Citi .B/H/S: 4/3/1

Operating conditions, as anticipated, have probably worsened of late in Suncorp's banking division, Citi suggests.

Suncorp is confident that cost savings could drive a cost-to-income ratio below 50% and the broker continues to give the company the benefit of the doubt.

Citi factors in the impact of the life sale, including a likely capital return and stranded costs.

With operating conditions seemingly favourable in the core general insurance business. the broker upgrades to Buy from Neutral and reduces the target to $14.60 from $16.00.

SYDNEY AIRPORT HOLDINGS LIMITED ((SYD)) Upgrade to Overweight from Equal-weight by Morgan Stanley .B/H/S: 4/2/2

Morgan Stanley upgrades to Overweight from Equal-weight, in view of the recent underperformance in the stock and the value relative to global listed airports, as well as Australian infrastructure stocks.

The broker acknowledges investors may be wary of passenger growth this year, as airports are cycling higher comparables and forward capacity data is pointing to moderating near-term growth.

The broker believes Sydney Airport has the best potential returns in the grouping and will benefit from a diversity of traffic sources. Target is reduced to $7.07 from $7.47. Industry view is Cautious.

Downgrade

BANK OF QUEENSLAND LIMITED ((BOQ)) Downgrade to Hold from Add by Morgans .B/H/S: 1/3/3

The latest APRA data show Bank of Qld's home loan book contracting in the three months to November. Loan repricings announced earlier this month will go some way to providing an offset, Morgans notes.

Yet now that the St Andrew's sale is off, the broker is no longer expecting a special dividend. Morgans does not see any earnings growth over the forecast period and thus downgrades to Hold from Add. Target falls to $10.40 from $11.30.

BWP TRUST ((BWP)) Downgrade to Lighten from Hold by Ord Minnett .B/H/S: 0/0/1

In Ord Minnett's view, the outlook for property earnings is robust while balance sheets are well positioned. Nevertheless, various asset classes are at, or approaching, peak cycle conditions.

Capitalisation rates are expected to bottom in the first half of FY19 and real estate assets to soften around -25-75 basis points, because of an excess supply of assets for sale and softening rental growth.

Office remains the stronger segment but the key market, Sydney, is at risk of reaching an inflection point in 2020.

Ord Minnett downgrades BWP Trust to Lighten from Hold. Target is steady at $3.30.

CHALLENGER LIMITED ((CGF)) Downgrade to Neutral from Buy by Citi .B/H/S: 1/5/1

The company has downgraded FY19 normalised earnings estimates. Citi lowers core estimates for earnings per share by -48% for FY19 and -8% for FY20.

The broker still expects the upcoming means test changes to be positive for the company's annuities. Uncertainty in the meantime, as well as the need for a new CEO to build market confidence, may not be enough to propel the stock forward.

There are also risks around the longer-term return-on-equity target. Rating is downgraded to Neutral from Buy. Target is reduced to $8.40 from $13.10.

CHARTER HALL LONG WALE REIT ((CLW)) Downgrade to Lighten from Hold by Ord Minnett .B/H/S: 0/1/1

In Ord Minnett's view, the outlook for property earnings is robust while balance sheets are well positioned. Nevertheless, various asset classes are at, or approaching, peak cycle conditions.

Capitalisation rates are expected to bottom in the first half of FY19 and real estate assets to soften around -25-75 basis points, because of an excess supply of assets for sale and softening rental growth.

Office remains the stronger segment but the key market, Sydney, is at risk of reaching an inflection point in 2020.

Ord Minnett downgrades to Lighten from Hold, because of a reduced growth outlook. Target is steady at $4.15.

CHARTER HALL RETAIL REIT ((CQR)) Downgrade to Lighten from Hold by Ord Minnett .B/H/S: 0/2/2

In Ord Minnett's view, the outlook for property earnings is robust while balance sheets are well positioned. Nevertheless, various asset classes are at, or approaching, peak cycle conditions.

Capitalisation rates are expected to bottom in the first half of FY19 and real estate assets to soften around -25-75 basis points, because of an excess supply of assets for sale and softening rental growth.

Office remains the stronger segment but the key market, Sydney, is at risk of reaching an inflection point in 2020.

Ord Minnett downgrades to Lighten from Hold. Target is steady at $4.30.

DEXUS PROPERTY GROUP ((DXS)) Downgrade to Lighten from Hold by Ord Minnett and Downgrade to Neutral from Outperform by Macquarie and Downgrade to Neutral from Buy by Citi .B/H/S: 0/4/0

In Ord Minnett's view, the outlook for property earnings is robust while balance sheets are well positioned. Nevertheless, various asset classes are at, or approaching, peak cycle conditions.

Capitalisation rates are expected to bottom in the first half of FY19 and real estate assets to soften around -25-75 basis points, because of an excess supply of assets for sale and softening rental growth.

Office remains the stronger segment but the key market, Sydney, is at risk of reaching an inflection point in 2020.

The broker downgrades Dexus to Lighten from Hold based on elevated multiples. Target is reduced to $10.60 from $11.00.

Macquarie reviews its stance on direct office markets and its investment thesis for Dexus, heading into the first half results. Strong rental growth in last few years is expected to underpin growth.

Market conditions are expected to soften from 2022 as major projects seeking pre-commitments may target tenants in existing stock and affect the outlook.

As the share price is trading largely in line with valuation, Macquarie downgrades to Neutral from Outperform. Target is raised to $11.51 from $11.06.

Citi forecasts the year ahead will be one of lower returns for A-REITs, expecting total returns of around 5% in 2019. The main risks are to the downside, in the broker's view, including falling shopping centre values and the risk that cap rates will rise in office/industrial.

A synchronised commercial property downturn is not the broker's base case but is slated as a possible occurrence if global and domestic economic growth risks recede and upward pressure resumes on global security yields.

Citi trims office exposure and reduces the Dexus rating to Neutral from Buy. Target is raised to $11.05 from $10.83.

See also DXS upgrade.

EVOLUTION MINING LIMITED ((EVN)) Downgrade to Neutral from Buy by Citi .B/H/S: 1/5/2

Citi analysts didn't like the fact that operational costs made quite a pronounced jump in the December quarter, even though a number of events can be held responsible. They have downgraded to Neutral from Buy, also noting the share price has appreciated by some 40% since the October low last year.

Evolution Mining is probably en route to meeting its FY guidance, but higher costs remain the disappointment. Target lifts to $3.70 from $3.35 nevertheless, due to additional Cowal value attribution.

GOODMAN GROUP ((GMG)) Downgrade to Sell from Lighten by Ord Minnett .B/H/S: 2/3/1

In Ord Minnett's view, the outlook for property earnings is robust while balance sheets are well positioned. Nevertheless, various asset classes are at, or approaching, peak cycle conditions.

Capitalisation rates are expected to bottom in the first half of FY19 and real estate assets to soften around -25-75 basis points, because of an excess supply of assets for sale and softening rental growth.

Office remains the stronger segment but the key market, Sydney, is at risk of reaching an inflection point in 2020.

Ord Minnett downgrades to Sell from Lighten. Target is steady at $9.10.

MIRVAC GROUP ((MGR)) Downgrade to Hold from Accumulate by Ord Minnett .B/H/S: 2/3/1

In Ord Minnett's view, the outlook for property earnings is robust while balance sheets are well positioned. Nevertheless, various asset classes are at, or approaching, peak cycle conditions.

Capitalisation rates are expected to bottom in the first half of FY19 and real estate assets to soften around -25-75 basis points, because of an excess supply of assets for sale and softening rental growth.

Office remains the stronger segment but the key market, Sydney, is at risk of reaching an inflection point in 2020.

Ord Minnett downgrades Mirvac to Hold from Accumulate and reduces the target to $2.50 from $2.55.

NATIONAL AUSTRALIA BANK LIMITED ((NAB)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 4/2/2

Macquarie suspects National Australia Bank will be unable to sustain its elevated pay-out ratio. The broker downgrades earnings growth forecasts and lowers the target to $25.50 from $28.50.

Rating is downgraded to Neutral from Outperform, given potential capital concerns following the announcement of NZ capital rules.

Healthy dividends, which should be sustained inside a lower growth environment, should still provide support for the sector at current levels.

NORTHERN STAR RESOURCES LTD ((NST)) Downgrade to Neutral from Buy by UBS .B/H/S: 1/3/3

December quarter production was -19% lower than UBS expected. The company has capitalised on higher Australian dollar gold prices to opportunistically mine lower grade and more marginal ore. This extends mine life but also lifts unit costs.

Unchanged guidance of 250-260,000 ounces in FY19 now appears to be a stretch. UBS believes the share price is factoring in positive momentum and the risk/return is now more balanced.

Rating is downgraded to Neutral from Buy on the back of the share price performance. Target is steady at $9.00.

PACT GROUP HOLDINGS LTD ((PGH)) Downgrade to Neutral from Outperform by Credit Suisse .B/H/S: 1/4/0

Credit Suisse observes the share price has rallied ahead of the result, due on February 20. As a result, the broker downgrades to Neutral from Outperform. Target is steady at $3.85.

Guidance signals FY19 operating earnings (EBITDA) of around $245m in earnings will be weighted towards the second half, with the full year inclusion of the TIC acquisition. Guidance assumes no changes to resin prices.

PEET & COMPANY LIMITED ((PPC)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 0/2/0

As the company's earnings are solely leveraged to the residential market, Macquarie believes there is a risk that earnings and margins decline.

The buyback provides support but the broker downgrades to Neutral from Outperform. The target is reduced by -28% to $1.06 to reflect the medium-term outlook for residential earnings.

QANTAS AIRWAYS LIMITED ((QAN)) Downgrade to Neutral from Outperform by Credit Suisse .B/H/S: 3/2/1

Credit Suisse suspects, at some point, a weak consumer environment and increasing geopolitical uncertainty will weigh on demand for air travel. The broker expects Qantas will respond with capacity adjustments, but there could be a lag.

The broker lowers second half domestic ticket yield growth forecasts to 2.5% from 4% and international to 3% from 4.4%. The broker is now less confident of an additional buyback in the second half.

Target is reduced to $6.70 from $7.35. While there remains plenty of upside at the current share price, the broker believes it is insufficient to justify the prior rating and downgrades to Neutral from Outperform.

RIO TINTO LIMITED ((RIO)) Downgrade to Hold from Add by Morgans .B/H/S: 4/3/0

Mined copper production in the December quarter surprised Morgans on the upside, driven by the ramping up of volumes from Escondida and solid output from Kennecott.

Healthy volumes were also delivered from the flagship Pilbara iron ore operations. The broker notes the company has built an incredibly strong position after multi-year process of refining the business.

With the stock supported by strong fundamentals and a positive share price performance, Morgans downgrades to Hold from Add. Target is raised to $82.55 from $82.28.

RESMED INC ((RMD)) Downgrade to Hold from Buy by Deutsche Bank .B/H/S: 3/4/1

Deutsche Bank has a mixed outlook for healthcare, being positive on the global plasma, OSA and hearing implant markets and expecting slower growth in Australian hospital and GP markets.

Companies with exposure to global markets generally have a better outlook, although this is largely priced into valuations. The broker downgrades ResMed to Hold from Buy. Target is raised to US$123 from US$122.

REGIS RESOURCES LIMITED ((RRL)) Downgrade to Underperform from Outperform by Credit Suisse and Downgrade to Lighten from Hold by Ord Minnett .B/H/S: 0/5/2

The company is reporting strong exploration results from the Rosemont underground central zone and the Garden Well depth extension underground.

Credit Suisse notes the McPhillamys project has been pushed out further, to around 2022. The broker notes new management has continued with the old strategy which has served the company well.

Rating is downgraded to Underperform from Outperform, purely on valuation because of the recent strength in the share price. Target is $4.45.

The company expects FY19 gold production to be in the mid to upper end of its 340-370,000 ounces guidance range and costs to be at the mid to lower end of guidance.

Ord Minnett is mostly concerned about the McPhillamys operation amid further delays. Completion of the definitive feasibility study is now expected for the June or September quarter.

The broker struggles to justify the valuation and downgrades to Lighten from Hold. Target is reduced to $4.30 from $4.40.

SCENTRE GROUP ((SCG)) Downgrade to Hold from Accumulate by Ord Minnett .B/H/S: 2/3/1

In Ord Minnett's view, the outlook for property earnings is robust while balance sheets are well positioned. Nevertheless, various asset classes are at, or approaching, peak cycle conditions.

Capitalisation rates are expected to bottom in the first half of FY19 and real estate assets to soften around -25-75 basis points, because of an excess supply of assets for sale and softening rental growth.

Office remains the stronger segment but the key market, Sydney, is at risk of reaching an inflection point in 2020.

Ord Minnett downgrades Scentre Group to Hold from Accumulate. Target is steady at $4.50.

SIMS METAL MANAGEMENT LIMITED ((SGM)) Downgrade to Sell from Neutral by UBS .B/H/S: 4/2/1

The company has guided to a downgrade to December half operating earnings (EBIT), to around $110m. UBS observes most of the weakness during the period has reflected for margins in Europe, which in turn reflects underinvestment and increased competition.

Municipal recycling was also weak. The broker remains cautious on the outlook, as global scrap markets face increasing disruption.

UBS acknowledges forecasting the company's earnings trajectory has not become easier. Forecasts are reduced by around -15-20% and downside risk is still envisaged.

The broker downgrades to Sell from Neutral and reduces the target to $8.50 from $12.50.

UNIBAIL-RODAMCO-WESTFIELD ((URW)) Downgrade to Accumulate from Buy by Ord Minnett .B/H/S: 2/2/0

Ord Minnett incorporates downgraded capital growth forecasts for retail property in the UK and Europe, following a challenging fourth quarter.

The broker believes the retail challenges will depress investor expectations of future rental growth.

This leads Ord Minnett to lower the target to $13 from $15 and downgrade the rating to Accumulate from Buy.

WOOLWORTHS LIMITED ((WOW)) Downgrade to Neutral from Buy by Citi .B/H/S: 1/5/2

Citi suspects the first half reporting season will be defined by retail trading through the Christmas period. Grocery remains the broker's preferred exposure, with favourable conditions continuing.

Citi downgrades Woolworths to Neutral from Buy as the valuation factors in upside from capital returns and margin expansion. Target is reduced to $31.30 from $33.00.

Total Recommendations Recommendation Changes

Broker Recommendation Breakup

Broker Rating Order Company New Rating Old Rating Broker Upgrade 1 ABACUS PROPERTY GROUP Buy Neutral Citi 2 ADELAIDE BRIGHTON LIMITED Neutral Sell Ord Minnett 3 ANSELL LIMITED Buy Neutral Deutsche Bank 4 ARISTOCRAT LEISURE LIMITED Buy Buy Ord Minnett 5 BRAMBLES LIMITED Buy Neutral Citi 6 CARINDALE PROPERTY TRUST Neutral Sell Ord Minnett 7 CHARTER HALL GROUP Buy Neutral Ord Minnett 8 COCA-COLA AMATIL LIMITED Neutral Sell Macquarie 9 CROMWELL PROPERTY GROUP Buy Sell Ord Minnett 10 DEXUS PROPERTY GROUP Neutral Sell UBS 11 GPT Buy Neutral Macquarie 12 HARVEY NORMAN HOLDINGS LIMITED Buy Neutral Macquarie 13 HOTEL PROPERTY INVESTMENTS Buy Neutral Ord Minnett 14 INDUSTRIA REIT Buy Neutral Macquarie 15 KATHMANDU HOLDINGS LIMITED Buy Neutral Credit Suisse 16 LENDLEASE GROUP Buy Neutral Macquarie 17 LENDLEASE GROUP Buy Neutral Citi 18 METCASH LIMITED Neutral Sell Macquarie 19 SANTOS LIMITED Buy Neutral UBS 20 SARACEN MINERAL HOLDINGS LIMITED Buy Neutral Macquarie 21 SHOPPING CENTRES AUSTRALASIA PROPERTY GROUP Buy Neutral Ord Minnett 22 STOCKLAND Buy Neutral Citi 23 SUNCORP GROUP LIMITED Buy Neutral Citi 24 SUPER RETAIL GROUP LIMITED Buy Neutral Credit Suisse 25 SYDNEY AIRPORT HOLDINGS LIMITED Buy Neutral Morgan Stanley Downgrade 26 BANK OF QUEENSLAND LIMITED Neutral Buy Morgans 27 BWP TRUST Sell Neutral Ord Minnett 28 CHALLENGER LIMITED Neutral Buy Citi 29 CHARTER HALL LONG WALE REIT Sell Neutral Ord Minnett 30 CHARTER HALL RETAIL REIT Sell Neutral Ord Minnett 31 DEXUS PROPERTY GROUP Neutral Buy Macquarie 32 DEXUS PROPERTY GROUP Neutral Buy Citi 33 DEXUS PROPERTY GROUP Sell Neutral Ord Minnett 34 EVOLUTION MINING LIMITED Neutral Buy Citi 35 GOODMAN GROUP Sell Sell Ord Minnett 36 MIRVAC GROUP Neutral Buy Ord Minnett 37 NATIONAL AUSTRALIA BANK LIMITED Neutral Buy Macquarie 38 NORTHERN STAR RESOURCES LTD Neutral Buy UBS 39 PACT GROUP HOLDINGS LTD Neutral Buy Credit Suisse 40 PEET & COMPANY LIMITED Neutral Buy Macquarie 41 QANTAS AIRWAYS LIMITED Neutral Buy Credit Suisse 42 REGIS RESOURCES LIMITED Sell Buy Credit Suisse 43 REGIS RESOURCES LIMITED Sell Neutral Ord Minnett 44 RESMED INC Neutral Buy Deutsche Bank 45 RIO TINTO LIMITED Neutral Buy Morgans 46 SCENTRE GROUP Neutral Buy Ord Minnett 47 SIMS METAL MANAGEMENT LIMITED Sell Neutral UBS 48 UNIBAIL-RODAMCO-WESTFIELD Buy Buy Ord Minnett 49 WOOLWORTHS LIMITED Neutral Buy Citi Recommendation Positive Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 LLC LENDLEASE GROUP 70.0% 30.0% 40.0% 5 2 CMW CROMWELL PROPERTY GROUP -17.0% -50.0% 33.0% 3 3 KMD KATHMANDU HOLDINGS LIMITED 50.0% 25.0% 25.0% 4 4 NWS NEWS CORPORATION 40.0% 20.0% 20.0% 5 5 SGP STOCKLAND 42.0% 25.0% 17.0% 6 6 MTS METCASH LIMITED 7.0% -7.0% 14.0% 7 7 CCL COCA-COLA AMATIL LIMITED -25.0% -38.0% 13.0% 8 8 CHC CHARTER HALL GROUP 63.0% 50.0% 13.0% 4 9 SUN SUNCORP GROUP LIMITED 38.0% 25.0% 13.0% 8 10 SUL SUPER RETAIL GROUP LIMITED 56.0% 44.0% 12.0% 8 Negative Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 SDF STEADFAST GROUP LIMITED 33.0% 67.0% -34.0% 3 2 DXS DEXUS PROPERTY GROUP -10.0% 20.0% -30.0% 5 3 VEA VIVA ENERGY GROUP LIMITED 75.0% 100.0% -25.0% 4 4 PGH PACT GROUP HOLDINGS LTD 20.0% 40.0% -20.0% 5 5 CLW CHARTER HALL LONG WALE REIT -50.0% -33.0% -17.0% 3 6 QAN QANTAS AIRWAYS LIMITED 33.0% 50.0% -17.0% 6 7 NST NORTHERN STAR RESOURCES LTD -29.0% -14.0% -15.0% 7 8 BOQ BANK OF QUEENSLAND LIMITED -29.0% -14.0% -15.0% 7 9 SGM SIMS METAL MANAGEMENT LIMITED 43.0% 57.0% -14.0% 7 10 RIO RIO TINTO LIMITED 50.0% 64.0% -14.0% 7 Target Price Positive Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 CHC CHARTER HALL GROUP 7.825 7.288 7.37% 4 2 DXS DEXUS PROPERTY GROUP 11.008 10.598 3.87% 5 3 GMG GOODMAN GROUP 10.687 10.402 2.74% 6 4 CMW CROMWELL PROPERTY GROUP 1.057 1.040 1.63% 3 5 BXB BRAMBLES LIMITED 11.158 11.020 1.25% 8 6 RMD RESMED INC 15.930 15.755 1.11% 8 7 ANN ANSELL LIMITED 25.891 25.650 0.94% 8 8 ALL ARISTOCRAT LEISURE LIMITED 32.243 31.971 0.85% 7 9 LNK LINK ADMINISTRATION HOLDINGS LIMITED 8.495 8.437 0.69% 8 10 PGH PACT GROUP HOLDINGS LTD 4.042 4.022 0.50% 5 Negative Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 CGF CHALLENGER LIMITED 9.319 11.261 -17.25% 8

2 SGM SIMS METAL MANAGEMENT LIMITED 11.864 14.207 -16.49% 7 3 URW UNIBAIL-RODAMCO-WESTFIELD 13.295 15.665 -15.13% 4 4 VEA VIVA ENERGY GROUP LIMITED 2.440 2.553 -4.43% 4 5 SYD SYDNEY AIRPORT HOLDINGS LIMITED 7.105 7.434 -4.43% 8 6 SUL SUPER RETAIL GROUP LIMITED 8.885 9.153 -2.93% 8 7 BOQ BANK OF QUEENSLAND LIMITED 10.257 10.529 -2.58% 7 8 STO SANTOS LIMITED 6.840 7.010 -2.43% 7 9 WHC WHITEHAVEN COAL LIMITED 5.646 5.756 -1.91% 8 10 SUN SUNCORP GROUP LIMITED 14.448 14.710 -1.78% 8 Earning Forecast Positive Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 AQG ALACER GOLD CORP 12.660 7.253 74.55% 4 2 URW UNIBAIL-RODAMCO-WESTFIELD 101.637 81.099 25.32% 4 3 SBM ST BARBARA LIMITED 34.820 31.848 9.33% 5 4 FMG FORTESCUE METALS GROUP LTD 46.715 43.557 7.25% 8 5 DXS DEXUS PROPERTY GROUP 58.620 56.550 3.66% 5 6 RIO RIO TINTO LIMITED 731.277 711.371 2.80% 7 7 OZL OZ MINERALS LIMITED 76.353 74.687 2.23% 7 8 WPL WOODSIDE PETROLEUM LIMITED 210.285 206.557 1.80% 7 9 LNK LINK ADMINISTRATION HOLDINGS LIMITED 47.291 46.520 1.66% 8 10 CHC CHARTER HALL GROUP 40.540 39.880 1.65% 4 Negative Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 NHF NIB HOLDINGS LIMITED 31.901 77.068 -58.61% 8 2 WSA WESTERN AREAS NL 6.360 9.892 -35.71% 7 3 S32 SOUTH32 LIMITED 30.923 37.742 -18.07% 7 4 PRU PERSEUS MINING LIMITED 2.760 3.350 -17.61% 3 5 GXY GALAXY RESOURCES LIMITED 4.679 5.445 -14.07% 5 6 SGM SIMS METAL MANAGEMENT LIMITED 81.413 94.380 -13.74% 7 7 WGN WAGNERS HOLDING COMPANY LIMITED 12.700 14.453 -12.13% 3 8 PLS PILBARA MINERALS LIMITED 3.450 3.925 -12.10% 4 9 CGF CHALLENGER LIMITED 52.343 58.886 -11.11% 8 10 NST NORTHERN STAR RESOURCES LTD 44.360 49.298 -10.02% 7 Technical limitations

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Uranium Week: Utilities On The Move

Utility interest is building in the uranium market both for term deliveries and spot market purchases.

-US nuclear generation set to decline -Kazakhstan cuts production and exports -Spot price moving up

By Greg Peel

The US Energy Administration last week published its 2019 Annual Energy Outlook, which projects US energy markets through to 2050. The report suggests the US will become a net energy exporter by 2020, on a combination of increased crude oil and LNG exports and slowing growth in domestic consumption, and will remain so through to 2050.

Over the period, the EIA's base case sees US coal-fired electricity production dropping to 17% of total generation from 28% in 2018, and nuclear generation dropping to 12% from 19%.

The decline in nuclear power will result from plant retirements, and no plants coming into operation from 2021, meeting slowing consumption growth, cheap gas-fired power and subsidised renewable energy generation.

On the other side of the ledger, Kazakhstan's uranium exports fell by -19% by volume in the nine months to September 2018. State-owned Kazatomprom said at the beginning of 2018 it planned to cut production by -20% over three years and achieved a cut of -6% in the first half of 2018. This suggests the company is ahead of schedule, having fallen well short of production cuts promised over 2017.

Since 2009 Kazakhstan has been the world's largest producer of uranium. To September 2018, 57% of Kazak exports made their way to China, 18% to Canada and 17% to Russia. The latter two are a little surprising given both are themselves major uranium producers.

Firing up for 2019

As the uranium market begins to ramp back up for 2019, after the traditional Christmas-New Year hiatus, utilities are assessing their requirements in all of the spot, mid-term and long-term markets. With several tenders out for term market delivery contracts, market participants are waiting to evaluate pricing.

This meant the number of spot market transactions was lower last week at five, totalling 740,000lbs U3O8 equivalent, but new buyers entered the market, industry consultant TradeTech reports, across the spectrum of utilities, intermediaries, producers and investors.

TradeTech's weekly spot price indicator rose US25c to US$29.10/lb.

There were no trades in term markets last week but there are some sizeable delivery contracts out to tender for deliveries out to 2025 and beyond.

TradeTech's term price indicators remain at US$29.00/lb (mid) and US$32.00/lb (long).

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. Percentages 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 January 24, 2019

The Short Report is now back in its standard format of highlighting week to week changes.

Last week saw the ASX200 rally to 5900 before returning from whence it came.

Last week also saw very little in the way of short position movements, as the table below suggests. Either the shorters have all now set themselves ahead of earnings result season or we're yet to see last minute repositioning.

Only two stocks saw short position movements of one percentage point or more, being Inghams Group ((ING)) and Nanosonics ((NAN)). See Movers & Shakers below.

Otherwise we might note last week saw two big pre-result profit warnings, from Challenger ((CGF)) and Sims Metal Management ((SGM)). The stock prices of each fell off a cliff as a result.

To that end we see Challenger shorts have fallen to 6.7% from 7.0%, suggesting no great rush to take profits on short positions, while Sims has reappeared on the table at 5.8% shorted from less than 5% prior, suggesting the sharks may be gathering.

Weekly short positions as a percentage of market cap:

10%+

SYR 16.9 GXY 16.6 JBH 16.0 ING 15.4 ORE 13.4 MTS 13.4 IVC 13.0 NXT 12.1 BWX 11.7 MYR 11.7 DMP 10.2

In: DMP Out: NUF

9.0-9.9

NUF, HVN, IFL, SUL, BAL, SDA

In: NUF Out: DMP 8.0-8.9%

PLS, MSB

No changes

7.0-7.9%

NAN, AMC, MND, NWS, BKL

In: NAN Out: CGF

6.0-6.9%

KDR, CGF, CCP, FLT, GMA, AMP, A2M, HT1, BEN, BOQ, BGA, SEK

In: CGF, SEK Out: NAN, APT

5.0-5.9%

APT, SGM, LYC, RSG, ARB, RWC, A2B, PTM, MLX, DHG, BIN, CLH, KAR, BHP, AAC

In: APT, SGM Out: SEK, VOC Movers & Shakers

Last week I noted shorts in medical technology company Nanosonics had fallen to 6.0% from 8.3% before Christmas. Last week the company provided an update, which resulted in both the share price rising and shorts returning to 7.5%.

This despite the one FNArena database broker covering the stock, Morgans, suggesting the update held no surprises and the stock looks attractive at current pricing.

Poultry producer Inghams Group has enjoyed a solid run in 2019 to date, which Citi suggests reflects the defensive nature of chook as a staple. But the broker downgraded the stock to Sell in December, warning of a significant cost headwind in the second half which leads to lower earnings and thus lower growth opportunities. Of six database brokers covering Inghams, none has a Buy rating.

Last week Inghams shorts rose to 15.4% from 14.3%.

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: Retail, A-REITs, Building & Banks

Weekly Broker Wrap: Specialist platforms; consumer stocks; online retail; A-REITs; building materials; and banks.

-Platform fees unlikely to suffer from material price compression: CLSA -Retail weakness heralds slowdown in consumer spending -Shoppers flag Amazon as major destination for electronics -Settlement risks increase for multi-residential apartments -Building materials stocks becoming attractive -Ord Minnett advises patience required for banking sector stocks

By Eva Brocklehurst

Specialist Platforms

CLSA believes specialist platform providers are already very competitive on price, with both Netwealth ((NWL)) and HUB24 ((HUB)) wholesale rates more than -30% below rack rates, and broadly in line with rates charged by Panorama and MLC.

The broker's analysis suggests platform fees are unlikely to suffer from material price compression over the medium term. Revenue margins are expected to contract at a moderate rate over the longer term, resulting in an -11 basis points decline by FY26.

Weak market returns throughout the December quarter were the major driver of balances in funds under administration (FUA) that were below expectations. HUB24, which reported second quarter FUA of $10bn, ahead of expectations, outperformed the market because of a large client transition and its second highest inflows on record.

CLSA has Buy ratings for Praemium ((PPS)), Onevue Holdings ((OVH)) and HUB24 and upgrades Netwealth to Buy, believing recent weakness is a short-term trading opportunity.

Consumer Stocks

A number of companies across the retail sector have flagged weaker conditions and while some downgrades over recent months have been company specific, UBS suggests the breadth of the weakness is an indicator that consumer spending is slowing down.

Weakness has been led by discretionary goods while trends in non-discretionary items such as groceries remains solid. In analysing sensitivities to consumption and other macro factors, UBS finds that gaming, discretionary retail and media are most positively correlated to overall consumption. Other discretionary and discretionary retail are also noticeably correlated with house prices.

The broker believes travel, renovations, white goods and car sales are most vulnerable and is underweight discretionary retail because of valuations and relative earnings risk. That said, some retailers have reported reasonable conditions over the Christmas period, such as Noni B ((NBL)), The Reject Shop ((TRS)) and Kogan ((KGN)).

Macquarie reviews the new lease accounting standards which are in effect this month for those stocks with December balance dates. The standard aims to reflect the financial commitment of an operating lease on the balance sheet.

Simply stated, the present value of lease commitments becomes a liability on the balance sheet and Macquarie believes the new standard is not good for Woolworths ((WOW)) or Myer ((MYR)), given longer leases of 11.1 and 11.0 years respectively.

The broker suggests the pre-tax profit of Woolworths could decline, given the new interest and depreciation charge may outweigh the adding back of cash rent expenses. Moreover, as evidenced by the previous Caltex ((CTX)) result, value adding strategies such a sale and leasing back of existing sites may now look less attractive.

Online Retail

Online retail sales rose around 11% in the 12 months to November 2018, which UBS calculates outpaced total retail growth by a factor of over 3x. Online now encapsulates around 9.0% of total retail, having accelerated post the launch of Amazon.

Moreover, the analysis shows domestic online retailing is outperforming international, a function of a lower Australian dollar, the removal of the GST-free threshold and buy now/pay later options. The category most at risk to online retailing are electronics, personal care and accessories. The broker believes online take-up will be driven by consumers obtaining what they want, when they need it and a good price.

Shoppers have also flagged Amazon is a major shopping destination for electronics. While cautious, UBS believes these issues are priced into retail stocks and prefers those with limited exposure to Amazon such as Woolworths, Metcash ((MTS)) and Treasury Wine Estate ((TWE)) as well as those with attractive valuations such as Super Retail ((SUL)) and Adairs ((ADH)).

A-REITS

UBS notes apartment prices are down around -7% in Sydney and around -2% in Melbourne and lending for new housing is down -22% from its peak. Sydney and Melbourne apartments make up 15% and 31% of operating earnings (EBIT) for FY19 and FY20 respectively for Mirvac ((MGR)) and 30% and 5% respectively for Lendlease ((LLC)).

UBS envisages a substantial amount of risk for Mirvac's settlements in FY20/21 from projects that were released late in the cycle as prices peaked. Most of these projects are in Sydney and appear already out of the money. The broker is less concerned about the settlement risk for Lendlease, given the price growth since the launch dates in 2015/16.

Cancellation rates continue to run at low levels but tightening credit, price declines, lower deposits and increased levels of incentives suggest this may turnaround. The broker expects Stockland's ((SGP)) second half settlements will disappoint, as cancellation rates increase and settlement times extend.

Building Materials

Macquarie expects a contraction in building activity in Australia, particularly among the high-rise multi-residential sector, yet finds opportunities in the sector. The declines depend on several factors and the extent of any downturn is not yet fully evident.

In the US the market may be slowing but fundamentals remain in favour of some growth. In the UK, attention is on the Brexit process, while over on the continent there are signs of a slowdown as trade uncertainties are felt.

The broker considers the sector is in for a bumpy ride although valuations are attractive. DuluxGroup ((DLX)) is upgraded to Outperform as the business is resilient and has consistent growth through the cycle. Macquarie envisages strength in Boral's ((BLD)) position in relation to the USG JV, which supports the potential for a value-adding deal. Ongoing broader market support also exists in the US.

Meanwhile, Reliance Worldwide ((RWC)) is trading at its lowest since listing, amid concerns about US housing activity and whether the repair and renovations market will shield earnings from volatility. Macquarie believes direct effects from Brexit are manageable but acknowledges secondary effects are harder to gauge.

The broker notes a lot of disappointment with James Hardie ((JHX)) over a long period but believes operating, product and market strategies should be positive over time. Again, the stock's valuation is at decade lows.

Banks

Ord Minnett expects the year ahead will be challenging for the Australian banking sector, although a number of issues could be resolved. The challenges are characterised by falling housing prices, slowing mortgage growth and regulatory and political concerns as well as margin pressures in retail banking.

Investors will have to be patient despite the attractive valuations, the broker advises. While the market is now pricing in a slight chance of a cut to the Reserve Bank of Australia's cash rate by the end of 2019, Ord Minnett suspects, given employment growth, this is overly pessimistic.

The broker's preferences lie with ANZ Bank ((ANZ)) and National Australia Bank ((NAB)), as greater exposure to business loans offers margin resilience. Macquarie Group ((MQG)), is also favoured, given the potential upside for short-term earnings, and assuming markets do not deteriorate further. Th least preferred stock is Bendigo & Adelaide Bank ((BEN)) as the valuation appears unattractive and there is a low return on equity.

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