

Week  
**30**

# Stories To Read From FNArena

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## Slump Ahead For Oz Dwelling Construction

A steep fall in residential dwelling commencements over the next two years is likely to overshadow the more modest increase in non-residential construction, a report from BIS Oxford Economics suggests.

-Fall in residential building commencements to accelerate sharply -Most severe declines in prices expected in medium-high-density where investor demand was concentrated -Non-residential building activity likely to remain at a high base until 2021/22

By Eva Brocklehurst

The boom in Australian building approvals may be over, with a resultant headache for the broader economy looming. BIS Oxford Economics expects the steep fall in dwelling commencements that is likely over the next two years will overshadow any increase in non-residential building and reduce the total value of building starts by -10%.

In the researcher's Building In Australia 2018-2033 report other investment drivers are slated as necessary for economic growth and employment. The downturn in residential building commencements is expected to accelerate sharply and fall -50% over the next two years, sparked by investor-driven apartments. Investor demand is weakening in the face of tougher lending criteria and increased charges on foreign buyers.

Falling demand and rising supply are leading to lower house prices and this reduces the attractiveness of housing as an investment. The most severe declines in prices are expected to be where there is a high concentration of investor demand, such as medium-high density dwellings.

While the retreat by investors has opened up opportunities for first home buyers and those upgrading or downsizing, strong growth in land prices is likely to constrain housing commencements, the report suggests. This is likely to act as a disincentive for new house building and pull buyers towards the established dwelling market.

### Population Growth Supportive

Much of the decline in new residential construction will be in the eastern states and, overall, national dwelling starts are still expected to remain at levels greater than any year prior to 2014, supported by sustained population growth and improving economic conditions.

The states and territories that experienced the greatest increases in recent years are expected to sustain the largest corrections in total dwelling starts. NSW dwelling starts are expected to decrease -26% over the next two years, Victoria -29%, Queensland -15% and the ACT -27%.

The analysis suggests only Western Australia and Queensland are experiencing a significant net oversupply of dwellings stock at a state level. Stock deficiencies are expected to start rising nationally again from 2019/20 and a renewed upswing in residential building commencements is expected in the early to mid 2020s.

However, BIS Oxford associate director, Adrian Hart, warns a deeper downturn could be experienced before then - and a delayed recovery - if fundamental drivers of residential activity such as net overseas migration or investor demand were to dissipate substantially.

### Non-Residential Building

The value of non-residential building commencements is likely to rise a further 5% over the next two years following cumulative increases of 51% over the past three years. NSW and Victoria are driving much of this boom.

Office buildings stand out, with the report noting 11 projects valued at or above \$250m have commenced construction. This is supported by a number of prison and defence projects as well as other social and institutional building. Activity in these markets should remain at relatively high levels for the next few years and there are also higher levels of commencements forecast for health, transport, entertainment, retail and accommodation.

BIS Oxford anticipates non-residential activity will remain near this high base until 2021/22 as economic conditions remain firm and there are large-scale transport infrastructure projects that generate flows for investment.

While increasing non-residential building activity will help offset the fall in residential work, much of the sharp increase has been driven in recent years by the private sector, although government sponsored projects across health, education, defence and entertainment are coming to the fore.

The report advises that, in this environment, it is important not to repeat the past mistake of pushing through a large volume of publicly-funded works in already heated local markets that will strain capacity and, ultimately, value for money, and calls for governments to look for ways to smooth the cycle while also satisfying long-term growth and the provision of services.

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## A-REITs Becoming Less Compelling

Global bond yields remain an important driver of the relative performance of A-REITs, yet brokers suggest the sector has become less compelling following its recent rally.

-Distribution yield spread to bond yields now less attractive -Demand for R/E assets supports strong growth in managers' FUM -Citi suggests selling the retail rally

By Eva Brocklehurst

Australian Real Estate Investment Trusts (A-REITs) have rallied strongly over recent months and brokers suggest there is now less value in the sector. Macquarie moves its sector stance to Neutral but remains encouraged by the returns on A-REITs of 7.7% since January, ahead of the broader market and because of the rally in global bonds.

Global bond yields remain an important driver of relative performance for A-REITs. Risk still exists for higher bond yields but the broker forecasts the trajectory to be lower, with 3.1% expected by the end of 2019 versus spot yields at 2.6%. Moreover, the distribution yield spread to bonds of A-REITs is less compelling now. The sector yield has fallen around -60 basis points since March, to 4.9%, Macquarie calculates.

Other valuation metrics are also looking less attractive to the broker. On the other hand, direct market transaction activity has been strong for quality products, and asset sales have still achieved premiums to book value. This should support growth in assets over the reporting season.

Morgan Stanley observes demand for real estate assets has supported strong growth in Funds Under Management for those managers that derive 10-60% of earnings from fees. Structural demand for real estate could also mean less volatile active earnings going forward for those with a low proportion of performance fees.

The broker singles out Lend Lease ((LLC)), where the investment management business currently accounts for 20% of the broker's price target of \$18.65. Holding other components constant, Morgan Stanley calculates a 12.7x implied valuation for Lend Lease investment management at the current share price.

This compares with 21.6x for Goodman Group ((GMG)) and 13.4x for Charter Hall ((CHC)). The broker suggests the visibility provided by the Lend Lease development pipeline may provide the next phase of the stock's re-rating.

Macquarie upgrades its target for Lend Lease by 20% to \$22.00, factoring in greater confidence in profits from recycling capital as well as investment earnings. Macquarie increases the target for Charter Hall by 12% to \$7.00 to reflect enhanced confidence in performance fees.

Citi retains among its top picks the fund managers Lend Lease, Charter Hall and Goodman Group and envisages further upside to share prices for all three. Each benefits from ongoing demand to invest in property, driving growth in FUM and expanding margins.

### Strong Growth, M&A

Macquarie expects the sector's growth rate to improve to around 6.5% in FY18 after a relatively weak FY17 because of dilutive asset sales. This compares with the industrials sector expectations of around 1.4% growth in FY18.

Nevertheless, the broker believes the outlook in FY19 for industrials has improved to 13.4% after years of negative revisions post the GFC. Macquarie prefers those A-REITs that are genuinely growing earnings and believes Mirvac ((MGR)) and Unibail Rodamco Westfield ((URW)) offer the best value.

M&A is also likely to feature, and Macquarie suspects those stocks trading at the smallest premiums or largest discounts to net tangible assets will be most susceptible. A significant dislocation in share prices could result in further M&A. The broker contemplates a dislocation in pricing for Mirvac, Stockland ((SGP)) and GPT Group ((GPT)) that may result in the breaking up of these diversified names.

### Office Vs Retail

Office is the key A-REITs segment for brokers, while retail remains tough and residential is slowing. Citi expects office-exposed A-REITs will outperform those exposed to retail, as Sydney office rents are upwardly revised because of supply delays.

Mirvac, Macquarie highlights, has a solid near-term earnings profile and its exposure to office markets underscores its strength. Citi agrees, and suspects Mirvac's FY19 guidance could surprise on the upside, which may drive a near-term rally. The broker remains bullish on the office, industrial and funds management exposures of Goodman Group, Charter Hall, Dexus Property ((DXS)) and GPT.

Citi acknowledges the potential support provided by net asset valuations in the retail segment but envisages risks to this view, given the growing stock of shopping centres that are on the market.

The broker downgrades Scentre Group ((SCG)) to Sell, acknowledging this is a non-consensus call but believing structural headwinds indicate subdued rental growth beyond FY20. Macquarie also downgrades Scentre Group to Neutral from Outperform post the rally.

Moreover, there is potential for a drop in house prices to weigh on tenant sales and the stock's multiple, particularly given its 58% exposure to Sydney, Citi asserts. The broker also downgrades Shopping Centres of Australasia ((SCP)) and Charter Hall Retail ((CQR)) to Sell.

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## Is Northern Star Fully Valued?

Northern Star delivered a robust June quarter for gold production, setting records. However, brokers disagree as to whether the stock is fully valued.

-Significant effort to extend reserves at Jundee -Capacity to generate over 700,000 ozs per annum -Stock now trading in line with global gold producers

By Eva Brocklehurst

Northern Star ((NST)) is intensifying its development and exploration expenditure after breaking records for gold production in the June quarter. The company has set a \$60m exploration budget for FY19 that is 33% above the prior year.

A further \$74m is slated for ancillary growth projects, such as a dual purpose decline development and increased Kanowna Belle tailings capacity. Northern Star is making a significant effort to extend reserves at Jundee, utilising ten diamond drilling rigs and targeting a number of the deeper areas of the mine.

The planned expenditure bodes well for continued growth in resources and reserves going forward and Canaccord Genuity considers the investment, in the absence of accretive M&A, a pragmatic approach to growing the scale of operations.

Brokers remain of the view that the company's mill in Kalgoorlie will be constrained and third-party processing capacity will be needed until further opportunities to acquire another mill become available. Macquarie also believes FY19 guidance could be conservative, noting the company is still considering the potential for mining at HBJ and guidance could be upgraded post completion of the review.

Credit Suisse was disappointed with FY19 guidance, which implies the 1.2mtpa Jubilee capacity may only contribute an additional 20-40,000 ounces. The broker suspects a step reduction in grade is likely, and also believes that the June quarter grade, production and cash were exceptional rather than sustainable.

### Production Outlook

June quarter production stood out, with the company delivering 184,000 ounces at an all-in sustaining cost (AISC) of \$982/oz. A strong production outcome was driven by increased mining and milling rates at Jundee and higher grades at the Kalgoorlie operations.

Net cash increased to \$512m and milled tonnage rose by 34%, largely from the integration of South Kalgoorlie capacity. FY19 production guidance is forecast at 600-640,000 ounces at AISC of \$1025-1125/oz.

Argonaut believes the company has a strong capacity to generate over 700,000 ounces per annum in the short term via existing capacity and toll treatment, or with M&A. Canaccord Genuity expects some normalising in the grade profile and lower quarter on quarter production going into FY19 but agrees there is scope for the company to grow annualised production beyond 700,000 ozs per annum.

The FY19 exploration program is likely to lead to further growth in production, Macquarie concurs, factoring in higher rates of utilisation at the Jubilee mill as well as higher mining rates at Jundee. The broker also adds two years of mine life to assumptions for Jundee and Kalgoorlie.

UBS observes the production result proves the infrastructure is capable, albeit a full year of mining rates/grade has not been sustained. Still, it highlights the sprint capacity that can be achieved, although this will require more in the form of reserves.

A lift in the six-year mine life and reserves could form the next catalyst although UBS, while retaining estimates for 692,000 ounces in FY19, acknowledges the production outcome will likely come down to grade.

### Valuation

Canaccord Genuity notes the company has the strongest balance sheet of its peer group with net cash of \$512m at the end of FY18. The broker not one of the eight monitored daily on the FNArena database, maintains a Hold rating as the stock is considered fairly valued. Target is \$7.10.

Also not one of the eight, Argonaut has a Hold rating and \$6.34 target. The broker assesses the enterprise value/production is now in line with North American producers and the stock is now trading in line with large global gold producers, such as Newcrest ((NCM)) and Gold Corp.

UBS calculates an extra year is worth around \$0.40 per share, and the company has in the past envisaged the possibility of more than 10 years of production at Jundee. A mine life of over 10 years would more than justify its price target, UBS asserts. Hence, a Buy rating.

Citi sticks with a Neutral rating because of the strong share price performance. The company has a lot of levers to pull on costs, in terms of sourcing its ore, and the broker assumes it will not lose margin by milling higher cost ounces.

Ord Minnett downgrades to Lighten from Hold, citing a declining gold price and recent outperformance in the stock. The broker recognises the significant value the company has been able to create by expanding existing operating assets, and the potential catalyst from a resources and reserves update.

There was no news on Paulsens, which ceased production in December, and it failed to deliver on six-month production guidance. Management has confirmed stopes, development and stockpiles have been left in position for a rapid re-start for when, and if, drilling would successfully contribute to mineable inventory.

The database has two Sell ratings, two Hold and one Buy (UBS). The consensus target is \$6.74, signalling -2.5% downside to the last share price. Targets range from \$5.20 (Credit Suisse) to \$7.50 (Macquarie, UBS).

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## Drought Casts A Pall Over Nufarm Earnings

Drought, increased inventory in the channel and a delay in product approval have caused Nufarm to sharply downgrade FY18 guidance and the issues are expected to linger into FY19.

-Increased competition and high inventories signal margin pressure -Headwinds largely seasonal so is this an entry opportunity? -Omega-3 considered a long-term driver of the business

By Eva Brocklehurst

The inevitable consequences of the prevailing drought in Australia have caught up with Nufarm ((NUF)), which has heavily downgraded FY18 guidance. Moreover, after a poor winter cropping season the Bureau of Meteorology is currently forecasting a dry spring.

As a result the company expects low levels of demand in the Australian market may also impact FY19 earnings. Nufarm company has lowered FY18 operating earnings (EBIT) guidance to \$255-270m.

The reduction to guidance was not completely unexpected by brokers, given recent downgrades by others in the sector, but it was worse than forecast. Morgans notes, while Nufarm usually benefits from geographic diversity, setbacks in Europe and adverse currency movement in Latin America have also had an impact.

The earnings downgrade, down around -16% at the low end of the range versus FY17, is attributed not only to the dry conditions in Australia but a lack of derogation from French authorities for the company's neonicotinoid seed product. While, typically, seasonal conditions are confined to the period in question, the extent of the dryness has also elevated inventory, creating another headwind.

One of Australia's driest autumns in almost 100 years has led to a poor winter crop and crop protection markets are down around -10-20%. Consequently, increased competition and high inventory levels have resulted in significant margin pressures.

The quantum of the downgrade was more than expected and, contrary to the rest of the brokers on the FNArena database, Deutsche Bank sticks with a Sell rating. Nufarm has guided to a \$200-300m increase in working capital requirements and the broker calculates net debt will be around \$1.35bn in FY19, with 2.5x net leverage. FY18 estimates are reduced by -30% and FY19 by -18%.

The impact on FY18 guidance was worse than Citi expected and high channel inventories are now likely to hit FY19. Nevertheless, the share price is observed to have more than captured the reduction in earnings potential, while investors are getting the Australasian and Omega-3 businesses for free. Hence, the broker reiterates a Buy rating.

Morgan Stanley's FY19 estimates are downgraded by -11%, taking on board the weakness in the Brazilian real against the Australian dollar as well, which will affect the translation of Latin American earnings. Still, the share price has declined -21% over the last two months as the seasonal issues became increasingly apparent.

Hence, Morgan Stanley estimates the retracement is broadly consistent with downgrades to FY18 net profit and, while recovery will take some time, still forecasts around 40% growth in operating earnings in FY19. The broker believes the share price undervalues the base business, let alone the upside from Omega-3 and an Overweight rating is maintained.

Credit Suisse also maintains a Outperform rating, believing the company is well-positioned to benefit from expansion of its footprint in North America and the recent acquisitions in the European portfolio. The broker's FY19 Australasian forecasts includes a partial recovery of the impact of the poor winter crop conditions and a full recovery for Australasian contributions to earnings by FY20.

Credit Suisse acknowledges the elevated inventory in the shift to lower-margin products in the second half of FY18 will reduce the likelihood of a complete recovery in Australasian earnings in FY19. Macquarie also suggests a two-year recovery path in Australia and lowers its FY18 estimates consistent with guidance.

### Neonicotinoid Ban

The French government is yet to grant approval of the company's application for the use of its Nuprid 600 seed treatment. Hence, Nufarm will likely miss the grower application window for the season and has signalled a risk to earnings to the tune of around -\$12m in FY18.



The European Commission has banned the use of neonicotinoids (insecticide) for indoor uses and Nufarm is seeking a declaration in France to enable the use of substitute products. Citi expects, in FY19, gross margins of around -\$15m are at risk, although the company's Century substitute may provide an offset.

Credit Suisse assumes the loss associated with the Nuprid 600 product is recovered over FY19 and FY20 by sales of substitutes through the European operations.

Ord Minnett believes Omega-3 is a long-term driver of the business and the headwinds currently battering the company are seasonal, not structural. Although risks remain, the recent share price declines suggests an entry opportunity.

Additional US approvals for Omega-3 are expected in the first quarter of FY19 and an earnings contribution is slated from 2021. Omega-3 canola has secured regulatory approval in Australia and is on track for commercialisation in 2019.

#### Heightened Competition

Bell Potter envisages heightened competition in agricultural chemicals in FY19-20, as Elders ((ELD)) has acquired Titan Ag with a desire to lift its internal sourcing of such products.

At its May briefing, Nufarm suggested this could have an impact on gross profit of -\$10-15m in FY19. The broker's forecasts assume that some of the void is filled by Nufarm products within the recently-acquired European portfolio.

Bell Potter, not one of the eight stockbrokers monitored daily on the database, expects the company to return to a period of growth in FY19-21m, as recent acquisitions are consolidated and the investment in Omega-3 begins to contribute. However, in the near term the structural change in Australian industry is likely to drive a step down in returns and the broker maintains a Hold rating. Target is \$8.30.

Traditionally, Morgans suggests the best time to buy agricultural stocks is during a drought. The broker believes the stock has been oversold but, given the lingering issues into FY19 and the fact Nufarm has a lot to prove, any re-rating is expected to take time.

FNArena's database shows six Buy ratings and one Sell (Deutsche Bank). The consensus target is \$9.01, suggesting 22.4% upside to the last share price. Targets range from \$6.75 (Deutsche Bank) to \$10.65 (Morgan Stanley).

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## Will Wesfarmers Be Stronger Without Coles?

Wesfarmers is planning to retain a 15% minority stake in Coles and 50% stake in Flybuys, ensuring the two companies are aligned in terms of digital, data and loyalty programs.

-Will Wesfarmers be a stronger business without Coles? -New Wesfarmers may be more affected by a slowing housing cycle -Coles may need to fund part of its dividend with debt to meet targets

By Eva Brocklehurst

Wesfarmers ((WES)) has reiterated its reasoning behind the proposed de-merger of Coles and has crunched more numbers, with the timetable for completing the process set for the end of November.

Shareholders will receive one Coles share for every Wesfarmers share. The company plans to retain a 15% minority stake in Coles and a 50% stake in Flybuys. This should support the alignment between the two in relation to growth initiatives in digital, data and loyalty programs.

Given the significance of these initiatives to the broader business, Morgans suspects Wesfarmers will retain its strategic holding in Coles for the longer term. By de-merging Coles, management can focus on deploying capital to better-returning businesses and free capacity to make value-accretive acquisitions.

The broker continues to believe de-merging Coles is the right move as it generates only 9% of returns on capital but consumes around 60% of capital employed by Wesfarmers. This is well below Bunnings Australasia (47%), department stores (26%), Officeworks (16%) and industrial (18%).

Wesfarmers has also announced a number of board appointments including James Graham as chairman. Coles is expected to have a dividend pay-out ratio of 80-90%, in line with Wesfarmers' current policy.

Morgans believes Wesfarmers without Coles will be a stronger business, given a bearish view on the long-term outlook for supermarkets. Yet UBS believes the outlook for Wesfarmers is challenging too, as Bunnings is affected by the weaker housing backdrop and there are consumer headwinds plaguing Kmart and Target. There is also new supply in the Western Australian ammonium nitrate market that affects the company's industrials division.

A potential catalyst, UBS asserts, is a capital management announcement at the FY18 result, due August 15. However, Citi suggests the prospects of capital management for Wesfarmers are only modest, with only 1% accretion to earnings per share from a potential buyback.

Cash conversion is likely to moderate without Coles, Ord Minnett expects, and there is a lack of valuation support for Wesfarmers. The broker finds the risk/reward no longer compelling and maintains a Lighten recommendation.

Shaw and Partners also cites speculation that the new Wesfarmers, with Bunnings taking up more than 50%, will be more affected by the slowing housing cycle, although this has always been a risk and managed well to date.

The broker, not one of the eight stockbrokers monitored daily on the FNArena database, considers Wesfarmers fairly valued with minimal growth in earnings over the next few years, and maintains a Hold rating and \$46.25 target.

The most urgent question for Shaw and Partners is how Coles will fare in the face of a resurgent Woolworths ((WOW)), which is expected to maintain its lead for at least the next two quarters, along with increased competition.

On a more positive note for Coles, UBS observes recent trading has improved, based on its supplier survey. The outlook for inflation is also improving. Nevertheless, the broker suspects significant investment is needed in the supply chain and the stores. Cash conversion could fall below 100% if inventory needs to increase.

There is also some uncertainty over the future strategy, given the new CEO Steven Cain is yet to start. While the top line appears to be improving UBS expects incremental return on invested capital will be well below that of the past 10 years.

### Valuation

There was nothing in the detail that changes Morgans' view. As a stand-alone entity Coles is valued on an EV basis of \$17.6bn based on a 12x FY19 EV/EBIT multiple and in line with global supermarket peers.

Deutsche Bank values Coles at around \$20.3bn, implying a share price of \$13.90, a 9.1x EV/EBITDA ratio and an FY19 PE of 18.2x, which indicates an -11% discount to Woolworths (adjusted for petrol). The broker expects the new Wesfarmers will trade on an FY19 PE of 18.6x and a share price of \$35.50, including its 15% stake in Coles.

### Gearing

Deutsche Bank is pleased that Coles will neither be over, nor under, geared and its net debt does not provide room for substantial investment price, which should make for a rational industry. Coles will also have operating lease commitments of around \$9.6bn with a weighted average lease expiry of around 6.5 years.

Citi agrees the decision to have a more prudent level of debt in Coles is welcome and a higher dividend pay-out signals rational behaviour as a stand-alone entity. Nonetheless, the broker suggests Coles may need to ramp up capital expenditure and fund part of its dividend with debt in order to meet its targets.

Coles will have some capacity to invest in refurbishments, small format stores, service and other areas to drive growth in earnings but Citi suspects it will be unlikely to organically fund expenditure and dividends in FY19.

Debt levels are in line with Ord Minnett's expectations and considered prudent, given there is only modest earnings growth on offer, although free cash to fund the dividend is acknowledged to be tight. The broker considers the de-merger a positive for industry competition.

The database shows four Hold ratings and three Sell for Wesfarmers. The consensus target is \$44.88, suggesting -9.1% downside to the last share price. Targets range from \$42.00 (Morgan Stanley) to \$47.34 (Morgans).

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## Iluka Enjoying Strong Pricing Trend In 2018

Strong sales volumes for Iluka's mineral sands in the first half amid forecasts for robust pricing and tight supply over 2018 have impressed brokers.

-Contracted prices for rutile lift 14% for the second half -Further upside to realised zircon prices expected -Demand running well ahead of supply over 2018

By Eva Brocklehurst

Iluka Resources ((ILU)) is enjoying a strong trend in selling prices. The June quarter demonstrated the benefit of higher prices and an unwinding of working capital as cash was built up. Sales of 439,000t for zircon, rutile and synthetic rutile in the first half exceeded most estimates.

The company is almost back to a net cash position less than two years after the debt-funded acquisition of Sierra Rutile. First half revenue was up 21% despite lower sales volumes and adverse currency rates, which suggests to Shaw and Partners that the underlying commodity price trend is favourable.

Zircon prices are up 47% from the first half of 2017 and rutile up 20%. Contracted prices for rutile in the second half of 2018 have increased 14% and zircon markets remain tight. The company has implemented an increase in the zircon reference price to US\$1410/t.

Credit Suisse was impressed with the the sales volumes in the first half and a lift in rutile pricing for the second half is expected to ensure the company's natural rutile prices rise to US\$1033/t.

In addition, the broker expects further upside to realised pricing in the second half when the company begins a new contract period for zircon and forecasts Iluka to lift the benchmark price to a conservative US\$1650/t.

The broker estimates 21% EPS growth in FY18, to reflect higher forecast sales volumes in conjunction with higher prices, and changes to FY19 estimates and beyond predominantly reflect revised pricing.

Nevertheless, the higher prices are starting to bring on more supply and Indonesia's monthly rates are up around 80%. Iluka estimates Indonesian exports have increased to 4400t per month. Higher prices have been accepted by end users with no evidence of substitution, Shaw and Partners observes, although thrifting has become more common in the ceramics and foundry industries.

Production of zircon, rutile and synthetic rutile was in line with Citi's estimates. Compositionally, zircon was better and offset lower rutile production, which was beset by issues with the Sierra Rutile dredge and finalising commissioning of the Lanti dry mining unit. Overall, production guidance of 690,000t for 2018 appears conservative to Citi.

### Titanium Feedstocks

Meanwhile, the company is experiencing strong demand for its high-grade titanium feedstocks and sales are being limited by production outages. Disruptions for other high-grade titanium feedstock producers have affected confidence, Shaw and Partners notes, but are yet to be translated into shortages down the value chain.

All second half high-grade feedstock is either under contract or allocated to customers with supply requests. Morgan Stanley points to some commentary which signals the rate of increase in pigment demand is moderating but notes that China recently announced price increases of US\$60-80/t.

### Demand

Demand is running well ahead of supply and mineral sands inventory, which is rapidly depleting, is largely in the domain of Iluka. Shaw and Partners believes this price and demand cycle should continue into 2019.

This environment should afford Iluka the opportunity to liquidate all its inventory, and be reflected in favourable free cash flow. The broker, not one of the eight monitored daily on the FNArena database, has a Buy rating and \$13 target.

Credit Suisse believes further positive price momentum should play out in both zircon and the high-grade titanium dioxide markets throughout 2018 and into 2019 because of the favourable supply/demand dynamics. Iluka remains the broker's key large cap mineral sands exposure in the Australian market.

FNArena's database shows four Buy ratings and one Hold (Macquarie). The consensus target is \$12.74, signalling 10.8% upside to the last share price.

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## Price War Looming For Wealth Platforms?

Is a price war looming for wealth management? Several brokers contemplate the outlook, as Westpac's BT Financial slashes fees on its Panorama platform.

-May ultimately translate into lower profitability -Aims to limit leakage to Netwealth and HUB24 -Uncertainty likely to limit sector performance in near term

By Eva Brocklehurst

Wealth manager platform fees appear under pressure. Westpac's ((WBC)) BT Panorama has reduced its platform pricing structure and others are expected to follow suit.

There is uncertainty regarding regulatory and political intervention in the wealth industry which is undermining confidence as banks are de-merging their wealth assets and industry funds are merging.

Vertical integration is likely to continue and planners progressively rebate commissions, while cross-subsidising is reduced, and Morgan Stanley suspects the current situation presents an opportunity to find value. Value will continue to move upstream and the importance of scale increase.

UBS is not surprised that with specialty providers increasing their share of retail wealth flows, major institutions have responded with tighter pricing. The broker envisages rising risks to platform fees, particularly if grandfathered commissions are abolished.

BT Panorama's price reductions are most effective at larger account balances, with those administration fees for balances over \$1m falling by -40% or more. Fees will now be capped at \$2040 per annum for these balances, versus a previously uncapped fee schedule.

UBS points out, BT Panorama is not necessarily breaking new ground on prices but is the first to deliver full functionality at this price point. A 20 basis points fee at \$1m is becoming the new norm, the broker suspects, as AMP's ((AMP)) North platform is already at 21, Macquarie's Wrap at 22 and MLC Wrap at 24 basis points.

Morgan Stanley believes the new platform fee structure at BT aims to limit leakage to Netwealth ((NWL)) and HUB24 ((HUB)) and break down the dealer group economics of the large advice networks that are white-labelling BT Financial.

Given the material investment that has been made in the Panorama platform, this appears to Macquarie to be a push for market share and presents some near-term risk for the margin forecasts for IOOF ((IFL)) and AMP.

Macquarie factors in -2-3 basis points of margin declines over the medium term. The broker notes Westpac remains committed to the wealth management space and, while its offering is superior to incumbent peers this is yet to translate into superior results.

### Market Share At What Cost?

Westpac needs to deliver stronger revenue growth and better performance on costs to justify its investment, Macquarie asserts. The reduction in platform fees will arguably improve its ability to retain and grow funds under management but it has come at the cost of around -\$50m in earnings per annum. The broker suggests, should the industry follow suit, it may ultimately translate into lower profitability.

Recently the major banks have generally underperformed contemporary platforms, as operators such as Netwealth and HUB24 delivered strong flows and grew market share rapidly. If current trends persist, Macquarie suspects the position of the majors may become marginalised.

Westpac's historical outperformance relative to peers has decreased and this may be a function of integration issues, in the broker's view, with a loss of momentum as resources were diverted to building a new platform.

### Uncertainty Prevails

Macquarie observes both AMP and IOOF are trading at a significant discount to their 5-year average relative to the market, given the risks associated with the Royal Commission and proposals for fee caps on low balance accounts. The broker prefers IOOF over AMP because of the "open architecture" model but realises uncertainty will limit the performance of the sector in the near term.

Morgan Stanley considers IOOF has some options to deal with the threat of a price war, although its Lonsdale dealer group is most exposed. Meanwhile, AMP's self-employed planners are considered its best defence.

The broker also believes the market remains too bullish on Challenger Group's ((CGF)) MyRetirement opportunity and sales momentum in the near term may be disappointing. There is slower-than-expected take-up on the AMP platform and potential delays in the rolling out of the BT platform solution. Challenger's sales in Japan are also weakening and pension test changes overhang lifetime annuity sales.

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## Domain Is The Prize In Nine-Fairfax Merger

Domain's real estate portal is the prize in Nine Entertainment's bid for Fairfax but does the merger deal provide value for Nine shareholders?

-Takes advantage of Nine's elevated valuation to acquire control of a high-growth asset -Synergies to come from combining old media assets -Yet main justification for the merger is the investment in new media

By Eva Brocklehurst

The highly-anticipated merger proposal between Nine Entertainment ((NEC)) and Fairfax Media ((FXJ)) is now on the table, which comes somewhat belatedly, brokers suggest, after the removal of regulatory restrictions last October.

Does the combination make for a bigger media company? Unequivocally yes, Morgan Stanley asserts. Whether it makes the combined business a better media company is also possible, as the broker notes scale is increasingly important and there are both cost reductions and synergies available across a number of assets.

Morgan Stanley is positive about the merger, at least for Fairfax shareholders, as it goes part way to recognising the strategic value of certain assets, in particular the 60%-owned Domain Group ((DHG)) real estate portal.

Domain is the quarry, not newspapers, Citi agrees, as it makes up 62% of its current Fairfax valuation. The transaction takes advantage of Nine's elevated valuation to acquire a controlling stake in a high-growth asset, while the rationale of combining TV and newspaper assets is secondary.

Nine appears to believe a combination with a TV network will boost Domain's growth rates. Domain will still need to pay for advertising and Citi does not expect Nine to provide a discount. Domain was spun out of Fairfax in order to realise the value of the asset and it is unclear to the broker if this same incentive exists for Nine.

The main issue for UBS is the cost synergies and how conservative the estimate of "at least" \$50m is likely to be. Also, what of the longer-dated revenue synergies? Assuming \$50m of synergies, the broker estimates the uplift to EPS for Nine could be around 5% in FY20 and 14% in FY21. Based on the broker's existing FY19 forecasts the proposed merger would create an entity that generates pro forma revenue/EBITDA of \$3.01bn/\$590m.

Synergies are expected to come from combining old media assets and removing the overlap between the Nine newsroom and the Fairfax Metro journalism unit, yet the main justification for the transaction is actually the investment in new media, Citi suggests. This includes Domain, Nine's digital division and STAN, which are likely to be the key growth drivers in the future.

The risk for Fairfax shareholders, Citi believes, is that Nine's share price is implying continued strong performance in TV advertising markets. The broker continues to believe current growth in TV advertising is cyclical rather than structural. The risk centres on any further decline in the Nine share price, which could necessitate the deal terms being improved in order to gain Fairfax shareholder acceptance.

The main debate for Morgan Stanley is whether it creates substantial value for Nine shareholders. Compared with hypothetical scenarios explored in prior research, which were significantly more accretive, the main difference appears to be a 22% premium for Fairfax shares versus Morgan Stanley's scenario of nil, and the cost reduction target being much lower than theorised.

Moreover, Nine will acquire all Fairfax assets versus the broker's scenario of cherry picking Domain, STAN, Macquarie Radio and metro media/digital sites. In sum, to justify the premium and create value, Morgan Stanley expects Nine will have to deliver higher cost reductions, higher revenue growth and exit some of the non-core Fairfax assets.

Counter Bids?

In terms of potential counter bids UBS envisages two types: an industry bid such as Seven West Media ((SWM)) or a private equity bid for Fairfax. Importantly, the Nine bid is virtually all scrip and thus, if Nine shares trade materially lower, the attraction of the deal to Fairfax shareholders fades. This is also a key question for Morgan Stanley: whether the premium for control is sufficiently large enough to succeed.

Citi suggests Seven West would be able to generate similar cost synergies and is most likely the source of a competing bid. Nevertheless, this would be challenging given Seven West's higher debt levels and lower market



capitalisation. For Seven West to submit a bid with a similar ownership structure - 51.1% of the group - the broker estimates it would need to raise almost \$1bn in debt to beat the Nine offer by 5%.

The likelihood of ACCC intervention is low. UBS expects the ACCC will take a fairly broad view of the market and consider the remaining diversity of news operators to be sufficient. Citi concurs as the companies have very little overlap and both are relatively small parts of the overall advertising industry.

#### Transaction

Fairfax shareholders will receive 0.3627 Nine shares for every Fairfax share held along with cash consideration of 2.5c per share. The offer implies a valuation of 93.9c per share for Fairfax, a 22% premium to the prior close. Nine will need to issue around 834m new shares. The transaction is subject to shareholder approval, court approval and no regulatory objections. It is expected to be completed before the end of 2018.

FNArena's database shows two Buy ratings and three Hold for Fairfax, with an \$0.86 target that suggests 4.4% upside to the last share price. There are three Buy ratings, two Hold and one Sell (Citi) for Nine Entertainment, with a target of \$2.22, signalling 0.3% upside to the last share price.

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## Weekly Ratings, Targets, Forecast Changes

By Rudi Filapek-Vandyck, Editor FNArena

### Guide:

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

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

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

### Summary

Period: Monday July 16 to Friday July 20, 2018 Total Upgrades: 16 Total Downgrades: 11 Net Ratings Breakdown: Buy 44.91%; Hold 39.70%; Sell 15.39%

It's not all about resources stocks in the Australian share market, but miners, energy producers and their service providers certainly remain the centre of attention among stockbroking analysts. For the week ending Friday, 20th July 2018, FNArena registered 16 upgrades for ASX-listed entities versus eleven downgrades, and many of these changes have been inspired by commodity prices and capex intentions.

Cimic Group (interim result report) and Senex Energy were the two sole recipients of rating upgrades, with fresh Buy ratings also arriving for Alumina Ltd, Fortescue Metals and Oz Minerals.

On the flipside, only three downgrades moved to Sell with Cabcharge, Freedom Foods and Northern Star the unlucky receivers.

Total ratings for the eight stockbrokers monitored remain heavily in favour of Buy ratings, currently representing 44.91% of all recommendations, alongside 39.70% Hold/Neutral ratings and 15.39% Sells. Historically, this would suggest a tough time for the share market, but in the present context it is more of an indication the local share market is heavily polarised; something every value investor can confirm.

Target prices retain a skew to the upside, with Fairfax Media receiving the largest increase for the week (+5.99%), followed by Northern Star, Western Areas and St Barbara.

Any negative adjustments remain rather benign, with only Spark Infrastructure, Perseus Mining and APN Outdoor worth mentioning.

It's a different picture for earnings estimates because companies such as Asaleo Care are issuing profit warnings. On the positive side, Senex Energy and Northern Star share the lead in a list that mostly contains of resources stocks.

On the flipside, gold miner Perseus Mining has managed to beat the -45.60% downgrade for Asaleo Care, with Alumina Ltd, Galaxy Resources and Ramsay Health Care following at respectable distance.

Preparations for the August reporting season are in full swing with GUD Holdings, Macquarie Group (AGM) and CYBG providing initial indications this week, alongside ongoing releases of quarterly production reports.

### Upgrade

AINSWORTH GAME TECHNOLOGY LIMITED ((AGI)) Upgrade to Neutral from Underperform by Macquarie .B/H/S: 0/1/1

Ainsworth has upgraded FY18 guidance by 8% thanks to increased sales to Churchill Downs in Kentucky. Further increases are possible in FY19, the broker notes, given Churchill Downs has the capacity to add 1100 more units and Ainsworth is sole supplier so far.

But the broker remains concerned about underperforming new game releases and in balancing out the positives and negatives, upgrades to Neutral from Underperform, despite the stock having underperformed the ASX300 by -49% since its May profit warning. Target rises to \$1.10 from 95c.

ALUMINA LIMITED ((AWC)) Upgrade to Outperform from Neutral by Credit Suisse .B/H/S: 3/1/1

Credit Suisse analysts are of the view that the way of least resistance for aluminium prices is south, but they also anticipate margins at JV AWAC are likely to hold up and the combination of these two factors leads to an upgrade in recommendation to Outperform from Neutral.

Note JV partner Alcoa is scheduled to report Q2 financial performance numbers on Wednesday this week, USA time. Target price gains 10c on increased estimates which pushes the price target to \$3.10.

Add-in a net dividend yield forecast of 9% in 2018 and the implied return from here is in excess of 17%. Current forecasts do imply this year will be the peak for a while to come in terms of profits and dividends.

CIMIC GROUP LIMITED ((CIM)) Upgrade to Outperform from Neutral by Credit Suisse and Upgrade to Accumulate from Hold by Ord Minnett .B/H/S: 3/2/1

First half net profit was up 12% and ahead of Credit Suisse estimates because of stronger margins. The company has reiterated 2018 net profit guidance of \$720-780m.

The broker notes work in hand is stable and management expects a further \$80bn of bidding opportunities during the year. The broker considers guidance is overly conservative and upgrades to Outperform from Neutral. Target is raised to \$47.50 from \$45.00.

First half net profit was ahead of forecasts. Ord Minnett increases EPS estimates by 3% for 2018 and 2% for 2019. The broker has previously argued that 2018 should be the strongest year of growth for east coast infrastructure-related stocks. With the mining business also growing strongly revenue accelerated in the June quarter.

The broker suspects management's growth estimates are conservative and assumes 12% net profit growth in the second half. Rating is upgraded to Accumulate from Hold. Target rises to \$48.90 from \$42.80.

EVOLUTION MINING LIMITED ((EVN)) Upgrade to Hold from Sell by Deutsche Bank .B/H/S: 1/5/2

Deutsche Bank has upgraded Evolution Mining to Hold from Sell, price target \$3.00 (was \$2.80).

FORTESCUE METALS GROUP LTD ((FMG)) Upgrade to Buy from Sell by Citi .B/H/S: 7/0/0

Fortescue plans to address widening discounts for lower grade ore by blending in ore from higher grade mines. Citi has increased its iron ore price forecasts and lowered its A\$ forecast with the net result being a target price increase to \$4.90 from \$4.00.

The broker does have a concern that bringing new mid-grade ore onto the market to replace lower grade shipments will actually widen the discount for the former and tighten the discount for the latter, but the target price increase is sufficient to trigger a rating upgrade to Buy from Sell.

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

After reviewing six long WALE real estate investment trusts Ord Minnett notes a total return of 16.3% has been delivered in FY18, outperforming the S&P/ASX 200 REIT index.

The broker upgrades Hotel Property Investments to Accumulate from Hold. The stock underperformed the other long WALE REITs in FY18 while offering a 6.6% dividend yield. Target is \$3.30.

MONADELPHOUS GROUP LIMITED ((MND)) Upgrade to Hold from Sell by Deutsche Bank .B/H/S: 1/4/1

Deutsche Bank has upgraded Monadelphous to Hold from Sell, with price target of \$13.30.

NAVITAS LIMITED ((NVT)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 1/4/1

The company has announced the rationalisation of its careers & industry division and will convert SAE Indonesia to a licensed operation and close two sub-scale SAE US colleges. The remaining six US colleges will be divested or closed because of ongoing regulatory constraints and underperformance.

With earnings re-based, Macquarie believes visibility over FY19 has improved and value is beginning to emerge. The broker upgrades to Outperform from Neutral. Target is reduced to \$4.55 from \$4.60.

OZ MINERALS LIMITED ((OZL)) Upgrade to Buy from Hold by Deutsche Bank .B/H/S: 4/2/0

Deutsche Bank has upgraded OZ Minerals to Buy from Hold while upping the price target to \$10.25 from \$9.10.

PRAEMIUM LIMITED ((PPS)) Upgrade to Add from Hold by Morgans .B/H/S: 1/0/0

Praemium reported strong June quarter inflows. Total funds on platform exceeded \$8bn for the first time while Australian funds on platform grew 45% to reach a new record of \$5.6bn.

The broker notes the company's separately managed account platform is considered one of the best platforms currently available.

Morgans rolls forward its base year and increases the valuation to \$1.07 from \$0.69. Rating is upgraded to Add from Hold.

**QBE INSURANCE GROUP LIMITED ((QBE)) Upgrade to Buy from Neutral by Citi .B/H/S: 5/3/0**

The upgrade to Buy from Neutral comes with a slightly higher price target -\$11.20 instead of \$11- as further analysis suggests to Citi analysts that only a reasonable performance in H1 should now suffice to pull the share price a lot higher.

Meanwhile, compositional changes have been made to forecasts resulting in yet more reductions. Despite the latter, the analysts keep on pointing out the valuation discount remains larger than historical averages.

**SOUTH32 LIMITED ((S32)) Upgrade to Buy from Neutral by Citi .B/H/S: 2/5/0**

Citi's upgrade to Buy from Neutral was inspired by higher forecasts for commodities prices. With EPS estimates receiving a boost, also from buybacks and the weakening AUD, the price target lifts to \$4.30 from \$3.80.

The analysts saw a rather mixed production report with thermal coal, aluminium and alumina all disappointing. Cost pressures are real too, in particular for the aluminium smelters.

In addition, with a projected US\$2.2bn in free cash flows, management should have plenty of options to please shareholders, suggest the analysts.

**SANTOS LIMITED ((STO)) Upgrade to Neutral from Sell by Citi .B/H/S: 1/3/2**

June quarter production was 7% above Citi's estimates. Citi observes the Cooper Basin is staging a revival, with a sustained period of reserves and production growth. This has led to an increase in valuation and near-term earnings forecasts.

The broker remains aware of the risks of over extending the expected growth in the Cooper Basin, as it has disappointed the market before, but no longer believes a Sell is the right call and upgrades to Neutral. Target is raised to \$6.04 from \$5.81.

**SENEX ENERGY LIMITED ((SXY)) Upgrade to Accumulate from Hold by Ord Minnett and Upgrade to Neutral from Sell by Citi .B/H/S: 4/3/0**

Ord Minnett marks to market oil price forecasts and increases its long-term Brent forecast to US\$60/bbl. The broker considers the sector fully valued and, for the most part, consensus has caught up with its estimates, which indicates the upgrade cycle may now be over.

The broker retains a preference for Senex Energy based on growth and value and upgrades its rating to Accumulate from Hold. Target is steady at \$0.46.

Beach Energy's ((BPT)) reserve upgrade for the Cooper Basin may have positive implications for Senex. Citi has increased its target to 45c from 40c, noting spot oil would imply 55c.

Citi sees the stock at fair value on its own long term forecast of US\$55/bbl, but concedes upside for those with a more positive view. Upgrade to Neutral from Sell.

Downgrade

**CABCHARGE AUSTRALIA LIMITED ((CAB)) Downgrade to Sell from Neutral by UBS .B/H/S: 0/1/1**

UBS analysis suggests momentum has slowed for Uber in both app downloads and share of taxi expenditure. However, Cabcharge only recorded a minimal uplift as a result, and the majority of the benefit appears to have gone to competitors.

The broker suspects the market does not fully appreciate the complexity of the earnings drivers. UBS suggests the stock is stretched and downgrades to Sell from Neutral. Target is raised to \$2.15 from \$1.65.

**COCA-COLA AMATIL LIMITED ((CCL)) Downgrade to Neutral from Buy by Citi .B/H/S: 2/4/1**

On the expectation that tougher times in Indonesia and PNG will lead to weaker sales and earnings, Citi has downgraded to Neutral from Buy. EPS estimates have been reduced by -0.5% and -1.4% for 2018/19.

As Indonesia is supposed to be the next growth engine for the company, the analysts (understandably) suggest investors awaiting a re-rating for the stock, will likely have to be more patient. Target loses -20c to \$9.50.

CHARTER HALL LONG WALE REIT ((CLW)) Downgrade to Hold from Accumulate by Ord Minnett .B/H/S: 0/2/1

Charter Hall LW will divest 50% of the ATO Building in Adelaide for \$135m to Charter Hall Direct Office Fund at book value. Ord Minnett considers this a good move as the transaction reduces risk and exposure to a relatively weak market, and frees up capital for another asset with a potentially higher risk-adjusted internal rate of return.

The main issue the broker has is that the asset was not put to market, as this raises the question regarding whether Charter Hall LW received full value for the property. Rating is downgraded to Hold from Accumulate on valuation grounds. Target is \$4.30.

FREEDOM FOODS GROUP LIMITED ((FNP)) Downgrade to Reduce from Hold by Morgans .B/H/S: 1/0/1

The company has downgraded FY18 sales forecasts by -7% and Morgans note this is now the fourth year in a row Freedom Foods has missed expectations. FY19 guidance is also lower. The broker believes consensus estimates are still too high and this may lead to further disappointment over time.

Whilst the company has a strong product portfolio, Morgans downgrades to Reduce from Hold on valuation grounds. Target is lowered to \$5.50 from \$5.90.

FAIRFAX MEDIA LIMITED ((FXJ)) Downgrade to Neutral from Buy by UBS .B/H/S: 3/3/0

Fairfax has finalised agreements with News Corp ((NWS)) to share printing networks. Fairfax estimates this will result in annualised cost savings of around \$15m. UBS suggests upside from further deals still exists but this is less straightforward and may involve additional capital expenditure considerations.

On an annualised basis, ex one-offs, the broker expects the deal to be around 8% accretive to EPS. With the stock price up 21% since February, the broker downgrades to Neutral from Buy on valuation grounds. Target is raised to \$0.80 from \$0.75.

NORTHERN STAR RESOURCES LTD ((NST)) Downgrade to Lighten from Hold by Ord Minnett .B/H/S: 1/2/3

Northern Star sustained record production of 184,000 ounces in the June quarter, 10% ahead of Ord Minnett's estimates. FY19 guidance of 600-640,000 ounces is below expectations, with some conservatism at Kalgoorlie but also lower grades suspected.

The broker remains comfortable that the company's strategy maximises the value of the assets and extends mine life, while acknowledging it does moderate some of the growth optimism embedded in the share price. Rating is downgraded to Lighten from Hold. Target is reduced to \$6.30 from \$6.50.

NETWEALTH GROUP LIMITED ((NWL)) Downgrade to Hold from Buy by Ord Minnett .B/H/S: 0/2/1

Ord Minnett observes the June quarter net inflows were incredibly strong and 9% ahead of estimates. While structural tailwinds driving independent advice and platform flows are accelerating so to are the broker's assumptions for net inflows and funds under administration.

Yet, Ord Minnett downgrades to Hold from Buy on valuation grounds and would welcome a step change in flows or a lower entry point to revise its recommendation. Target is raised to \$9.00 from \$6.40.

OIL SEARCH LIMITED ((OSH)) Downgrade to Hold from Accumulate by Ord Minnett .B/H/S: 3/4/1

June quarter production was -12% below Ord Minnett estimates and reflected the residual impact from the recent earthquake. A higher proportion of spot sales also affected realised LNG prices.

Nevertheless, the issues are temporary and the broker continues to like the outlook. Target is raised to \$8.80 from \$8.60. As the stock is now trading in line with the target, Ord Minnett downgrades to Hold from Accumulate.

SPARK INFRASTRUCTURE GROUP ((SKI)) Downgrade to Hold from Add by Morgans .B/H/S: 2/4/1

Morgans factors in the draft WACC guidelines and the target is reduced to \$2.20 from \$2.57. The company is expected to start paying tax shortly and the WACC change is expected to affect revenues negatively.

Furthermore, the sustainability of the distribution at the current level into the next decade is now questionable. Hence, the broker downgrades to Hold from Add.

WHITEHAVEN COAL LIMITED ((WHC)) Downgrade to Neutral from Outperform by Credit Suisse .B/H/S: 4/4/0

After a strong run in the share price Credit Suisse downgrades to Neutral from Outperform on valuation grounds. Despite the move, the broker does not believe the stock is expensive, particularly taking into account the capacity for capital management beyond the current dividend policy.

Still, the broker now has less conviction about the quantum of capital returns that may be delivered in August. There is also the risk of a moderation in FY19 guidance for Narrabri and questions over its longer-term sustained production rate. Target is raised to \$5.00 from \$4.60.

WORLEYPARSONS LIMITED ((WOR)) Downgrade to Hold from Buy by Deutsche Bank .B/H/S: 4/2/1

Deutsche Bank has downgraded WorleyParsons to Hold from Buy, with price target of \$18.10 (was \$17.74 in May).

Total Recommendations Recommendation Changes

Broker Recommendation Breakup

Broker Rating Order Company New Rating Old Rating Broker Upgrade 1 AINSWORTH GAME TECHNOLOGY LIMITED Neutral Sell Macquarie 2 ALUMINA LIMITED Buy Neutral Credit Suisse 3 CIMIC GROUP LIMITED Buy Neutral Credit Suisse 4 CIMIC GROUP LIMITED Buy Neutral Ord Minnett 5 EVOLUTION MINING LIMITED Neutral Sell Deutsche Bank 6 FORTESCUE METALS GROUP LTD Buy Sell Citi 7 HOTEL PROPERTY INVESTMENTS Buy Neutral Ord Minnett 8 MONADELPHOUS GROUP LIMITED Neutral Sell Deutsche Bank 9 NAVITAS LIMITED Buy Neutral Macquarie 10 OZ MINERALS LIMITED Buy Neutral Deutsche Bank 11 PRAEMIUM LIMITED Buy Neutral Morgans 12 QBE INSURANCE GROUP LIMITED Buy Neutral Citi 13 SANTOS LIMITED Neutral Sell Citi 14 SENEX ENERGY LIMITED Neutral Sell Citi 15 SENEX ENERGY LIMITED Buy Neutral Ord Minnett 16 SOUTH32 LIMITED Buy Neutral Citi Downgrade 17 CABCHARGE AUSTRALIA LIMITED Sell Neutral UBS 18 CHARTER HALL LONG WALE REIT Neutral Buy Ord Minnett 19 COCA-COLA AMATIL LIMITED Neutral Buy Citi 20 FAIRFAX MEDIA LIMITED Neutral Buy UBS 21 FREEDOM FOODS GROUP LIMITED Sell Neutral Morgans 22 NETWEALTH GROUP LIMITED Neutral Buy Ord Minnett 23 NORTHERN STAR RESOURCES LTD Sell Neutral Ord Minnett 24 OIL SEARCH LIMITED Neutral Buy Ord Minnett 25 SPARK INFRASTRUCTURE GROUP Neutral Buy Morgans 26 WHITEHAVEN COAL LIMITED Neutral Buy Credit Suisse 27 WORLEYPARSONS LIMITED Neutral Buy Deutsche Bank

Recommendation Positive Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 FMG FORTESCUE METALS GROUP LTD 93.0% 64.0% 29.0% 7 2 WSA WESTERN AREAS NL 14.0% -14.0% 28.0% 7 3 PRU PERSEUS MINING LIMITED 100.0% 75.0% 25.0% 4 4 SXY SENEX ENERGY LIMITED 50.0% 29.0% 21.0% 7 5 AWC ALUMINA LIMITED 30.0% 10.0% 20.0% 5 6 OZL OZ MINERALS LIMITED 67.0% 50.0% 17.0% 6 7 STO SANTOS LIMITED -17.0% -33.0% 16.0% 6 8 S32 SOUTH32 LIMITED 29.0% 14.0% 15.0% 7 9 IGO INDEPENDENCE GROUP NL -7.0% -21.0% 14.0% 7 10 ORG ORIGIN ENERGY LIMITED 69.0% 56.0% 13.0% 8

Negative Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 SBM ST BARBARA LIMITED -40.0% -20.0% -20.0% 5 2 FXJ FAIRFAX MEDIA LIMITED 50.0% 67.0% -17.0% 6 3 CLW CHARTER HALL LONG WALE REIT -33.0% -17.0% -16.0% 3 4 WOR WORLEYPARSONS LIMITED 43.0% 57.0% -14.0% 7 5 ORA ORORA LIMITED 36.0% 50.0% -14.0% 7 6 SKI SPARK INFRASTRUCTURE GROUP 7.0% 21.0% -14.0% 7 7 APO APN OUTDOOR GROUP LIMITED 20.0% 33.0% -13.0% 5 8 CCL COCA-COLA AMATIL LIMITED 6.0% 19.0% -13.0% 8 9 WHC WHITEHAVEN COAL LIMITED 44.0% 56.0% -12.0% 8 10 NST NORTHERN STAR RESOURCES LTD -36.0% -29.0% -7.0% 7

Target Price Positive Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 FXJ FAIRFAX MEDIA LIMITED 0.832 0.785 5.99% 6 2 NST NORTHERN STAR RESOURCES LTD 6.236 5.907 5.57% 7 3 WSA WESTERN AREAS NL 3.493 3.321 5.18% 7 4 SBM ST BARBARA LIMITED 4.213 4.070 3.51% 5 5 SXY SENEX ENERGY LIMITED 0.456 0.441 3.40% 7 6 WHC WHITEHAVEN COAL LIMITED 5.245 5.076 3.33% 8 7 OZL OZ MINERALS LIMITED 10.450 10.117 3.29% 6 8 STO SANTOS LIMITED 5.748 5.570 3.20% 6 9 OSH OIL SEARCH LIMITED 8.545 8.330 2.58% 8 10 S32 SOUTH32 LIMITED 3.903 3.824 2.07% 7

Negative Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 SKI SPARK INFRASTRUCTURE GROUP 2.449 2.529 -3.16% 7 2 PRU PERSEUS MINING LIMITED 0.603 0.615 -1.95% 4 3 APO APN OUTDOOR GROUP LIMITED 5.700 5.800 -1.72% 5 4 CLW CHARTER HALL LONG WALE REIT 4.093 4.110 -0.41% 3 5 AWC ALUMINA LIMITED 2.840 2.850 -0.35% 5 6 CCL COCA-COLA AMATIL LIMITED 8.834 8.859 -0.28% 8

Earning Forecast Positive Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 SXY SENEX ENERGY LIMITED -0.714 -0.757 5.68% 7 2 NST NORTHERN STAR RESOURCES LTD 35.010 33.183 5.51% 7 3 OZL OZ MINERALS LIMITED 76.735 73.286 4.71% 6 4 WSA WESTERN AREAS NL 9.238 8.865 4.21% 7 5 STO SANTOS LIMITED 34.609 33.444 3.48% 6 6 NEC NINE ENTERTAINMENT CO. HOLDINGS LIMITED 18.014 17.414 3.45% 6 7 OGC OCEANAGOLD CORPORATION 27.411 27.122 1.07% 6 8 APE AP EAGERS LIMITED 50.215 49.715 1.01% 4 9 AST AUSNET SERVICES 6.600 6.540 0.92% 6 10 S32 SOUTH32 LIMITED 31.552 31.291 0.83% 7

Negative Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 PRU PERSEUS MINING LIMITED 0.168 0.315 -46.67% 4 2 AHY ASALEO CARE LIMITED 4.967 9.130 -45.60% 3 3 AWC ALUMINA LIMITED 26.011 27.392 -5.04% 5 4 GXY GALAXY RESOURCES LIMITED 11.667 12.183 -4.24% 5 5 RHC RAMSAY HEALTH CARE LIMITED 269.929 281.043 -3.95% 8 6 WTC WISETECH GLOBAL LIMITED 13.938 14.488 -3.80% 5 7 BHP BHP BILLITON LIMITED 211.220 219.274 -3.67% 8 8 EVN EVOLUTION MINING LIMITED 15.939 16.381 -2.70% 8 9 NUF NUFARM LIMITED 42.021 42.893 -2.03% 7 10 NWS NEWS CORPORATION 56.666 57.822 -2.00% 6

Technical limitations

If you are reading this story through a third party distribution channel and you cannot see charts included, we apologise, but technical limitations are to blame.

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## Uranium Week: Decision Pending

After a prolonged delay, the US Department of Commerce announced last week it will indeed investigate uranium imports into the US.

-DoC to pursue investigation -Spot volumes lift on the news -Argentina overlooked

By Greg Peel

The story so far...

Earlier this year two US uranium producers petitioned the US government to consider forcing US nuclear power producers to purchase 25% of their uranium needs from domestic producers, as a matter of national security, but more realistically to head off cheaper foreign imports that were threatening the commercial viability of US production.

At the same time, US nuclear power companies have been shutting down or threatening to shut down legacy reactors, and scrapping plans or threatening to scrap plans for new reactor builds, due to the inability of nuclear power to remain commercially viable in face of cheap gas-fired power and subsidised renewables. Even at a time of historically low uranium prices.

This would presumably sway the Trump administration against mandating domestic uranium purchases, but then “national security” is the underpinning argument for Trump’s global tariff rollout. Clearly both problems cannot be simultaneously solved.

Trump will have the final say when the US Department of Commerce completes its investigation into foreign exports in April next year. Yes, another nine months away. And even then, the president has another long window of time in which to reach a decision.

A cloud of uncertainty will thus continue to hover over the uranium production/consumption sectors, but for now at least one element of uncertainty has been removed, for better or for worse, in that the DoC is actually proceeding.

The result last week was a sharp lift in uranium spot market activity, with nine transactions concluded for a total of 1.7mlbs U3O8 equivalent, industry consultant TradeTech reports. Sellers backed off as the week progressed, sending TradeTech’s weekly spot price indicator up US50c by week’s end to US\$23.75/lb.

Two transactions were reported in term markets. TradeTech’s term price indicators remain at US\$26.50/lb (mid) and US\$28.00/lb (long).

Don’t Cry For Me

The headline players in the global nuclear sector are currently China (reactor builds) and Japan (reactor restarts) on the one hand and Europe and South Korea (winding down nuclear power) on the other, along with the US for reasons above. Alongside are India, South Africa and other EMs looking to initiate/increase nuclear capacity.

Little spoken of is Argentina, but research house Hallgarten & Co last week released a report suggesting the South American country could be set to become a major consumer of uranium.

The report outlined several supporting factors.

The country now has an aggressive nuclear expansion campaign underway, from a base of a handful of reactors. Public opposition to nuclear power is minimal - indeed any form of power, given a persistent energy shortage. Uranium supply required for the life of the existing reactors alone is estimated at 16.5mlbs U3O8.

The new Macri regime could lower labour and other mining costs from currently high levels. To date Argentina has been paying significantly more than spot for uranium supplies from Kazakhstan and Canada.

Despite a lack of price incentive in the post-Fukushima years, several Canadian miners have bravely pushed on and now have credible projects in Argentina. Yet the Argentine government is yet to reveal a policy on promoting vertical integration from producing uranium domestically.

And uranium remains cheap.



The implicit suggestion from Hallgarten is “Watch this space”.

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## The Short Report

### Guide:

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

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

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

### Summary:

Week ending July 19, 2018

Interday volatility for the ASX200 was evident again last week, but still the index is not ultimately going anywhere much.

In terms of short position movements, only one stock in the 5% plus shorted table saw its shorts change by more than one percentage point last week, being graphite producer Syrah Resources ((SYR)), which fell to 19.3% from 20.8%.

I have noted often enough that the share prices of miners of battery-related products are notoriously volatile, and thus too movements in short position. Hence, no big deal.

What is interesting nevertheless is that Syrah has for so long now sat a-top the table with daylight second and third, but at 19.3%, Syrah has now converged with a rising JB Hi-Fi on 19.2%.

Otherwise we note that there is a lot more bracket-creep green in the table below than red, and quite a few stocks dropping out of the elite 10% plus club. Could there be an earnings result season approaching?

Finally we note it was this week agri-products vendor Nufarm ((NUF)) issued a profit warning related to the drought in Australia. Nufarm had already appeared at the bottom end of the 5% plus shorted table, suggesting one or more short players had assumed such (not exactly a major revelation, the drought).

Last week we saw Graincorp ((GNC)) make an appearance at 5.3% shorted, pre-Nufarm announcement.

No Movers & Shakers this week.

Weekly short positions as a percentage of market cap:

10%+

SYR 19.3 JBH 19.2 DMP 14.8 GXY 14.5 ORE 13.1 MYR 12.2 ING 12.1 MTS 11.8 VOC 11.7 GXL 11.0 NWS 10.0

Out: AAC, IVC, NAN, GEM

9.0-9.9

AAC, NAN, GEM, HVN, IVC, MLX, CSR

In: AAC, NAN, GEM, IVC 8.0-8.9%

BIN, SFR, IGO, HT1, IFL, MYX

In: SFR

7.0-7.9%

CCP, FLT, GMA, SIG, MOC

In: MOC Out: RFG, NSR, BGA

6.0-6.9%

NSR, KAR, TNE, NEC, MYO, BKL, BGA, SEK, RFG, BWX

In: NSR, BGA, RFG, BWX Out: MOC, IPH, PLS, BAP

5.0-5.9%

IPH, BAP, CLQ, PLS, QUB, BEN, TPM, AAD, RSG, SUL, GNC, WEB, NUF, MSB, APT

In: IPH, BAP, PLS, GNC Out: BWX, JHC

Movers & Shakers

See above.

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: Airlines, Insurers And Telcos

Weekly Broker Wrap: regional banks; airlines; insurance; supermarkets; billing utilities; and telcos.

-Little earnings growth expected for regional banks -Headwinds gathering for domestic airlines -Major regulatory issues still confront insurers -Only one major supermarket likely to make online profitable -Changes to electricity distribution pricing probably manageable -Consensus expectations for telcos sector may prove optimistic

By Eva Brocklehurst

### Regional Banks

Ord Minnett has reviewed earnings forecasts for the regional banks. Forecasts have been reduced by around -1% for both Bank of Queensland ((BOQ)) and Bendigo and Adelaide Bank ((BEN)) for the next three years, to reflect expectations that re-pricing of mortgages will not cover a deterioration in funding costs.

The broker is concerned retail banking margins have peaked, while competition remains elevated. No earnings growth is expected from the first half base over the next three years. Bank of Queensland has announced back book re-pricing of its variable rate mortgage by 9-15 basis points and Bendigo and Adelaide has increased most rates by 10 basis points.

The delayed nature of the repricing poses downside risk to second half results, in the broker's view, given the bank bill swap to overnight index swap spread has been running at above 40 basis points since mid March.

### Airlines

Domestic passenger growth slowed to 2% in May 2018 versus the prior year with a weak performance from the Sydney-Melbourne-Brisbane hub. Capacity in these regions grew 3% in May, with Qantas ((QAN)) adding 2% and Virgin Australia ((VAH)) adding 1%.

Using bookings data from Travelport, the broker estimates Qantas yields rose 5% on average in May across the S-M-B routes as well as transcontinental markets. However yields fell -1% in May for the Sydney-Melbourne route versus April.

International capacity grew 9% across key markets, Ord Minnett notes, with the historical correlation between oil price movements and the Qantas share price remaining broken.

On key international routes the broker calculates Qantas yields were down -4% in May and Virgin Australia yields up 3%. The worst performing route was Sydney to Denpasar, with Qantas yields down -19%. The broker expects both airlines to face headwinds amid increased competition, weak demand, excess capacity and higher fuel costs.

### Insurance

A number of issues are clouding the insurance sector, Citi notes, and topping the list is the Royal Commission, amid major implications for AMP ((AMP)). AMP and Suncorp ((SUN)) are affected by changes proposed in the federal budget and Westpac's ((WBC)) recent move to cut platform fees for BT Panorama has increased margin pressure in the wealth management industry.

Citi believes the QBE Insurance ((QBE)) share price has now fallen to such a level that delivering a reasonable first half should be enough to underpin the share price without needing to accommodate a turnaround story.

The broker finds Suncorp's value not quite as compelling as before, but the second half should provide the market with more confidence in FY19 and targets. Citi expects Insurance Australia Group ((IAG)) to announce a capital return, with a \$750m buyback forecast.

Meanwhile, evidence suggests benign health insurance claims inflation and this could be a source of upside risk for Medibank Private ((MPL)) and, to a lesser extent, nib Holdings ((NHF)).

### Supermarkets

Citi notes online penetration is rising towards 3% for both Woolworths ((WOW)) and Coles ((WES)). Nevertheless, online is loss-making for both on a EBIT margin headwind of around 40 basis points. The broker believes only one of

the two has the opportunity to turn online into a profitable channel through an exclusive deal with Ocado. This could add 5% to long-term earnings with a 15-year agreement.

Ocado has signed up five major retailers and they licence exclusively the warehouse automation that enables them to service online profitably. A de-merged Coles is the most likely retailer to partner, in the broker's view, as online losses have more impact on a stand-alone business and Coles has made less investment in online than Woolworths in recent years.

The UBS survey of Australian grocery shopping over June signals shifts in market share are moderating and consumers are experiencing promotional fatigue. Shoppers are now placing less emphasis on price, while loyalty now ranks as the second most important driver of trips to the supermarket. Those retailers that are differentiating and investing in loyalty remain best positioned.

Coles is performing better, as its relative score in the survey is stabilising, while Woolworths is peaking and the rate of share loss by Metcash ((MTS)) is easing. UBS lifts estimates for Coles' sales by 1% for FY19 and no longer forecasts a decline in share.

The consistent message from suppliers was the need to improve promotional effectiveness. Woolworths is playing a long game and investing in online, data and refurbishments but this has not been reflected in the views of suppliers and customers through June and July, which suggests to UBS the positive impact is waning.

#### Billing Utilities

The ACCC has recommended that the Australian Energy Regulator set a simple default retail price for electricity in each distribution area in the National Electricity Market.

The price would be set midway between current standing offers and average market offers, and ACCC believes average household bills could be reduced by -20-25%. Morgan Stanley suspects the changes, if implemented, will be manageable, with AGL Energy ((AGL)) having slightly more flexibility than Origin Energy ((ORG)).

The broker estimates that billing utilities would need to reduce discounts by less than -300 basis points across the board to recoup the one-off price reduction. Disengaged customers pay a "loyalty tax" versus customers who shop around and the broker believes the ACCC has effectively recommended a cut to the loyalty tax rate. As the industry structure is oligopolistic Morgan Stanley anticipates incumbents would recoup the loyalty tax reduction over time.

The broker suggests disruptions to the market could come in the form of automation of comparison/switching and changes to the structure, such as the entry of second-tier operators and/or a large vertical or horizontal participant.

#### Telecoms

Morgan Stanley suspects consensus expectations for FY18-21 earnings and distributions in the Australasian telecommunications sector will prove optimistic. Telstra's ((TLS)) recent investor briefing highlighted a severe impact from structural change and disruptive competitors on fixed line and mobile.

Consensus expectations have been lowered for Telstra's FY19 and operating earnings by around -15% and the broker suspects these headwinds exist for all incumbents. In fixed line TPG Telecom ((TPM)) may be able to do a better job of holding up margins and, the broker suspects, as a disruptor in mobile, the focus will be on the timing and budget of its roll-out plans.

Morgan Stanley also expects, after recent instability, that the market should be more positive regarding Vocus Group ((VOC)), if first time FY19 and operating earnings guidance is up 0-5%. Meanwhile, investors will be tuned to the maiden FY19 and dividend guidance for Spark New Zealand ((SPK)). The broker forecasts the existing NZ\$0.25 distribution to be maintained, placing the stock on a yield of 6.4%.

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## Audinate Sales Surge In June Quarter

Audinate has confirmed its technological dominance of the professional AV industry, beating prospectus forecasts and securing strong operating cash flow in the June quarter.

-Well capitalised to invest in strategic growth initiatives -Cash receipts increased 34% in the June quarter -Strongest sales in June quarter since inception

By Eva Brocklehurst

Audinate ((AD8)) has beaten prospectus forecasts after a significant June quarter and confirmed its dominance of the professional audio-visual market. Shaw and Partners welcomes the quarterly numbers as the business continues to surpass its "lofty" expectations, which were set in the wake of a robust first half and after a recent site visit.

The audiovisual addressable market is more than \$450m annually, according to industry calculations. However, this number excludes post-production equipment and specialist broadcasting, part of Audinate's remit.

The company's fourth quarter is typically its strongest and this reflects OEM partner product launches in line with large industry trade shows. FY18 operating cash flow of over \$1m was helped by flows of more than \$1.7m in the June quarter.

Shaw and Partners notes operating cash flow was strong despite higher proportionate product manufacturing, operating and advertising costs in the fourth quarter, exceeding its forecast of \$200,000.

Canaccord Genuity considers the company well capitalised to invest in a number of strategic growth initiatives, aiding its Dante product in the medium term. Dante incorporates IT into the professional AV industry.

### Market Leader

Audinate leads its market with over 80% share of its segment. Canaccord Genuity suggests the company's product is quickly becoming a default standard for system integrators/installers and OEMs.

Gross profit margins are around 75% which illuminate the potential for long-term sustainable EBIT margins of over 35%, the broker asserts. Cash receipts increased 34% in the quarter, its strongest period since inception.

Assuming a fair value EV/EBIT multiple of 14x, the broker calculates the marginal investor is implying \$47m in revenue, or three years forward at the company's historical growth trend of over 30% per annum. Canaccord Genuity forecasts FY18 revenue of \$19.8m, up 31% on FY17 and 5% above its prior revenue estimates. The broker has a Speculative Buy rating and \$4 target.

Shaw and Partners has put its target (\$3.40) under review, pending the official results on August 27, and maintains a Buy rating. The main supportive factor is robust cash collection over the year of \$19.7m. The broker uses this as a proxy for revenue, amid slight adjustments such as the deferral of software maintenance fees, engineering support and treatment of R&D. The company did not provide details about the operating earnings (EBITDA).

Estimated cash outflow in the first quarter of FY19 is expected in the vicinity of \$6.2m as staffing and administration costs rise proportionately. This relates predominantly to the payment of staff bonuses, insurance and ASX listing fees. This is why the first quarter cost base is seasonally high versus other quarters, Shaw and Partners points out.

At the FY18 result, or soon thereafter, the broker notes 33.5m shares and 600,000 unlisted options will be released from escrow.

See also, Audinate Accelerates Digital AV on March 27, 2018.

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## Australian Equities Pre-August: Polarisation Remains The Word

In this week's Weekly Insights:

-Australian Equities Pre-August: Polarisation Remains The Word -Next Week -Conviction Calls -Inverted Yield Curve: Historical Perspective -Rudi Talks -Rudi On TV -Rudi On Tour

Australian Equities Pre-August: Polarisation Remains The Word

By Rudi Filapek-Vandyck, Editor FNArena

Twice each year investor attention in Australia goes out to how well corporate profits are stacking up in comparison with share price valuations and market forecasts. However, not every ASX-listed company reports its financial numbers in February and August.

To my knowledge, FNArena is the only service around that consistently and meticulously keeps a close watch on corporate earnings reports in Australia. Earlier this year, we launched a dedicated section to the website:

[https://www.fnarena.com/index.php/reporting\\_season/](https://www.fnarena.com/index.php/reporting_season/)

Even though we counted 53 companies reporting in between February and the upcoming August results season, not much attention is usually given to what has happened in this corporate results sideshow. Admittedly, our coverage also includes banks and we know CommBank ((CBA)) reports in August, and stocks like ResMed ((RMD)) which, being US-listed, updates every three months.

But the bulk of companies reporting in let's call it the in-between season consists of smaller mining companies, retailers, infrastructure and mining services providers, agricultural companies, building materials and housing related companies, financial services providers and funds managers, plus a number of technology companies - quite the diversified bunch which, outside the banks, Macquarie Group ((MQG)), REA Group ((REA)), and Aristocrat Leisure ((ALL)) has little representation in the ASX50.

This week we closed off the in-between reporting season with the upside surprise delivered by Cimic ((CIM)) the final inclusion for this season. Before we zoom in on what August might deliver, are there any conclusions we can take on board from the 4.5 months past?

Conclusion number one has to be that significant parts of corporate Australia are doing it tough. Small cap analysts at Canaccord Genuity have counted more than 200 profit warnings have been delivered thus far in Australia since the beginning of calendar year 2018. Most of these warnings have remained outside the scope of most investors. Asaleo Care ((AHY)), despite many of its products being bought on a weekly basis by Australian households, never made it to common household name status in the share market, and the stock is no longer a member of the ASX200.

A similar observation can be made for smaller technology stocks such as Objective Corp ((OCL)), Hansen Technologies ((HSN)) and Integrated Research ((IRI)). And for agri-company Nufarm ((NUF)) who only a few months ago delivered a feeble result but with better-than-anticipated guidance. Since then a dire and extensive drought in rural parts of Australia has put a big dent into management's forecasts.

Hands up who had been anticipating a super result from Australian Pharmaceuticals ((API))? Myer ((MYR))? Village Roadshow ((VRL))? Even wealth manager Perpetual ((PPT)) never seemed primed for a result that would instantly turn around the stock's downward sloping trajectory.

In broad, general terms we can conclude the in-between results season largely confirmed what we already knew about the Australian economy and the transformation that is currently taking place. We have sectors under pressure, including bricks and mortar retailers, banks and financial services providers, plus telecom and, apparently, smaller technology service providers. Corporate results from companies in these sectors came out in-line at best, with the risks skewed towards a negative disappointment.

On the other hand, we have mining and infrastructure services providers and engineers, we have building materials stocks, miners and energy producers, and we have healthcare on the positive side and -lo and behold- companies operating in these industries have been prone to more likely deliver a positive surprise.

The one added observation that is worth mentioning is that a number of disappointing releases have stemmed from small cap mining companies, likely indicating that, no matter the overall environment shaped by commodity prices,



there will always remain an above average risk attached to drilling and mining a small operation exposed to nature's brutality.

Equally noteworthy is the fact that share market darlings including Macquarie Group, Aristocrat Leisure, Fisher & Paykel Healthcare ((FPH)), Hub24 ((HUB)), Netwealth Group ((NWL)), Praemium ((PPS)), REA Group, ResMed, Synlait Milk ((SM1)), and Xero ((XRO)) have kept up their performance despite many criticising their valuations - in all cases this was underpinned by robust results that at the very least met elevated expectations.

The share market's polarisation has been firmly on display post the February reporting season and it'll be anyone's guess whether the upcoming August results season might deliver the change in dynamics so many value-investors have been waiting for. My guess is that the underlying bifurcation between the Haves and the Have Nots is unlikely to change soon, but let's wait and see what August has to offer.

No matter how well prepared one can probably be, every season delivers unexpected surprises, in addition to one or two hallmark events. This year earnings estimates are rising, albeit slightly, and predominantly because analysts are marking-to-market commodity prices, while also incorporating a weaker Aussie dollar into their models.

Insurance companies seem to enjoy a favourable wind ahead of the season. Miners and energy producers seem poised for solid performances, with capital management certain to be on the agenda. But there are equally very few who anticipate disappointment from CSL ((CSL)), or from ResMed, or from Charter Hall ((CHC)), or Goodman Group ((GMG)).

As per always, companies that manage to positively surprise, and force analysts to upgrade forecasts, often enjoy positive momentum for many months after the reporting season. Those who fail to meet expectations can often expect severe punishment, in particular if the share price has rallied prior, or if the longer term trajectory is being called into question.

Quant analysts at Macquarie have singled out Lovisa Holdings ((LOV)), Qantas ((QAN)), a2 Milk ((A2M)), Nine Entertainment ((NEC)) and Emeco Holdings ((EHL)) as likely candidates to deliver a positive surprise in August. On the other hand, their quant modeling shows Ramsay Health Care ((RHC)), Tabcorp ((TAH)), Western Areas ((WSA)), Commbank ((CBA)) and Japara Healthcare ((JHC)) are most likely to disappoint with their results releases.

All shall be revealed over the coming six weeks.

From the moment the corporate results season starts gaining genuine traction, FNArena's dedicated corporate results monitor shall be refreshed and updated daily (see website or the link above).

By then we will also add an extra compartment that covers the monitors we produced since August 2013; for those who like to analyse past data, percentages and company performances.

The Monitor for this year's March-mid-July period will be attached when this story is published on the website on Wednesday morning.

## Next Week

Next week I will spend across the border in Queensland where the Australian Investors' Association's (AIA) National Conference takes place on the Gold Coast. I am an active participant in the Monday's Grand Debate, while presenting my views about what's happening in the local share market, and outside of it, on Wednesday.

By Friday, I will be in Canberra to present to local members of the Australian Shareholders Association (ASA).

As a result of the above there will be no Weekly Insights next week. The next edition will be written and published in the second week of August, when daily Broker Call Reports are filling up.

If you happen to be around on the Gold Coast or in Canberra, do come over and say Hi. No doubt, the August reporting season is going to keep us all busy, as per always.

## Conviction Calls

Deutsche Bank analysts, both here, overseas and on the ground in China, are expecting more support from Chinese authorities to cushion their domestic market against an intensifying trade conflict with the Trump administration in the US. As a direct consequence, equity strategists in Europe are calling for increased exposure to mining stocks, having upgraded the sector to Overweight.

One of the consequences of the recent switch in Chinese policy towards more accommodation is that infrastructure spending should again start growing at a faster rate, predict Deutsche Bank analysts, while China's monthly PMI surveys should at the very least stabilise in the months ahead.

Investors should also be aware the Chinese government is considering cutting taxes to further stimulate domestic consumption, with interest payments on mortgage loans, and education, training and medical expenses soon to be made tax deductible.

\*\*\*\*

One of the mining stocks that has put in a remarkable recovery over the past twelve months is rare earth producer Lynas corp ((LYC)). The share price had been in a long downslope since April 2011, having peaked above \$24, but the year past has seen a steep recovery to \$2.80 from circa 80c.

The share price is trying to find new momentum around the \$2 mark. Lynas also made its re-entrance into the S&P/ASX200.

Friday's quarterly production update did not please everyone, and higher costs were one element of disappointment, but this has not deterred analysts at CLSA to reiterate their High Conviction Buy rating for the shares. Fundamentals for both rare earth elements and for the company remain supportive, say the analysts.

They find the stock significantly undervalued, arguing the political/regulatory risk for operating in Malaysia has been well and truly priced in. CLSA's price target is \$3.50.

UBS reinstated coverage on Tuesday with a Buy rating and \$3.30 price target. We hadn't heard from UBS since July 2015. Back then, the rating was Neutral with a price target of 5c.

In the latter's view, Lynas owns the best global rare earth deposit in the world, and it is being exploited through the only active non-China processing facility. The company's key product, generating circa 90% of all revenues, is Neodymium-Praseodymium (NdPr), which is used in high growth new energy applications such as Electric Vehicles and Wind Energy.

To add to the attraction, UBS points out Lynas is highly cash-generative and de-gearing quickly. According to the analysts, the difficulties the company has had to get its operation up and running signals just how tough it will be for anyone with the intention of building the next project.

Needless to say, investors looking to jump on board must have the stomach to cope with above average share price volatility. It was only in early May that the share price had reached \$2.88. UBS points out the new Malaysian government has a few members who have been long-time critics of Lynas operating in the country. Plus a long-term tailings solution for the plant's waste still needs to be approved.

\*\*\*\*

One does not often see sector analysts preferences fall in line with each other, hence investors looking to add exposure to AREITs, be it for yield/income or for other reasons, might want to pay attention to the common denominator in sector updates by Morgan Stanley, Macquarie and Citi.

Forget about the usual this stock looks undervalued, while another one might have rallied too hard. All three teams of analysts agree that potential outperformance is likely to come from those companies that have the ability to add genuine growth. All three are pointing towards funds management operations which highlights the quality and long-term sustainability of Lend Lease ((LLC)), Charter Hall ((CHC)) and Goodman Group ((GMG)).

Equally interesting is that earnings risk for the sector overall is seen as relatively low ahead of the August reporting season.

#### Inverted Yield Curve: Historical Perspective

Flattening and inverting yield curves. You probably heard these terms a number of times already in the weeks/months past. Have no doubt: you are going to hear a lot more about it as the calendar year progresses.

According to some, the curve inside the US bond market (the difference in yield between 2-year Treasuries and ten-years) is the most reliable financial indicator around, but this sounds a lot scarier than history shows us about how to treat the current set-up in US bond yields.

The current context is one whereby the difference in yield between two-years and ten-years continues to narrow, suggesting the US economy might be facing its next economic recession sometime in late 2019-mid-2020, all else remaining equal. Further tightening by the Federal Reserve pushes up the two-year yield while the ten-year seems to have decided that above 3% yield is a bridge too far.

But things are seldom this straightforward in global finance, let alone during times of quantitative easing/tightening on this Grand Scale.

Economists at Citi recently lined up a few historical references (with assistance from Haver Analytics) and one would have to conclude history by far is not as straightforward as some experts would like it to be.

Since the late 1970s, the US yield curve has seven times flatlined, of which a grand total of two occasions saw an actual inverted curve. On both occasions (1980 and 2000) the US share market was in the negative twelve months later, but not in the months immediately after the curve went negative.

Here are the raw data:

#### Rudi Talks

Audio interview from Tuesday last week on why value investing has become such a hard slog in the Australian share market, and what are the dynamics behind the scenery:

<https://www.boardroom.media/broadcast?eid=5b4e878073d9bb0cd6e6be58>

Audio interview from Tuesday the week prior about the local share market and high valuation stock outperforming their lesser peers:

<https://www.boardroom.media/broadcast?eid=5b4429a484c6a07ee10af84f>

#### Rudi On TV

This week my appearances on the Sky Business channel are scheduled as follows:

-Tuesday, 10.30am Skype-link to discuss broker calls (earlier than usual) -Thursday, from midday until 2pm -Friday, 11am, Skype-link to discuss broker calls

#### Rudi On Tour

-AIA National Conference, Gold Coast QLD, July 29-August 1 -ASA Presentation Canberra, 3 August -Presentation to ASA members and guests Wollongong, on September 11 -Presentation to AIA members and guests Chatswood, on October 10 -Presentation to ATAA members and guests Sydney, October 18

(This story was written on Tuesday 24th July 2018. It was published on the day in the form of an email to paying subscribers at FNArena, and again on Wednesday as a story on the website).

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