

Week
10

Stories To Read From FNArena

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GPO Box 3145
Sydney NSW 2001

info@fnarena.com

Your editor
Rudi Filapek-Vandyck

Your dedicated team of
journos
Greg Peel
Eva Brocklehurst

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Is Ramsay Health Care's Valuation Justified?

While conditions for Ramsay Health Care in Australia are subdued, European operations are expected to provide the main boost to earnings in FY19.

-Australian healthcare industry faces headwinds, amid pressure on private health insurance -Benefits from Capio, increased tariffs in France and the UK as well as Australian revenue growth should be forthcoming in FY20 -Is the rally in the share price justified?

By Eva Brocklehurst

The outlook for Ramsay Health Care ((RHC)) has a number of moving parts and brokers seek to order a degree of importance, in order to obtain clarity on the stock. The company has reaffirmed FY19 guidance for growth in earnings per share of up to 2% and provided guidance for operating earnings (EBITDA) growth of 10-12% including newly-acquired Capio, or 4-6% ex Capio.

The Capio business is now expected to be slightly dilutive to earnings per share (EPS) FY19 versus the neutral impact that was forecast at the AGM last November. The downturn in UK NHS volumes now appears to be correcting and there is a 2019 tariff increase in train in France.

Meanwhile, the Australian business faces headwinds. Credit Suisse calculates the offshore regions account for around 30% of earnings and, therefore, these businesses should trade at lower multiples versus Australia.

Hence, the broker is one that believes the recent rally in the share price is not justified, maintaining an Underperform rating. Credit Suisse envisages downside risk to earnings in Australia, amid the upcoming federal election and the renegotiation of key health insurance contracts.

Morgan Stanley does not find the valuation compelling either. There is support from offshore through the increase in French tariffs and UK NHS volumes, but the major investment debate centres on Australia. Private health insurance is not growing and that should likely result in tougher contracting terms with health insurers, and the increasing evolution of alternative care models.

In contrast, CLSA, not one of the eight brokers monitored daily on the FNArena database, has a positive medium-term investment view, maintaining an Outperform rating and \$71.40 target.

Australia

CLSA agrees the Australian business must turn around the recent declines in earnings that have been a feature over the past few years. However, the broker suspects there may be difficulty sustaining cost reductions in Australia without repercussions from the associated doctors.

The broker also notes one of the issues includes the supply of private hospital operating theatres in Australia. The company plans to open more operating theatres in FY19, which should positively affect FY20 earnings growth.

Macquarie retains a positive view on the stock, underpinned by contributions from brownfield developments, although agrees potential risks primarily relate to the Australian business.

Management has indicated that its returns criteria for developments of 15% over a three-year period is unchanged although there is flexibility to extend time horizons to four years, based on the strategic merit of the project. Negotiations relating to consumables contracting (the Ascension JV) have commenced and initial benefits are expected in the second half of FY20.

Citi considers Australian revenue growth of around 5% in the first half was confirmation the company is taking market share. Ramsay Health Care appears to be attracting doctors and driving market share gains.

The broker believes the key to the business over the next few years centres on two aspects, higher synergies, eventually, from the Capio assets, and continued growth in the Australian business. The broker acknowledges diminished consumer confidence as well as decreased affordability of private health are key risks and downgrades to Neutral following the recent rise in the share price.

Morgans observes the company's domestic admissions growth is above the market, although still below trend, and operating efficiencies are allowing for margin expansion.

The broker agrees there are challenges which limit revenue growth and keep profit reliant on cost reductions although, in the longer term, assesses the fundamentals are sound and the valuation of the stock not a problem. With recent gains in the share price at risk of reverting a Hold rating is considered appropriate.

The performance of Australian hospitals reflects an industry that is under pressure from health insurance issues and UBS suspects this will intensify with a 2% cap to health insurance premiums, likely to be introduced if the Australian Labor Party wins government.

In the event of increased pressure on Australian insurer contract rates, UBS believes future cost savings, Capio synergies and ongoing improvements in processes will be required to sustain hospital margins.

Ord Minnett agrees the domestic private hospital sector may come under material pressure if the capped premium policy for health insurers is enacted. Looking at FY20, the broker takes a positive view on top-line growth from the Capio acquisition as well as higher tariffs in both the UK and France.

Europe

France is likely is to sustain fairly flat revenue outcomes, Morgans believes, while Capio margins are contracting and the integration risk remains large. Capio may have contributed to gains above the line in the half-year but management disruptions, softness in Germany and a weak December remain of concern. On the other hand, there are signs of improvement in the UK, although the broker considers there is little visibility around the potential impact of Brexit.

Deutsche Bank agrees benefits should accrue from increased tariffs in France and the UK, amid synergies from the Capio acquisition. Moreover, the company can achieve revenue growth and margin expansion in the Australian business. This broker, citing minimal returns implied by its target, also downgrades to Hold.

FNArena's database shows one Buy rating (Macquarie), six Hold and one Sell (Credit Suisse). The consensus target is \$63.02, signalling -1.0% downside to the last share price targets range from \$54.80 (Credit Suisse) to \$72.00 (Macquarie).

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Metcash Hungers For Growth

Metcash has outlined an expenditure program designed to lift all areas of its business over FY20-24. Brokers contemplate the outlook in light of the latest trading update.

- Minimum return hurdle of 15% signalled from \$300m in expenditure
- Trial of corporate liquor stores to be expanded
- To spend \$90m on hardware initiatives in next three years

By Eva Brocklehurst

There was something for everyone in the Metcash ((MTS)) trading update and strategy briefing, expressed in a wide range of views from brokers. Metcash will spend \$300m on growth across FY20-24 and management has signalled a 15% minimum return hurdle. If this is not achieved, expenditure will slow and capital management will resume.

The growth expenditure is matched with \$550m of potential funding capacity from retained cash flows and debt. This implies upside to estimates and UBS, along with several other brokers, welcomes the decision to invest more in stores and improve the network quality.

There is also a \$50m cost reduction program over FY20-21 to offset cost inflation. Implementation costs are calculated to be 25% of the savings. Macquarie disputes whether the savings can be considered as outright upside to net profit but acknowledges the positive aspects.

The strategy may be well-crafted but Credit Suisse believes the positive implications for shareholders are less obvious. Moreover, the stock is likely to trade on near-term earnings guidance while capital is being committed for growth.

Credit Suisse makes no material changes to forecasts resulting from the update, although acknowledges proposed cost savings have now been pinned down. As a negative impact on valuation would arise from including \$300m in capital expenditure without a commensurate earnings uplift, the broker refrains from including the additional growth expenditure in its forecasts.

Citi retains a Sell rating (along with Deutsche Bank which is yet to update on the strategy) and continues to envisage downside risk to earnings forecasts. Citi cites the structural challenges for growth in grocery and cyclical headwinds in hardware, as well as an increase in capital intensity, as reasons to be cautious.

The broker considers the growth outlook, following this strategy update, is largely neutral and not sufficient to overcome the numerous structural challenges the company faces. The elevated capital expenditure profile will also weigh on free cash flow, as the broker calculates the cash flow yield will drop to 7.9% by FY24.

In the absence of more material investment, or a return to elevated inflation, the broker asserts that, while some of the negatives are factored into the price, a wider margin of error is required.

Food/Liquor

UBS believes the outlook for the Australian supermarket sector is improving, supported by easing deflation, reduced promotional intensity and a focus on differentiation. This outlook is supportive of independent grocers and Metcash will benefit by being the most leveraged to deflation and the main supplier to independents.

Macquarie finds the outlook still challenging, noting FY20 growth will be affected by the loss of the Drakes contract. The broker also notes the company has called out intense competition in food, price deflation and the impact of Aldi.

Metcash will focus on the fresh and private-label food business, acknowledging it is under-indexed in this area and this has hurt the business. However, the bulk of capital expenditure allocated to food is for the trial in corporate liquor, and the company has flagged additional capital will be required following a decision to roll out further.

Morgan Stanley observes the company continues to close a sales growth gap to the major supermarkets as its strategy gains traction, while second half sales growth, ex tobacco, was in line with first half trends. The broker also finds significant opportunity in the liquor business, as convenience trends, corporate store trials and private-label all drive growth.

Credit Suisse is surprised by the trial of a corporate liquor store, given the success of the current independent brand network. The broker suspects the company maintains a belief it needs to participate in retail liquor to be a better wholesaler. There are three pilot stores currently in operation with 10 targeted by December.

Hardware

In hardware, trends have slowed but sales growth remains positive. There is still significant rationalising of distribution centres to come over the next two years. NSW will close by September and WA on exploration of the lease. This will be supported by the conversion of more HTH stores to the Mitre 10 banner. The company's aim is to return to three distribution centres in total.

Even though retailer sales growth may turn negative as the housing cycle worsens, Morgan Stanley believes cost reductions can limit the impact. Macquarie assesses the company is better placed to deal with a downturn in DIY versus peers, including Bunnings ((WES)), which have around 90% earnings exposure to the segment. Tasmania is the bright spot, with sales growth of around 20%, although less material to group earnings.

The company will spend \$90m on its hardware initiatives over the next three years, on refurbishing the existing network and also promoting products that are not available at Bunnings. The company does not believe Bunnings is materially competitive on price, nor that Bowens will start a price war.

The hardware strategy has also meant more corporate stores ,although Credit Suisse does not believe this is such a change in view, given these have been a large part of the segment for some time.

FNArena's database SHOWS three Buy ratings, two Hold and two Sell for Metcash. The consensus target is \$2.75, suggesting 0.4% upside to the last share. The dividend yield on FY19 and FY20 forecasts is 5.6%.

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Coles Unloads Risk With Pub Deal

Brokers welcome the decision by Coles to transfer its hotel operations to Australian Venue Company, while retaining earnings from its liquor stores.

-Coles is expected to invest the proceeds in its digital offering and refurbishments -Positive outlook for groceries but company-specific issues prevail -Will Woolworths follow suit?

By Eva Brocklehurst

Coles ((COL)) has unloaded the social and intangible risks in its hotels business, undertaking a joint venture with Australian Venue Company. The profit from around 87 hotels (76 in Queensland, seven in South Australia and four in Western Australia) will be received by AVC, while earnings from liquor stores (243 in Queensland, 10 in South and Western Australia) will stay with Coles.

Coles will receive around \$200m cash in the transaction and the deal satisfies liquor laws in Queensland, because to obtain a liquor license for a retail shop in that state, the owner must already hold a commercial hotel licence within 10km. This made it difficult for Coles to operate retail liquor shops without having to operate hotels. The structure of the JV is designed with the Queensland laws in mind, because of the weighting of the business to that state.

Management has also previously expressed a desire to exit the hotels business as these activities are considered non-core. Subject to satisfying certain conditions, including obtaining the consent of several landlords, the transaction is expected to be finalised by June.

The deal makes sense to UBS because it allows Coles to focus on its food & liquor business. The main question for the broker is: what will Coles do with the proceeds? Capital management and acquisitions are considered unlikely. Instead, Coles is expected to use the proceeds to improve its distribution centre, digital offering and refurbishments, areas brokers consider were under-invested.

The deal is estimated to be broadly neutral for earnings per share. The pubs business generated around \$13m in earnings and around \$300m in revenue in 2018. There will be no impact on property ownership, as all pub sites are leased, or on existing liquor earnings.

UBS may be more positive about the grocery sector, amid an expected lift in market growth in FY19/20 of more than 4%, but still believes Coles will face company-specific issues in the near term. This relates to strengthening its competitive long-term position, which will cost money and take time.

Deutsche Bank agrees Coles has a lot of work to do, yet is positive about the deal because it separates Coles from the operation of pubs, which reduces its social and reputation risk. It also removes the company's economic exposure to an industry with regulatory risk. The broker perceives the hotel assets are now under the control of an operator that can extract more value. Using the extra capital to fund investment in supermarkets also gets a tick from Deutsche Bank.

The broker would like to consider the stock more positively following its de-rating but, with costs growing faster than sales, margin dilution will be difficult to avoid, while cycling the boost from the Little Shop promotion will make matters worse.

The metrics for Coles are undemanding, Morgans agrees, although the operating environment is still tough and there are a number of headwinds, including market share loss in NSW and higher labour and energy costs. Until there is sustained improvement, the broker sticks with a Hold rating.

Woolworths To Follow?

Financial metrics aside, Morgans believes the exit from hotels has intangible benefits from an ethical perspective and suspects Woolworths ((WOW)) may look to execute a similar transaction for its joint venture.

Citi agrees this is a clean solution to the Queensland liquor and gaming laws and is pleased the company has brought its focus back firmly to food & liquor, having also exited petrol. The broker agrees this JV is a positive signal for Woolworths, although Woolworths has to deal with a much larger, widespread hotels and liquor business.

While the transaction is accretive to Citi's valuation, this is offset by a de-rating of global peers. The broker maintains a Buy rating and preference over Woolworths on valuation grounds.

FNArena's database shows one Buy rating (Citi), for Coles, four Hold and three Sell. The consensus target is \$11.92, signalling 4.8% upside to the last share price. Targets range from \$10.84 (Credit Suisse, yet to update on the deal) to \$13.40 (Citi).

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OZ Minerals Greatly Expands Copper Horizons

OZ Minerals plans to increase copper production at Carrapateena significantly, which is expected to more than offset the forecast decline in output from Prominent Hill.

-Satellite deposits could extend copper production for decades -Block caving technically more challenging, sufficient water needs to be defined -Capital expenditure substantial, expansion not included in most base case valuations

By Eva Brocklehurst

OZ Minerals ((OZL)) is flowering, outlining a much more significant mine development at Carrapateena. Just four years ago, Shaw and Partners points out, the stock was considered a "one trick pony", facing a short mine life at its one asset, Prominent Hill in South Australia. There are now several growth options across the province.

Macquarie suggests the increased production at Carrapateena is likely to more than offset the forecast decline in output from Prominent Hill. The Carrapateena ore body appears to justify a block cave with expanded infrastructure and 10-12mtpa milling capacity.

The scoping study has revealed an increase in mined ore to 10-12mtpa from 4.2mtpa, raising production to 105-125,000tpa of copper over 20 years. The growth options also highlight the potential for extra units of gold and nickel.

The first production from the block cave is expected in 2026 and pre-production capital expenditure is calculated at \$1-1.3bn. UBS asserts this is a refinement of the block cave strategy that has been considered before but the plan and the sequencing makes sense.

The broader province and satellite deposits, such as Khamsin, Saddle and Fremantle Doctor also provide potential to extend the life beyond 20 years. Shaw and Partners is most enthusiastic, expecting a lot of copper will be produced for decades to come.

The ramp up of the mine is expected to take three years and optimise higher grade ore within the deposit. As this is only a scoping study there is no economic outcome outlined. A pre-feasibility study is due mid 2020 and the company has committed an extra \$30m to project studies over the current year.

A final investment decision is expected in the second half of 2021. At that point, Canaccord Genuity believes OZ Minerals should have enough cash to progress the project, should the outcomes of the pre-feasibility be positive.

A higher level of upfront capital from 2022-23 is modelled, in order to establish the infrastructure and development and because of the bottom-up method of block cave mining. The broker considers the expansion around 20% accretive to the base case project. Nevertheless, increased study costs are expected to offset the benefits in the short term.

Canaccord Genuity, not one of the eight stockbrokers monitored daily on the FNArena database, has a Buy rating and \$11 target. The broker believes the superior mine life, health of the balance sheet and diverse assets support the stock as its preferred copper exposure.

High Capex

Credit Suisse is less positive, as headline expenditure is well above forecasts. The additional capital required to get more appropriate scale for the resource signals that greater efficiency and value creation could have been achieved if this scale was initially implemented. The trade-off was lower initial expenditure but at a unit cost disadvantage.

The broker is frustrated by the lack of detail in the study and simplistic modelling. Credit Suisse models on the basis of life-of-mine grade, assuming this will be consistent from the blending of in-cave ore, and asserts the risk lies with an understatement of initial grades and an overstatement of later grades.

Block caving is technically more challenging and there is also the issue of water availability. Credit Suisse notes management is already contemplating pumping seawater from the coast if sufficient local water cannot be defined. UBS and Macquarie agree water seems to be the largest risk. Management is drilling wells, and seeking ways to reduce water use.

Macquarie finds the economics of the expansion study encouraging, pointing out the block cave design is smaller than previous studies, and expects the sustaining capital for the block cave will be significantly lower than for the sub-level cave. Still, a lot of cash will be needed, UBS notes, to unlock the company's vision and capital pay-back is not envisaged until 2028.

Morgan Stanley also believes the amount of capital expenditure is significant, when considered in light of the production uplift and reduction in operating costs. The broker acknowledges this is an early stage in the study and future opportunities in the region could make the development attractive.

Value Distant

UBS suspects investors will be reluctant to include the value of the expansion upfront but instead will wait for milestones, such as first sub-level cave production in the December quarter of 2019, in order to de-risk the project.

Citi also leaves the expansion out of its base case valuation, because the company could still find a more value accretive use of its capital. Macquarie does not have a block cave production scenario factored into its modelling and therefore assesses there is upside risk to its base case for OZ Minerals.

Shaw and Partners, not one of the eight monitored daily on the database, believes the market has not fully grasped, let alone valued the long-term outlook. Top-line growth could hit around 200% out to 2026/27, the broker calculates, which is a compound growth rate of around 15%, and mostly internally funded.

OK, the ups and downs in the copper price will chop the share price around but, over the long-term, valuation should grow with future cash flow, and Shaw and Partners maintains a Buy rating and \$13 target.

FNArena's database shows three Buy ratings, four Hold and one Sell (Credit Suisse). The consensus target is \$11.21, suggesting 7.8% upside to the last share price. Targets range from \$9.50 (Credit Suisse) to \$12.50 (Citi).

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Material Matters: M&A, LNG, And Coal

Corporate battles, market restructuring and trade tensions drive commodities action

Global mining deals total US\$114bn as sector consolidates, capital raisings fall Battle between North American gold titans could mean rich pickings for local miners LNG prices to remain high as east coast market restructures Metallurgical coal holds up despite China ban; thermal coal price languishes By Nicki Bourlioufas

Global mining sector consolidates, cuts back new capital raisings

The total value of financial deals in the mining sector worldwide fell by -14.9% in 2018 to US\$114bn, according to data and analytics company GlobalData.

The value of mergers and acquisitions rose by 13.5%, but this was more than offset by a -32.4% decline in the amount of capital raised. Five countries made up 65.2% of the global total, with Australia the third largest in terms of deal value, behind China and Canada but ahead of the US and Indonesia.

The largest deal was Tianqi Lithium Corp's acquisition of a 23.77% share in Chilean lithium miner SQM. China's Tianqi bought the stake from Canadian fertilizer giant Nutrien for US\$4.1bn. Chile has the world's largest reserves of lithium, which GlobalData calls "a high growth commodity given the rise in demand for lithium ion batteries for electric vehicles".

The five largest deals, out of the total of 3,000, were all worth more than US\$2bn. Together they accounted for 15.8% of the global deal value. Another 60 deals ranging between US\$500m and US\$2bn accounted for 44.1% of the total value.

Aussie gold miners could pick up assets as North American giants wrestle for control

Ord Minnett says Australian miners could play a role in any deal that emerges from the skirmishing between Canada-based Barrick Gold and its US rival Newmont Mining. Barrick has launched a hostile all-scrip US\$18 bn offer for Newmont, citing potential benefits of more than US\$7bn if the two giants combine their operations.

Ord Minnett says consolidating Barrick's and Newmont's footprints in the US states of Nevada and Colorado would unlock valuable synergies, but it is unlikely that Newmont shareholders would be willing to share this equally with Barrick when Newmont is getting close to concluding its own US\$10 bn bid for Canada's Goldcorp.

The manoeuvring has the potential to shake loose some of the North American companies' non-core Australian assets. Ord Minnett identifies potential buyers as Newcrest Mining ((NCM)), Northern Star Resources ((NST)) and Evolution Mining ((EVN)).

The stockbroker says Newcrest could pay as much as US\$3-4bn for assets without putting significant pressure on its balance sheet. With current market capitalization of around US\$14bn, Newcrest has gearing of 11.5%, a net debt to operating earnings ratio of 0.6, and excellent operating cash flow. The Ords team rates Newcrest a Hold with a target price of \$25.00 by December 2019.

Northern Star has already made its first foray into North America, buying the Pogo operation in Alaska in part with an equity raising that was very well supported. Ords says this miner is "the key growth stock within the ASX gold sector" and could look at more opportunities almost immediately. Ord Minnett rates Northern Star at Accumulate, with a target price of \$10.20.

Evolution Mining is expected to generate \$429m of free cash flow in 2018-19 and can look to allocate more capital to exploration, dividends and M&A opportunities in the next 12 months. Ord Minnett rates Evolution a Hold, with a target price of \$3.40.

Evolution has recently paid \$51m for a 19.9% stake in Tribune Resources, giving Evolution 8.4% of the East Kundana Joint Venture via Tribune's holdings in Northern Star and Rand Mining. The stockbroker says the key question is whether the investment brings Evolution and Northern Star closer to discussing synergies or combining their Kalgoorlie businesses.

Structural changes in east coast gas market to keep prices high

Commonwealth Bank's Global Markets Research says gas prices on the east coast are likely to stay high over the next decade due to changes in market structure. The team's analysis looks beyond 2019, when the east coast gas market is expected to produce enough gas to meet expected export and domestic demand, according to an interim report from the Australian Competition and Consumer Commission in December.

The first long-term structural change is that LNG exports have linked international LNG prices to domestic gas prices. The linkage means that "LNG netback prices are now the best gauge of domestic gas prices".

The second change is that Queensland will become the main source of gas for New South Wales, Victoria and South Australia. The higher cost of production in coal-seam gas (CSG) is likely to result in gas prices above A\$10 per Gigajoule.

Third, the growing importance of Queensland's gas production places a strain on the pipeline network connecting Queensland to the southern states. Improvements to the network and LNG import terminals have been proposed, but these would add to upward pressure on prices, suggests the report.

Price trends diverge for metallurgical and thermal coal

Morgan Stanley says prices for metallurgical coal and thermal coal may be heading in opposite directions. Metallurgical coal is trading at around US\$211 per metric ton, supported by robust steel production in China and India and perennial fears about supply, but thermal coal is weak on soft demand for seaborne coal, resulting in prices of around \$90/t (free on board Newcastle).

In late February, China's Dalian port group said it would ban imports of Australian coal indefinitely, sparking fears of a nationwide ban. In 2018, China bought 50 Megatons of thermal coal and 39 Megatons of metallurgical coal from Australia, which represented about 5% and 12% of the respective seaborne markets.

But Morgan Stanley says China is unlikely to ban Australian metallurgical coal completely, as Australia's premium low sulphur hard coking coal is essential for its steel industry. No alternative seaborne suppliers can replace Australian metallurgical coal on a like-for-like basis, and China does not have enough high-quality supplies of its own.

Thermal coal is a different story. Japan, the biggest buyer of Australia's thermal coal, has been cutting back on its Australian imports on weaker demand and diversification of supply. Japan took 81 Megatons, or 40% of Australia's exports of thermal coal, in 2018 but its imports in the fourth quarter of 2018 were down -4% on the same quarter a year earlier.

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Material Matters: Iron Ore, Copper, Gas & Gold

A glance through the latest expert views and predictions about commodities. Iron ore; copper; Queensland gas; and Oz gold assets.

-Iron ore strength likely to continue over 2019, but outlook beyond is unclear -Macro issues may play a part in pushing copper prices higher, despite easing tightness -Opportunities for production growth in Queensland CSG could offset other sources -Which miner is likely to run the ruler over Barrick/Newmont Oz gold assets?

By Eva Brocklehurst

Iron Ore

Iron ore exports recovered in February with the big four Australian producers exporting 65.6mt, up 4% year-on-year. UBS notes all operators lifted monthly volumes and are within their annual capacity target bands.

The broker has downgraded Rio Tinto ((RIO)) to Neutral from Buy as the stock is now trading at a premium. Rio Tinto stock has rallied 23% over the year to date, supported by the strength in the iron ore price.

The risk to its view, the broker acknowledges, lies with the iron ore market and further disruptions in Brazil. UBS calculates the stock is pricing in a long-term iron ore price of US\$56/t against the spot price of US\$88/t, and the latter is not sustainable. UBS envisages an average 2019 price of US\$74/t.

Morgan Stanley raises its iron ore price forecasts by 30% because of the tightness in the market caused by the dam failure at Vale's Brazilian iron ore mine. Price forecasts are raised to US\$81/t for 2019 and US\$68/t for 2020.

The broker observes there is still 140mt of iron ore in China's ports, cushioning the market and, by the time these excess stocks are diminished, supply should recover. Vale's mine is expected to recover to 386mt in 2020.

Citi is more pessimistic and believes low-cost iron ore spare capacity in Brazil will be wiped out for years to come, and the market is likely to remain highly vulnerable to disruptions going forward.

Citi also turned bullish on iron ore earlier in February, raising its 2019 average price forecasts to US\$88/t and the spot target to US\$100/t. The broker perceives the implications of the disruption to Brazilian supply are yet to be fully priced.

The broker estimates the global market is losing around -81mt per year of Brazilian supply, accounting for around 4% of the market. This supply is hard to replace with either spare capacity from Brazil and Australia or high cost supply from China, India and elsewhere. Although Citi concedes it is not impossible at the right price.

Still it is questionable whether traditional swing suppliers will respond at current or higher prices. A major decline in mining expenditure in past years and tighter environmental restrictions are likely to limit supply in China.

Morgan Stanley, on the other hand, expects supply outside of Brazil to respond to current market tightness and elevated prices, but suspects other major iron ore suppliers will be keen to limit the spike in prices and avoid high-cost supply returning to the market. However, the broker does not envisage significant volumes of idled supply will be available for a quick re-start neither in nor outside of China.

Morgan Stanley also suggests the market is ignoring the iron ore leverage of Mineral Resources ((MIN)), likely because of a lack of detail in the reporting for the mining services division. The upgrade to the broker's iron ore price outlook substantially lifts earnings estimates for the business. Morgan Stanley maintains an Overweight rating on the stock with a \$20.80 target.

Copper

Chinese copper consumption appears to be improving and Citi notes exchange inventory is at 10-year lows. Citi suspects that Chinese demand may not be fulfilled that easily from imports, noting reduced production. China relies on a sizeable surplus outside of its borders to feed its consumption of copper.

Despite an easing of market tightness, Citi suspects prices may still head higher because of macro issues, such as the ongoing frictions over the China/US trade deal and a continuation of Chinese stimulus.

Demand is expected to rebound both seasonally and with stimulus measures in the next few months, and raise the threshold for ex China demand to compete for trade flows. President Trump has also confirmed he will delay the US tariff increase that was scheduled for March 1.

Citi remains constructive on copper, expecting prices to reach US\$6800/t by the end of the year. The broker has a long-term target of US\$7500/t. The share prices of global copper companies remain down year-on-year and offer potential upside, in the broker's view.

Citi points out copper is highly leveraged to macro sentiment and equities offer significant potential. The broker highlights Antofagasta in Europe, Southern Copper in the Americas and OZ Minerals ((OZL)) in Australia as top picks.

Queensland Gas

Queensland coal seam gas assets have significantly more gas than any other source on the east coast, with the majority exported through the Curtis Island facilities near Gladstone.

Ord Minnett envisages opportunities for production growth that could offset the declining supply elsewhere and keep the market balanced. Assuming total exports remain at current levels, the broker assesses increased upstream production should mean more gas available for domestic use, and there could be more than 200PJ per annum available by 2023. Ord Minnett forecasts total Queensland gas production to increase to 1627PJ by 2025 from 1341PJ in 2018.

The broker also calculates that current extraction costs will rise materially over time, as well productivity diminishes. The broker estimates that by 2025, more than 25% of Queensland CSG wells will need prices above \$12/GJ to recover capital invested. Queensland's gas output is expected to grow 4% per annum and upstream gas production has increased materially over the last three years since LNG export facilities came online.

Many of the process plants are still underutilised and, now that Santos ((STO)) is less capital constrained, incremental investment in well development should result in higher production. Of the three facilities APLNG, 37.5% owned by Origin Energy ((ORG)) and QCLNG, operated by Shell, are at capacity. Gladstone LNG (GLNG), 30% owned by Santos is operating at around 80-85%.

While Ord Minnett envisages most of the growth will come from GLNG and QCLNG, APLNG has the lowest cost of production because it has the highest average well flow rates. Low flow rates, meanwhile, are expected from the Western Surat fields of Senex Energy ((SXY)) which makes economic the project appear particularly challenging. Ord Minnett recently downgraded Senex Energy to Lighten.

Gold

Ord Minnett has assigned a value of US\$5.6bn to the combined Barrick/Newmont Australian assets, having reviewed the likely options for local gold miners to bid for these assets should Barrick's hostile takeover of Newmont be successful. This local portfolio produces around 2m ounces of gold a year versus Newcrest Mining's ((NCM)) production of 2.4m ounces.

The broker notes gold provides a natural diversification from growth-focused commodities such as iron ore and copper and, as its economists recently pointed out, the chance of a US recession within 12 months has risen to 45%. Being long on gold is considered one of the best late-cycle trades.

The broker suspects BHP ((BHP)), Rio Tinto, South32 ((S32)) and Fortescue Metals ((FMG)) could run the ruler over these assets. The main difference is that gold miners would need to raise equity whereas those mentioned could largely fund acquisitions from existing balance sheets.

The least likely is BHP, as the broker suspects the company's focus on tier 1 assets prevented from considering precious metals. The assets would be strategically sound for South32, but here again the broker assesses the company's appetite is likely to be low.

Meanwhile, gold assets could help Fortescue trade on high multiples and could be more material in terms of scale, while the Australian location would be a good strategic fit. Adding gold in order to diversify could possibly re-rate the business. Meanwhile, an offer may make sense coming from Rio Tinto but Ord Minnett suspects the company is likely to be too conservative in terms of valuation.

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

ESG Focus: The Coal Story (Part I)

-The world has started to abandon thermal coal, the leading carbon emitter per-kilowatt-hour -The introduction of a global carbon tax is a near certainty -Demand for coal continues - primarily from industrialising nations -Coal in China is the largest single source of primary energy in the world

By Sarah Mills

Thermal coal is the world's leading carbon emitter per-kilowatt-hour by a considerable margin, earning itself the ESG reputation of public enemy No. 1. As a result, the industry is likely to be increasingly subject to regulatory imposts, disincentives, ESG investing exclusions and lawsuits.

Add to that the fact that the economics of energy generation have now turned in favour of renewables, coal's future as an investment is increasingly uncertain. And yet its future as a generator of energy - at least for the next two decades - is a sure thing. China and India will continue their industrialisation apace, and as more Asians enter the middle class, the demand for basic appliances such as refrigeration, not to mention luxuries such as air conditioning, will continue to rise.

Neither country is likely to totally convert to renewables in the near future, despite a strong commitment to clean energy, because of the financial muscle required to do so in such a short timeframe. Diversification across different sources of energy generation remains an important strategic consideration too.

This represents a quandary for investors who are developing strategies to manage the rapidly rising risk of investing in coal, while maintaining an exposure to any upside. Many large funds are hedging their exposure by only investing in companies with a 30% to 50% direct investment in coal, and in those companies that demonstrate best ESG practice. Exclusionary investors are boycotting coal altogether.

In the end though, it's the money that talks, and much will depend on the rate at which the price of renewable energy falls, the rate of technological development in high-efficiency generators and to a lesser extent carbon recapture storage; the success of ESG investors in directing the world's capital to alternatives; and the commitment of regulators to supporting that drive. In the meantime, FNArena checks out the state of play with thermal coal and ESG.

Outcast Coal

From an ESG perspective, the outlook for thermal coal is bleak. Coal falls foul of the United Nations' Sustainability Goal (SDG) 13: Take urgent action to combat climate change and its impacts. The key word here that distinguishes it from many other SDG goals is "urgent".

It is the carbon footprint of coal that is the main problem. Coal produces 980 grams of carbon dioxide emissions per-kilowatt-hour of electricity generated, compared with 465 grams for natural gas, 14-45 grams for solar, and 11 grams for wind energy, according to the US Department of Energy's National Renewable Energy Laboratory. Geothermal energy produces about 11.3-47 grams, bio-power about 43 grams and hydropower and tidal/ocean power a tiny 7 grams.

The introduction of a global carbon tax is a near certainty. It is also conceivable that regulations and other taxes will be used as stick, should the carbon tax not reach its desired objective. And of course, funding sources are increasingly drying up as the world's major funds direct money in manner that align with the SDG goals. Major investors are discriminating against utilities that exceed a certain threshold of coal energy in the mix.

Then there is the threat of climate litigation - a new and largely untested field. Litigation certainly had far-reaching impacts on the tobacco industry in the western world, but will it have the same sway in Asia? The only thing that might alleviate some pressure on thermal coal is a huge advance in carbon efficiency or recapture technology but, to date, innovation has been unimpressive. There are only three carbon recapture plants in the world and the coal produced by high efficiency generators has a carbon footprint closer to that of gas than renewables.

Coal also has social governance exposures in instances where coalmining affects agricultural land and the air quality of communities: Beijing being the most infamous case, which resulted in a firm commitment by authorities towards renewables, one of the largest blows to the coal industry in history.

Technological Disruption Has Arrived

All that aside, the much more immediate threat to coal are the changing economics of energy generation. Technological disruption is hitting the thermal coal industry hard and fast. Renewable energy is now unquestionably cheaper than coal-generated energy - and that is after accounting for power storage.

The GenCost 2018 study, conducted by the CSIRO and the Australian Energy Market Operator (AEMO) shows the levelled cost of solar and wind is now well below that of any other generation sources. These findings have been confirmed in other studies by Bloomberg New Energy Finance, and big utilities such as AGL Energy ((AGL)), Origin Energy ((ORG)) and the Snowy Hydro. The CSIRO says that the GenCost estimates are conservative.

Growing competition from renewables is also affecting the existing coal generation industry. Once revenue-per-megawatt hour falls below a coal generator's operating costs the only option is to switch the plant off. This results in lower utilisation, further eroding returns. The wear and tear and fuel consumption arising from turning a plant off and on can reduce the life of a coal plant by a decade.

Fewer banks are funding coal plants on this basis alone and they will be increasingly less likely to fund refurbishments. ANU modeling suggests the life of coal plants is falling from 50 years to 30 years, which means coal-powered generation - at least in the West - is forecast to fall -70% between 2020 and 2030.

It is still cheaper to use existing thermal generators than to decommission the plants and build renewables, but the broad consensus is that it is only a matter of time until this next tipping point is reached. Utilities are aware of this and are already changing their energy generation mix.

The main thing holding back the widespread adoption of renewables at this stage is not the cost of generation but the investment in transmission grids to handle the more volatile energy source. Not surprisingly, banks are becoming increasingly reluctant to fund thermal coal projects - the rejection of the Adani Carmichael proposal being a case in point.

Banks, insurance companies, hedge funds, utilities and other operators in advanced economies are exiting coal. Renewables meanwhile will continue their expansion out to 2023, and will constitute 40% of global energy consumption growth and almost one third of the world's total energy electricity generation, according to the International Energy Association's Renewables 2018 report.

And yet, the demand for coal continues - primarily from industrialising nations.

Demand Still Growing

Global electricity demand is expected to rise 57% by 2050, with the shift to electric vehicles constituting 9% of total demand, according to Bloomberg's New Energy Outlook 2018. The International Energy Agency says coal remains the second-largest global source of primary energy, behind oil, and the largest source of electricity in the world.

Coal in China is the largest single source of primary energy in the world. The country consumes more coal than the rest of the world combined. In this sense, the coal story is essentially the China story. World demand for coal eased and steadied after 2013, when China took drastic steps to reduce its reliance on the product in response to debilitating air pollution in Beijing. Nevertheless, China (and India) are lobbying for concessions on coal consumption in international forums, saying they cannot continue industrialising apace without it.

Chinese delegates to the IPE conference in Dublin said the country would stick to coal as a source of energy and heat production. "In no foreseeable future will China be able to survive without coal," said Robert Li, senior vice-president and investment strategist at China Asset Management Co. Nevertheless, China introduced tough environmental regulations just last August, leaving the world in no doubt to its commitment to reduce its reliance on coal. As a result, analysts believe that, despite consumption rising for the first time in 2017 into 2018, China's demand is expected to wax and wane for the next few years, remaining fairly steady, despite the country generating more electricity.

(To be continued in Part II)

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

Weekly Ratings, Targets, Forecast Changes

By Rudi Filapek-Vandyck, Editor FNArena

Guide:

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

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

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

Summary

Period: Monday February 25 to Friday March 1, 2019 Total Upgrades: 7 Total Downgrades: 25 Net Ratings Breakdown: Buy 42.26%; Hold 43.06%; Sell 14.68%

The final week of the February reporting season saw one deviation from the prior months: total Hold/Neutral ratings for ASX-listed entities is now the largest group for the eight stockbrokerages monitored daily by FNArena.

This, of course, is the direct result of stockbroking analysts issuing decisively more downgrades than upgrades in their ratings for such stocks, with the index up double digit percentage since late December, of which some 6% (incl dividends) were added in February.

For the week ending Friday 1st March 2019, FNArena counted 25 downgrades versus seven upgrades, taking the total tallies to respectively 43.06% Hold/Neutral ratings and 42.26% Buy ratings, with the remaining 14.68% on Sell. Only two of the seven upgrades did not move to Buy.

Only five of the 25 downgrades moved to Sell, and for some it was one of a number of downgrades received. Plenty of stocks received multiple downgrades during the week, ranging from Appen, Atlas Arteria, and OZ Minerals, to Ramsay Health Care. In all cases share prices went up and financial results have been released.

Among the fresh Sell ratings we find NextDC, Costa Group, OZ Minerals, Seek, and Spark Infrastructure.

Target prices have struggled to post net positive gains throughout the season and last week only saw a few stocks post gains that are worth mentioning: Michael Hill enjoyed the week's largest gain (7.57%), beating G8 Education, OZ Minerals, Automotive Holdings and Costa Group.

The negative side of the week's ledger is populated by half a dozen stocks whose consensus target suffered by 2% or more, with FlexiGroup receiving the biggest blow (-4.7%), followed by Caltex Australia, Seek, Spark Infrastructure, and Stockland.

As is usual practice during reporting season, many amendments to consensus earnings forecasts, be it negative or positive, are nothing short of ginormous. NextDC, Atlas Arteria, Unibail-Rodamco-Westfield and Rio Tinto grabbed the honours on the positive side, whereas the heaviest reductions fell down upon Perseus Mining, Galaxy Resources, Automotive Holdings, and Spark Infrastructure.

This week will see the February flood of broker research come to a sudden and immediate stand still. Investors will continue to focus on macro events, while stocks going ex-dividend will continue to populate the calendar.

Upgrade

AUSTRALIAN FINANCE GROUP LTD ((AFG)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 2/0/0

First half net profit was in line with Macquarie's estimates. The broker considers the valuation is now attractive as political/regulatory risk appears to have eased.

Forecasts reflect probable broker remuneration changes as well as negative mortgage settlement activity extending through FY20.

Macquarie assumes mortgage settlement activity remains negative until FY21, which drives downgrades to estimates of earnings per share of -26.3% in FY20.

Rating is upgraded to Outperform from Neutral and the target is raised to \$1.48 from \$1.17.

AUTOMOTIVE HOLDINGS GROUP LIMITED ((AHG)) Upgrade to Neutral from Underperform by Macquarie .B/H/S: 0/6/1

First half results were weaker than Macquarie expected. While the broker envisages downside risk to guidance concerns over the balance sheet have diminished as costs are being controlled.

FY19 net profit guidance is revised lower, to \$52-56m. The company expects a second half recovery but the earnings skew is inconsistent with history, in the broker's view.

Macquarie upgrades to Neutral from Underperform, given the improved balance sheet. Target is raised to \$1.95 from \$1.50.

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

Cash net profit fell sharply in the first half, largely because of an impairment in the vendor finance book. Certegy was a highlight while cards continue to be a drag, Deutsche Bank observes.

Still, despite profit declines, the company appears to be entrenched in consumer finance and should generate more cash than listed finance peers that are valued on significantly higher multiples, in the broker's view.

Given strong valuation support and the upside risk from new initiatives the broker upgrades to Buy from Hold. Target is \$1.80.

MICHAEL HILL INTERNATIONAL LIMITED ((MHJ)) Upgrade to Add from Hold by Morgans .B/H/S: 3/1/0

First half results were ahead of forecasts. Morgans senses a change in momentum after a prolonged period of the company missing expectations, and makes material upgrades to forecasts for FY20 and FY21.

The broker believes the cost-cutting program will underpin two years of solid growth and upgrades to Add from Hold. Target is raised to \$0.78 from \$0.62.

MYER HOLDINGS LIMITED ((MYR)) Upgrade to Neutral from Sell by UBS .B/H/S: 0/2/3

Myer has underperformed the index by -18% over the past three months, UBS notes, due to market concern over weak Christmas trading. Yet retail company reports this season suggest that while tough, Christmas was not as bad as feared. Moreover, Myer is making good progress on handing back floor space and landlords are becoming more prepared to accept rental reductions.

And most importantly, Myer has not provided a trading update (Read: profit warning). UBS thus upgrades to Neutral. Target unchanged at 38c.

TREASURY WINE ESTATES LIMITED ((TWE)) Upgrade to Accumulate from Hold by Ord Minnett .B/H/S: 5/2/1

Ord Minnett reviews its valuation of Treasury Wine Estates, noting since the first half result the share price has fallen -11.7%. Yet significant earnings (EBITS) growth is forecast.

Now, cash conversion and the concerns over the agricultural cycle are better reflected in the share price.

As the risk/reward equation is more attractive the broker upgrades to Accumulate from Hold. Target is steady \$17.50.

WISETECH GLOBAL LIMITED ((WTC)) Upgrade to Buy from Neutral by Citi .B/H/S: 2/2/0

Citi's upgrade to Buy from Neutral following a -24% fall in the share price over the past seven days. In addition, the analysts believe the latest acquisition (of Containerchain) "appears to be highly strategic" for the company.

Forecast FY19 revenue growth of \$114m (51%) is split 23% organic and 28% acquisitive, the analysts explain, Target price lifts to \$21.31 from \$21.09.

Downgrade

ATLAS ARTERIA ((ALX)) Downgrade to Hold from Add by Morgans and Downgrade to Neutral from Buy by UBS and Downgrade to Neutral from Outperform by Credit Suisse .B/H/S: 2/4/0

Morgans found no major surprises in the results as toll revenue had already been published. The broker was hoping for news about the removal of the Eiffarie debt amortisation, as this accounts for 8-9c per security of its FY20-21 distribution forecast.

Of most concern to Morgans is a potential change of legislated tax rate reductions in France. The broker downgrades to Hold from Add, given recent strength in the share price. Target is reduced to \$6.64 from \$6.74.

2018 results revealed a doubling of cash flow that more than covered the distribution. UBS expects 2019 will be a year of transition as there are a number of traffic disruptions and temporarily elevated corporate costs.

Guidance is for a 25% rise in the 2019 distribution to \$0.30 per security, which reflects an expected 10% increase in cash flow from APRR.

UBS downgrades to Neutral from Buy, given a period of strong outperformance and insufficient upside to valuation. Target is reduced to \$6.90 from \$7.10.

Credit Suisse lowers 2020 distribution growth forecasts to 10% from 23%, estimating there is a significant risk that Dulles Greenway may not pass the one-year debt test in December 2019. This would prevent distributions until 2021.

Credit Suisse downgrades to Neutral from Outperform, having removed the option value for a favourable long-term toll regulation deal for Dulles Greenway. Target is lowered to \$7.15 from \$7.50.

AUSTRALIA & NEW ZEALAND BANKING GROUP ((ANZ)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 4/4/0

ANZ's focus on expense management in a tough revenue environment and its leading capital position provide support, but Macquarie sees downside risk to forecasts given challenging revenue conditions, ongoing market share losses and RBNZ capital requirement uncertainty. The broker's forecasts have been trimmed.

Recent relative outperformance has taken ANZ back to its five-year PE average and its dividend yield down to a sector-low 5.8%. Macquarie downgrades to Neutral from Outperform, retaining a \$28 target.

APPEN LIMITED ((APX)) Downgrade to Neutral from Buy by UBS and Downgrade to Neutral from Buy by Citi .B/H/S: 0/2/0

Appen delivered an exceptionally strong result in UBS's view, 10% above forecast. FY19-21 guidance has been upgraded by 10-20% and thereafter in excess of 20%. The broker believes FY19 guidance looks conservative on current momentum, noting the company's leading market position will allow it to leverage accelerating global investment in AI.

That said, the broker has raised its target to \$24 from \$16 but downgrades to Neutral from Buy, noting the stock has gained 90% in a quarter compared to a 30% increase in sector multiple.

Appen's 2018 financial performance seems to have beaten expectations, but Citi, in firm reference to the 75% share price rally year-to-date, downgrades to Neutral from Buy. The analysts have added 18%-20% to forecasts.

The combination Appen-Leapforce has potential to become the ultimate "winner" in the global race for analytics, state the analysts. Target price lifts to \$23.29 from \$17.31. Citi analysts add the suggestion that management's guidance for 2019 might yet prove conservative.

DPS estimates have been lowered.

COSTA GROUP HOLDINGS LIMITED ((CGC)) Downgrade to Lighten from Hold by Ord Minnett .B/H/S: 3/1/0

2018 net profit was ahead of Ord Minnett's forecasts. The company may have a strong market position and good growth opportunities but the broker finds guidance for 30% growth in 2019, off a depressed year, below expectations.

Forecasts for 2019 and 2020 are reduced by -5% and -2%, respectively. The broker believes the exposure to the uncertainties of agricultural supply/demand is not reflected in the premium valuation and downgrades to Lighten from Hold. Target is reduced to \$4.69 from \$4.74.

CHARTER HALL GROUP ((CHC)) Downgrade to Hold from Accumulate by Ord Minnett .B/H/S: 2/2/0

First half results were in line with Ord Minnett's forecasts. Ord Minnett estimates funds management operating margins rose by 770 basis points over the past 12 months, to 57%.

The potential for increasing economies of scale is relatively strong, the broker suggests. The share price has risen 18% over the past four weeks in anticipation of stronger earnings and now appears fair value. Rating is downgraded to Hold from Accumulate.

To reflect higher forecast medium-term earnings because of a reduced need for external capital, as well as a higher operating margins, the target is raised to \$9.00 from \$8.75.

CROMWELL PROPERTY GROUP ((CMW)) Downgrade to Hold from Accumulate by Ord Minnett .B/H/S: 0/2/1

First half operating profit was below Ord Minnett's forecasts because of lower rental income and higher corporate costs. The company has maintained earnings guidance for FY19 of not less than 8c per share.

Over time, Ord Minnett expects capital to be realised in the company's office portfolio as assets are re-positioned and re-deployed into aged care or into Europe via co-investment.

This is an opportunistic strategy that the company believes is justified by higher returns, although it carries increased complexity that the broker believes will not appeal to some investors.

Rating is downgraded to Hold from Accumulate. Target rises to \$1.13 from \$1.10.

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

Deutsche Bank observes convenience store targets are looking tougher to attain. The broker expects the current low fuel price will support retail fuel margins and refining margins will eventually revert.

However, the departure of the general manager of convenience makes the broker less confident about the uplift target from the transformation. The broker believes Viva Energy ((VEA)) is a better way to play the thematic as it has market share opportunity.

Rating is downgraded to Hold from Buy. Target is reduced to \$27.50 from \$28.00.

G8 EDUCATION LIMITED ((GEM)) Downgrade to Hold from Add by Morgans .B/H/S: 4/2/0

2018 results were in line with guidance. Morgans observes occupancy in the year to date is up around 2% but excess supply continues to make for a challenging market.

The company has reiterated a medium-term occupancy target of 81%. Morgans downgrades to Hold from Add as the total shareholder returns are under 10%. Target is raised to \$3.16 from \$3.04.

HUON AQUACULTURE GROUP LIMITED ((HUO)) Downgrade to Hold from Buy by Ord Minnett .B/H/S: 0/2/0

First half operating earnings (EBITDA) were below Ord Minnett's forecasts. FY19 volume guidance of 20,000t is unchanged. Guidance requires flat production costs for the second half, which the broker suspects could be challenging.

Ord Minnett reduces FY19 and FY20 earnings forecasts by -24% and -14% respectively. The broker believes the company is well invested, but there are risks to forecasts from higher production costs in the near term and lower wholesale prices in the longer term.

Rating is downgraded to Hold from Buy. Target is lowered to \$4.40 from \$5.41.

KELLY PARTNERS GROUP HOLDINGS LIMITED ((KPG)) Downgrade to Hold from Add by Morgans .B/H/S: 0/1/0

First half net profit was weaker than expected. The Sydney CBD business underperformed. The company has provided net profit guidance for FY19 of \$4m.

Morgans downgrades to Hold from Add, suspecting management has contained the underperforming business but will need to deliver on guidance and organic growth into FY20 to restore confidence. Target is reduced to \$1.08 from \$1.65.

NEXTDC LIMITED ((NXT)) Downgrade to Sell from Hold by Deutsche Bank .B/H/S: 4/2/1

Deutsche Bank observes the business is increasingly exposed to a concentration of buyers, lower returns on invested capital and an unpredictable sales cycle.

Sales velocity appears to have decreased because of the more complex nature of hyper-scale contracts. The company is also incurring significant expenditure to achieve its growth ambitions and this is leading to elevated debt and interest levels in the short term.

The broker downgrades to Sell from Hold. Target is \$5.50.

OZ MINERALS LIMITED ((OZL)) Downgrade to Hold from Buy by Deutsche Bank and Downgrade to Underperform from Neutral by Credit Suisse and Downgrade to Hold from Add by Morgans .B/H/S: 3/4/1

2018 results beat Deutsche Bank estimates, driven by lower depreciation & amortisation. The broker had expected more detail on the progress at Carrapateena, given its importance in the portfolio.

In updating 2019 assumptions and its views on copper, the broker observes the stock has outperformed peers and the copper price, downgrading to Hold from Buy. Target is \$11.

2018 net profit was less than Credit Suisse expected. The broker observes forensic analysis is required to unravel the company's circuitous accounting. This diverts attention from cash and the outlook and Credit Suisse wonders how the board understands the accounts as presented.

The broker notes Brazil is not yet materialising and the concentrate treatment plant project has been shelved. Credit Suisse downgrades to Underperform from Neutral. Target is \$9.

2018 results were in line with expectations. Morgans observes the company continues to prudently manage its growth options. The focus is on re-affirming the construction schedule and budget for Carrapateena.

Upside to the broker's valuation has been reduced following a strong run up in the share price and the rating is downgraded to Hold from Add.

Upon the full de-risking of Carrapateena the stock offers upside to valuation, the broker assesses. The target is raised to \$11.40 from \$10.75.

RAMSAY HEALTH CARE LIMITED ((RHC)) Downgrade to Hold from Buy by Deutsche Bank and Downgrade to Neutral from Buy by Citi .B/H/S: 1/6/1

First half results pleased Deutsche Bank, demonstrating the Australian business can achieve decent revenue growth and margin expansion, while European profitability is improving.

The broker expects the the company to benefit from increased tariffs in France and the UK, amid synergies from the Capiro acquisition. The broker downgrades to Hold from Buy on valuation. Target is \$64.90.

Ramsay delivered a solid result, in line with Citi's forecast. Revenue growth in Australia suggests Ramsay continues to take market share and by continuing to invest in hospital capex, the company is attracting more doctors and driving market share gains, the broker notes.

France surprised to the upside and weakness in the UK reduced in the Dec Q. Capiro integration is now the focus, Citi believes, but could take time. On recent share price strength the broker pulls back to Neutral from Buy. Target rises to \$65.00 from \$61.25.

SPEEDCAST INTERNATIONAL LIMITED ((SDA)) Downgrade to Neutral from Outperform by Credit Suisse .B/H/S: 0/4/0

2018 results were in line with downgraded expectations. Credit Suisse expects the company will need to deliver some organic growth in 2019 in order to obtain a re-rating.

The broker, which changes analyst coverage with this report, is also concerned about elevated gearing and downgrades to Neutral from Outperform.

The broker is pleased the company has acknowledged investor reservation and committed to de-leveraging. Target is reduced to \$3.70 from \$5.50.

SEEK LIMITED ((SEK)) Downgrade to Sell from Neutral by UBS .B/H/S: 2/3/2

First half results were in line with expectations and UBS envisages inherent risk to the second half if Australasian job volumes and the macro environment in China worsen.

The broker cuts underlying estimates for earnings per share by -10% and downgrades to Sell from Neutral, reducing the target to \$17.00 from \$18.50.

STOCKLAND ((SGP)) Downgrade to Hold from Accumulate by Ord Minnett .B/H/S: 1/3/2

First half funds from operations were well below Ord Minnett's forecasts, driven by weaker residential earnings and retail operating income.

The broker downgrades forecasts by -3.5% in FY19 and -6% in FY20, based on lower assumed residential and retail earnings.

Because of uncertainty and risks with additional asset sales and re-positioning of the portfolio, the broker downgrades to Hold from Accumulate. Target is reduced to \$3.80 from \$4.30.

SPARK INFRASTRUCTURE GROUP ((SKI)) Downgrade to Underweight from Equal-weight by Morgan Stanley .B/H/S: 0/5/2

Morgan Stanley believes compressed regulatory returns and tax uncertainty have reduced the stock's relative appeal and downgrades to Underweight from Equal-weight.

The 2018 performance was in line with the broker's estimates but the risks are considered skewed to the downside going forward.

Target is reduced to \$2.28 from \$2.43. Industry view is Cautious.

SUPERLOOP LIMITED ((SLC)) Downgrade to Hold from Buy by Deutsche Bank .B/H/S: 1/1/0

Deutsche Bank is concerned the continued lack of sales momentum on Superloop's HK and Australian networks is concerning. Management's plans to focus on the core network and broadband businesses is a step in the right direction, find the analysts, but also a step back, nevertheless.

Deutsche Bank has downgraded to Hold from Buy. The analysts suggest it will take time for this company to demonstrate traction on the new strategy. New price target of \$1.28 compares with \$2.80 in August last year.

UNIBAIL-RODAMCO-WESTFIELD ((URW)) Downgrade to Hold from Accumulate by Ord Minnett .B/H/S: 0/3/1

Ord Minnett has reassessed the prospects for the company. The focus on prime shopping centres in wealthy catchments is likely to mean the business is a long-term winner but the broker envisages few near-term catalysts in a tough retailing environment.

Ord Minnett downgrades to Hold from Accumulate and lowers the target to \$12.60 from \$13.00. The broker notes 2019 earnings growth guidance was lowered for several reasons.

The company is aiming to sell EUR4bn in property and the broker is unsure how much was incorporated in guidance.

Total Recommendations Recommendation Changes

Broker Recommendation Breakup

Broker Rating Order Company New Rating Old Rating Broker Upgrade 1 AUSTRALIAN FINANCE GROUP LTD Buy Neutral Macquarie 2 AUTOMOTIVE HOLDINGS GROUP LIMITED Neutral Sell Macquarie 3 FLEXIGROUP LIMITED Buy Neutral Deutsche Bank 4 MICHAEL HILL INTERNATIONAL LIMITED Buy Neutral Morgans 5 MYER HOLDINGS LIMITED Neutral Sell UBS 6 TREASURY WINE ESTATES LIMITED Buy Neutral Ord Minnett 7 WISETECH GLOBAL LIMITED Buy Neutral Citi Downgrade 8 APPEN LIMITED Neutral Buy Citi 9 APPEN LIMITED Neutral Buy UBS 10 ATLAS ARTERIA Neutral Buy Morgans 11 ATLAS ARTERIA Neutral Buy UBS 12 ATLAS ARTERIA Neutral Buy Credit Suisse 13 AUSTRALIA & NEW ZEALAND BANKING GROUP Neutral Buy Macquarie 14 CALTEX AUSTRALIA LIMITED Neutral Buy Deutsche Bank 15 CHARTER HALL GROUP Neutral Buy Ord Minnett 16 COSTA GROUP HOLDINGS LIMITED Sell Neutral Ord Minnett 17 CROMWELL PROPERTY GROUP Neutral Buy Ord Minnett 18 G8 EDUCATION LIMITED Neutral Buy Morgans 19 HUON AQUACULTURE GROUP LIMITED Neutral Buy Ord Minnett 20 KELLY PARTNERS GROUP HOLDINGS LIMITED Neutral Buy Morgans 21 NEXTDC LIMITED Sell Neutral Deutsche Bank 22 OZ MINERALS LIMITED Neutral Buy Morgans 23 OZ MINERALS LIMITED Sell Neutral Credit Suisse 24 OZ MINERALS LIMITED Neutral Buy Deutsche Bank 25 RAMSAY HEALTH CARE LIMITED Neutral Buy Citi 26 RAMSAY HEALTH CARE LIMITED Neutral Buy Deutsche Bank 27 SEEK LIMITED Sell Neutral UBS 28 SPARK INFRASTRUCTURE GROUP Sell Neutral Morgan Stanley 29 SPEEDCAST INTERNATIONAL LIMITED Neutral Buy Credit Suisse 30 STOCKLAND Neutral Buy Ord Minnett 31 SUPERLOOP LIMITED Neutral Buy Deutsche Bank 32 UNIBAIL-RODAMCO-WESTFIELD Neutral Buy Ord Minnett Recommendation Positive Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 MHJ MICHAEL HILL INTERNATIONAL LIMITED 75.0% 50.0% 25.0% 4 2 AIZ AIR NEW ZEALAND LIMITED -25.0% -50.0% 25.0% 4 3 WTC WISETECH GLOBAL LIMITED 50.0% 25.0% 25.0% 4 4 GUD G.U.D. HOLDINGS LIMITED 88.0% 70.0% 18.0% 4 5 MYR MYER HOLDINGS LIMITED -58.0% -75.0% 17.0% 6 6 FXL FLEXIGROUP LIMITED 67.0% 50.0% 17.0% 6 7 AHG AUTOMOTIVE HOLDINGS GROUP LIMITED -14.0% -29.0% 15.0% 7 8 ALG ARDENT LEISURE GROUP 13.0% 10.0% 3.0% 4 9 TME TRADE ME GROUP LIMITED 20.0% 17.0% 3.0% 5 Negative Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 ALX ATLAS ARTERIA 33.0% 83.0% -50.0% 6 2 OZL OZ MINERALS LIMITED 25.0% 63.0% -38.0% 8 3 GEM G8 EDUCATION LIMITED 67.0% 83.0% -16.0% 6 4 CMW CROMWELL PROPERTY GROUP -33.0% -17.0% -16.0% 3 5 SKI SPARK INFRASTRUCTURE GROUP -29.0% -14.0% -15.0% 7 6 SEK SEEK LIMITED -7.0% 7.0% -14.0% 7 7 CTX CALTEX AUSTRALIA LIMITED 43.0% 57.0% -14.0% 7 8 VCX VICINITY CENTRES 50.0% 63.0% -13.0% 3 9 URW UNIBAIL-RODAMCO-WESTFIELD -25.0% -13.0% -12.0% 4 10 ANZ

AUSTRALIA & NEW ZEALAND BANKING GROUP 44.0% 56.0% -12.0% 8 Target Price Positive Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 MHJ MICHAEL HILL INTERNATIONAL LIMITED 0.753 0.700 7.57% 4 2 GEM G8 EDUCATION LIMITED 3.457 3.297 4.85% 6 3 OZL OZ MINERALS LIMITED 11.150 10.675 4.45% 8 4 AHG AUTOMOTIVE HOLDINGS GROUP LIMITED 1.859 1.783 4.26% 7 5 CGC COSTA GROUP HOLDINGS LIMITED 5.852 5.642 3.72% 5 6 MYO MYOB GROUP LIMITED 3.200 3.118 2.63% 3 7 RIO RIO TINTO LIMITED 91.023 89.936 1.21% 8 8 WTC WISETECH GLOBAL LIMITED 19.858 19.803 0.28% 4 9 ALX ATLAS ARTERIA 7.087 7.082 0.07% 6 Negative Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 FXL FLEXIGROUP LIMITED 1.653 1.735 -4.73% 6 2 CTX CALTEX AUSTRALIA LIMITED 29.794 30.647 -2.78% 7 3 SEK SEEK LIMITED 19.334 19.859 -2.64% 7 4 SKI SPARK INFRASTRUCTURE GROUP 2.271 2.324 -2.28% 7 5 SGP STOCKLAND 3.738 3.822 -2.20% 6 6 NXT NEXTDC LIMITED 7.644 7.807 -2.09% 7 7 URW UNIBAIL-RODAMCO-WESTFIELD 11.610 11.810 -1.69% 4 8 GUD G.U.D. HOLDINGS LIMITED 13.603 13.812 -1.51% 4 9 CMW CROMWELL PROPERTY GROUP 1.043 1.057 -1.32% 3 10 VCX VICINITY CENTRES 2.800 2.830 -1.06% 3 Earning Forecast Positive Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 NXT NEXTDC LIMITED 0.133 -0.750 117.73% 7 2 ALX ATLAS ARTERIA 45.357 23.373 94.06% 6 3 URW UNIBAIL-RODAMCO-WESTFIELD 46.959 33.509 40.14% 4 4 RIO RIO TINTO LIMITED 840.589 726.091 15.77% 8 5 GEM G8 EDUCATION LIMITED 19.800 17.420 13.66% 6 6 VEA VIVA ENERGY GROUP LIMITED 15.420 13.780 11.90% 6 7 ORE OROCOBRE LIMITED 10.913 10.584 3.11% 8 8 SGP STOCKLAND 35.067 34.233 2.44% 6 9 ORG ORIGIN ENERGY LIMITED 61.974 60.546 2.36% 8 10 NSR NATIONAL STORAGE REIT 9.700 9.500 2.11% 3 Negative Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 PRU PERSEUS MINING LIMITED -0.130 2.970 -104.38% 3 2 GXY GALAXY RESOURCES LIMITED 1.265 3.465 -63.49% 5 3 AHG AUTOMOTIVE HOLDINGS GROUP LIMITED 0.534 0.814 -34.40% 7 4 SKI SPARK INFRASTRUCTURE GROUP 6.684 9.622 -30.53% 7 5 OZL OZ MINERALS LIMITED 57.798 76.017 -23.97% 8 6 IPL INCITEC PIVOT LIMITED 18.086 22.889 -20.98% 8 7 BAL BELLAMY'S AUSTRALIA LIMITED 31.233 38.367 -18.59% 3 8 OML OOH!MEDIA LIMITED 25.533 27.858 -8.35% 4 9 EHE ESTIA HEALTH LIMITED 16.275 17.625 -7.66% 4 10 BIN BINGO INDUSTRIES LIMITED 7.767 8.300 -6.42% 3 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: Held To Ransom

The US section 232 investigation is curtailing demand in the uranium market and leading to price consolidation.

-Section 232 slows activity in US uranium market -Sellers becoming anxious -Paladin Energy looks to a restart

By Greg Peel

Uncertainty surrounding section 232 has “frozen” the US uranium market, noted Cameco CEO Tim Gitzel at last week’s Global Metals & Mining Conference in Florida, with US utilities generally reluctant to enter into new purchase agreements.

To recap: Two US uranium producers have petitioned the White House to force US utilities to purchase 25% of their requirements domestically, rather than (cheaper) foreign imports, as a matter of “national security”. This comes under section 232, the same act implemented in imposing tariffs on foreign imports. Nuclear power utilities are already struggling to compete in US electricity markets even with cheaper uranium on offer.

The US Department of Commerce is investigating, and has been now for over a year. The petition was filed in January 2018. Most recently the DoC sent out an extensive questionnaire which has been described by various parties as “onerous” and “intrusive” as well as time-consuming. The deadline for return of the questionnaire was end-February.

The DoC is scheduled to issue a report and any recommendations to the president by April 18, and he then is permitted months to ponder his response.

232 uncertainty has been hanging over the uranium market for over a year yet it was in April last year uranium prices began their steady climb, given the extent of investor interest and producer purchases required to make up for curtailed production. It has only been this year, with the questionnaire being issued and the deadline approaching, that activity has stalled.

In the meantime, several leading uranium industry participants, including utilities and producers (but not the petitioners) are looking to draft their own proposal for the government’s consideration.

With utilities preoccupied, the upward momentum seen in prices in 2018 has waned in 2019. A fall-off in demand has led sellers to become more urgent, hitting buyers at lower prices as last week progressed. By the last day of February industry consultant TradeTech’s spot price indicator had fallen to US\$28.00/lb. A slight bounce on the Friday saw the weekly indicator at US\$28.15/lb, down -US75c from the week before.

Five transactions were concluded in the week, totalling 800,000/lbs U3O8 equivalent.

Month on month, the spot price ended February down -US90c from end-January.

TradeTech’s term market indicators remain unchanged from end-January at US\$30.00/lb (mid) and US\$32.00/lb (long).

Restart

Australian-listed uranium miner Paladin Energy ((PDN)) last week commenced a pre-feasibility study for the restart of its Langer Heinrich mine in Namibia, which was shut down due to uneconomical uranium prices.

The company has identified multiple options that could reduce operating costs, improve processing reliability and potentially recover a saleable vanadium bi-product.

The options were identified in a concept study begun in September last year, which concluded the company is in a strong position to restart Langer Heinrich “when there is a sustained recovery in uranium prices”.

Had to be a catch.

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

The Short Report

Guide:

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

Please take note of the Important Information provided at the end of this report. Percentage 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 February 28, 2019

It was a choppy week last week for the ASX200. A general trend upward was punctuated by a one-day washout that appeared to have shaken out the Nervous Nellies.

It was the last week of result season and while not quite as busy as the prior week, still quite substantial in terms of number of companies reporting. And those reports were responsible for some notable changes in short positions.

Increases of a percentage point or more were suffered by both SpeedCast International ((SDA)) and Hub24 ((HUB)) post result, yet one "beat" and the other "missed". See below.

I noted last week that it was no shock Bingo Industries ((BIN)) fell off the bottom of the 5%-plus shorted table after its share price lost -49% on a profit warning. Well, the share price has recovered about half that loss since, the ACCC has approved the acquisition of Dial-a-Dump, and Bingo is back at 5.3% shorted.

Also appearing at the bottom of the table this week, at 5.1% shorted, is perennial profit warner Pact Group ((PGH)). The packaging company lost -35% in value over the course of two weeks following yet another guidance downgrade. Looks like the shorters are moving in for the kill.

At the other end of the table, infant formula producer Bellamy's ((BAL)) has seen its share price rally 37% since reporting. Bellamy's is back in the 10%-plus club this week with a tick up to 10.5% from 9.8%.

Weekly short positions as a percentage of market cap:

10%+ SYR 17.6 ING 17.1 GXY 15.4 ORE 12.7 JBH 12.8 IVC 12.0 BWX 11.6 MTS 11.5 MYR 11.0 SDA 10.6 BAL 10.5 NXT 10.4

In: BAL, SDA Out: DMP

9.0-9.9

DMP

In: DMP Out: BAL, SDA, HVN 8.0-8.9%

HVN, PLS, SUL, IFL,

In: HVN, IFL

7.0-7.9%

BOQ, BKL, NUF, MSB, AMP, BEN, SGM, AMC

Out: IFL

6.0-6.9%

HUB, DHG, LYC, CGF, A2B, RSG

In: HUB, LYC , A2B Out: RWC, NAN

5.0-5.9%

NAN, CCP, CSR, HT1, GMA, BGA, RWC, CAR, WSA, APT, BIN, KDR, CLH, PGH, MLX, KAR, LNG

In: NAN, RWC, CSR, BIN, PGH, LNG

Out: LYC, A2B, HUB, SEK, MND, AHG

Movers & Shakers

Satellite company SpeedCast International was another to provide a profit warning ahead of its result release, back in December. The day ahead of the release the share price dropped sharply in anticipation.

The opposite occurred upon release, given full year guidance suggested a much better second half for the company. The shorters aren't convinced, increasing positions to 10.6% from 9.6%.

Wealth platform provider Hub24 was enjoying a solid rally in February, right up to its result release. The story for platforms in a post Hayne world is unclear. On the one hand, Hub24 and peers are expected to enjoy an inflow of funds from disgruntled investors abandoning evil banks and fund managers, but in response, those fund managers are reducing fees and competition is becoming fierce.

Hub24 disappointed with its result, missing all broker forecasts due to higher costs. The share price took a dive, and shorters increased positions to 6.9% from 5.1%.

ASX20 Short Positions (%)

Code Last Week Week Before Code Last Week Week Before AMC 7.2 7.3 RIO 4.1 4.1 ANZ 1.7 1.6 S32 0.8 0.6 BHP 4.2 4.4 SCP 0.7 1.1 BXB 0.4 0.3 SUN 0.8 1.0 CBA 2.2 2.2 TCL 1.5 1.5 COL 2.3 2.3 TLS 0.8 0.7 CSL 0.2 0.2 WBC 2.0 2.0 IAG 0.2 0.4 WES 1.6 1.4 MQG 0.3 0.3 WOW 2.7 2.8 NAB 1.2 1.0 WPL 0.7 0.8 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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FNArena is proud about its track record and past achievements: Ten Years On

The Wrap: GDP, A-REITs & Financial Advice

Weekly Broker Wrap: Oz economy & RBA cash rate; A-REITs; retailers; financial advice; and online classifieds.

-December quarter GDP brings official rate cut into play, Macquarie expects -50bps in cuts by year end -Office, industrial property the highlight of A-REITs performance while retail, residential under pressure -Outlook for retailers increasingly cautious -Shake out continues for financial advice, superannuation -Subdued outlook for online classifieds

By Eva Brocklehurst

Oz Economy And RBA Cash Rate

Australia's December quarter GDP grew just 0.2%, below expectations. Annual growth has slowed to 2.3% and the second half of 2018 was the slowest six months of growth since 2008. Dwelling and mining investment were the main detractors from growth, while government spending was the main driver.

Housing exposed sectors are a key point of weakness and dwelling construction appears to have peaked. Household expenditure was also very subdued, with the slowdown centred on discretionary categories.

Morgan Stanley suggests the GDP numbers are a signal that household de-leveraging is beginning and more likely to be a headwind to expenditure going forward. The broker lowers GDP growth forecasts to 2.2% for 2019.

This implies that, in turn, the Reserve Bank of Australia will need to reduce its GDP forecast for 2019, after reducing it 50 basis points to 2.75% just a month ago. This, in turn, increases the risk of an official rate cut this year, although the broker notes the RBA governor, Philip Lowe has made it clear the labour market will be the ultimate determinant of rate reductions.

As Morgan Stanley expects the unemployment rate will only rise to 5.2% over 2019, with government-linked sectors absorbing spare capacity, this is not expected to be enough to propel the central bank to cut the cash rate, yet.

Macquarie, on the other hand, now suspects the RBA will cut the cash rate by -50 basis points to 1% this year, noting the markets have a -25 basis points reduction fully priced by late this year.

Macquarie suggests May or August are the most likely months for the first cut to the cash rate. The broker is definitely not of the view that central banks should keep their moves in check in case growth turns out to be weaker down the track.

Instead, if additional policy support is necessary the broker believes it should be provided, and provided early, rather than having to take more drastic action if growth turns down sharply. In the event of a sharp downturn in economic growth, Macquarie believes there is ample fiscal ammunition and unconventional policy tools such as quantitative easing available to policymakers.

The broker is also not of the view that reducing the cash rate, which is at a low level historically, would provide little economic support. Reductions are likely to be substantially passed through to actual lending rates, and the Australian dollar would also be lower. There is also little risk that easier policy will lead to growth that is too strong.

A-REITs

Office and industrial property revealed strong net operating income growth over the recent reporting season. Fundamentals remain supportive. Within the sector, valuation differentials have widened and higher multiples were ascribed to stocks with expanding earnings growth, Ord Minnett points out. The broker observes healthy user demand and limited supply coming online.

Meanwhile, in retail, conditions remain challenging and capitalisation rates were flat, with pockets of weakness also noted in valuations. Development has been scaled down and the number of assets on the market is increasing.

The broker also notes the time to sell is being pushed out. Ord Minnett expects residential A-REITs earnings will peak soon, and most groups in this market rely on a second half skew. This will mean pressure on FY21 or FY22 because of slower sales rates. Ord Minnett has recently upgraded Vicinity Centres ((VCX)) to Buy and Charter Hall Group ((CHC)) to Accumulate.

Residential and retail segments were worse than UBS expected in the latest reporting season. The number of retail assets on the market have come under increased scrutiny and appear set to be the largest headwind for the sector in 2019.

UBS downgrades the earnings of those A-REITs exposed to residential and retail by -2-4%, to reflect lower residential sales rates, lower retail income growth and a deterioration in pricing/terms of retail assets. The broker upgrades expectations for Goodman Group ((GMG)) and Charter Hall, to reflect higher growth in funds under management, more performance fees and increased development profits.

Retailers

Credit Suisse observes most retailers under coverage experienced decelerating sales growth over the latest half-year reports. The outlook appears increasingly cautious. Online business once again dominated the growth scenario, accounting for half of retail sector revenue growth in the period.

Expenditure on digital technology also increased, even though the monetisation remains elusive in many areas. Credit Suisse evaluates Woolworths ((WOW)) as the most advanced in its digital initiatives.

Meanwhile, Breville Group ((BRG)) delivered the highest shareholder return over the past three months, followed by Harvey Norman ((HVN)) and Wesfarmers ((WES)). Debate centres on the impact of structural change, particularly in electrical, and the broker remains decidedly bearish. Expectations for margin expansion also appear to have been tempered.

Credit Suisse elevates Woolworths in order of preference amongst retailers and maintains an Outperform rating on Caltex ((CTX)), as an off-market buyback is providing support for the near term and convenience earnings appear to be stabilising.

Credit Suisse likes the under-gearred balance sheet and strong cash generating businesses of Wesfarmers and considers the company's next step is likely to be an acquisition. The outcome for Flight Centre ((FLT)) in the first half was worse than Credit Suisse expected in the broker now envisages a higher risk of a downgrade.

Financial Advice

The upheaval in financial advice has instigated a record decline for large integrated operators over February, with Bell Potter noting -135 advisers have left the likes of AMP ((AMP)), IOOF ((IFL)) and the major banks. The broker believes the recommendations from the Hayne Royal Commission are material and it will take years for the industry to properly adjust. AMP appears the most caught up in the whirlwind.

Following the 2018 federal budget, reforms to superannuation were passed in February, limiting fees on balances below \$6000, consolidating inactive accounts and removing exit fees.

AMP has flagged a meaningful impact on earnings while IOOF is yet to do so. Both have flagged price reductions and Bell Potter envisages a need to cut fees further. The broker continues to have a Sell rating on both stocks and envisages material downside. Bell Potter's preferred exposure in the segment is Netwealth ((NWL)), followed by Onevue Holdings ((OVH)).

Online Classifieds

The latest reporting season has reinforced the view that online classifieds will sustain a softer second half, with implications for Domain Group ((DHG)) and REA Group ((REA)). UBS notes, in Sydney, new listings for real estate have declined -25% for the four weeks to February 24 and, importantly, on more meaningful volumes. New listings have also declined -24% in Melbourne.

The NSW election, in three weeks time, is seen impacting marketing campaigns. UBS envisages some improvement post the election as an early Easter in 2018 is cycled, but growth is likely to worsen again as the Easter break and Anzac Day clash at the end of April. Then there is the federal election in May, also likely to have a negative impact on new listings.

On the employment front, hiring activity after the Chinese New Year has not been as strong, which has implications for Seek ((SEK)). UBS observes some positive aspects are emerging for display advertising in the automotive segment as dealer expenditure online improved, with growth of 17% in January.

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AMA Group Zooms In On Acquisitions

AMA Group has substantial opportunities in the automotive aftermarket and continues to consolidate a position in panel repair.

-Targeting \$1bn in revenue by FY21 -Enters heavy-motor panel repair market, procurement negotiations continue - Sustained organic revenue growth and acquisition opportunities support outlook

By Eva Brocklehurst

Automotive aftermarket specialist AMA Group ((AMA)) continues to grow and consolidate its position in panel repair and vehicle protection. The company has cited an underperforming acquisition, ARM in Sydney, as the cause of weak margins in panel repair in the first half result.

Panel repair operating earnings (EBITDA) margins were reduced to 8.8% versus 11.5% in the prior corresponding half. AMA Group has reaffirmed its FY19 guidance for operating earnings, excluding greenfield losses, of \$58-60m and a target of \$1bn in revenue by FY21.

The company has entered the heavy-motor panel repair market, while procurement negotiations continue. A major customer is expected before the full-year results in August.

Brokers, while disappointed with the miss to expectations in the first half, have zoomed in on the consolidation opportunities, which UBS calculates is now worth over \$70m in revenue. This will be complemented by 4-6 greenfield developments in the pipeline. UBS does not consider the valuation demanding and maintains a Buy rating with a \$1.35 target.

Wilson is still slightly concerned about panel margins, although agrees that sustained revenue growth in panels and the acquisition pipeline support the company's consolidation strategy and outlook. Operating cash flow benefited from a negative working capital position while gearing remains modest. An interim dividend of 0.5c per share was in line with the prior corresponding period but below the broker's forecasts.

Wilson lowers its forecasts to the lower end of guidance, which marks a -5% decline in estimates for earnings per share. The broker also lowers the longer-term panel margin forecasts to 9.7% from 10% and maintains a Hold rating and \$1 target.

At this stage, neither Wilson nor Bell Potter include any contribution from the new procurement business in estimates because of a lack of clarity. Earnings were slightly lower than Bell Potter's estimates for the first half while revenue was modestly ahead, growing 32% to \$302.4m.

The broker expects strong growth in underlying earnings out to FY21, driven by organic growth and acquisitions. Growth forecasts of 59%, 34% and 28% are slated for FY19, FY20 and FY21, respectively. Bell Potter has a Buy rating and \$1.25 target.

The company operates several business divisions including panel repair, vehicle protection, automotive electrical & cable accessories, and the re-engineering of components such as transmissions and torque converters.

The business is the largest accident repair group in Australia, although it still has a relatively small market share of a very fragmented industry. The company is considering further acquisitions in the panel business as well as a component/accessories.

The main strength of AMA Group's is the management team, in Bell Potter's view, because of long-standing customer relationships and a proven track record of targeted acquisitions and successful integration. Each acquisition needs to be incorporated into the centralised finance and administration system and this remains an important key to integration success.

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EML Payments Ups The Ante In The US

EML Payments sustained substantial earnings momentum in the first half and is now ramping up its sports betting payment systems in the US.

-Evidence in first half of the company's ability to win contracts -Legalisation of sports wagering in US opens up opportunity -Capital management may be an option in 2019

By Eva Brocklehurst

Stored value card and supplier payments business, EML Payments ((EML)), has turned up its focus on sports betting, as the US market has deregulated, and brokers welcome the potential upside. Wilsons understands the company is looking at a number of M&A opportunities which should build out its customer base.

The broker believes organic growth, in tandem with the fast execution of its payment technology in US sports betting, could drive a re-rating. Revenue growth was 39% in the first half on a like-for-like basis with gross debt value (GDV) up 16%.

The company has raised FY19 revenue guidance to \$88-94m and narrowed operating earnings (EBITDA) guidance to \$27-28m. Wilsons expects the business will hit the top end of updated guidance, with the potential for additional upside. Operating cash flow was ahead of expectations and, while costs were also ahead, the business still managed to improve margins.

The broker suspects cost synergies are likely to increase in future with the PerfectCard DAC acquisition. Management expects gross profit margins to revert to around 80% by FY21, having posted a 66% margin in the first half because of amortisation of incentive payments to secure previous contracts. Wilsons expects continued strength in the company's earnings with a strong performance across all vertical markets and reiterates a Buy rating with a \$2.20 target.

Bailieu suggests the first half result underscores the company's capacity to win contracts and provide organic growth. The company has turned the marketing focus in the US to the reloadable wagering industry after the legalisation of sports betting.

EML Payments is considered to be strong in this regard, given its Australian experience and recent deal with PointsBet in the US. Bailieu has a Buy rating and \$2.40 price target on the stock. The broker considers GVC and Caesars are, potentially, sizeable contracts that should support growth beyond FY20. There are further M&A opportunities as well as new products and partnerships.

Canaccord Genuity flags management's reference to capital management initiatives in 2019, suspected to be in the form of a buyback and in the absence of a large-scale acquisition. The company has also grown its domestic salary packaging product as well as Australian/European gaming partners and improved the revenue conversion of LuLaRoe.

In the non-reloadable gift and incentive card business revenue increased by an impressive 49% to \$32.4m in the first half. Canaccord Genuity notes this was driven by GDV and the successful launch of various small contracts in Europe and Australia as well as the contribution of Pre-Send/PerfectCard.

The company had business/revenue model that includes 1200 customer programs across 21 countries and nine currencies. Canaccord Genuity notes a high degree of operating leverage and believes the stock is trading on undemanding multiples. The broker retains a Buy rating and \$2.25 target.

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

Collection House Gathers Another Portfolio

Collection House has made its third acquisition in recent months and brokers assess the potential upside could be substantial.

- Main risk is realising cash potential from the acquired debt ledgers, and leveraging the extra costs over future years
- Contribution from Volt Bank could provide significant growth in FY20
- Higher debt levels reduce flexibility in the face of any unexpected PDL valuation pressure

By Eva Brocklehurst

Collection House ((CLH)) has added another purchased debt ledger (PDL) portfolio to its stable, which brokers assess is a significant acquisition in terms of the potential upside. Selected assets and the PDL portfolio of ACM Group, which will cease collecting and whose founder is retiring, have been acquired for \$40.3m, funded by cash and a \$50m expansion of the bank financing facility.

This is the company's third acquisition in recent months, after the NZ\$40m acquisition of RML in January and the \$8.5m equity stake in Volt Bank in November 2018.

The company has acquired the plant & equipment, intellectual property and the Sydney lease from ACM Group. Cash collections of \$75m are expected, while one-off expenses will total \$1.3m, in the company's estimation.

Collection House expects to achieve \$5.5m in earnings (EBIT) from the transaction in FY20. While Morgans expects the company will be able to use existing resources to significantly reduce the cost to collect debt, guidance implies a further \$4m in costs have been taken on board.

The main risk is, therefore, realising the level of cash potential in the portfolio and leveraging the extra costs over future years. Morgans also notes that, as this is effectively a PDL acquisition, the level of earnings will decline unless the increased scale enables a higher level of PDLs to be maintained.

Excluding the acquisition, the company's underlying estimate of earnings per share is 15.5c and PDLs, including corporate transactions, worth at least \$120m are now secured.

Ord Minnett suspects the the valuation of the ACM Group business, underwritten by expected future recoveries of \$75m, could be a stretch, after assessing historical filings with the Australian Securities and Investments Commission (ASIC).

Still, the expected returns from the Volt Bank acquisition sets the business up for significant growth in FY20, which the broker calculates could be more than 30% based on underlying FY19 forecasts.

Canaccord Genuity chooses not to reflect the contribution from Volt Bank in its forecasts, until there is a better indication of the customer numbers and nature of the services Collection House will provide. Despite this, the broker is increasingly confident that the business is positioned for an uplift in cash collections and earnings, upgrading to Buy from Hold, with a target of \$1.60.

Debt

Morgans estimates Collection House will have around \$193m in net debt as of June. While the loan-to-valuation ratio and cash interest cover are alright on current metrics, the broker considers the balance sheet relatively stretched. The gearing position also heightens the risk for any negative portfolio valuation movements in future years.

Relative to gross cash collections, the company's carrying value of PDL is a highest versus listed peers, Morgans adds. Overall, the broker assesses higher debt levels have reduced the company's flexibility in terms of sustaining any unexpected PDL valuation pressure. Morgans has a Hold rating and \$1.42 target.

Ord Minnett notes the acquisition diversifies Collection House into telecommunications debt. The company has now acquired two competitors in the PDL market in Australasia in the past two months. Removing ACM Group from the market is unlikely to materially change the structure, the broker hastens to add, as it experienced a decline in PDL purchasing over the past five years.

Even so, from a relationship perspective with clients, the transfer of the arrangement book to Collection House should be a meaningful positive for the original debt issuers. Ord Minnett has a Lighten rating and \$1.25 target.

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Reporting Season: Reality Versus Sentiment

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-Reporting Season: Reality Versus Sentiment -Conviction Calls -Aussie Banks & Market Sentiment -Have Your Say -No Weekly Insights Next Week -Rudi On TV -Rudi On Tour

[Non-highlighted parts will appear in Part Two on Friday]

By Rudi Filapek-Vandyck, Editor FNArena

Reporting Season: Reality Versus Sentiment

Corporate reporting seasons are important. They provide tangible indications about whether investor sentiment, assumptions and speculation are justified or misguided, but the release of corporate earnings reports never takes place in a vacuum. There are always other factors equally in play, be they macro-economics or geopolitical, or otherwise.

This year, the February reporting season took place against a background of a heavy, four month-long sell-down on the back of slowing growth globally, followed by a swift recovery that took everybody by surprise. That swift recovery was supported by Fed officials reversing their policy outlook towards a more market supportive "neutral" stance, with market participants now anticipating more accommodative policy reversals from central banks across the globe, and expectations of a trade war truce/solution/agreement between the Trump administration in the US and China.

Other factors that equally played a decisive role in February include far from worst case scenarios recommendations in the Hayne report to fix malfeasance inside the sectors of banking, insurance and wealth management in Australia, significant disruption to the availability of seaborne iron ore due to more production problems experienced by Brazil's Vale, and changing dynamics in the local telecom industry as incumbents start preparing for 5G and market share hungry TPG Telecom decided to shelve its own mobile plans on the back of the Australian government banning Huawei equipment, but also intending to merge with Vodafone Australia.

As positive momentum simply begat more positive momentum, equity indices in Australia rose some 13% from the lows around Christmas time, with February adding circa 6% in total return, including the first round of dividend payments. At face value, one would be inclined to conclude everything is hunky dory in the land of falling house prices, collapsing construction of tiny apartments and declining car sales, but when it comes to actual corporate results releases, a different reality opens up.

On more than one statistic, February 2019 has been one of the worst corporate reporting seasons in Australia post the GFC years of 2008 and 2009. FNArena's statistics only reach as far back as August 2013, but never have we registered more than 27% in companies failing to meet expectations. In fact, 26%-27% has been a rather common statistic during these eleven reporting seasons, accounting for four of the them, and this expands to six (more than half) if we expand the range to 24%-27%.

This year, however, the tally stopped at 33.4%; well above anything recorded in prior years.

Now consider also that analysts had already been lowering forecasts since last year, and that many of February's "misses" were due to rising costs and a more subdued outlook, and it should be clear: corporate Australia is genuinely experiencing challenging conditions. On UBS's assessment, some 15% of companies upgraded their guidance, but 17% of companies guided towards a less profitable outlook.

The numbers released by quant analysts at Credit Suisse look a lot worse, with 16.9% of companies beating expectations, 36.2% missing expectations, and 46.9% reporting in-line. (Different sample & methodology, different results).

Equally unprecedented is the fact that FNArena's average price target adjustment for the season as a whole ended up flat (strictly taken the end result was -0.06%). This too occurred against a background of valuations and price targets already in decline since the prior year. Looking back at the series since mid-2013, average price target increases have ranged between +5.6% in February 2015 and +1.2% in August of that same year.

Never has our calculation for the 300+ companies reporting been flat, let alone slightly negative.

But not everything that happened during February set new negative records. Earnings forecasts dropped lower, but only mildly so and nowhere near the heavy reductions some were fearing beforehand. Here the outperforming sectors were mining companies and contractors to those mining companies.

EPS growth for ASX200 companies fell by a little over -1%, which is quite standard in Australia, leaving average EPS growth now at 3.3% for FY19 with only four sectors providing positive contributions in February: apart from miners, communication, utilities and real estate all forced analysts to upgrade forecasts. Industrials, Financials, Healthcare and Technology were all major detractors to the downside.

Counter-weighting the above average 34.4% in negative disappointments, was a virtually equal 33.3% in positive surprises. Past seasons have taught us corporate surprises ("beats") can run as high as 37% (in February 2018 and February 2016) but our history of eleven prior seasons offers only one prior example when "beats" did not outnumber "misses". It happened in August 2017, when both percentages stopped at 27%.

At face value, this suggests corporate Australia is still very much divided between "Haves" and "Not Haves", separating companies that are in good shape and achieving plenty of progress and profits from others that are struggling with persistent headwinds. It's a theme that has dominated reporting seasons in years past, also bifurcating expert views about "value" versus "growth".

But February 2019 was not simply an extension of trends observed and established in recent years. This time around the boundaries between groups and themes got significantly blurred with many of the registered "positive surprises" actually being a case of "not as bad as feared" while others still managed to put in a decent performance, but it simply was seen as not good enough.

What really blurred the distinction between "Haves/Quality&Growth" and "Not Haves" this February was that, all of a sudden, many that have been in the first group in years past this time around displayed signs of weakness and vulnerability. Combine all of this with extreme cases of share price volatility, in either direction, and it shouldn't be a surprise last month has proved an exceptionally tricky reporting season for investors to manoeuvre successfully.

Before we highlight some of the individual companies and sector themes that should have investors' attention, let's spend a few more moments on the key themes that stand out from February reports (with thanks to EL & C Baillieu Chief Investment Officer Malcolm Wood):

-Sluggish top line growth - at face value the statistics do not look bad, but average growth is being supported by a small group of rapidly growing outperformers. Underlying, argues Wood, average sales growth did not exceed 2.6% which is more than annual inflation, but hardly something to genuinely crow about.

-Operational costs are on the rise - this was unmistakably one of the stand-out negative revelations during the season. Whether it be from input costs (energy, raw materials, etc) or from regulatory and compliance costs, or from higher wages, most negative surprises throughout February seemed to have a direct link to companies' inability to keep a lid on rising costs, or to pass it on to customers.

-Scarcity of pricing power - inflation the world around remains below central bankers' targets, and a lack of pricing power by companies is showing up during reporting season.

-Capital management funded by asset sales - Balance sheets are strong and which shareholder does not welcome a special dividend or share buyback, but Wood points out most are being paid for by asset sales and spin-offs. Great. But where then does future growth come from?

-Limited growth prospects - Look beyond the "beats" and "misses" and but a small selection of companies in Australia is pursuing a significant growth agenda or acquisitions. Again, this poses the question: where is future growth coming from? Wood names Amcor ((AMC)), Transurban ((TCL)) and Woodside Petroleum ((WPL)) as positive examples of companies actively engaging in strategies to find additional pathways for growth.

Anaemic top line growth proved one of the stand-out characteristics of healthcare companies reporting in February with all of CSL ((CSL)), Cochlear ((COH)) and ResMed ((RMD)) failing to meet or beat market expectations and share prices weakened in the immediate aftermath as a result.

In a defensive growth sector that has generated the best investment returns post GFC in Australia, all of a sudden achieving organic growth has become somewhat of a challenge. In addition to the three local market leaders already mentioned, we can add Ramsay Health Care ((RHC)), Healthscope ((HSO)), Healius ((HLS)), Mayne Pharma ((MYX)), and numerous others, including the listed aged care providers, and Ansell ((ANN)) and InvoCare ((IVC))

which are often also put inside the healthcare basket (note Ansell is 50% healthcare at most and InvoCare, well, yes, what can I say?).

One swallow does not a summer make, and one disappointing reporting season does not by definition imply investors are now abandoning the sector in droves, but it remains a remarkable turn of events when a whole reporting season flies by and nobody can remember one single healthcare company that blew the lights out.

Investors should also take into account that, since reporting, analysts have observed CSL continues to outperform its peers globally, suggesting its somewhat disappointing performance in February was not company-specific. The same observations have been made regarding Ramsay Health Care.

As per always, such observation brings out both the bears and the bulls in the share market. Sector analysts at Credit Suisse are worried about a de-rating for the sector over the year ahead, as growth is slowing and valuations remain at a market premium. Their peers at Citi, on the other hand, hold a strong view that share price weakness for quality healthcare stocks offers investors with an opportunity to get on board.

Citi has now upgraded heavily punished Cochlear to Buy with a price target of \$198. Before anyone asks: CSL remains a Buy at Citi with a price target of \$213. (See Stock Analysis on the FNArena website for all other healthcare stocks).

The rather sober performance of the healthcare sector last month has coincided with similarly less glamorous performances from a plethora of previously highly popular, quality growth business models, enjoying longer term growth trajectories that many would label as "secular". In contrast to prior reporting seasons, companies including GUD Holdings ((GUD)), Carsales ((CAR)), Bapcor ((BAP)), and Orora ((ORA)) this time around were unable to keep the positive momentum alive.

For others, including Blackmores ((BKL)), Bellamy's ((BAL)), Domino's Pizza ((DMP)), Hub24 ((HUB)) and Praemium ((PPS)), the market punishment was much harsher, and to date much more persistent too. It suggests investors have quickly distinguished between popular growth stocks that might have miss-stepped once, but still have a bright outlook, and others for which the future might now look more uncertain and challenged.

Most positive surprises were generated by discretionary bricks and mortar retailers, but the complicating matter here is this was to a large extent because of investors fearing the worst pre-February, a phenomenon described by some analysts as "peak pessimism" preceding results.

On balance, foot traffic in physical stores remains under pressure, sales are increasingly shifting online, and costs are rising here too. With analysts anticipating store rollouts domestically have peaked for most retailers, and margins will continue to face pressure into FY20, this segment is likely to remain tricky at best, and a graveyard for silly aspirations and lost ambitions for many an investor under most scenarios.

For those keen to invest in the sector, stockbroker Morgans' favourites are Lovisa Holdings ((LOV)), Baby Bunting ((BBN)), Adairs ((ADH)), AP Eagers ((APE)), and Noni B ((NBL)).

The many challenges for bricks and mortar retail shops are equally having an impact on the A-REITs sector, where many a landlord is battling sector transformation and decline. On some analysts' estimation, a record number of retail assets are currently up for sale in Australia. This is likely to depress prices, with flow-on impact for valuations of such assets on balance sheets of retail landlords.

The warning here is that "value" can easily turn into a "value trap" under less favourable conditions.

Most sector analysts continue to prefer fund managers, and industrial and office assets operators above retail landlords. Over at Credit Suisse, for example, the ranking order for AREITs post February has been updated to, in order of preference, Goodman Group ((GMG)) -still most preferred though others might consider it too richly valued- followed by Scentre Group ((SCG)), Mirvac ((MGR)), Vicinity Centres ((VCX)), GPT ((GPT)), Shopping Centres Australasia ((SCP)), and Charter Hall Retail ((CQR)), with Stockland ((SGP)) least preferred.

Irrespective of all of the above, few would debate the fact the stand-out champions of the February reporting season have been large cap resources stocks, miners in particular. Product prices remain higher-for-longer, cash is flowing in and investments are only made in a measured manner. The formula is working to near perfection, at least for the time being.

To many sector analyst, miners remain in a free cash flow sweet spot, which is why shareholders continue to enjoy rising dividends, accompanied by special dividends, and share buybacks. Said mining analysts at Credit Suisse recently: "We cannot recall a time where balance sheets were so undergeared right across the sector."

Underneath the surface, however, rising costs and operational challenges are making their presence felt across the sector. Investors will have to stay agile and focused. The FNArena Reporting Season Monitor for February shows

many a smaller cap mine operator disappointed in February, making the sector not a risk free winner for all.

Capex growth from resources (including energy thus) is projected around the 20% growth mark, which bodes well for contractors. Macquarie's favourites are Downer EDI ((DOW)) and WorleyParsons ((WOR)).

A special mentioning remains reserved for a select number of companies that truly has the wind in the sails, with company management doing all the right things, while showing investors true opportunity does not necessarily lay with turnaround attempts at beaten-down share prices, but equally so with Champion stocks at above market multiples that continue exhibiting their quality, ingenuity and strength.

Companies worth pointing out within this context include Magellan Financial Group ((MFG)), Cleanaway Waste Management ((CWY)), Appen ((APX)), Altium ((ALU)), a2 Milk ((A2M)), Bravura Solutions ((BVS)), Goodman Group, Charter Hall ((CHC)), IDP Education ((IEL)), and Nanosonics ((NAN)).

Plenty of others proved why cheap looking share prices were probably appropriate.

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Rudi's View: Noni B, Nanosonics, And Webjet

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[Non-highlighted parts appeared in Part One on Thursday]

By Rudi Filapek-Vandyck, Editor FNArena

Conviction Calls

The February reporting season has triggered three changes to the selection of Conviction Buys at Wilsons, with each of GWA Group ((GWA)), Nanosonics ((NAN)) and Ruralco ((RHL)) no longer included.

Ruralco is now in take-over mode as the board has agreed with the \$4.40 per share cash offering from Canada's Nutrien, while Nanosonics is facing temporary interruption from the change in relationship with GE come July, while last month's interim report by GWA has raised more questions, making Wilsons a little more cautious.

Stocks that remain on the Conviction List are Arq Group ((ARQ)), Bravura Solutions ((BVS)), Collins Foods ((CKF)), Ridley Corp ((RIC)), ImpediMed ((IPD)), EQT Holdings ((EQT)), Pinnacle Investment ((PNI)), Noni B ((NBL)), Ausdrill ((ASL)), Mastermyne ((MYE)), and NRW Holdings ((NWH)).

Over at stockbroker Morgans, market strategists didn't think the reporting season was good enough to warrant the strong performance for share market indices. They are worried for a repeat of the August reporting season experience last year when, once fundamentals had been fully digested by investors, share price weakness starting kicking in once the season had concluded.

But Morgans wouldn't be a hard core stockbroker if at the same time it hadn't spotted a number of opportunities regardless.

New opportunities to emerge from reporting season, report the strategists, include offshore growth exponents, steady cashflow growers, companies enjoying industry tailwinds, those past their cycle lows and cheap stocks being overlooked by investors, for whatever reason.

The first group includes stocks such as Treasury Wine Estates ((TWE)), Corporate Travel ((CTD)), Lovisa Holdings ((LOV)) and Iress Market Technology ((IRE)), for the second group investors are advised to consider Wesfarmers ((WES)), Origin Energy ((ORG)) and Aventus Group ((AVN)), while candidates put forward for group number three include Oil Search ((OSH)), PWR Holdings ((PWH)), Data#3 ((DTL)) and Redhill Education ((RDH)).

Companies now well and truly past their cycle lows are, in Morgans' view, Telstra ((TLS)), QBE Insurance ((QBE)) and AP Eagers ((APE)) while the final selection generates names including CML Group ((CGR)), Bingo Industries ((BIN)), Noni B ((NBL)), Whitehaven Coal ((WHC)), and Orocobre ((ORE)).

Small cap specialists at Ord Minnett have updated their Key Picks in this segment post reporting and on top of the table sits Webjet ((WEB)) as the broker's Top Pick, while Tassal Group ((TGR)) remains the broker's Bottom Pick.

Analysts at Credit Suisse have updated their ranking order for stocks grouped together under the label of diversified financials. The updated ranking has Link Administration ((LNK)) as most preferred, followed by Magellan Financial Group ((MFG)), Computershare ((CPU)), Hub24 ((HUB)), Netwealth Group ((NWL)), IOOF Holdings ((IFL)), Perpetual ((PPT)), Challenger ((CGF)), Pental Group ((PDL)), Platinum Asset Management ((PTM)), Janus Henderson ((JHG)), and the ASX ((ASX)) last.

Sector analysts at Morgan Stanley have analysed casino operators on both sides of the Tasman Sea, and the result is their conviction has grown that Star Entertainment ((SGR)) should be most preferred by investors seeking exposure to the sector, with Crown Resorts ((CWN)) second, and SkyCity Entertainment (SKC.NZ) third.

Aussie Banks & Market Sentiment

Readers who have been reading Weekly Insights for many years, and I know this covers the overwhelming majority of the database, might still remember how I used to closely watch share prices for the Big Four Majors in Australia in order to gauge market sentiment, and establish whether it had gone too far into the euphoria zone.

Once upon a time all it took was watching the gap close between share prices and consensus price targets, and start reducing risk when premia started appearing. But then the banks encountered their own idiosyncratic reversal of fortune and as with every other market indicator (Baltic dry index, copper, etc), this is when the indicator surpassed its use by date.

Banks have staged a noticeable come-back following the release of the Hayne report in Australia. Share prices have a more distinct solidity attached these days. Is it time to revisit the old indicator?

We won't know for certain until at some point further into the future, but if share prices for major banks in Australia can (again) be used as a gauge for excessive investor exuberance, then this market still has further upside to explore.

Allow me to explain.

On Tuesday, when I write this Weekly Insights, CommBank ((CBA)) shares are trading 4.6% above consensus target, which doesn't mean CBA shares are more "expensive" than its peers; it's simply a sign CommBank is still widely regarded as the prime banking stock in Australia, and the shares trade at a sector premium in response.

For those subscribers who use The Icarus Signal on the FNArena website. Always keep this in mind. When looking at the raw data, the right context is equally important. On my observation, with exception of relatively brief interruptions in time, CommBank shares always trade at a noticeable premium to local peers, and they perform best when times get tough, as well as over time.

This is counterintuitive for investors who are being told "valuation" is the secret to long term investment performance. It's not. Context is. Because context explains why the most "expensive" stock in the banking sector is also the best performer (I have extensive data and research to back up CommBank's superior performance over two decades, and more; no need to argue the point).

Returning to my share market indicator, CommBank is but one member of the Big Four and sector laggard (because it is widely seen as the prime candidate to cut its dividend payout at some stage) is National Australia Bank ((NAB)), whose shares are trading -8.4% below consensus target.

With one being the leader on a sector premium and the other the sector laggard trading at a discount to peers, maybe a better gauge for investor sentiment is to take guidance from the two Major Banks in the middle.

Here the good news is ANZ Bank ((ANZ)) shares still have a gap of circa 3.5% to close and for Westpac ((WBC)) shares the gap, on Tuesday, is still 2.3%.

On the assumption the local banking indicator is back alive and well, I'd draw from this the conclusion this market is starting to "feel" expensive, but there can still be another leg higher until the level of oxygen in the air becomes a genuine problem.

The beauty about this is that if we add, say, another 3% upside to the ASX200 (which is what ANZ and Westpac are suggesting) this will take the index back to the highs from 2018, with the index peaking on August 30th last year at 3373.50 (intraday) and 3351.80 (day's close).

And this, I know from years of observing and analysing the local share market, this is how good indicators interact under the best of circumstances. History also shows there is no certainty in these calculations and suggestions, but I wouldn't be surprised if somehow this market finds enough optimism and oomph to try to reach for last year's high.

After that, I also would not be surprised if by then we all decided it's getting a bit crazy. Results season wasn't that good, and it doesn't look like it's getting better quickly.

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