Week

13

Stories To Read From FNArena

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Are Synlait Milk's Implied Returns Excessive?

Synlait Milk is moving towards a higher value packaged product as the industry focus remains on the large Chinese infant formula market.

-Market paying little attention to downside risks associated with margin contraction -Synlait Milk increasingly benefiting from supply agreements outside of a2 Milk -Are long-term returns implied in the share price excessive?

By Eva Brocklehurst

Key customers and smoother operations helped Synlait Milk ((SM1)) deliver a robust first half result, reflecting a growing proportion of the business exposed to infant formula. The value per kilogram of milk solids processed and sold by the company has grown materially.

Gross margins expanded significantly, although there was a positive contribution that was likely to be one-off in the first half. The company's margins on ingredients have improved which reflects the mix, operating efficiencies and supply chain benefits.

Synlait Milk, in ramping up canning capacity, expects some softening of margins in the second half because of the under-recovery of overheads and higher R&D spending. Guidance for packaged infant formula volumes in FY18 has been raised to 35,000t from 28,000t.

Bell Potter considers the volume guidance achievable but offset by higher fixed costs on the back of recent capacity additions. The half-on-half sales profile in the powders and creams business will also be more evenly distributed versus historical outcomes.

It would appear to Credit Suisse that the company may be guiding to lower profit in the second half, although the earnings growth outlook remains attractive. Still, the broker suspects there is little attention being paid to the downside risks associated with margin contraction in a business that still has limited diversity in its customer base.

Sustainability of long-term margins remains a consideration for Macquarie, as well as the risk with plant commissioning. However, the broker believes the company is well-positioned for its capital investments, which include the NZ$125m at the liquid milk plant and NZ$260m at the new Pokeno site, and incorporates these into forecasts.

The broker assumes a modest ramp up and long-term return of a little over 20% for both of these facilities. Deutsche Bank also suggests the next phase for the company is the super-sizing of its footprint in cream and the North Island site.

Valuation

The main surprise in the results was the stronger margins in ingredients, resulting from the shift in mix towards higher-value products, and Deutsche Bank rolls forward its target price, increasing this by 25% to NZ$7.50. This reflects a material upgrade to near-term earnings forecasts, although the broker cannot justify the share price and maintains a Sell rating.

Catalysts may all turn out to be positive but Credit Suisse requires more visibility and, hence, maintains a Underperform rating with an NZ$6.64 target. Meanwhile, Macquarie downgrades to Underperform from Neutral on valuation, raising the target to NZ$7.00 from NZ$5.29.

The broker likes the company's high-value B2B strategy but believes the share price is implying a long-term return on capital employed of over 30%, which is ahead of even the company's target of around 20%.

Bell Potter counters this view with a Buy rating and $10.45 target, raised from $7.90. The broker acknowledges, while the move to a higher-value packaged and infant formula product (versus bulk commodities) is largely being driven by a2 Milk ((A2M)), the company is increasingly benefiting from supply agreements with several other customers, namely New Hope Nutritionals, Bright Dairy, Munchkin and Foodstuffs.

New five-year supply agreements have recently been arranged with both New Hope and Bright Foods and Synlait Milk is in the process of securing Chinese FDA registration for both brands. Bell Potter also suggests operating cash flow is increasingly underpinning the company's ability to internally generate capital to fund growth initiatives.

The main earnings drivers currently include the pace at which a2 Milk secures market share in the Chinese infant formula market, the timing of US FDA approval for the Munchkin grass-fed product, as well as the timing of CFDA approval for New Hope and Bright Foods brands in China.

Key Customer

What happens with key customer a2 Milk over the next 12-24 months will be of interest to Credit Suisse, given recent developments in that company's arrangements with competitor Fonterra. Importantly, a longer-term contract with a2 Milk could lock in long-term margin expectations in Synlait Milk's existing business and de-risk the second site.

Synlait Milk is the exclusive supplier of a2 Milk's infant formula products in China and holder of the CFDA registration for the product. Bell Potter suggests if a2 milk can generate sales velocity in the Chinese market anywhere near the level it achieves in Australia, then leverage for the Synlait business will be material.

Yet Credit Suisse wants more detail on regulatory approvals, customer commitments and a firm plan for market entry that utilises the liquid processing plant, where investment is now underway. This would go a long way to generating the comfort that the broker requires for the company to move beyond securing the second site and meet the hurdles to de-risking investment in a fourth dryer.

Detailed disclosure remains a problem for Macquarie too, because of variable margins for differing volumes, as it remains hard to isolate one-off movements from underlying improvements in the business.

The broker suspects that, as the company did not signal margin expansion in infant formula in the results, despite increased volumes, some of the operating leverage of the plant is being passed back to the customer under a contractual arrangement.

Transurban Pays Up In Canada

Transurban will acquire the A25 toll road and bridge in Montreal, in line with its strategy to expand its North American presence.

-Opportunity to drive efficiencies, upgrades and network enhancement -Auction success suggests constructive view of eventual revenue upside -WestConnex likely to drive the share price in the next few months

By Eva Brocklehurst

Transurban ((TCL)) is venturing onto new ground with its first toll road acquisition in Canada. In keeping with a stated strategy of expanding North American operations, the company is acquiring the A25 toll road and bridge in Montreal, a city of around four million people.

The acquisition, for CAD840m and CAD18m in transaction costs from Macquarie Infrastructure Partners, is generally considered to be full. This is based on a view that the concession has only 24 years to run, the asset-level debt is expensive and revenues are being shared with the government.

The concession expires in September 2042. Montreal is heavily urbanised and congested and there are opportunities to drive value in operating efficiencies, customer product upgrades and network enhancement.

Morgans expects the acquisition to be mildly accretive. Revenue has sufficiently exceeded the original forecast such that it is now being shared with the government. Tolls escalate with the Canadian CPI and also lift when overall traffic levels exceed pre-defined thresholds.

The transaction highlights the breadth of growth opportunities, Ord Minnett believes, estimating average daily traffic grew by 4% in FY17 while toll revenue was up 8%. The revenue sharing component, above an undisclosed threshold, adds to the attraction.

Average daily traffic growth across FY16-17 was 3.4%. The asset is also taxable at a 27% tax rate. Morgans calculates the enterprise value represents around 3% of its total valuation for Transurban, so this is a relatively small entity in the company's rapidly expanding portfolio.

Macquarie considers this an incremental acquisition with an attractive tolling profile that creates a new growth front. The acquisition in a new city through an auction process is unlikely to mean the asset is undervalued, and the broker suggests the value being added is utilising the latent equity in the balance sheet.

UBS also points out that the company was successful in a contested process without any obvious cost-of-funding advantage or adjacent asset synergies. This suggests a more constructive view of the eventual revenue upside.

On the basis of an estimated 4% debt funding cost the asset is estimated to be marginally accretive to cash flow. The tolling structure is also novel versus other roads in the Transurban network as it represents a hybrid between the Australian and Washington models, including the revenue sharing arrangement with the Montreal transport authority.

The main risk, in Morgan Stanley's view, is the underperformance of traffic in winter. The company intends to use CAD-denominated debt to fund the acquisition, similar to its funding arrangements in Virginia. Morgan Stanley believes overall group gearing and credit ratings remain prudent and sustainable.

Full Price

Headline metrics suggest the valuation of the asset is high and RBC Capital Markets calculates the equity internal rate of return (IRR) is below its 8% equity IRR value for Transurban shares. The broker estimates around 2% accretion to FY19 free cash flow per security but requires further information, particularly on the tolling mechanism, to make a better assessment.

The A25 is modestly accretive to Deutsche Bank's cash flow forecasts but the acquisition cost is below its 9.1% IRR, while the EBITDA (operating earnings) multiple at 26x is high, particularly given the remaining concession is for 24 years.

CLSA agrees the acquisition price looks full, estimating the IRR to be around 7.4%, which is offering around a 5% return over the current 10-year bond yield, and this demonstrates that the stock is trading at too great a discount to fair value for the existing portfolio.

The broker suggests that while it may take some time for investors to become comfortable with the impact of higher yields versus economic reality, the discount to fair value is likely to close. CLSA, not one of the eight stockbrokers monitored daily on the FNArena database, has a Buy rating and $13.65 target.

Comparing transaction multiples is highly subjective, Ord Minnett asserts, given the variation in asset time, location, demographics and the length and terms of concessions. Still, on first appearances the price appears to be full.

Margin expansion will, therefore, be critical. Yet, the broker is confident that operating improvements, upgrades and network enhancements will drive expansion of the operating earnings margin to a forecast 75% by FY30, from 68% in FY17.

WestConnex

RBC Capital Markets does not believe the company's foray into Canada alters its probable desire to acquire WestConnex, as Montreal is not a significant deal in the context of the overall enterprise value.

The broker, not one of the eight monitored daily on the database, rates the stock a Sector Perform with a $12.50 target. The broker is reluctant to become more positive, despite recent stock and sector weakness, until there is further clarity on WestConnex.

Others, including UBS and Deutsche Bank also expect WestConnex will be the key driver of the share price over the next six months, as this will either mean the company solidifies control of the Sydney network or a new operator emerges.

The database shows six Buy ratings and one Hold (Morgan Stanley). The consensus target is $13.12, suggesting 19.1% upside to the last share price. Targets range from $12.80 (Credit Suisse, yet to comment on the acquisition) to $14.50 (Ord Minnett).

Galaxy Flags Strategic Value In Sal De Vida

Galaxy Resources has updated Mt Cattlin estimates and signalled its highly-anticipated Sal de Vida financing/offtake decisions may extend to late 2018.

-Resource development drilling could provide longer mine life at Mt Cattlin -Interest in Sal de Vida from financing/offtake partners is high -Share price likely to bounce around, reflecting developments and lithium price

By Eva Brocklehurst

Brokers keenly await drilling results and development approvals from lithium producer Galaxy Resources ((GXY)), which will provide the catalysts for the stock over 2018. The company updated its resources and reserves estimates with its 2017 results, which drew mixed responses. Underlying operating earnings (EBITDA) were $51.9m. Net profit was $170,000.

Higher depreciation & amortisation combined with non-cash expenses affected the profit line but such accounting adjustments mean the result has little bearing on broker views on the investment outlook. Revenue was in line with UBS estimates and underlying operating earnings below, while high margins are expected to be maintained. The results imply margins of US$450/t were achieved.

Canaccord Genuity anticipates around 28% production growth in 2018, expected to be driven by modifications to the Mt Cattlin process plant, and improved recovery should lift concentrate production. No exact pricing guidance has been provided for 2018 but the broker expects prices to be firmer and earnings set to benefit from toll treating/sale of refined lithium chemicals.

Mt Cattlin

Mt Cattlin resources have been re-cut following completion of grade control drilling and now total an estimated 11.6mtpa at 1.2% lithium oxide. Tonnage is down -29% but grade has improved by 11% on prior estimates.

Total reserves have been re-estimated at 7.6mtpa at 1.05% lithium versus prior estimates of 10mtpa at 1.05%. The main issue for brokers is the lift required in recoveries to 70-75% post the June quarter, from a December quarter average of 58%.

The updated reserve implies mine life of around five years and Canaccord Genuity believes additional resources/reserves from regional targets and resource development drilling within the mining lease could provide a longer mine life.

Sal de Vida

Management has suggested finalising the offtake for Sal de Vida may now extend into late 2018. Canaccord Genuity understands that interest from potential project financing/offtake partners is high and aligning various competing interests makes for a complex negotiation. Still, brokers consider this will be the main catalyst for the share price this year.

There are few development-ready lithium projects globally where production is uncommitted and this enhances the strategic value of Sal de Vida. Canaccord Genuity, not one of the eight stockbrokers monitored daily on the FNArena database, maintains a Buy rating and $5.00 target.

Two thirds of Ord Minnett's valuation of the stock relates to Sal de Vida. The broker assumes first production occurs in 2021. The base case is for Galaxy to source capital through debt markets but the broker acknowledges the potential for a strategic partner is high.

UBS believes the company is hoping a mix of both end-user OEMs and potential sell-down partners will provide the majority of the capital required to develop the project.

Meanwhile, James Bay continues to progress and environmental permits are expected to take around two years. UBS notes, unlike Mt Cattlin, this is planned as an integrated upstream and downstream operation with feasibility studies being undertaken this year.

Citi envisages a long lead time for both Sal de Vida and James Bay, expecting the share price to bounce around as the studies, developments and pending regulatory approvals take place, as well as reflecting movements in the lithium price.

FNArena's database shows two Buy, two Hold and one Sell (Macquarie, yet to report on the result). The consensus target is $3.58 suggesting 13.3% upside to the last share price. Targets range from $3.00 (Macquarie) to $4.60 (Citi).

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Large Potential At Cowal For Evolution Mining

Brokers observe Evolution Mining has compelling potential with the expansion of the Cowal gold mine.

-Improved scale could lower processing costs at Cowal substantially -Capital management likely to be the driver of shareholder value -Considered low-risk alternative to Newcrest for gold exposure

By Eva Brocklehurst

After recently visiting the Cowal gold mine in NSW, brokers were impressed with the potential of Evolution Mining's ((EVN)) flagship asset. Cowal is a long-life, high-margin asset where an expanded plant could unlock reserves and reduce processing costs.

Deutsche Bank calculates that with higher throughput and a reduced cut-off grade, Cowal could be operating at 300,000 ozs per annum by FY21 and sustain a life beyond the current reserves. Nevertheless, the broker considers this growth already largely captured in the valuation.

Evolution Mining acquired the Cowal asset in 2015 and, after years of limited capital and exploration, Credit Suisse observes the company has moved exceptionally fast to unlock the potential.

The site visit confirmed a well-run operation with a clear sight of mine life of 14 years and the broker expects near-term upside from productivity gains and cost reductions under the company's lean operating practices.

Macquarie also suggests that as with a number of other assets acquired around the same time as Cowal, it has become apparent that many historical exploration targets and geological models were not tested by previous owners.

Two major projects are now underway. The float tails leach project is on track to be commissioned in the December half and should improve recoveries by 4-6% at an incremental processing cost of $1.50-1.70/t. The project is also expected to provide the flexibility to co-treat high-grade oxide stockpiles, which are expected to double with the mining of Stage H.

Feasibility Study

A feasibility study is underway to assess the options to increase plant throughput up to 9.8mtpa. The company believes this could be achieved through the addition of a secondary crushing circuit for material that currently stymies SAG mill capacity.

Deutsche Bank notes the operation is currently permitted to 7.5mtpa and its recent performance suggests something closer to 8.0mtpa is achievable. Around 100 additional operators have been brought in to deal with the increased material movements.

The broker does point out a cut-back beyond Stage H would require the re-location of the primary crusher and therefore appears uneconomical at the present time.

Deutsche Bank suggests improved scale could lower processing costs by -10-15% on a unit basis. The company has proposed a 12-months turnaround for the expansion approval and, pending a favourable outcome from the feasibility study, expansion could be fully implemented by FY21. In turn, this would be well timed for Stage H ore.

Expansion is a likely outcome and Macquarie lifts production forecasts from 2021. While the broker expects improved recoveries and expansion, the stock appears fairly valued at current levels and a Neutral rating is maintained. While exploration appears promising, near-term success is expected to take some time to translate into additional production.

Macquarie observes both Cowal and Ernest Henry have transformed the company's portfolio. While opportunities for value adding acquisitions are limited at present capital management is expected to be the most likely driver of shareholder value.

Credit Suisse agrees scale and the balance sheet have been enhanced by both the Ernest Henry transaction and the divestment of Edna May. Consolidation of various assets has elevated the company to Australia's second largest gold producer with annual production in excess of 800,000 ozs.

Evolution Mining has also been entrenched as a low-cost operator and, as Credit Suisse notes, a low-risk alternative to Newcrest ((NCM)) for gold exposure.

FNArena's database shows two Buy ratings, five Hold and one Sell (Morgan Stanley). The consensus target is $2.84, signalling -5.8% downside to the last share price. Targets range from $2.40 (Deutsche Bank, Morgan Stanley) to $3.45 (Citi).

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Material Matters: Coal, Alumina And Copper

A glance through the latest expert views and predictions about commodities. Coking coal; alumina; copper; and Australis Oil and Gas.

-Market increasingly concerned about rapid rise in steel stockpiles -Protracted outage at Alunorte may keep alumina prices at heightened levels -Opposing factors weighing on/supporting the copper price

By Eva Brocklehurst

Coking Coal

Coking coal prices are falling amid concerns over demand downstream as steel rebar stocks rise to the highest level since 2013. The rise in stockpiles reflects stronger steel production, as China's crude steel output rose by 5.9% in January and February despite restrictions in place on industrial output during the heating season.

This, in turn, is a reflection of just how strong the incentive is for steel mills to boost production, given steel mill margins, Commonwealth Bank analysts suggest. The rapid rise in steel stockpiles has the market worried. Construction accounts for around 50% of China's steel demand.

The analysts envisage premium coking coal prices should gradually trade down to US$170/t by the December quarter and the price is supported at US$160/t. The spot price is high, so Chinese steel mills will look for cheaper domestic coal and this will help support new production.

Local production is already receiving support from policy as China aims to increase coal output by 7.3% this year.

Alumina

The outage at the Alunorte refinery in Brazil appears more protracted than previously thought and UBS suggests the sudden lift in alumina prices likely reflects a market participant unexpectedly short alumina and deciding to cover at a substantially higher price.

Alunorte is the world's largest alumina refinery and produces 6.6 mtpa or 5% of global supply. Heavy rain led to elevated water in the tailings and production was cut by -50%. According to recent news reports, Brazilian authorities have now discovered additional unregulated spills into a local river from the refinery.

Norsk Hydro has also expanded the scope of an independent review into the facility which suggests to UBS the nature of the outage is shifting and may be more prolonged.

A protracted outage would have a sizeable impact on the alumina market and UBS suspects this could mean prices remain above US$400/t for a few months. Those favourably exposed to higher prices from a prolonged outage are Alumina Ltd ((AWC)) and South32 ((S32)).

Copper

UBS believes the copper price is about right. While China's demand appears to be decelerating the rest of the world is more robust. Tender activity remains weak and grid spending for the period period of August 2017 to February 2018 is down -16%. Property sales, while positive, have also been decelerating. Visible inventory is also lifting. UBS suggests, perhaps due to these factors, speculators have been selling copper and this has weighed on prices recently.

The bullish factors to consider are the risks of elevated supply disruptions, as 3mtpa of mines are in employment negotiations in 2018. Scrap supply is also tightening from further importation restrictions imposed by China's policy makers.

UBS suggests this could disrupt around 400,000 tpa of contained metal. Smelters are also seen dropping fees to try and source more concentrate because of either the risk from mine disruption globally or scrap disruption in China.

Macquarie observes, despite the fact that overall demand from end users has not yet picked up post the Chinese New Year, sentiment remains positive. There is some evidence of growth in orders from a few downstream industries.

Fabricators expect higher output rates and sales for the next month while, at the same time, smelters have lifted capacity and expect production to rise in April. The broker has learnt that Chinese smelters expect to undergo less maintenance this year versus last year, and so the utilisation rate should stay high in coming months.

Copper traders also intend to restock copper, which reflects a positive outlook on the market. Macquarie's survey does not yet report tightened liquidity for traders, although this is now regarded as a looming risk to their willingness to buy.

Australis Oil And Gas

Australis Oil and Gas ((ATS)) is undertaking a test production program in the Tuscaloosa marine shale oil play in the US. Acquisition of the Encana assets in 2017 has provided a very dominant position in this area.

Bell Potter notes, supported by stronger oil prices, the company's modest production is now generating useful cash flow that covers overheads. The broker believes the company can generate significantly enhanced returns and showcase a viable oil business in the Tuscaloosa play based on new production.

The company plans an initial phase of 4-10 new wells in the September quarter to test enhanced completion techniques and demonstrate the viability of significantly boosting oil production. Bell Potter has a Buy rating, removing the Speculative qualifier, and a $0.75 target, raised from $0.39.

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Material Matters: Nickel, Steel & Manganese

A glance through the latest expert views and predictions about commodities. Nickel; steel raw materials; steel scrap; and manganese, thermal coal.

-Market may be underappreciating margins for Indonesian NPI operations -Steel-making raw materials likely to come under pressure in the second half -Macquarie makes significant upgrades to manganese ore and thermal coal forecasts

By Eva Brocklehurst

Nickel

China's nickel ore imports have lifted 41% in February as imports from Indonesia surged. Commonwealth Bank analysts observe the rise in nickel ore exports from Indonesia more than offset a decline from the Philippines. The analysts envisage downside pressure on nickel prices amid surpluses in the nickel ore and nickel pig iron (NPI) markets.

Around 2% of global nickel supply was added in 2017 alone. This could increase in 2018 as Indonesia's government has approved over 28.4mt of low-grade nickel ore exports. The analysts still envisage Filipino nickel ore exports could recover in 2018, although this may take longer than previously expected.

The Philippines accounts for around 20% of global nickel ore output and around half of the nation's nickel output was at risk of closure under former mining minister Gina Lopez. The analysts suspect nickel prices will be driven by developments in the stainless steel market, as it accounts for around two thirds of nickel consumption.

Canaccord Genuity takes a closer look at the NPI segment, believing the market is underappreciating the margins for Indonesian NPI operations. In a global context, the analysts believe NPI is the most significant segment providing supply growth in the nickel market, estimated to account for over 30% of the current nickel market.

The broker agrees stainless steel will continue to dominate the nickel market in the near to medium term. Integrated stainless/NPI production could displace higher costs production elsewhere and potentially free up class 1 nickel products for other uses. NPI product offers several advantages such as competitive capital and operating costs, high suitability for steel making and superior payability.

In the wake of a site visit to state-of-the-art integrated stainless steel and NPI production facilities in Indonesia, the broker upgrades nickel price forecasts by 15% for 2018 and 4.5% for 2019. The broker also upgrades Western Areas ((WSA)) to Hold from Sell and increases the target to $3.10.

Steel Raw Materials

High steel inventory in China over March and weak downstream demand have put steel-making raw materials under pressure. Iron ore has fallen -13% month on month while metallurgical (coking) coal has dropped -11%. Morgan Stanley still expects China's steel sector to pick up in the second quarter and support prices before markets come under further pressure in the second half of the year.

The broker suggests that several factors clashed in March, with the traditional peak season for construction and extended winter capacity cuts keeping China's demand lower for longer. In the second half, nonetheless, the forecast slowdown in housing starts and infrastructure construction should begin to weigh on demand and margins once again.

The upside risk for both iron ore and metallurgical coal could come from higher scrap prices, which would put pressure on electric arc furnace (EAF) costs and result in lower growth in output in China. In turn, this would raise demand for iron ore. Metallurgical coal risks are largely supply-based amid the ongoing Aurizon ((AZJ)) dispute which threatens up to 20mtpa of coal shipments.

Steel Scrap

Macquarie observes steel scrap has outperformed amid the price weakness experienced by steel raw materials. Scrap prices have increased in the year to date versus the declines posted by iron ore and coking coal. The broker observes steel trade protectionism has underscored this situation along with a likely increase in scrap demand in the US, which is world's largest scrap exporter.

EAF producers are expected to experience some margin compression in 2018 relative to integrated producers, and higher scrap prices could end up benefiting iron ore pellet producers. Macquarie's envisages the scrap trade is well supported and this is key to Sims Metal Management ((SGM)).

While a boost to domestic EAF production in the US could constrain the export market supply over time, the broader incentive to increase scrap collection will also grow as prices rise. While recent threats to impose a 25% duty on recycled aluminium could affect around 5% of the company's revenue, Macquarie believes diversion to other markets is entirely possible.

Manganese, Thermal Coal

Macquarie make significant changes to its forecasts for manganese ore and thermal coal pricing. Manganese ore has benefited from Chinese environmental reforms and the broker incorporates price increases of 13-25% over the next five years and a 50% lift to the long-term forecast.

The loss of the Chinese domestic production capacity is expected to mean more high-cost seaborne ore is supplied to the market in the long-term. As a result, the broker upgrades South 32 ((S32)) to Outperform from Underperform as its long-term outlook has been significantly enhanced.

Upgrades to coal price forecasts have transformed the long-term outlook for both Whitehaven Coal ((WHC)), upgraded to Outperform from Neutral, and New Hope Corp ((NHC)), on Outperform and currently the broker's preferred coal exposure.

Other notable changes that have affected Macquarie's coverage include long-term upgrades to forecasts for copper, aluminium and alumina. The changes reflect the application of forecast marginal cost of production in 2024. The broker reiterates an Outperform rating for Alumina Ltd ((AWC)), as the stock is underpinned by a strong dividend yield.

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 March 19 to Friday March 23, 2018 Total Upgrades: 2 Total Downgrades: 6 Net Ratings Breakdown: Buy 43.88%; Hold 40.66%; Sell 15.46%

At a time when geopolitical and macro concerns are weighing on general investor sentiment, stockbroking analysts in Australia are issuing more downgrades than upgrades for ASX-listed entities.

For the week ending Friday, 23rd March 2018, FNArena only counted two upgrades and six downgrades. Both upgrades lifted to Buy (pfew) but then three of the downgrades sank to Sell.

Brambles and Nufarm were the lucky receivers of a new Buy rating each post an investor update and financial results release respectively. This can only be interpreted as encouraging by local investors.

On the flipside, Seek, Senex Energy and Synlait Milk all received one downgrade to Sell and valuation was a key factor in all three decisions.

Two retailers that updated investors with financial performances feature on top of the week's table for positive amendments to price targets, with Premier Investments and Kathmandu followed by Nufarm, Nine Entertainment and Brambles.

Only one stock features in the week's overview for negative revision to price targets: Seek.

Synlait Milk, Brickworks and TPG Telecom all had sizeable upward adjustments to earnings forecasts, followed by OZ Minerals, OceanaGold and Kathmandu. Alas, downward adjustments for the week look a lot stronger with struggling Myer at the very bottom, followed by Newcrest Mining, Nufarm, then Sigma Healthcare and New Hope Coal.

All in all, it appears that macro will continue dominating the micro and the picture for the latter remains rather ambiguous.

Upgrade

BRAMBLES LIMITED ((BXB)) Upgrade to Outperform from Neutral by Credit Suisse .B/H/S: 3/4/0

The company has offered a detailed plan for turning around the performance of the US business, improving cash conversion and offsetting cost inflation.

Credit Suisse is now more confident significant improvement can be delivered over the next 2-3 years and expects the technology investment will strengthen the network advantage.

Rating is upgraded to Outperform from Neutral. Target is raised to $10.40 from $9.40.

NUFARM LIMITED ((NUF)) Upgrade to Buy from Hold by Ord Minnett .B/H/S: 6/0/1

First half earnings were affected by weakness in Latin America and the downtime at the Laverton plant. Ord Minnett notes the company has enjoyed strong sales momentum in core geographies despite little or no market growth recently.

Ord Minnett observes increased valuation support for the stock which leads to an upgrade to Buy from Hold. Target is raised to $10.50 from $9.00.

Downgrade

MINERAL RESOURCES LIMITED ((MIN)) Downgrade to Accumulate from Buy by Ord Minnett .B/H/S: 3/1/0

Given recent share price strength, Ord Minnett downgrades its recommendation to Accumulate from Buy and lowers the target to $19.50 from $20.50.

The broker notes ASX lithium companies have largely recovered from recent concerns about oversupply. The broker prefers Orocobre ((ORE)), Galaxy Resources ((GXY)) and Kidman Resources ((KDR)) in the sector.

NINE ENTERTAINMENT CO. HOLDINGS LIMITED ((NEC)) Downgrade to Neutral from Outperform by Credit Suisse .B/H/S: 2/3/0

Credit Suisse increases FY18 earnings estimates by 2.9% to reflect a strong start to the 2018 ratings year. The broker forecasts a 39.0% market share in FY18. FY19 earnings estimates are raised by 8.1%.

A high level of sustainable market share is now factored into the price as well as reasonable valuations for the digital assets, in the broker's opinion. Rating is downgraded to Neutral from Outperform. Target rises to $2.35 from $2.10.

PREMIER INVESTMENTS LIMITED ((PMV)) Downgrade to Neutral from Buy by Citi .B/H/S: 3/3/0

Citi notes a large acceleration in online business during the first half. Bricks and mortar sales declined by -0.8% while online grew 72%. Citi forecasts a decline in second half gross margins of -43 basis points, softer than the first half decline of -87 basis points.

Meanwhile, inventory is expected to be in a good position and year-on-year discounting should not increase as much.

Rating is downgraded to Neutral from Buy, given the increase in the share price over the past four months. Target is raised to $16.40 from $15.30.

SEEK LIMITED ((SEK)) Downgrade to Reduce from Hold by Morgans .B/H/S: 1/2/4

The launch of Google For Jobs is expected in Australia shortly. Morgans believes that ultimately Seek has the power to see off the threat from Google, but initially there may be a drag on short term earnings.

There will likely also be a dip in market sentiment towards Seek given the potential impact of a new player, that being Google no less. Morgans still likes Seek long term but short term downside risk is elevated. Downgrade to Reduce. Target falls to $19.07 from $21.07.

SYNLAIT MILK LIMITED ((SM1)) Downgrade to Underperform from Neutral by Macquarie .B/H/S: 0/0/3

First half results were ahead of Macquarie's forecasts. No quantitative guidance was provided for the second half but this is expected to be softer because of some margin benefits in the first half.

Macquarie downgrades to Underperform from Neutral on valuation. The strong result was supported by the success of key customers and earnings are expected to grow as infant formula volumes ramp up.

Price target is raised to NZ$7.00 from NZ$5.29.

SENEX ENERGY LIMITED ((SXY)) Downgrade to Sell from Neutral by Citi .B/H/S: 3/3/1

Citi has downgraded to Sell/High Risk from Neutral/High Risk following a recent rally in the share price. Target price remains untouched at 35c.

As Citi has also increased its in-house forecasts for Brent and WTI oil prices by US$6 in 3Q18 to US$60/bbl and US$58/bbl respectively, earnings estimates have been lifted.

While pointing out there remains significant upside value potential, risks remain as well around well performance, cost control, gas contract pricing, funding and execution. As a result, investors are unlikely to pay up for the potential as yet, suggest the analysts.

Total Recommendations Recommendation Changes

Broker Recommendation Breakup

Broker Rating Order Company New Rating Old Rating Broker Upgrade 1 BRAMBLES LIMITED Buy Neutral Credit Suisse 2 NUFARM LIMITED Buy Neutral Ord Minnett Downgrade 3 MINERAL RESOURCES LIMITED Buy Buy Ord Minnett 4 NINE ENTERTAINMENT CO. HOLDINGS LIMITED Neutral Buy Credit Suisse 5 PREMIER INVESTMENTS LIMITED Neutral Buy Citi 6 SEEK LIMITED Sell Neutral Morgans 7 SENEX ENERGY LIMITED Sell Neutral Citi 8 SYNLAIT MILK LIMITED Sell Neutral Macquarie Recommendation Positive Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 BXB BRAMBLES LIMITED 43.0% 29.0% 14.0% 7 2 NUF NUFARM LIMITED 71.0% 57.0% 14.0% 7 3 S32 SOUTH32 LIMITED -57.0% -71.0% 14.0% 7 4 BSL BLUESCOPE STEEL LIMITED 79.0% 75.0% 4.0% 7 Negative Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 SM1 SYNLAIT MILK LIMITED -100.0% -67.0% -33.0% 3 2 NEC NINE ENTERTAINMENT CO. HOLDINGS LIMITED 40.0% 60.0% -20.0% 5 3 KMD KATHMANDU HOLDINGS LIMITED 50.0% 67.0% -17.0% 4 4 PMV PREMIER INVESTMENTS LIMITED 50.0% 67.0% -17.0% 6 5 OZL OZ MINERALS LIMITED 14.0% 29.0% -15.0% 7 6 SEK SEEK LIMITED -50.0% -36.0% -14.0% 7 7 SXY SENEX ENERGY LIMITED 29.0% 43.0% -14.0% 7 8 MIN MINERAL RESOURCES LIMITED 63.0% 67.0% -4.0% 4 Target Price Positive Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 PMV PREMIER INVESTMENTS LIMITED 15.963 15.197 5.04% 6 2 KMD KATHMANDU HOLDINGS LIMITED 2.465 2.365 4.23% 4 3 NUF NUFARM LIMITED 9.783 9.440 3.63% 7 4 NEC NINE ENTERTAINMENT CO. HOLDINGS LIMITED 1.910 1.860 2.69% 5 5 BXB BRAMBLES LIMITED 10.523 10.309 2.08% 7 6 OZL OZ MINERALS LIMITED 9.879 9.836 0.44% 7 Negative Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 SEK SEEK LIMITED 18.303 18.589 -1.54% 7 Earning Forecast Positive Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 SM1 SYNLAIT MILK LIMITED 38.735 33.426 15.88% 3 2 BKW BRICKWORKS LIMITED 126.425 110.475 14.44% 4 3 TPM TPG TELECOM LIMITED 43.690 40.189 8.71% 8 4 OZL OZ MINERALS LIMITED 77.529 75.357 2.88% 7 5 OGC OCEANAGOLD CORPORATION 22.292 21.931 1.65% 5 6 KMD KATHMANDU HOLDINGS LIMITED 19.550 19.259 1.51% 4 7 RIO RIO TINTO LIMITED 632.676 626.238 1.03% 8 8 NEC NINE ENTERTAINMENT CO. HOLDINGS LIMITED 17.496 17.368 0.74% 5 9 S32 SOUTH32 LIMITED 29.129 28.935 0.67% 7 10 WEB WEBJET LIMITED 42.412 42.272 0.33% 5 Negative Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 MYR MYER HOLDINGS LIMITED 2.990 4.476 -33.20% 6 2 NCM NEWCREST MINING LIMITED 64.172 79.394 -19.17% 8 3 NUF NUFARM LIMITED 44.551 49.696 -10.35% 7 4 SIG SIGMA HEALTHCARE LIMITED 5.230 5.783 -9.56% 4 5 NHC NEW HOPE CORPORATION LIMITED 28.290 30.313 -6.67% 3 6 OSH OIL SEARCH LIMITED 32.745 33.380 -1.90% 8 7 BXB BRAMBLES LIMITED 56.129 57.083 -1.67% 7 8 PMV PREMIER INVESTMENTS LIMITED 75.270 76.412 -1.49% 6 9 NAB NATIONAL AUSTRALIA BANK LIMITED 226.075 227.575 -0.66% 8 10 SEK SEEK LIMITED 60.927 61.070 -0.23% 7 Technical limitations

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Uranium Week: The Cost Of Clean-Up

The Trump administration has suspended government sales of uranium in FY18, previously undertaken to fund an environmental clean-up.

-DoE suspends US government uranium sales -Global price gap begins to close -Japan restarts number seven

By Greg Peel

The US Department of Energy announced last week it would suspend government sales of uranium from excess inventories, which had previously been undertaken on a gradual basis in order to fund the environmental clean-up of the department's Portsmouth enrichment facility in Ohio.

The suspension will last until the end of the government's fiscal year (September) but energy secretary Rick Perry hinted that a more permanent suspension would be preferable, leaving the clean-up to be funded through the usual budget means. The initial suspension will remove some 1.6mlbs U3O8 equivalent from the market.

This will bring the total of all uranium supply removed from the market recently to 30mlbs, through policy decisions and producer supply cuts.

The spot uranium market initially sparked up on the news last week until it was learned the president was hesitating in signing the bill. Trump did ultimately sign the bill on Friday but it was too late for market participants to respond.

This suggests there may be a brighter week ahead, given industry consultant TradeTech's weekly spot price indicator shed -US20c by week's end to US$21.65/lb. Seven transactions were concluded totalling 900,000lbs U3O8 equivalent.

Mind the Gap

The spot price indicator may have fallen but last week finally saw some buyers taking advantage of the price gap that had opened up in past weeks between prices for delivery in the US and Europe. Greater demand for material in Europe had sent the spot price for delivery in France above that of delivery in the US.

That gap began to close last week as more interest was shown in US material, likely reflecting the fact once the price difference exceeds the relevant cost of delivery, an arbitrage opportunity opens up for intermediaries.

Quick Succession

After a seven year period of relative stasis, in which only five of Japan's previous forty-odd nuclear reactors had passed regulatory safety inspections and received approval at all government levels to be able to restart operation, suddenly things are moving quickly.

Two weeks ago saw the restart of a sixth reactor and last week saw the restart of a seventh – Kyushu Electric's Genkai unit 3.

Furthermore, a Japanese district court rejected a lawsuit to halt construction of the new Ohma nuclear plant, which had been delayed post-Fukushima and is now expected to be completed by 2024-25.

And the Genkai town assembly has sent a proposal to the government to support the government's Strategic Energy Plan in favour of the construction of new plants.

There were no transactions recorded in uranium term markets last week. TradeTech's term price indicators remain at US$25.75/lb (mid) and US$29.00/lb (long).

The Wrap: Second Half Skew, Banks & Contractors

Second half club; banks; Bank Royal Commission; telcos; contractors and supermarkets.

-Earnings outlook for second half of FY18 seen resilient overall -Banks still expected to return capital despite subdued growth profile -Significant changes to bank industry practice likely to be proposed by Royal Commission -Optus the only telco showing better outcomes over the first half of FY18 -Volumes among WA contractors rising with the main upside in major iron ore contracts -UBS survey suggests Coles is regaining momentum

By Eva Brocklehurst

Second Half Club

Deutsche Bank notes ASX earnings forecasts for FY18 have been resilient, as downgrades have tended to come through at this time of the year. The bulk of the support for the market is coming from the resources sector which remains in an upgrade cycle.

Still, the broker concludes the picture is not that bad the rest of the market and moderate growth appears likely. There are the usual concerns that a lot of companies are in need of a big second half in order to hit forecasts in the wake of first half results that were on the lean side. The broker suggests this risk is not really that evident this time.

Stocks that have a higher-than-normal skew to the second half and could potentially be regarded as candidates for downgrades, the broker assesses, include Aurizon ((AZJ)), Amcor ((AMC)), Boral ((BLD)), Domino's Pizza ((DMP)), Mirvac ((MGR)) and Tabcorp ((TAH)). Consensus forecasts also suggest downside risk for Adelaide Brighton ((ABC)), AMP ((AMP)) and Newcrest Mining ((NCM)).

Companies which have the potential for a smaller-than-normal skew to the second half include CSL ((CSL)), REA Group ((REA)), Star Entertainment ((SGR)) and Stockland ((SGP)). The broker adds BHP Billiton ((BHP)), BlueScope ((BSL)) and Rio Tinto ((RIO)) to this list, amid upgrades to spot commodity prices, as well as Monadelphous ((MND)) and WorleyParsons ((WOR)) as upgrade candidates.

Banks

Funding costs have risen in recent weeks for the banks and Macquarie observes this has been driven by a spike in the bank bill-OIS (overnight indexed swap) spread. The spread has widened to around 50 basis points from around 22 basis points in the second half of 2017. This affects banks that have an overweight position in mortgages and loan portfolios that are priced off the cash rate.

The broker estimates that a 10 basis points increase in these spreads reduces bank margins by -1-2 basis points and earnings by around -1%. While negative for short-term returns, the spike in funding costs is not considered structural. Banks are expected to raise mortgage rates to offset this.

The issue is also affecting banks globally, although Macquarie finds the precise reason unclear. One possible explanation could be at the result of tax changes in the US, as this offers corporations an opportunity to repatriate funds which were held overseas. This led to a drop in demand for short-term securities and a widening of spreads.

Macquarie continues to believe bank valuations are attractive at current levels, and while the underlying growth profile is subdued, banks are still expected to return capital to shareholders via special dividends and buybacks.

Banking Royal Commission

The Royal Commission into Financial Services has completed two weeks of hearings involving bank misconduct in the consumer lending area. Indicative findings unearthed a number of breaches of legislation, regulatory guidance and company policy.

Banks are likely to be paying a considerable amount of remediation costs and/or penalties. Ord Minnett suggests National Australia Bank ((NAB)) is likely to be the least affected, as its only case study related to the introducer program for which remediation should be manageable and its own whistleblower policy had brought the fraud to light.

The broker expects significant changes to industry practice will be proposed, which should improve lending standards and provide a further constraint to household credit.

The four main regulators involved in banking oversight appear to the broker to be at cross purposes in fulfilling their mandates, which provides mixed signals for the future of banking regulation in Australia. Ord Minnett does not expect a resolution any time soon and suggests confusion may weigh on already depressed bank valuations in the short term.

While interim findings are not due until September, UBS believes the banks will tighten their standards regarding responsible lending. As banks revert to a full assessment of each credit application and comprehensive credit reporting is rolled out the broker believes this could lead to two potential scenarios.

The first is a credit tightening where assessed household income is reduced and the household expenditure measure (HEM) benchmark is increased over time and the housing market slowly deflates.

The second is a credit crunch where income assessment is tightened and the HEM is lifted significantly to more realistic levels. This could sharply reduce credit availability, especially for lower income households, and may result in an economic downturn.

Telcos

Ord Minnett estimates total industry fixed broadband and NBN penetration were up 81.1% and 31.1% respectively in the first half of FY18. Broadband subscriber additions were below estimates, as digital subscriber line (DSL) subscriber losses were greater than expected, despite the additions to the NBN subscriber base coming in above estimates.

The broker estimates Telstra ((TLS)), TPG Telecom ((TPM)) and Vocus ((VOC)) all lost share while Optus gained. Within the NBN, Ord Minnett notes Optus and Vocus gained share while Telstra and TPG lost. Telstra and TPG lost voice share while Optus and Vocus gained.

Total reported fixed broadband revenues were in line with estimates, at $1.97bn, while total voice revenues of $1.59bn were worse than the broker expected. Optus was the only provider to report better-than-expected outcomes.

Contractors

Ord Minnett finds volumes among contractors in Western Australia encouraging and companies are starting to envisage potential for price rises. In terms of contracts a lot of work is going on at the moment in gold, lithium and other minerals but the main upside for many contractors will be major iron ore contracts.

After visiting 11 contracting companies in Perth the broker notes cost concerns are widespread, with the potential for increasing labour rates as foreign capacity has exited the market and infrastructure expansion is underway on the east coast.

The broker notes, since February, the one-year forward price/earnings ratios of contractors have de-rated by -19%. This could be the result of short-term buying opportunities or the start of an industry de-rating, as valuations are still 38% above the 10-year averages.

In this environment, Ord Minnett prefers those stocks that have earnings upside and undemanding valuations. The broker's order of preference for the sector is RCR Tomlinson ((RCR)) with a Buy rating, followed by CIMIC ((CIM)) and Monadelphous with Hold ratings and then ALS ((ALQ)) and Downer ((DOW)) with Lighten ratings.

Supermarkets

UBS suggests, from its survey of 1100 Australian grocery shoppers over February, that Coles is regaining momentum. This was the main surprise in the survey along with a deceleration at Aldi. Price is becoming a less important driver of expenditure, which is a positive for industry growth and profit.

Shoppers appear to be visiting Coles ((WES)) more often and its share of wallet is increasing. Woolworths ((WOW)) continues to perform well, the broker notes, particularly in fresh, although there are signs its share gains are peaking. Aldi and IGA were both softer.

The survey showed customers were visiting the major supermarket chains more often at the expense of independents and discounters and promotional fatigue is setting in. This results in non-price factors such as loyalty, service and store theatre becoming more prominent.

While Metcash ((MTS)) food & grocery continues to decline, albeit in line with UBS estimates, few catalysts are envisaged for underperformance, given the cost reductions and upside to hardware.

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The Short Report

Guide:

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

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

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

Summary:

Week ending March 22, 2018

In the five trading days ending March 22, the ASX200 tracked sideways. It was on March 23 when trade war fears toppled the index, in line with Wall Street.

The table below shows that there was a lot of short position reduction going on lower down, albeit most moves were unsubstantial. The total number of ASX-listed stocks shorted by 5% or more fell to 46 from 50.

There were nevertheless notable moves in three stocks last week. I will highlight these with the caveat that often large percentage in short positions end up proving to be a simple ASIC data blip and prior positions are restored the following week.

Shorts in nickel miner Independence Group ((IGO)) fell to 12.0% from 16.0%.

Medical device company Nanosonics ((NAN)) saw its shorts rise to 10.1% from 8.4%.

Pet/vet chain Greencross ((GXL)) saw a reduction to 6.2% from 8.3%.

See Movers & Shakers below.

Weekly short positions as a percentage of market cap:

10%+

SYR 20.6 DMP 17.3 JBH 15.8 GXY 14.1 HSO 12.0 IGO 12.0 VOC 11.4 RFG 10.8 MYX 10.7 NAN 10.1 HT1 10.1

In: NAN Out: MYR, FLT

9.0-9.9

FLT, MYR, NWS, ORE, AAC, APO

In: FLT, MYR, NWS, ORE

8.0-8.9%

BWX, HVN, AAD, PLS

Out: NAN, NWS, ORE, GXL, TGR

7.0-7.9%

MTS, TGR, GMA

In: TGR Out: BAP, APT

6.0-6.9%

APT, BAP, TPM, BEN, GXL, QUB, ING

In: GXL, APT, BAP, ING Out: KAR, IVC

5.0-5.9%

IFL, KAR, SUL, CSR, IVC, JHC, SEK, BGA, RSG, GEM, AHG, RIO, WEB, MLX, NSR, SHV, CCP, WOW, GTY

In: KAR, IVC Out: ING, NSR, SHV, CCP, WOW, GTY

Movers & Shakers

Typically I ignore largish moves in the short positions of both nickel miners and battery related miners (eg Syrah Resources, Galaxy Resources), as these top-of-the-table names often experience a deal of short position volatility, jumping up and down from week to week. But a four percentage point drop for Independence Group is not to be sniffed at.

The nickel price tends to be the most volatile of all traded base metals and this month has seen mostly weakness in line with an increasing nickel surplus, ahead of trade war fears adding to volatility. Independence Group's share price has traded accordingly. Last week I noted nickel peer Western Areas' ((WSA)) shorts have fallen to below 5% when not so long ago, the two miners were shoulder to shoulder atop the 10% plus shorted table.

Are the shorters tiring of their nickel-related positions?

There has been no new news from Nanosonics, producer of high-level disinfection solutions for medical devices, since the company disappointed with its earnings result back in February and the share price tanked in response. Analysts called the selling overwrought, but the stock has chopped around ever since.

It is unclear why shorts have suddenly jumped to 10.1% from 8.4%, only to note the past few weeks have seen Nanosonics climbing quietly up the table.

Similarly, the share price of pet shop/veterinary clinic chain Greencross has tumbled steadily since the company's February result, with increasing competition from on-line being a factor. Similarly, there has been no new news from the company of late, yet last week shorts fell to 6.2% from 8.3%.

Supposedly.

ASX20 Short Positions (%)

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

IMPORTANT INFORMATION ABOUT THIS REPORT

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

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

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

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

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

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

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

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

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Audinate Accelerates Digital AV

Momentum in Audinate's business is accelerating as original equipment manufacturers recognise the benefits of its AV networking technology.

-Plans to extend Dante across OEM products and add OEM partners -Dante enables OEMs to fast track product development -New products to increase market opportunity

By Eva Brocklehurst

There is a structural shift in the way audio systems are designed, built and used in the professional industry and Audinate ((AD8)) has ambitions to make its Dante platform the industry standard across original equipment manufacturers (OEM).

The company, which provides professional digital AV network technologies, uses its Dante platform to distribute digital signals over computer networks.

Second quarter results impressed Shaw and Partners and FY18 estimates for sales are upgraded by 6% to $19.7m, which suggests a possible breaking even of operating earnings (EBITDA) in FY18. The broker expects higher revenue growth from 2019-22, which results in an increase in the target to $3.20 from $2.20. Shaw and Partners has a Buy rating.

The broker believes momentum is clearly growing quarter of-on-quarter as the Dante ecosystem extends to legacy equipment (analogue). Dante is designed to bring the benefits of IT to the professional AV industry that is largely distributing via legacy point-to-point analogue technology.

Around 392 OEM partners license the technology including tier 1 manufacturers such as Bosch, Bose, Harman, Symetrix, Roland, Sony and Yamaha (which is a 10% shareholder). The company estimates there are over 2000 professional audiovisual OEMs with a total addressable market of over $400m per annum.

Only 50% of the company's partner OEMs have launched Dante-enabled products which provides an indication of the potential revenue growth over the medium term. The company intends to increase both the number of OEMs adopting the technology and extending Dante across an OEM product portfolio.

The Dante platform enables OEMs to fast track product development and offers a simple routing and network monitoring platform. Ease-of-use and interoperability are the key competitive advantages.

Audinate stock may not be cheap but, as Canaccord Genuity asserts, quality rarely is. The company is the industry leader with over 80% of market share and has an elevated historical growth rate, coupled with high gross profit margins of around 75%. This reflects the strength of the company's IP and barriers to entry, in the broker's opinion.

New products such as adapters, video networking and software solutions should increase the overall market opportunity and add new growth to the business. Canaccord Genuity initiates coverage with a Speculative Buy rating and target is $3.45.

Shaw and Partners believes Audinate should be included with the "A-Team" of Australian tech companies such as Aconex, Altium ((ALU)), and Atlassian, given its significant addressable market and position as a global standard in digital audio networking.

Sensera At The Fore In High-Tech Devices

Sensera, which develops sophisticated devices, has a large application across the healthcare, industrial and military sectors and TMT Analytics initiates coverage of the stock.

-Gross margins above 60% expected as use of facilities increases over time -Expected to become positive on operating earnings at the end of FY19 -Key acquisition of Nanotron in August 2017

By Eva Brocklehurst

High-tech business Sensera ((SEI)) has caught the eye of TMT Analytics. The company designs, develops and manufactures devices for medical and industrial applications. There is a large market for Sensera products in health care, automotive, military and consumer electronics and the company currently supplies the medical, industrial and military verticals.

Sensera is targeting markets that are experiencing strong growth because of fast uptake of Internet of Things (IoT) applications. These are being addressed through the company's flexible manufacturing set-up with third parties. TMT Analytics anticipates the company can drive gross margins above 60% as utilisation of its facilities increases over time.

The broker expects the company will exhibit rapid growth in the next 3-5 years and become positive on operating earnings (EBITDA) towards the end of FY19. TMT Analytics initiates coverage with a Buy rating and price target of $0.50. The stock is valued using a peer group comparison and discounted cash flow calculation.

MEMS

One strand of the company's high-tech devices, also known as micro-electromechanical systems (MEMS), include miniaturised mechanical and electro-mechanical components used to measure a wide range of variables. They set off a signal to another system in response to measurements such as pressure, vibration, acceleration and temperatures.

Ongoing miniaturisation and increasing functionality means MEMS are finding a way into more and more products. These items are used for crash-sensing in cars and in blood pressure and glucose measurement systems in medical uses.

Manufacturing MEMS uses a semi-conductor process which the company can perform 85-90% in-house at its Boston manufacturing facility in the US. The remainder is outsourced to third parties with specialised tools or capabilities.

Nanotron

The company's devices also include location-aware wireless network sensors, such as farm animal locating and collision avoidance systems for mining. Solutions assist with the maintenance of exclusion zones for the personnel moving around vehicles, which reduces fatalities from mining accidents.

Production improvements are also enabled by more efficient transportation and equipment scheduling. In the case of livestock health, tracking farm animals and combining location data with feeding data and health measurements optimises production.

Sensera gained expertise around sensor-based location with the acquisition of Germany's Nanotron Technologies in August 2017. Nanotron developed and patented several technologies which focus on accurately locating radio frequency identification (RFID) tags through pulse ranging and measuring differences in signal arrival times at different receivers.

Nanotron's system designs are proprietary, while all chip manufacturing and system assembly is done through third parties. This outsourced manufacturing model allows for limited capital expenditure, while the company has access to first-class production facilities. Nanotron uses both Global Foundries and STMicro, a French manufacturer, to produce various chip sets and anchors are manufactured by Prettl in Germany.

TMT analytics notes, while operating margins for outsourced models are typically lower compared to fully integrated production models, Nanotron does not have the scale required to run its own anchor production and assembly operations. This could change as revenues grow and proprietary assembly starts to make economic sense.

The broker suggests this stage could be realised with revenue above US$10m. Chip manufacture is likely to be always outsourced because of the large scale required to run a fabricator economically.

The company reaffirmed revenue guidance recently for FY18 of US$6.25-7.25m. TMT analytics believes this signals the strong uptake expected for the MEMS business following the commercial deal that was recently achieved with Abiomed.

The broker projects FY18 revenue of US$4.35m for Nanotron and US$2.5m for the MEMS. Longer term a revenue split of 70:30 is expected between Nanotron and micro devices.

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