Week
20

Stories To Read From FNArena

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REA Group Resisting Hostile Environment

Despite a hostile housing environment, REA Group posted a robust March quarter, improving its depth penetration and take-up of new products.

-REA Group still expects the rate of revenue growth to exceed the rate of cost growth over FY19 -Has online depth penetration reached a ceiling? -Financing business decline expected to continue into FY20

By Eva Brocklehurst

Brokers consider REA Group ((REA)) posted a strong outcome in the March quarter, offsetting the decline in residential listings with price rises, improved depth penetration and the take-up of new products.

Continued switching of residential agents to Premiere All subscription plans has more than offset the fall in volumes of new listings in the March quarter. Excluding associate losses, earnings growth of 6% was achieved in the quarter despite a volume decline of -9%. Overseas associate losses will be higher in FY19 because of the recently-acquired leads referral business, OpCity.

Listings weakness is expected to be severe in the fourth quarter - April volumes were down -22% nationally - because of the timing of holidays and the federal election. Countering the ups and downs, Ord Minnett points out the company has built a network that is resilient and it continues to command substantial pricing power.

Still, the penetration of premium advertising has reached around 18%, which the broker believes is close to the 20-25% ceiling it ascribes for depth products on online platforms in general and this could limit further revenue growth. REA is more confident, believing it has "several more" years of growth in Premiere All and is nowhere near full penetration.

Unusual Circumstances

Market conditions may not be expected to improve in the short term but these are unusual circumstances, with a combination of weak property markets and a federal election looming, and Macquarie points out the company still expects the rate of revenue growth to exceed the rate of cost growth over the full year.

The broker expects a rebound in depth revenue from the first half of FY20 amid improving volumes. Depth penetration growth in absolute terms is likely to moderate as the cycle turns, Macquarie assesses, as some of the growth in depth penetration is counter-cyclical.

Morgans is also optimistic, despite the worst residential listing environment in decades. The company has now implemented larger-than-expected price rises for FY20 and the broker upgrades forecasts and valuation.

Most of surprises in the March quarter came from tight cost controls amid a record penetration rate for depth plans. The broker acknowledges the risks lie in the steep falls in Australian residential listing volumes, amid potential for new product initiatives to fail to find widespread acceptance.

Still potential near-term re-rating catalysts include better results from Asian and US operations and success in lifting the volume of home loans through the new financial services initiative. Morgans expects a few years of double-digit earnings growth and very high levels of free cash generation, which should underpin increases in dividends.

Credit Suisse found the results reasonable, although the numbers are tracking behind its forecasts for 8.5% growth in revenue and 5.5% in operating earnings (EBITDA) in FY19. Still, the broker notes REA Group is continuing to outperform rival Domain Holdings ((DHG)).

Ord Minnett expects listing volumes to decline -13% in the second half and also lowers depth penetration estimates based on channel checks. Price growth expectations have been reduced to 8% from 10% for FY20. As a result, the broker downgrades FY19 operating earnings estimates to $524.5m from $526.2m previously.

Developer, Commercial Growth

Developer and commercial business grew firmly, benefiting from increased project profile duration and spending on display advertising by developers. The company has also reached a new partnership deal to expand the reach of Juwai in China. Juwai markets international properties, mostly in Australasia, to Chinese investors.

The financing business declined because of tighter lending conditions and uncertainty in the property market and similar conditions are anticipated over the remainder FY19 and into FY20. Ord Minnett lowers FY20 first half mortgage services growth estimates to flat, as a decline in mortgage settlements is expected to continue.

FNArena's database shows four Buy ratings, two Hold and one Sell (Ord Minnett). The consensus target is $86.29, signalling 4.4% upside to the last share price. Targets range from $71 (Ord Minnett) to $105 (Citi, yet to update on the quarterly).

See also, Property Slowdown Hampers REA Group on February 11, 2019.

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Uncertainty Prevails As CommBank Re-Sets

The third quarter was always going to be the weakest for Commonwealth Bank, and a range of new customer initiatives signals the re-basing of its business is significant.

-Remediation expenses in the near term, revenue challenges in the medium term -Divestments to provide an uplift to capital surplus -Further cost savings likely over the medium term

By Eva Brocklehurst

Third quarter trends were weak for Commonwealth Bank ((CBA)), brokers agree, but the extent to which these trends are deteriorating remains the key question. Citi suspects the majority of the weakness can be considered temporary, while Morgans opts to downgrade to Hold from Add, given the extent of re-basing announced by the bank.

Commonwealth Bank has, since FY18, introduced a range of new customer initiatives, including fee removal, fee reductions and pre-emptive fee alerts for the benefit of customers. This is expected to result in foregone annual income across continuing operations of $415m, of which $275m will be recognised in FY19. This re-basing predominantly affects non-interest income but also reduces net interest income because of a change in the calculation of interest on credit cards.

The March quarter provided evidence that Commonwealth Bank, while in an enviable position in the Australian banking landscape, is not immune to the challenges, Ord Minnett observes. This was particularly evident in the $714m of additional remediation, regulatory and compliance provisions that were taken in the quarter, as well as the ongoing pressure on non-interest income.

Valuation is fair to full, the broker assesses. Macquarie concurs Commonwealth Bank is ahead of its peers with respect to re-setting the business to the current environment, but challenges in retail banking remain and it is difficult to justify the stock's current premium valuation.

Revenue Challenges

Macquarie downgrades estimates by -5%, largely as a result of higher remediation expenses in the near term and the revenue challenges in the medium term and, while it is hard to ascertain whether the bank is being more assertive versus its peers, the results confirm the sector's revenue challenges.

Credit Suisse, albeit disappointed with the March quarter outcomes, assesses the structural re-basing of the business has been completed, downgrading FY19 estimates for earnings by -7% to incorporate the $500m post-tax remediation charge. Outer year estimates are down -4% because of lower revenue.

While maintaining an Outperform rating, Credit Suisse agrees there are immediate challenges for the sector, amid some cautious commentary regarding asset quality. Against the backdrop of further regulatory uncertainty the banking sector is considered unlikely to outperform the market.

Third quarter revenue fell -4% on the quarterly average of the first half. Morgan Stanley believes the update highlights the growing pressure on retail bank profitability from slower loan growth, margin pressure and new customer initiatives. The broker argues that a reduction in profitability may be required over the next few years to win back the support of key stakeholders and enhance long-term sustainability.

While the bank is taking steps to restructure and simplify, UBS considers the significant headwinds in the sector make it hard to envisage much upside.

Final Remediation?

CBA topped up its provisions for remediation, and believes there is little more to be done in this regard. Morgan Stanley disagrees and forecasts a further $200m of charges, which would bring the bank's total, ex AUSTRAC, to the lower end of the peer group. The broker calculates CBA booked around $1.7bn in fines and remediation over the past two years, including the AUSTRAC settlement.

Citi is more positive, suspecting the bank has ruled a line through customer remediation, choosing to accelerate this across a number of business products and services. After this announcement, CBA's advice remediation is on par

with Westpac's ((WBC)) and expected to be sufficient. Morgans acknowledges the bank's comment but remains mindful of further costs in the future.

Asset quality metrics deteriorated, as bad and doubtful debts increased and consumer arrears were higher. Total accounts in negative equity came in at 3%, and approximately three quarters of this was in Western Australia and Queensland. The bank has stated that emerging signs of weakness in the discretionary retail, drought-affected communities and single name exposures drove the increase in troublesome assets.

Morgan Stanley forecasts around $3.5bn of buybacks over the next two years, noting that capital management cannot commence until asset sales are completed and it will not be sufficient to offset the dilution from the divestments program.

However, Ord Minnett expects a strong capital position should emerge over the next 12 months, while there are cost savings to be had over the medium term. The CEO has stated that, contrary to recent media reports, the bank is not contemplating large-scale branch reductions in the near term.

Morgans expects Commonwealth Bank to achieve APRA's unquestionably strong CET1 benchmark of 10.5% by January 1 2020, calculating divestments will provide an uplift of around 120 basis points, subject to regulatory approvals. The divestment of Comminsure Life is expected to be completed in the first half of FY20. While this is likely to underpin surplus capital of around $5.5bn, the broker is mindful that some of this will be pulled into matters classed as contingent liabilities.

FNArena's database shows three Sell ratings, four Hold and one Buy (Credit Suisse). The consensus target is $69.58, signalling -3.5% downside to the last share price. Targets range from $60 (Deutsche Bank) to $78 (Credit Suisse). The dividend yield on FY19 and FY20 forecasts is 6.0% and 6.1% respectively.

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IOOF Hits Another Snag To OnePath Deal

Further delays to the acquisition of the OnePath wealth business have meant brokers are reassessing the earnings outlook for IOOF.

-Coupon rate on ANZ debt note steps down significantly -Uncertainty surrounding acquisition leads to downgrades to earnings outlook -If acquisition does not proceed would a buyback ensue?

By Eva Brocklehurst

The acquisition of the OnePath pensions & investments business by IOOF Holdings ((IFL)) has hit another snag and brokers suspect time is running out for the company to complete the transaction as it stands.

ANZ Bank ((ANZ)) has completed the separation of its pensions & investments business but a sign off by the trustee is yet to occur. Moreover, in order to obtain an 82% economic interest prior to the completion of the transaction, IOOF has been receiving a 14.4% coupon rate on an $800m debt note issued by ANZ.

This coupon rate, now ANZ has completed its successor fund transfer and split the life and wealth business, reduces to 2%, so IOOF is no longer receiving any economic interest. Brokers assume, given the cost of debt is more than 2%, that IOOF will redeem the note and repay the debt.

Completion of the transaction remains conditional on receipt of notices of no objection from OnePath custodians. Steps are being taken to satisfy the requirements but it appears completion of the deal could be delayed. Should the delays extend to July 5 additional approval will also be required from the Australian Prudential Regulatory Authority, following recent legislative amendments.

This, in turn, is likely to extend the completion date further. Macquarie notes that on October 17 it will be two years since the initial agreement was signed and both parties will have the option to terminate the agreement. IOOF would have the opportunity to walk away at no cost or revisit its offer price.

Hence, given the changing industry landscape, the broker suspects this could give rise to a redrawing of the deal. Macquarie downgrades estimates for earnings per share by -4.9% for FY19 and -8.4% for FY20 to reflect a lower coupon rate.

Morgan Stanley pushes back the timing for realised synergies, although continues to target $75m in the longer term. The broker assumes the deal is completed in the first quarter of FY20. Were the acquisition not to proceed, earnings per share would likely fall -15-20% in FY21. Morgan Stanley assesses the downgrade to profit would be partly offset by the repurchase of over 20% of shares outstanding at the current stock price using the company's cash balance.

UBS lowers estimated pre-tax profit for FY19 by -4.6% to reflect a lower contribution to the second half earnings from the step-down in the coupon. The broker agrees IOOF is likely to redeem the note and reduce debt until the outcome for the transaction is clear.

Remediation

In addition to the uncertainty around the acquisition, Credit Suisse also points out the company's estimates of customer remediation costs are significantly below its peers. Pro rata, remediation costs are calculated to be around $500m. Remediation costs, therefore, could consume the company's excess capital and the business is also facing a large amount of brand damage and industry pressure. Hence, the broker finds no appropriate risk/reward trade at current levels.

Citi envisages downside risks, including the need for IOOF to materially change its business model, while advice remediation costs would eat into profit and/or capital. The broker recognises the initial review of the advice business found no systemic issues and IOOF has limited exposure to the more problematic corporate super plan business. However, with banking peers expecting costs to the tune of $1-1.7bn each, it would be surprising if IOOF's final exposure can remain at $5-10m.

Bell Potter is quite incredulous that IOOF has only earmarked up to $30m in client remediation, all of this just to perform client file reviews. There is nothing, at this point, allocated to refunds and the broker considers this a major risk. Findings suggest major banks have provisioned or expensed on average above $1bn per adviser whereas IOOF barely registers as a comparison.

An increase in provisions is anticipated over coming months which could be in the hundreds of millions of dollars. Earnings are revised down because of changed assumptions around income payments from the ANZ notes and the broker, not one of the eight monitored daily on the FNArena database, retains a Sell rating with a $4.39 target.

Buyback?

Setting aside the risk of remediation costs and fines, if the acquisition is not completed in its entirety then the business will have around $500m in excess cash and, potentially, as much as $600m in debt headroom, depending on gearing. Credit Suisse calculates it would only take a buyback of $775m to deliver earnings per share of $0.86, which would be in line with estimates for earnings per share if the acquisition were to proceed.

Still, such a move would remain dilutive for IOOF. The largest risk to excess cash, Credit Suisse points out, is still customer remediation costs. Citi concedes it possible that additional remediation costs would temper the size of any buyback if the acquisition of OnePath fails to occur. The broker estimates a buyback could be up to $400m.

There are five Hold ratings on the database. The consensus target is $5.78, signalling 4.1% upside to the last share price. The dividend yield on FY19 and FY20 forecasts is 9.2% and 8.8% respectively.

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Confident Outlook For Goodman Group

Industrial property developer Goodman Group is increasingly confident in the opportunities inherent in its global land bank, reaffirming a robust outlook.

-Market expectations remain high and stock priced accordingly -Elevated development margins and performance fees continue -High level of work expected to be sustained for some years

By Eva Brocklehurst

Global demand for well-positioned industrial property continues apace and developer Goodman Group ((GMG)) is in the box seat, with work in hand expected to approach $5bn by FY20, as two large development projects in Hong Kong get underway.

The company has flagged high-quality locations in its land bank and the increasing scale of developments, reaffirming FY19 guidance for 9.5% growth in earnings per security and distribution growth of 7%.

UBS notes a solid capital position is allowing the company to unlock opportunities in gateway cities with increasing conviction and the outlook commentary is very bullish, despite the March quarter been slower than usual.

Development pre-commitments have fallen to 52%, the lowest level on record, as buoyant tenant markets provide the confidence for more speculative projects, and Ord Minnett points out Australasia and Europe remain at record lows in terms of pre-commitments.

High Expectations

Several brokers point out that market expectations remain very high and the stock is priced accordingly. Goodman Group is expected to outperform the A-REIT sector and Macquarie suggests the market is also likely to reward strong fundamentals and superior earnings growth over the medium term.

Shaw and Partners, not one of the eight stockbrokers monitored daily on the FNArena database, is unconcerned about the company's ability to generate attractive development returns, performance fees and earnings growth, yet believes the stock is expensive on valuation grounds, retaining a Sell rating with an $11.30 target.

As, overall, market uncertainty is highly evident, the broker acknowledges that sentiment could remain positive because of the strong balance sheet and leverage to e-commerce.

Most of the company's managed funds are in the money and Ord Minnett agrees further capitalisation rate (income versus asset value) compression in Australasia should underpin elevated development margins and expansion in performance fees out to FY21.

The bulk of performance fees in the first half came from continental Europe, having been predominantly from Asia in the prior corresponding half. For FY20 Ord Minnett forecasts performance fees to lift to $174m, equivalent to 40 basis points of assets under management and representing 35% of management revenue.

High Value Projects

High-value projects are expected to commence across Asia and Australia in the coming year and a high level of work will be sustained for some years because of the long life nature of the projects. Total assets under management (AUM) are expected to exceed $45bn by the end of this financial year.

During the March quarter, AUM increased by $1.2bn while external (third party) assets under management grew by $800m. Credit Suisse assumes the company can reach $51.8bn in external assets under management by June 2021, underpinned primarily by completed developments.

Macquarie expects FY20 to be a bumper year. The stock may appear expensive relative to history but the broker notes it is trading below its growth peers in Australian equity markets. In addition, Goodman Group's earnings profile is less risky. Development yields around 7% versus portfolio yields of around 5%, indicate margins are robust. This will be the focus, UBS asserts, as the company expands its land bank globally.

FNArena's database has three Buy ratings, two Hold and one Sell (Ord Minnett). The consensus target is $13.30, suggesting -1.1% downside to the last share price. Targets range from $11.50 (Ord Minnett) to $14.57 (Macquarie).

Goodman Property Trust

NZ-listed Goodman Property Trust, which specialises in the Auckland industrial market, has sold its last remaining non-Auckland industrial asset. The issue for brokers now centres on stimulating cash earnings growth.

UBS suggests growth could be achieved through value-added investments but also notes, despite favourable industrial market fundamentals, material increases in rent growth are not evident. Yet demand for industrial sites remain strong, manufacturing sales growth is positive and primary and secondary vacancies are substantially below long-term averages.

Macquarie observes the high-quality Auckland industrial portfolio is the best in the sector, albeit under-rented, but the stock's valuation has become more challenging, downgrading to Neutral from Outperform. The broker believes the business is positioned for long-term upside, although acquisitions may not be significantly accretive in the near term.

Credit Suisse downgrades Goodman Property Trust to Underperform from Neutral on valuation, although expects New Zealand's low interest-rate environment will continue to support the stock in the near term. Goodman Group has a strategic 20% stake in Goodman Property Trust.

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The Looming Gold Reserve Crisis

McKinsey & Company warn that a lack of recent exploration investment threatens a gold reserve crisis, while Macquarie singles out Africa-based miners as solid growth prospects.

-Era of cost-outs leads to a lack of exploration -Few significant gold finds in recent times -Oz miners in Africa offering re-rate potential

By Greg Peel

The gold industry has endured a rollercoaster ride in the 21st century to date, with the gold price rising from US$255/oz in 2001 to US$1900/oz in 2011, before falling to US$1050 by end-2015. The soaring price in the noughties prompted global gold miners into aggressive debt-funded M&A programs, note researchers McKinsey & Company.

The near halving of the price from 2011 forced now debt-heavy miners to take hefty impairments and initiate dramatic cost-out programs. Between 2012 and 2017, all-in sustaining costs (AISC) declined by -20% to US$879/oz.

The gold price has since recovered some ground (to US$1300/oz at the time of writing) and the initiatives taken beforehand mean large gold miners are much healthier, McKinsey notes, enjoying stronger cash flows, leaner cost structures and deleveraged balance sheets. But what miners were not doing while engaging in this cost and debt rationalisation phase was investing in high cost, high risk exploration.

The result is gold reserves have declined by approximately -26% to 713moz, due partly to a -70% reduction in exploration spending as miners sought to preserve cash. This raises the uncomfortable prospect, McKinsey warns, of a looming reserve crisis.

During the noughties, miners sought to boost reserves through M&A, with the annual acquisition value peaking at US$38bn in 2011. The average price paid per ounce for acquired reserves in this period was often up to 300% prices a decade earlier. Such value destruction as a result of aggressive M&A means miners today are far more cautious at resorting to this approach to replenish reserves, McKinsey observes, despite price/earnings multiples of potential M&A targets having fallen back to decade lows.

Exacerbating the reserve replenishment challenge has been a lack of exploration success. Only a handful of greenfield projects have delivered significant gold discoveries above 6moz since 2006, and there are long lead-times between discovery and production.

As a result, relying on traditional greenfield strategies may not be the solution for growth either.

Hence, McKinsey suggests, the gold industry finds itself at an inflection point between the past cost-out and balance sheet deleveraging era and today's need to focus on growth and reserve replenishment. Investors in gold miners looking for improved returns are unlikely to support the traditional means to reserve replenishment -- significant M&A programs.

"The future strategic options to drive growth will differ across industry players," Mc Kinsey suggests, "but all players will need to consider a mix of organic [exploration] and inorganic [acquisition] approaches if they want to return to growth in an economic and sustainable way".

Out of Africa

ASX-listed West African gold developers Resolute Mining ((RSG)), Perseus Mining ((PRU)) and West African Resources ((WAF)) are trading at a -26% discount in price to net asset value terms to the rest of Macquarie's gold coverage universe, and a -67% discount in enterprise value to FY21 production terms.

Yet at the same time, each of these developers is expected to deliver some of the highest rates of growth in the sector over a three-year horizon.

An element of geographic (sovereign) risk will always be present, Macquarie admits, but with high-quality geology and projects on the cusp of delivery, the broker sees strong potential for a production-led re-rating in a similar fashion to that enjoyed recently by Gold Road ((GOR)) and Alacer Gold ((AQG)).

The ramp-up of Resolute's Syama underground project in Mali is expected by Macquarie to reach its planned 2.4mtpa mining rate late this year. Optimisation work at the company's Ravenswood mine in Queensland is intended

to lift production to above 5mtpa. The broker sees Syama delivery as a pivot point, providing significant cash flow fire power to grow the business.

Development of Perseus' third mine at Yaoure in the Cote d'Ivoire is expected to more than double the company's production outlook to around 500kozpa by 2022. Yaoure development is fully funded through a mix of debt and cash flow and first production is expected by late next year.

West African's development of the Sanbrado project in Burkina Faso is well underway, Macquarie notes, the company continues to extend the high grade underground resource, offering the potential for further mine life extensions.

Over time, Macquarie expects the bolstered earnings potential of the three miners to unlock further growth and the maturation of their businesses.

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Material Matters: LNG, Bulks And Steel

Trade tensions; LNG; bulks; and steel.

-US tariff hike a fresh bear risk for commodity markets -Divergence in oil and LNG prices putting pressure on buyers to exit LNG contracts -Iron ore stocks at Chinese ports likely to be exhausted by September quarter -Outlook for coking and thermal coal diverging further

By Eva Brocklehurst

Trade Tensions

Morgan Stanley asserts an increase in US tariffs on US$200bn of Chinese goods, to 25% from 10%, provides a fresh bear risk for commodity markets. Commodities are exposed to weaker GDP growth, as doubts are raised about China's recovery.

Globally, the broker's economists expect GDP growth to be -30-40 basis points weaker, with an -80 basis points impact already seen since initial tariffs were imposed. This translates to a mild negative for base metals demand. China's response to trade tensions has been via domestic stimulus but, if this persists for a further 3-4 months, economists expect further fiscal easing up to an additional 0.5% of GDP.

All commodities should gain from this, but particularly steel and its raw materials, those most exposed to China's domestic construction/infrastructure sector. Morgan Stanley suggests tariffs should drive a redistribution of demand but it will take time. Existing tariffs are already affecting US raw material imports from China and the incremental impact is largely on metal in products. As much as 3% of China's total copper demand is re-exported to the US in this way.

Hence, Morgan Stanley believes the impact will be a delayed recovery rather than a further downturn. Any safe-haven demand for US dollars could also be negative for commodities, although the analysts observe the adjustment is occurring via bond/equity markets rather than the US dollar.

The broker's base case remains for a US dollar sell-off. However, upside is likely for gold as equity markets fall. Buying opportunities could emerge, most likely in copper, but the near-term risk in the broker's view is firmly to the downside.

LNG

The divergence between oil and LNG spot prices is increasingly expected to put pressure on buyers to exit LNG contractual commitments. Buyers will also be pursuing contract price reviews more aggressively and Credit Suisse notes Woodside Petroleum's ((WPL)) Pluto and Oil Search's ((OSH)) PNG LNG contracts are both under discussion.

The broker's valuation for Woodside could drop by -2% and Oil Search by around -5%. Credit Suisse suspects buyers have more leverage and are under more pressure than ever before in the history of the industry. Negotiations could be protracted, with any outcome in 2019 unlikely. Hence, there could be at nasty surprise for the two companies later in 2020.

Buyers could evade contractual commitments via exercising what is known as Downward Quantity Tolerance (DQT). This is the amount by which a buyer can fall short of its annual contract quantity in a take-or-pay gas sales contract without incurring sanctions.

Credit Suisse envisages long-term LNG contracts will retain the 11.5-12% linkage to Brent range, although does not rule out volume producers such as Shell being willing to offer sub-11.5% volumes for the more fiercely competed tenders to buyers such as KOGAS.

The broker notes the glut of LNG globally is likely to persist to 2021 and Europe will be the "sink" for excess LNG, where it will compete with Russian gas.

Bulks

Credit Suisse lifts iron ore price forecasts, expecting a peak in the price of US$110/t in the September quarter when Chinese trade stocks at ports are expected to be exhausted. The broker estimates a -57mt iron ore deficit in 2019.

This is driven by stronger forecasts for Chinese steel output and Vale's expectation it will lose -65-75mt of iron ore production because of suspensions.

Australian miners, meanwhile, have cut guidance by -32mt following Cyclone Veronica. When supply is no longer available from ports, steel mills are likely to bid aggressively for spot cargoes rather than willingly curtail blast furnaces, in the broker's view.

Chinese steel output is critical for iron ore and coking (metallurgical) coal forecasts. China produces half the world's steel and imports 70% of the world seaborne iron ore. Self-sufficiency for metallurgical coal is greater, as China imports only 18% of the world exported supply. However, domestic coking coal prices appear to support the seaborne price.

The broker lifts metallurgical coal price forecasts, now expecting prime hard coking coal to remain at US$200/t for an extended period. Credit Suisse gained confidence in the durability of the Chinese coking coal price from a visit to Shanxi, noting quality shortages. The long-term hard coking coal price forecast increases to US$160/t, modelled as an incentive price.

Credit Suisse reduces its Newcastle thermal coal price forecasts, undermined by discounted coal displaced from Europe. European coal prices have slumped as a mild winter meant ports were overstocked. And LNG surplus is also driving gas prices down to levels where coal-to-gas switching appears viable. This is expected to persist to 2021.

Cheap gas may accelerate the closure of coal-fired power plants in Europe, Credit Suisse suggests. And Atlantic coal suppliers will look to Asia for new markets.

High-energy coal is experiencing the brunt of the price erosion, as this is the main grade displaced from Europe. Indonesian coal has remained unaffected so far as its major markets of India, China and ASEAN (Alliance of South East Asian Nations) are not facing the threat of large coal-to-gas switching.

Between the extremes, Credit Suisse forecasts a flat price outlook for Australian high-ash 5500 calorie coal, which is largely driven by the Chinese price. The thermal market is expected to head into modest surplus, although there are large uncertainties surrounding Indonesian production.

Steel

JPMorgan estimates that lagged US steel spreads need to hold at US$510/t for the remainder of the second half of FY19 to achieve the guidance that BlueScope Steel ((BSL)) has provided. US steel in scrap prices have fallen and the lagged steel spreads are down -12.5% from a month ago.

The lagged Australian hot rolled coil spread is presently at $331/t. Based on this, and raw material price movements, the broker calculates BlueScope Steel's second half earnings (EBIT) could decline by -$390m on the first half. This implies FY19 earnings of $1.31bn versus guidance of $1.4bn.

With spreads continuing to decline in the US, offsetting a recovery in Australia, JPMorgan believes investors may need to revise expectations ahead of BlueScope's results in August. The broker maintains a Overweight rating based on a discounted cash flow valuation to FY25.

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Weekly Ratings, Targets, Forecast Changes

By Rudi Filapek-Vandyck, Editor FNArena

Guide:

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

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

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

Summary

Period: Monday May 6 to Friday May 10, 2019 Total Upgrades: 9 Total Downgrades: 20 Net Ratings Breakdown: Buy 40.72%; Hold 43.67%; Sell 15.61%

The Australian share market continues to suffer from falling earnings forecasts and out-of-season corporate results releases from banks, agricultural producers and chemical companies, thus far, have simply continued to contribute to the negative underlying trend.

With macro matters and US equities supporting risk assets at elevated levels, it should not surprise stockbroking analysts are issuing more than twice as many downgrades in recommendations for individual ASX-listed stocks than they are issuing fresh upgrades. No surprise also most downgrades are hitting companies reporting out-of-season corporate results, a profit warning, or both.

For the week ending Friday, 10th May 2019, FNArena registered nine downgrades and twenty upgrades for ASX-listed stocks by the eight stockbrokers monitored daily. Reductions in earnings estimates far outweigh increases. Overall changes in valuations and price targets remain rather tepid to the upside, but this equally applies to downside adjustments.

Operational updates will continue to flow in during the week ahead, including by CommBank ((CBA)) on Monday morning, DuluxGroup ((DLX)), and Xero ((XERO)).

Upgrade

ADELAIDE BRIGHTON LIMITED ((ABC)) Upgrade to Hold from Sell by Deutsche Bank .B/H/S: 0/5/2

Deutsche Bank analysts have responded to the company's pre-AGM profit warning by upgrading their rating to Hold from Sell, while reducing the price target to $3.60 from $4 in line with reduced forecasts.

While disappointing, the analysts now believe this is in the share price.

See also ABC downgrade.

ALUMINA LIMITED ((AWC)) Upgrade to Neutral from Sell by UBS .B/H/S: 2/3/0

UBS forecasts a US11.9c per share dividend in 2019. This is well down on 2018, which was driven by a very high, yet unsustainable, pricing environment.

The broker envisages a longer-term dividend of US11-12c per share based on a US$350/t alumina price that will support the share price, assuming free cash flow is returned to shareholders.

UBS considers the outlook now more balanced and moves to a Neutral rating from Sell. There is potential downside risk in the alumina price should Alunorte reach full capacity in the current quarter. Target is steady at $2.20.

ERM POWER LIMITED ((EPW)) Upgrade to Add from Hold by Morgans .B/H/S: 3/0/0

Morgans believes the stock is back into buying territory, and upgrades to Add from Hold. The broker forecasts an 11% total shareholder return on a 12-month horizon.

Upside potential exists if gross margins for Business Energy Australia are in the mid-upper range of guidance, or if the energy services division can increase its earnings faster than forecast.

The broker assumes the Neerabup power station will be refinanced in the first half of FY20. Target is reduced to $1.86 from $1.90.

EVOLUTION MINING LIMITED ((EVN)) Upgrade to Accumulate from Hold by Ord Minnett .B/H/S: 1/4/3

Ord Minnett reviews its valuation, noting the share price has fallen more than -20% from its January highs and has underperformed the ASX gold sector.

Outside of supportive mark-to-market valuations, the broker notes Evolution Mining is reaching a net cash position and should deliver improvements to operations at Cowal in the next 12 months.

Ord Minnett does not believe the share price correlates with fundamentals and upgrades to Accumulate from Hold. Target is steady at $3.50.

GRAINCORP LIMITED ((GNC)) Upgrade to Hold from Reduce by Morgans .B/H/S: 3/1/0

First half results were poor and materially below Morgans' forecasts. Seasonal conditions are below average on the east coast of Australia leading into the 2019/20 winter cropping season which will affect FY20 earnings.

The business is also currently affected by unfavourable trading positions which have reduced operating earnings (EBITDA) by -$40m. The company has not provided FY19 earnings guidance.

While the de-merger may unlock value in the malt business, Morgans believes that, in the absence of a derivative instrument, the new GrainCorp will trade at a material discount.

Rating is upgraded to Hold from Reduce, after share price weakness, and the target is reduced to $7.57 from $7.90.

See also GNC downgrade.

ORICA LIMITED ((ORI)) Upgrade to Neutral from Sell by Citi .B/H/S: 0/7/0

First half results have cleared any doubts about the company's operating leverage, Citi acknowledges. Strong growth was driven by higher volumes, improved product mix and better manufacturing. Market conditions are improving and price/cost headwinds fading.

However, the broker notes further delays with Burrup. Burrup remains a swing factor, with a negative impact on cash flow forecast by the company in FY19 of -$40-45m. Burrup's operating earnings (EBITDA) are forecast to be $45m in FY21.

Citi upgrades to Neutral from Sell and raises the target to $20 from $16.

See also ORI downgrade.

PLATINUM ASSET MANAGEMENT LIMITED ((PTM)) Upgrade to Hold from Sell by Ord Minnett .B/H/S: 0/3/1

The stock has underperformed the Small Ordinaries index by -19% despite its international fund rising 13% and Ord Minnett upgrades to Hold from Sell on valuation.

The broker raises the target to $4.77 from $4.72.

RESMED INC ((RMD)) Upgrade to Buy from Neutral by UBS .B/H/S: 5/2/1

UBS upgrades estimates for earnings per share by 5% and increases the rating to Buy from Neutral. Results in the March quarter were well ahead of expectations. Mask growth stood out and new products and re-supply performed well.

The broker believes the success of Brightree and opportunities from recently-released analytics means market saturation will not occur in the short to medium term. Target is raised to US$119 from US$109.

TPG TELECOM LIMITED ((TPM)) Upgrade to Accumulate from Hold by Ord Minnett .B/H/S: 2/1/3

The ACCC opposes the merger between TPG Telecom and Vodafone Australia ((HTA)). The regulator cited an already very concentrated mobile and fixed broadband industry as well as its belief there is a real chance the company will roll out a mobile network if the proposed merger does not proceed.

Ord Minnett agrees with the two companies' legal analysis and believes the case has a better chance of being approved in court. Rating is upgraded to Accumulate from Hold and the target raised to $6.90 from $6.50.

Downgrade

ADELAIDE BRIGHTON LIMITED ((ABC)) Downgrade to Neutral from Outperform by Credit Suisse and Downgrade to Sell from Neutral by Citi .B/H/S: 0/5/2

The company has provided maiden 2019 guidance, indicating net profit will be down -10-15%. Adelaide Brighton cited a weak residential environment, import competition and competitive pressure in Queensland.

Credit Suisse notes the dispute between Boral ((BLD)) and Wagners ((WGN)) appears to have had an impact. The company, and others, responded by lowering price expectations to protect volumes.

The dividend yield provides some store of value, in the broker's view. Rating is downgraded to Neutral from Outperform and the target lowered to $3.90 from $5.00.

The company has warned of a -10-15% drop in 2019 earnings. Softening demand for residential construction materials, increased competition from cement imports and increasing competition in Queensland were cited.

Citi notes the acceleration in the downturn in the residential market, particularly in NSW and Victoria, appears to have caught the company by surprise. The downgrade to expectations comes just 2.5 months after the 2019 outlook described a stable demand environment.

Citi downgrades to Sell from Neutral and reduces the target to $3.50 from $4.50.

See also ABC upgrade.

COCA-COLA AMATIL LIMITED ((CCL)) Downgrade to Underperform from Neutral by Macquarie .B/H/S: 0/5/3

Macquarie downgrades to Underperform from Neutral following the recent re-rating of the share price above its target, which is steady at $8.15. The broker believes Australian beverages remain susceptible to a number of headwinds such as competition and sugar issues, and more investment in price is likely.

The broker expects more money will need to be spent to meet growth targets and forecasts $10-20m per annum expenditure over the next three years. Indonesian volumes have improved but Macquarie notes this can be attributed to the cycling of undemanding comparables.

CSR LIMITED ((CSR)) Downgrade to Underperform from Neutral by Credit Suisse and Downgrade to Hold from Buy by Deutsche Bank .B/H/S: 0/4/3

FY19 net profit was in line with guidance. Credit Suisse believes the downturn in building activity is only just beginning and volume declines are likely to accelerated during the year. History points to significant operating leverage for the company.

The broker also believes it will be challenging to maintain earnings for aluminium, given the second half step up in coal, alumina and other costs. The broker downgrades to Underperform from Neutral, maintaining a target of $2.90.

FY19 net profit was broadly in line with Deutsche Bank's expectations. No quantitative guidance was provided for FY20, as is usually the case.

Management has indicated that building products volumes in April are consistent, although there are mixed economic signals which make it difficult to predict activity in FY20.

Deutsche Bank believes risk is to the downside for building product margins. Aluminium earnings are expected to remain depressed until at least FY21. The broker downgrades to Hold from Buy and reduces the target to $3.60 from $3.80.

GRAINCORP LIMITED ((GNC)) Downgrade to Reduce from Hold by Morgans .B/H/S: 3/1/0

Long Term Asset Partners has withdrawn its $10.42 bid for Graincorp following due diligence that left LTAP disappointed. Morgans finds it concerning that initial operating assumptions were not met.

Graincorp's de-merger proposal may provide some share price support, but with at least two more tough years ahead for grains, Morgans moves to Reduce from Hold ahead of the company's result release on Thursday. Target falls to $7.90 from $9.30.

See also GNC upgrade.

HUB24 LIMITED ((HUB)) Downgrade to Sell from Neutral by Citi .B/H/S: 1/1/2

Citi continues to believe HUB24 will be a beneficiary of the structural shift towards specialist providers and triple its market share in the next five years. However, because of a 25% increase in the share price since the first half result, the broker downgrades to Sell from Neutral.

Target is lowered to $13.35 from $13.60. The broker does not believe the current share price reflects the downside risk to revenue margins from competition and operating earnings (EBITDA) margin from the ongoing need to invest in the platform to support growth.

HARVEY NORMAN HOLDINGS LIMITED ((HVN)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 1/4/2

Macquarie acknowledges Harvey Norman is executing well in its global business, shielding it from weaker domestic outcomes. Property is also resilient. Given the rally in the share price and a sharp slowing in shopping centre sales, the broker suspects the risks are building.

Rating is downgraded to Neutral from Outperform. Target is $4.20. The company is successfully pivoting the business to enjoy a greater proportion of earnings from offshore. Still, Macquarie believes the underlying business may start to struggle.

JB HI-FI LIMITED ((JBH)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 2/4/2

Macquarie suspects the buy case for the stock will likely become harder. The business is considered a well-run retailer capitalising on gaming, smart home and a shorter PC replacement cycle, in order to offset structural & cyclical headwinds.

Nevertheless, the stock has rallied, and the bulk of catalysts have now played out, so the broker downgrades to Neutral from Outperform. Target is reduced to $25.83 from $28.80.

JANUS HENDERSON GROUP PLC. ((JHG)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 1/3/1

Janus Henderson's March Q result fell short of the broker, with net outflows continuing to disappoint and fee margins also lower. Macquarie had seen value in the stock for some time and a re-rating had been underway, but with no sign of flow momentum improving the broker now pulls back to Neutral.

The stock is trading at a -25% discount to the five-year average PE and some -42% discount to listed fund managers but Macquarie sees limited scope for outperformance from here. Target falls to $36.00 from $39.50.

MAGELLAN FINANCIAL GROUP LIMITED ((MFG)) Downgrade to Hold from Buy by Ord Minnett .B/H/S: 0/7/0

Ord Minnett notes strong absolute returns have benefited global fund managers. Magellan Financial has rallied, returning 87% in 2019, following a 16% absolute return in its global fund, strong retail and institutional net flows.

The stock has now run past fundamental value and Ord Minnett downgrades to Hold from Buy. Target is raised to $40.33 from $34.34.

MACQUARIE GROUP LIMITED ((MQG)) Downgrade to Hold from Accumulate by Ord Minnett .B/H/S: 3/4/0

FY19 net profit was slightly ahead of Ord Minnett's forecast. The result was more heavily reliant on lower-quality items than the broker expected, with gains on sale and performance fees contributing 30% of net operating income in the second half.

Hence, the broker is not surprised the FY20 outlook commentary was disappointing. Based on Ord Minnett's estimates, valuation is only fair for a stock trading on a forecast 15x FY20 PE multiple and with lower quality earnings mix than in recent years.

Rating is downgraded to Hold from Accumulate and the target lowered to $130 from $133.

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

UBS notes the stock price has lifted around 58% in the year to date as the new CEO executes well and delivers on early commitments. The broker's analysis of lease expiry suggests a significant opportunity, resulting in 10-33% upgrades to earnings per share.

Still, the market remains, in the broker's opinion, overly optimistic on the size of potential upgrades and the pace at which the new strategy can be executed. Hence, the broker downgrades to Sell from Neutral. Target is raised to $0.59 from $0.47.

NICK SCALI LIMITED ((NCK)) Downgrade to Sell from Neutral by Citi .B/H/S: 0/1/1

Downward pressure from declining house prices are intensifying with plenty of profit downgrades being issued by small cap companies being impacted. Analysts at Citi don't think Nick Scali will remain immune either.

The analysts have reduced estimates by -4%-5%. Target price falls to $5.35 from $5.60. Downgrade to Sell from Neutral.

NETWEALTH GROUP LIMITED ((NWL)) Downgrade to Accumulate from Buy by Ord Minnett .B/H/S: 1/3/1

While there is limited valuation headroom, Ord Minnett believes the federal election brings a potentially significant catalyst for the platform sector. Labor's proposed ban on franked credit refunds will affect the self managed super (SMSF) sector, where around 30% of assets are in pension phase and therefore benefiting from refunds. Pooled superannuation vehicles managing tax as a single entity can use pension member franking credits to offset accumulation member taxes. Many platform superannuation funds have a structural tax advantage over SMSFs.

While other superannuation funds will also be able to leverage this benefit, the broker observes only platforms come with many of the investment management freedoms afforded an SMSF. Ord Minnett observes the leading specialist platforms are winning more than their fair share of industry churn while incumbent businesses are losing flows to industry funds.

The broker estimates the company could double its superannuation assets with pension transitions and still be able to offer pension members refunds of their credits. Should this occur there could be 30-40% upside for the Netwealth target. Rating is downgraded to Accumulate from Buy and the target raised to $9.57 from $8.14.

ORICA LIMITED ((ORI)) Downgrade to Neutral from Outperform by Credit Suisse .B/H/S: 0/7/0

Credit Suisse found several positives in the company's first half results. The broker was pleased with the recovery in the Latin American performance, while noting the take-up of electronic and wireless blasting solutions appears to be accelerating and, potentially, validating the technology.

There is also prospective upside from product rationalisation initiatives and management appears more confident in the price environment. The broker also welcomes the absence of any "worse" news on Burrup.

Credit Suisse considers the stock is fair value and downgrades to Neutral from Outperform. Target is raised to $19.24 from $19.08.

See also ORI upgrade.

PUSHPAY HOLDINGS LIMITED ((PPH)) Downgrade to Lighten from Hold by Ord Minnett .B/H/S: 2/0/0

FY19 revenue was in line with expectations. The deceleration in the back book suggests to Ord Minnett that either the company is finding it harder to increase online penetration or revenue churn is having an impact.

As such, with growth becoming increasingly reliant on signing new customers, amid significant leadership changes, the risks are now considered outweighing the rewards.

Rating is downgraded to Lighten from Hold. Target is reduced to $3.27 from $3.47.

QANTAS AIRWAYS LIMITED ((QAN)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 2/4/1

Qantas increased revenues in the March Q, reflecting the timing of Easter. Macquarie sees revenue per available seat-kilometre growth easing into FY20 given lower corporate travel, the impact from the election and a weaker domestic consumer.

The broker's forecast is below consensus and Macquarie sees RASK risk skewed to the downside. Downgrade to Neutral. Target falls to $5.75 from $6.25.

QBE INSURANCE GROUP LIMITED ((QBE)) Downgrade to Sell from Hold by Deutsche Bank .B/H/S: 7/0/1

Recent share price recovery has been followed up with a downgrade to Sell from Hold at Deutsche Bank with an $11.80 price target. Direct reason is the expectation of a more prolonged housing downturn in Australia, which should lead to a spike in lenders' insurance claims.

QBE's LMI business is the second largest in Australia, the broker explains. It generated $100m of insurance profit in FY18, representing approximately 17% of Australian insurance profit or 8% of group earnings.

TABCORP HOLDINGS LIMITED ((TAH)) Downgrade to Neutral from Outperform by Credit Suisse .B/H/S: 4/2/0

Credit Suisse is reducing the rating to Neutral from Outperform and considers FY20 likely to be a 'no growth' year. Higher depreciation has reduced FY20-21 forecasts for earnings per share by around -3%. Lower wagering revenue

projections have also shaved -1-2% off estimates.

The broker points out Tabcorp had the opportunity to update investors at the investor forum on April 30 and, not only did it not disclose revenue, cautioned against intense competition. Target is steady at $5.05.

Total Recommendations Recommendation Changes

Broker Recommendation Breakup

Broker Rating Order Company New Rating Old Rating Broker Upgrade 1 ADELAIDE BRIGHTON LIMITED Neutral Sell Deutsche Bank 2 ALUMINA LIMITED Neutral Sell UBS 3 ERM POWER LIMITED Buy Neutral Morgans 4 EVOLUTION MINING LIMITED Buy Neutral Ord Minnett 5 GRAINCORP LIMITED Neutral Sell Morgans 6 ORICA LIMITED Neutral Sell Citi 7 PLATINUM ASSET MANAGEMENT LIMITED Neutral Sell Ord Minnett 8 RESMED INC Buy Neutral UBS 9 TPG TELECOM LIMITED Buy Neutral Ord Minnett Downgrade 10 ADELAIDE BRIGHTON LIMITED Sell Neutral Citi 11 ADELAIDE BRIGHTON LIMITED Neutral Buy Credit Suisse 12 COCA-COLA AMATIL LIMITED Sell Neutral Macquarie 13 CSR LIMITED Sell Neutral Credit Suisse 14 CSR LIMITED Neutral Buy Deutsche Bank 15 GRAINCORP LIMITED Sell Neutral Morgans 16 HARVEY NORMAN HOLDINGS LIMITED Neutral Buy Macquarie 17 HUB24 LIMITED Sell Neutral Citi 18 JANUS HENDERSON GROUP PLC. Neutral Buy Macquarie 19 JB HI-FI LIMITED Neutral Buy Macquarie 20 MACQUARIE GROUP LIMITED Neutral Buy Ord Minnett 21 MAGELLAN FINANCIAL GROUP LIMITED Neutral Buy Ord Minnett 22 MYER HOLDINGS LIMITED Sell Neutral UBS 23 NETWEALTH GROUP LIMITED Buy Buy Ord Minnett 24 NICK SCALI LIMITED Sell Neutral Citi 25 ORICA LIMITED Neutral Buy Credit Suisse 26 PUSHPAY HOLDINGS LIMITED Sell Neutral Ord Minnett 27 QANTAS AIRWAYS LIMITED Neutral Buy Macquarie 28 QBE INSURANCE GROUP LIMITED Sell Neutral Deutsche Bank 29 TABCORP HOLDINGS LIMITED Neutral Buy Credit Suisse Recommendation Positive Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 EPW ERM POWER LIMITED 83.0% 50.0% 33.0% 3 2 PTM PLATINUM ASSET MANAGEMENT LIMITED -25.0% -50.0% 25.0% 4 3 AWC ALUMINA LIMITED 40.0% 20.0% 20.0% 5 4 RMD RESMED INC 50.0% 31.0% 19.0% 8 5 WES WESFARMERS LIMITED -21.0% -31.0% 10.0% 7 6 TPM TPG TELECOM LIMITED -25.0% -33.0% 8.0% 6 7 EVN EVOLUTION MINING LIMITED -31.0% -38.0% 7.0% 8 Negative Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 CSR CSR LIMITED -43.0% -14.0% -29.0% 7 2 MYR MYER HOLDINGS LIMITED -58.0% -42.0% -16.0% 6 3 QAN QANTAS AIRWAYS LIMITED 14.0% 29.0% -15.0% 7 4 ABC ADELAIDE BRIGHTON LIMITED -29.0% -14.0% -15.0% 7 5 TAH TABCORP HOLDINGS LIMITED 50.0% 64.0% -14.0% 7 6 CCL COCA-COLA AMATIL LIMITED -38.0% -25.0% -13.0% 8 7 QBE QBE INSURANCE GROUP LIMITED 69.0% 81.0% -12.0% 8 8 JBH JB HI-FI LIMITED -6.0% 6.0% -12.0% 8 9 MQG MACQUARIE GROUP LIMITED 43.0% 50.0% -7.0% 7 Target Price Positive Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 RMD RESMED INC 16.448 15.077 9.09% 8 2 MYR MYER HOLDINGS LIMITED 0.473 0.453 4.42% 6 3 QBE QBE INSURANCE GROUP LIMITED 13.108 13.020 0.68% 8 4 MQG MACQUARIE GROUP LIMITED 129.814 129.314 0.39% 7 5 PTM PLATINUM ASSET MANAGEMENT LIMITED 4.430 4.418 0.27% 4 6 WES WESFARMERS LIMITED 32.249 32.174 0.23% 7 Negative Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 ABC ADELAIDE BRIGHTON LIMITED 3.800 4.471 -15.01% 7 2 TPM TPG TELECOM LIMITED 6.375 6.500 -1.92% 6 3 QAN QANTAS AIRWAYS LIMITED 5.921 6.021 -1.66% 7 4 JBH JB HI-FI LIMITED 24.365 24.736 -1.50% 8 5 EPW ERM POWER LIMITED 1.903 1.917 -0.73% 3 Earning Forecast Positive Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 STO SANTOS LIMITED 57.008 55.556 2.61% 8 2 PNI PINNACLE INVESTMENT MANAGEMENT GROUP LIMITED 16.533 16.133 2.48% 3 3 WOW WOOLWORTHS LIMITED 129.929 127.157 2.18% 8 4 MYR MYER HOLDINGS LIMITED 3.750 3.690 1.63% 6 5 ORI ORICA LIMITED 94.131 92.859 1.37% 8 6 CWY CLEANAWAY WASTE MANAGEMENT LIMITED 6.854 6.794 0.88% 6 7 MQG MACQUARIE GROUP LIMITED 865.567 858.900 0.78% 7 8 PTM PLATINUM ASSET MANAGEMENT LIMITED 26.975 26.825 0.56% 4 9 CPU COMPUTERSHARE LIMITED 98.660 98.267 0.40% 8 10 ASB AUSTAL LIMITED 14.700 14.667 0.22% 3 Negative Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 GNC GRAINCORP LIMITED -8.340 -0.688 -1112.21% 4 2 CSR CSR LIMITED 30.163 36.378 -17.08% 7 3 ABC ADELAIDE BRIGHTON LIMITED 25.627 29.660 -13.60% 7 4 SUN SUNCORP GROUP LIMITED 75.143 84.400 -10.97% 8 5 GMG GOODMAN GROUP 51.292 55.577 -7.71% 6 6 NAB NATIONAL AUSTRALIA BANK LIMITED 208.757 218.500 -4.46% 8 7 APE AP EAGERS LIMITED 46.343 48.445 -4.34% 4 8 RMD RESMED INC 49.770 51.421 -3.21% 8 9 CTX CALTEX AUSTRALIA LIMITED 190.167 195.620 -2.79% 7 10 WBC WESTPAC BANKING CORPORATION 206.186 210.414 -2.01% 8 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: Restricted Share Prices

Sachem Cove Partners believes listed uranium miners present an extraordinary investment opportunity even as the uranium price continues to slide.

-Asymmetrical opportunity in uranium miners -Spot market extremely weak -Three Mile Island to close

By Greg Peel

"The near-decade-long bear market for uranium miners has ended," notes uranium investment platform Sachem Cove Partners. "Due to unsustainably low prices, the market is seeing significant production curtailments, no green-field project development, shrinking inventories, and reduced secondary supplies. As a result, the uranium market has entered a significant multi-year supply deficit.

"The price of uranium needs to rise at least 100% from today's spot market levels -- and stay there for a sustainable period -- before the majority of miners can even contemplate re-starting idled capacity or moving ahead with new project development."

The spot uranium price has risen some 33% since its low in late 2017, albeit including a -14% decline in 2019. Sentiment towards the sector has improved, as evidenced by growing interest in uranium investment vehicles. Further supporting prices has been purchases in the spot market by producers, rather than loss-making production, in order to satisfy contract obligations

Sachem Cove believes a "material re-rating" of listed uranium miners is being held up by two factors. The first is the section 232 investigation much discussed previously in this weekly report.

The second, lesser appreciated factor is a decision last year by Global X, sponsor of the Global X Uranium ETF (URA:NYSE), to reconstitute the fund from 100% pure play uranium miners to 60% miners and 40% nuclear construction companies, mostly Asian conglomerates. The intention of the reconstitution was to reduce volatility and attract greater funds flows. The move backfired.

The move required Global X to sell US$150m of its uranium miner positions into the market, pushing down share prices even as the uranium price was recovering. Assets under management have since almost halved.

Even if the uranium price can rally 100% to incentivise production restart or development, a lead time of 2-10 years on new developments will ensure deficits well into the future, Sachem Cove notes. On the demand side, the delivery contracts settled by utilities in the 2007-11 cycle are now expiring at an accelerating pace, leaving dangerously low utility inventories.

Sachem Cove believes the section 232 and ETF dampeners provide for "the most asymmetric opportunity available in today's market", referring to listed uranium miners.

No Interest

Near term demand for spot uranium remains "extremely weak", industry consultant TradeTech notes. Utility interest is largely absent. Spot activity was very slow last week, with only five transactions concluded totalling 500,000lbs U3O8 equivalent.

In order to attract buyers, sellers were forced to continually lower offer prices, TradeTech's weekly spot price indicator has fallen -US30c to US$24.70/lb.

TradeTech's term price indicators remain at US$28.50/lb (mid) and US$32.00/lb (long).

End of an Era

Before Fukushima there was Chernobyl. Before Chernobyl there was Three Mile Island.

Exelon's Three Mile Island plant has been running at a loss for years. Exelon was facing a June 1 deadline to purchase uranium needed for the plant while awaiting the outcome of two bills put to the government of Pennsylvania to provide financial support for nuclear power. The bills failed to advance.

Three Mile Island will close for good on September 30.

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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 May 9, 2019

Last week was a very volatile one for the local market, with the ASX200 bouncing up and down on a mix of escalated trade tensions and rising hopes for an RBA rate cut.

The table below suggests not a lot of movement in short positions, with said volatility likely keeping shorters at bay. But there were a couple of themes worth noting.

To follow up on last week's focus on lithium miners, in the wake of Wesfarmers' ((WES)) takeover bid for Kidman Resources ((KDR)), we note that having dropped to 14.9% from 16.9% the week before, last week saw Galaxy Resources shorts fall to 13.8%.

Pilbara Minerals ((PLS)) shorts surprisingly rose to 10.0% from 9.5% the week before despite what appeared to be a short-covering rally in the stock, but last week fell back to 9.5%

The only other stock on the table seeing a move in shorts of one percentage point or more last week was Bellamy's Australia ((BAL)), which saw an increase to 12.5% from 11.5%. The infant formula producer is a poster child for retailers heavily exposed to Chinese earnings, which are at risk from any further escalation in US-China trade relations.

To that end we note shorts in pill and potion retailer Blackmores ((BKL)) rose to 9.0% from 8.4% and shorts in dairy product company Bega Cheese ((BGA)) rose to 7.6% from 6.9%. Both are also exporters to China.

No additional Movers & Shakers this week.

Weekly short positions as a percentage of market cap:

10%+

SYR 17.6 ING 16.4 JBH 15.4 NUF 15.2 NXT 15.1 GXY 13.8 BAL 12.5 ORE 12.4 MTS 11.7 BWX 11.2

Out: PLS

9.0-9.9

SDA, SUL, PLS, IFL, PPT, IVC, HVN, KGN, BKL

In: PLS, KGN, BKL 8.0-8.9%

DMP, CSR, SGM, MYR, HUB, AMC, BIN, BOQ

In: BIN Out: KGN, BKL

7.0-7.9%

BGA, RWC

In: BGA Out: BIN

6.0-6.9%

AMP, WSA, CGF, MSB

Out: BGA

5.0-5.9%

RSG, SEK, GMA, COE, MLX, NEC, CGC, HT1, BEN, LNG

In: NEC Out: RIO

Movers & Shakers

See above.

ASX20 Short Positions (%)

Code Last Week Week Before Code Last Week Week Before AMC 8.2 8.8 RIO 4.6 5.1 ANZ 1.2 1.2 S32 1.1 1.2 BHP 3.4 3.4 SCP 1.0 1.2 BXB 0.1 0.2 SUN 0.3 0.3 CBA 1.7 1.8 TCL 1.3 1.4 COL 1.7 1.7 TLS 0.5 0.5 CSL 0.2 0.3 WBC 2.2 2.1 IAG 0.6 0.5 WES 1.9 2.0 MQG 0.4 0.3 WOW 2.5 2.5 NAB 1.0 0.9 WPL 0.7 0.7 To see the full Short Report, please go to this link

IMPORTANT INFORMATION ABOUT THIS REPORT

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

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

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

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

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

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

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

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

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The Wrap: Economy; Wealth, IMF And Imaging

Weekly Broker Wrap: consumer tax lift; RBA and Oz economy; wealth platforms; infant milk formula; diagnostic imaging; and supermarkets.

-Consumer spending may be lifted from July as tax rebates take effect -Slowing employment growth the key to an RBA decision on cash rates in the second of 2019 -Change to franking credit policy could be positive for Australian wealth management platforms -Sales of infant milk formula in China decelerating as births slow -Healthy outlook for the diagnostic imaging segment -Improving inflation outlook underpinning supermarket sector

By Eva Brocklehurst

Consumer Tax Lift

Tax relief in the 2019/20 federal budget should provide a de-facto tax cut to around 10m Australian residents and inject a significant amount of cash into the household sector from mid July, Commonwealth Bank economists assess. This will occur regardless of the outcome of May 18 election, as the ALP opposition has backed the government's policy.

In many ways, the economists suggest this is akin to the $900 “cash splash" per person delivered from the government during the GFC in 2009. The CBA economists believe 2009 provides a guide as to how households may spend this rebate from the 2019 budget.

Evidence shows there was a clear, short term positive impact on spending and there could be a material bounce in retail trade for a 3-4 month period. In total, the Australian household sector will receive around $7.25bn in rebates over 2019/20 and a similar amount will be refunded in 2020/21.

RBA And Oz Economy

Franklin Templeton finds it interesting that, despite downward revisions to the RBA's growth and inflation forecasts, cash rates were left unchanged at 1.5% at the latest board meeting.

The analysts consider the RBA's downgrade to both growth and inflation was the largest possible without contradicting the interest-rate decision a few days prior, and now hangs on the outlook for the labour market.

Franklin Templeton focuses on employment by groups of industries to reflect the major components of demand such as consumer and business spending, government expenditure and exports. The analysis points to employment exposed to private consumption slowing sharply, while business and government-exposed employment is growing at a better rate.

Exports-exposed employment has been mixed. This is the smallest category because of the capital-intensive nature of these industries. Employment in business spending-exposed groups also tends to lag employment in consumer-exposed group by around 12 months.

The analysis implies a slowdown in overall employment growth is likely to begin in the June quarter and become more pronounced throughout the remainder of 2019. Amid falling house prices and near-zero real income growth, a rebound in consumer-related expenditure appears unlikely, absent a boost to disposable income via lower interest rates.

Unemployment, therefore, is expected to rise the second half of 2019. Even growth in government employment is unlikely to offset this. If this occurs, Franklin Templeton considers the RBA will have no choice but to reduce the official interest rates and the only question would be by how much.

Australian Wealth Platforms

Citi suspects a change to franking credit policy could be positive for Australian wealth management platforms. The proposal by Labor could be positive for Netwealth (NWL)) and HUB24 ((HUB)) as it could result in incremental flows from off-platform self managed super funds (SMSFs).

However, whether this eventuates is not certain as the amount of flows into each platform depends on the mix of accumulation and pension members. Other strategies could also be adopted to minimise the impact of any change.

The proposed changes could result in SMSFs moving assets to an industry fund or retail super fund, continuing to utilise excess franking credits. Still, Citi calculates using the share of advisers as a proxy, Netwealth could attract $1.2-2.9bn of incremental flows while HUB24 could attract $750m-1.9bn.

Upside exists if the policy changes also result in increased churn from platform super funds that are in a net refund position to Netwealth and HUB24, given the relative tax position. Still, the policy change could also represent a risk to platforms, as SMSFs already represent a substantial portion of funds under administration through both companies' investment wrap offering, and the changes may make this less attractive.

Infant Milk Formula

Nielson data has revealed that sales of infant milk formula (IMF) at retail outlets in China (ex online business) decelerated to growth of just 4% in January and February. This compares with growth of 11% in the previous six months.

Morgan Stanley assesses the developments in the industry based on channel checks, data and company updates, acknowledging that Nielson data cannot capture sales trends in certain channels and outlets in lower-tier cities.

Still, the broker expects overall demand to trend lower amid declining birth rates in China, which in 2018 were down -12%. China's government has not revealed any policies designed to counter the decline and Morgan Stanley suspects it will be difficult to prevent.

As industry growth slows, and major operators develop similar strategies, the scope for competition to affect earnings and returns of companies such as a2 Milk ((A2M)) and Bellamy's Australia ((BAL)) is increased. Competition from Chinese brands is also set to increase.

Morgan Stanley believes many tailwinds for a2 Milk will not continue into FY20 and growth will slow considerably. Factors leading to slower growth include higher spending on marketing, increased dairy costs and a non-recurrence of the earnings benefit from the new Synlait Milk ((SM1)) deal.

Diagnostic Imaging

Ord Minnett notes revenue growth for both Integral Diagnostics ((IDX)) and Capitol Health ((CAJ)) is underpinned by long-term average growth in benefits of 6%, now supplemented by indexation of almost 80% of the Medicare Benefits Schedule from FY21. Added to this is the pledge by Labor to support the industry with $600m over four years with free will scans for cancer patients, a measure expected to boost utilisation of unlicensed MRIs (magnetic resonance imaging).

Ord Minnett also notes Integral Diagnostics' new prostate specialist centre should contribute meaningfully to earnings once at full capacity in FY21. The broker expects earnings growth of 16.8% in FY21 and upgrades to Buy from Accumulate. Meanwhile, Capitol Health is trading at a discount to Integral Diagnostics as as well as recent bid multiples, and is likely to remain a potential target, in the broker's view.

Supermarkets

UBS acknowledges an improving inflation outlook should provide some upside risk to forecasts for the supermarket sector but suspects this is being priced into the stocks. The broker downgrades Woolworths ((WOW)) to Neutral from Buy and moves Metcash ((MTS)) to its most preferred stock. While retaining a Sell rating for Coles ((COL)) the broker is becoming less negative.

UBS forecasts 4.0% industry growth in 2019/20 on the back of an improving inflation outlook. This is supported by a fall in share of promotional mix, supply shortages in fresh produce, cost pressures from Imports & fresh produce, as well as tax on tobacco. The broker assesses every 1% of industry inflation will have a 3-7% positive impact on group earnings (EBIT).

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Two Retailers Showcasing Success

In a difficult, changing and subdued retail/housing environment the success of City Chic Collective and Adairs can be attributed to a deep knowledge of their customer base. Canaccord Genuity initiates coverage on the two.

-City Chic growing partnerships globally with retailers and online marketplaces -Adairs highly successful in category and private-label expansion -Both developing a significant online presence

By Eva Brocklehurst

Two retail stocks have attracted the attention of Canaccord Genuity: City Chic Collective ((CCX)) and Adairs ((ADH)), both standing out in a difficult environment. City Chic specialises in large women's apparel in Australasia via a network of over 100 stores. Underpinning the company success is an understanding of customer needs amid the poor service provided by mainstream clothing retailers.

Adairs boasts a network of around 170 stores, specialising in home furnishings, and is continuing to take share of the home decoration wallet through larger, fashionably-designed store formats and expanded categories.

City Chic's online store represents 35% of sales and its products are offered by major US and European retailers, both in-store and online. The message appears to resonate with the global consumer for such items, which the broker believes points to the potential for a long period of growth.

The reason for the company's success is that major fashion labels, in the main, have opted not to produce large sizes (over 14). Those that have such offerings also tend to be inconsistent in terms of variety and stocking. The broker suspects these retailers are leaving a lot of money on the table.

In Australia, the US and Europe over half of adult females fit the category yet represent less than 20% of the total expenditure on women's wear. However, media coverage promoting body confidence is resulting in shoppers demanding more from their retail experience.

The broker expects City Chic to participate in the growth in this segment globally by building out international partnerships with retailers and online marketplaces, rolling out new stores domestically, which funnel future online sales, and improve better-performing stores by increasing product ranges.

Financials

Historically, there is limited information on the financial performance because this was combined with the other retailers within the Specialty Fashion group until 2017. Yet, City Chic's total sales online have grown in the last two years by 87%. Canaccord Genuity assesses that, while all stores are profitable, the online business is delivering the majority of like-for-like sales growth.

The balance sheet is ungeared and, while operating cash flow was negative in the first half, the broker expects this to normalise in the second half. Citi has noted that dividends are back on the agenda and the interim dividend of 2.5c paid at the last results was well ahead of forecasts. There was also a special 2.5c dividend. Citi has a Neutral rating and $1.45 target while Canaccord Genuity initiates coverage with a Buy rating and $2 target.

The company attributed reduced cash flow in the first half to a one-off shortening in trade creditor terms while it finalised a new trade facility. Cannaccord Genuity expects FY19 growth of 2% like-for-like in physical stores and 25% online. There is limited local competition in what the broker describes as a $1bn market, and this is mostly focused on an older demographic.

Domestically, beme, owned by Noni B ((NBL)), and My Size are the closest competitors. Both retailers has significantly fewer stores and tend to have ranges at lower price points. Autograph, also owned by Noni B, and Taking Shape specialise in larger sizes but appear more focused on an older demographic.

Adairs

Adairs has the largest national footprint of its peer group and is also developing a deep knowledge of customer preferences. On this basis, the company's investment in online channels, if this continues to be successful, will provide a buffer against a weakening consumers/housing backdrop, Canaccord Genuity asserts.

Morgans agrees that the company's ability to sustain solid sales growth is becoming sharply evident, despite weakness in macro housing conditions. The company has transitioned from being a retailer of third-party linen, bedding and towel products to stocking and designing its own ranges which incorporate fashion trends and inspire customer loyalty.

Category expansion has also been successful, with the product range growing at around twice the rate of core products since the IPO in June 2015. Category expansion is seen driving like-for-like sales rather than a higher average basket price.

Expansion items include soft furnishings, tableware, occasional furniture and bedroom furniture. Online sales are growing rapidly, UBS points out, suggesting benefits from the omni-channel approach are starting to be realised. The broker finds the valuation undemanding and retains a Buy rating and $2.60 target.

Financials

Adairs has delivered relatively consistent performance financially since listing, Canaccord Genuity notes, ahead of initiating coverage with a Buy rating and $2.32 target. Winter sales are the most significant of the seasonal promotional campaigns and responsible for a slight weighting to second half revenue and earnings. Cash conversion has been strong and net debt has fallen to $10m at the end of 2018. Guidance provided in August 2018 indicated FY19 like-for-like sales growth of 5-8%.

Higher costs were one area that disappointed Morgans in the first half, although this was attributed to capacity constraints at the distribution centre. The broker also notes the dividend pay-out policy has been increased to 60-85% from 55-70%. Morgans maintains an Add rating and $2.25 target.

The company's target customer is in the middle to upper class, with a desire to decorate their living space and move with trends. Canaccord Genuity estimates the average transaction value is around $120.

Adairs is now largely a private-label retailer and estimates the Australian homewares market at around $14bn. Home textiles is a small percentage of this, which Canaccord Genuity estimates at $2bn, implying a market share for the company of just under 20%. Direct competitors are Bed, Bath N' Table, Sheridan, Pillow Talk Homewares and My House.

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Mayne Pharma Reviewing Generics

Increased competition in generic drugs has caused a significant deterioration in Mayne Pharma earnings and the company is reviewing the carrying value of these assets.

-Specialty brands revenue and contract services up strongly -Improved distribution model flagged as well as new contract manufacturing opportunities -Focus on more durable earnings stream including women's health and specialty drugs

By Eva Brocklehurst

Mayne Pharma ((MYX)) has experienced a significant deterioration in generic product performance since the company's first half results. Revenue declined -15% in the period January-April, with gross profit declining -20%. Increased competition in certain products, such as liothyronine which experienced a decline in sales of -23% in January-April when Greenstone launched its 5mg generic product, was cited as the cause.

BAC and dofetilide have also experienced increased competition. Dofetilide sales were down -84%. Mayne Pharma is currently reviewing its carrying value for generic assets that could result in an impairment. Bell Potter suggests this could involve write-downs against acquired intangibles, internally developed products on the market and developments in the pipeline.

Excluding the generics, all divisions exhibited solid growth. While liothyronine revenue appears to have slumped this was a known risk, in Bell Potter's view, albeit the extent of the decline was more than expected. Moreover, gross profit margin declined to 45% from 57% because of price erosion as well as penalties for failure to supply product.

Limited improvement is expected in FY20 when the full-year impact of the erosion of pricing is offset by two new licensing agreements. The company has flagged an improved distribution model as well as new contract manufacturing opportunities that could drive a -US$15m reduction in the cost of generic goods sold.

Meanwhile, specialty brands revenue rose 53%, including Fabior up 45%, Sorilux up 4% and Doryx up 39%. The company expects Tolsura and Lexette to grow strongly in FY20. Yet Credit Suisse suspects Tolsura is likely to take time to emerge in the formulations of US hospitals.

UBS includes a full year contribution from Lexette from FY20 and a modest contribution from Tolsura as it is launched across the US. Yet the broker reduces revenue growth forecasts for Sorilux, noting a soft performance over the first months of this year.

Rebound Expected

Despite the weakness early in the year, May and June are seasonally stronger months and management expects a rebound in the final two trading months of FY19. UBS downgrades estimates for earnings per share across FY19-21 by -18-58%. Credit Suisse expects gross profit to be flat in FY19 and does not expect earnings to return above FY18 levels until FY21.

While, continuing to envisage merits in the company's strategy to move towards a more stable earnings profile in specialty brands the outlook is unclear and Credit Suisse downgrades to Neutral from Outperform.

Wilsons maintains a Buy rating but reduces the target to $0.67. The broker believes, while the update is disappointing, specialty brands and contract services performed well and were still capable of driving improvements in operating margins, cash conversion and valuation.

The broker, not one of the eight monitored daily on the FNArena database, acknowledges the upgrade in April was premature and it underestimated the impact of competitor launches against key products. Nevertheless, while generic earnings may still be volatile in the short term, consistent growth in other areas should improve the stability of earnings.

UBS agrees there is merit in the repositioning towards specialty brands and sustainable generic portfolios but awaits tangible evidence before incorporating any positive impact on earnings estimates.

Women's Health

Mayne Pharma also provided a strategy update, highlighting a focus on its more durable earnings stream which includes women's health and specialty drugs. There are potential product acquisitions and launches over FY20 in women's health.

Regardless, UBS believes the near-term outlook is likely to be challenging and the competitive pressures in generics will trump potential opportunities. Approval and successful commercialisation of a pipeline of products remains crucial to improving revenue in generics, the broker asserts.

Macquarie agrees the risks for the near term remain. While specialty revenue growth was robust it was below forecasts as well, although there were variations on a product basis. The broker's downgrade to estimates for earnings per share of -53% in FY19 and -43% in FY20 reflects lower generic revenues and tempered specialty growth assumptions.

Over the long-term, Bell Potter, not one of the eight monitored daily on the database, considers the future of doing business with large wholesalers is bleak. Generics manufacturers are at the mercy of large buyers with respect to pricing and terms, with penalties for failure to supply. The broker welcomes a focus on channels which bypass wholesalers.

Bell Potter downgrades to Hold from Buy and lowers the target to $0.62. FNArena's database has two Hold and one Sell (Macquarie) rating. The consensus target is $0.60, signalling 6.5% upside to the last share price.

See also, Time To Buy Mayne Pharma? on April 16, 2019.

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All About Dividends

In this week's Weekly Insights (published in two parts):

-All About Dividends -Royal Commission: Ongoing Impact -Quote Of The Week -No Weekly Insights Next Week -FNArena's Corporate Reporting Monitor -June Rebalance For ASX200 Index -Conviction Calls -Rudi On Tour -AIA Conference Special

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

By Rudi Filapek-Vandyck, Editor FNArena

All About Dividends

Ask a share market expert what is the main force behind listed equities and you are more than likely to hear "corporate profits".

In recent years more and more experts have been pointing towards excess liquidity provided by major central banks, or to artificially depressed government bond yields, though both factors are largely intertwined.

Occasionally one might try "economic growth" or "global growth momentum" but that story would be quickly dismissed by dozens of academic papers unable to establish a reliable link between share market performances and economic growth, irrespective of day traders' unwavering focus for what might come out next in terms of economic data and indicators.

In more recent times, for obvious reasons, fingers are pointed towards US President Trump, China and the so-called "Trade Wars".

Other reasons that are occasionally mentioned include monthly PMI surveys, funds flows, corporate share buybacks, earnings revisions, and credit spreads.

Dividends, or more specifically: growth in dividends, is not often referred to.

Yet recent analysis by analysts at Citi suggests global equities move in strong correlation with growth in dividends, making this at least one extra indicator investors might want to pay attention to.

Starting off with Citi's key conclusion: global equities are up around 7% per annum since 2010 simply because global dividends are up by around 7% p.a. since that time.

Moreover, reports Citi, throughout the period since the MSCI AC World Index trailing dividend yield has traded in a narrow 90bp range oscillated around a global average yield of 2.5%, which is where global equities are at right now.

Thus while on a day-by-day basis, equity indices can trade heavily on internal and external factors, including those mentioned earlier, it appears underlying the ultimate direction stems from growth in dividends.

The graph below, courtesy of Citi, suggests the correlation between global equities and dividend growth is quite solid and reliable, even though equities can temporarily move off course in either direction.

For example, the graph clearly suggests the savage sell-off in 2008 was extreme as dividend cuts were nowhere nearly as large, and the same conclusion stands with regards the eurozone crisis in 2011-2012 (also clearly visible). The same can be said of 2015.

On the other hand, the graph also shows equity markets were overvalued in the years running up to late 2007, and the same happened in 2017 and 2018.

The first conclusion to draw is that global equities in 2019 do not seem out of kilter with global dividends that have continued to grow throughout the sell-off in late 2018 and the subsequent V-shaped recovery throughout January-April.

The second conclusion should thus be: equities might well pull back on the back of geopolitical tension and uncertainties, but unless global dividends will be affected, a gap will open up similar to late last year, and this will be closed again some time later.

Taking guidance from global dividend growth also takes care of the main worry that stems from the fact equity indices seem to have failed for a third time to break above levels that equally proved too high in September and January last year. To some technical analysts, three failed attempts, also referred to as a Triple Top formation, spells trouble ahead.

Maybe short term. Investor sentiment can turn nasty and dark any time, in particular with equity markets looking elevated on other measures of valuation, but if history is our guide, and dividends continue to grow regardless, the strong correlation of the past suggests equities remain poised for higher levels further down the track.

Wait a minute, I hear you think, if equities beneath the surface of day-to-day volatility are ultimately guided by dividend growth, how come US indices have significantly outperformed the Australian market? Aren't we supposed to be the dividend capital of the world?

Yes, we are the dividend capital of the world, but predominantly because companies including Telstra and the banks carry extremely high payout ratios, transferring most of their cash flow onto shareholders instead of spending money on securing additional growth. It is here that an all-important lesson is embedded for everyday investors: the average yield on such Australian stocks might be high, the growth in these dividends is not.

Actually, Telstra has already been forced to rebase its dividend twice, whereas AMP had to virtually annihilate its dividend while both Bank of Queensland and National Australia Bank cut their dividends recently and doubts have emerged whether Westpac should not follow next. These are but a few examples, but they are symptomatic for what has been happening with yield stocks on the ASX.

Dividends in Australia have continued to grow, including throughout the recent reporting season in February, but mostly because of the resources sector led by BHP Group, Rio Tinto, Fortescue Metals, Alumina Ltd, South32, Whitehaven Coal, and others.

In contrast, and despite widely held criticism US companies have been, and still are spending billions of dollars on share buybacks, the US market has developed into a solid provider of yield in recent years, with (still) rapidly growing, maturing technology companies at the forefront of this.

The graph below, from an earlier analysis published by Citi, shows that while US companies have been spending most of their cash on share buybacks, capex and dividends are also in a steady uptrend since 2009.

Looked at it from a macro, top-down perspective, the post-GFC, lower-for-longer bond yield environment has pushed up the average yield available from US equities to circa 2%. Prior to the GFC, this average yield was all over the place. While volatility has by no means disappeared, the correlation between US equities and the average 2% yield has become a lot narrower.

The same phenomenon can be observed in other markets too, including Emerging Markets and Australian equities. In Australia, the correlation with yield was already more prevalent pre-GFC with the market's average yield trending up and down between 3% and 4%.Post GFC, that average has reset between 4% and 5% with occasional overshoots beyond 5% (2011-2012 and 2015-2016 when equities diverged significantly from underlying dividend growth, as also explained earlier with the global example).

Right now, believe it or not, the average yield from Australian equities sits smack bang on the post 2010 average; not that dissimilar from Citi's observation about where equities are in general vis-a-vis global growth in dividends.

The not so good news, for investors in Australian equities, comes in the form of growth expectations. These remain at low single digits on average for the next few years, well below expectations elsewhere, including for US companies. If these growth projections prove accurate, it is difficult to see how Australian equities can manage to sustainably outperform overseas markets.

The current out-of-season reporting season in Australia, for instance, has led to analysts further reducing expectations for Australian banks. Most forward projections are now working off stable dividends from all major banks in coming years, down from minor growth assumed prior to the latest market updates.

In plain English this translates into: no growth.

While many a pensioner or retiree in Australia thinks this is good enough as it is plain impossible to find similar yield outside Australian banks, or even the Australian share market, without taking on excessive risk, this should also translate into low expectations in terms of total investment returns achievable.

Meanwhile, greater returns will continue to be achieved from companies that are able to continue to grow their profits, and dividends, as witnessed through performances of Goodman Group ((GMG)), Charter Hall ((CHC)), Transurban ((TCL)) and even CSL ((CSL)), REA Group ((REA)) and Aristocrat Leisure ((ALL)).

Whereas the average growth in dividends for all the banks looks rather tepid (if not negative) over the past five years, growth in dividends per annum over that same period for the companies mentioned in the previous sentence has been respectively 8%, 9.5%, 11.9%, 12%, 15.9% and 39.45%.

(Paying subscribers can look up these dividend growth numbers through the dividend calculator in Stock Analysis on the website).

Given all of these shares have significantly outperformed in years past, I think we can safely say there is a strong correlation between dividend growth and share price performances. Thanks to Citi's analysis we know now this relationship holds for individual stocks as much as it does for share market indices.

Below: US equities as assessed on the basis of dividend yield and deviation from the mean by US newsletter Investment Quality Trends (IQT). Here too the conclusion is that, overall, the market's valuation is closer near the top than near the bottom of its natural range, but it looks by no means excessively over-valued.

No Weekly Insights Next Week

Next week, starting Monday 20th May, I am visiting Toowoomba in Queensland (first time ever) to present to local investors. Hence there will be no Weekly Insights that week. The next update will be written and published in the week May 27-31.

Also, in case you missed it, Australia's one and only business & finance TV channel, Your Money, will broadcast its final hour on Thursday this week (16th May). This also gives me the opportunity to move back to the original rhythm of writing Weekly Insights on Monday.

FNArena's Corporate Reporting Monitor

Just a reminder to all, FNArena is running a Corporate Results Monitor, which gets extremely busy throughout February and August, but the overview with regular updates runs all-year around and can be visited (even without a paid subscription) at its designated section on the website:

https://www.fnarena.com/index.php/reporting_season/

For those who like to go back to, and analyse, past Reporting Seasons, there is a special section with past reports, data and updates. This section is accessible by paying subscribers only.

Conviction Calls

"Market-leading student management, attitudinal assessment and profiling systems for tertiary education and training providers";"Mission-critical people management software for educators and employers" and "Ready for the Future of Work" are just a few quotes from the corporate website of newly listed ReadyTech Holdings ((RDY)).

The shares listed on the ASX on April 17 with a price of $1.78 only to subsequently fall to $1.65 but, apparently, appearances do mislead or maybe this is simply a case of bad timing? Earlier press reports had it that the company had been aiming for a listing in 2018, but a severe change in the overall investment climate put that idea to bed at the time.

Analysts at Wilsons initiated coverage this week and immediately added the stock to their select list of Conviction Buys. Wilsons sees double digit growth and expansion in PE multiples ahead.

At face value, the company does have several buzzwords to offer that sound extremely attractive in the present context, including 85% recurring revenues, Software-as-a-Service (SaaS), mission critical nature of software, uncommonly high operating margins and, not to be dismissed, provider of education and employment software.

Wilsons sees a robust growth outlook, starting from an attractive valuation. The maiden Buy (with Conviction) rating is accompanied by a twelve month price target of $2.35. The two lead managers of the company's float were Macquarie and Wilsons. It'll be interesting to note whether Macquarie's initiation -no doubt not far off- is able to match the bullish enthusiasm at Wilsons.

ReadyTech Holdings is profitable and on Wilsons projections will grow earnings per share (EPS) by 114% and 34.7% in the two years ahead (FY20 and FY21) while the company is also expected to start paying out annual dividends from next year onwards (100% franked).

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Meanwhile, portfolio managers at stockbroker Morgans reported they have been reviewing several positions, including in major banks, Transurban ((TCL)), Cleanaway Waste Management ((CWY)), Corporate Travel ((CTD)) and Rio Tinto ((RIO)), and ultimately decided to not make any changes, at least not for the Balanced Model Portfolio.

In addition: "Cash holdings remain flexible enough to capture any opportunities on weakness."

The stockbroker's Growth Portfolio added ANZ Bank ((ANZ)), AP Eagers ((APE)) and more of Treasury Wine Estates ((TWE)) while trimming positions in Rio Tinto and Megaport ((MP1)), the latter post SPP.

AIA Conference Special

Following on from my regular attendances in years past, I shall be participating in the upcoming Australian Investors Association's (AIA) National Conference at the Marriott Resort and Spa, Surfers Paradise, Qld, July 28-31.

I will be busy too. Apart from a one hour presentation on the approaching August reporting season, I am part of the share market panel "Buy, Sell or Hold" on Monday evening, as well as co-host of the Conference Dinner on Tuesday.

FNArena subscribers and readers who like to attend can do so through a Special Promotion offered by the AIA, but which expires on May 31st. The Special Offer includes three months of free AIA membership and a discount on entry tickets to the Conference.

To take up this offer, investors need to Join using this link https://administration.investors.asn.au/civicrm/?page=CiviCRM&q=civicrm%2Fcontribute%2Ftransact&reset=1&id=3.

After you have joined, you'll need to Register for the conference using this link https://administration.investors.asn.au/civicrm/?page=CiviCRM&q=civicrm/event/ical&reset=1&list=1&html=1

This year's Conference Theme is Boom. Boom. Boom...?? Investing beyond the boom.

Rudi On Tour In 2019

-ASA Toowoomba, Qld, May 20 -U3A Investor Group Toowoomba, Qld, May 22 -AIA Adelaide, SA, June 11 -AIA National Conference, Gold Coast, Qld, 28-31 July -AIA and ASA, Perth, WA, October 1

(This story was written on Tuesday 14th May 2019. Part One was published on the day in the form of an email to paying subscribers, and again on Thursday as a story on the website. Part Two appears on the website on Friday).

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Rudi's View: Link Admin, Clinuvel Pharma & Altium

In this week's Weekly Insights (this is Part Two):

-All About Dividends -Royal Commission: Ongoing Impact -Quote Of The Week -No Weekly Insights Next Week -FNArena's Corporate Reporting Monitor -June Rebalance For ASX200 Index -Conviction Calls (with update) -Rudi On Tour -AIA Conference Special

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

By Rudi Filapek-Vandyck, Editor FNArena

Royal Commission: Ongoing Impact

A recent encounter with an industry veteran has taught me the domestic industry of funds managers and financial planners is most likely facing even more upheaval and transformation than I had assumed previously - see also Weekly Insights last week, "Value & The Eye Of The Beholder".

On one hand we have the cohort of aging pensioners and retirees who, faced with Labor's new franking ideas and low returns in general, will be eying further reduction in costs, where possible. This points to direct shares ownership or ETFs, but certainly away from actively managed funds whose costs are higher and not necessarily offering a better return (certainly not for income oriented investors).

On the other hand, there already is pressure on financial planners to lower the costs of managing the income generating capital. Since financial planners like to retain their own margin, here too a trend is being established towards ETFs, away from actively managed funds.

Thirdly, industry super funds are also taking another look at their costs and allocation of funds with outside managers. Their problem is the size of the Australian share market, which remains rather small, in particular at the top. In practice, this translates into lots of overlap in share ownership between internal and external managers, as well as between the external managers.

Meanwhile, Australian investors continue to redirect funds away from retail funds, owned by AMP ((AMP)) and the banks, or otherwise. Here the winners are industry funds. Recent data suggest a cumulative $7.5bn in funds flowed out of AMP, National Australia Bank ((NAB)), Westpac/BT ((WBC)) and ANZ Bank ((ANZ)) in the six months to March 2019.

Morgan Stanley's industry sources suggest many industry funds are budgeting for similar flows out of retail funds and under their management in the six months ahead. Underlying growth in membership for industry funds has lifted post Royal Commission to more than 3.5% from less than 1% previously. This is a sizable step up.

One of the obvious beneficiaries of the latter trend should be Link Administration ((LNK)) whose share price has been creeping up from a low near $6.40 in December to $7.80 more recently. Morgan Stanley estimates every new member of an industry fund whose member accounts are administered by Link translates into an extra $50 per annum in revenues.

While this doesn't sound like much, the analysts add 3% growth in membership thus means $10m extra for Link, which equals in excess of 4% of the company's earnings.

Link Administration is included in my personal selection of All-Weather Performers (see website) and has been part of the FNArena/Vested Equities All-Weather Model Portfolio for quite a while (with the intention of keeping it there for much longer).

Quote Of The Week

In 2015 I published the book "Change. Investing in a Low Growth World" and ever since in my writings and on stage presentations I have tried to convene the message that investors should adapt and adjust, because so many changes are descending upon us, the past surely cannot be relied upon to assess investment opportunities.

To my utter surprise, I do not find my core message has been widely accepted and adopted. Yet, on my own observations, changes and disruptions are increasingly becoming a deciding factor for ASX-listed companies. And I still think this is yet only the beginning of what the decade ahead is going to serve up.

On Tuesday morning, prior to writing this week's Weekly Analysis, I stumbled upon the following quote from market analysts at Schroders Australia: "We must try and identify why and how a business has made money in the past, and how this will change in the future".

My advice to you all is: print it out and place it somewhere on your desk. This principle should now be part and parcel of your own research and portfolio strategy. It'll increasingly prove its value in the years ahead. Read Citi's downgrade for Unibail-Rodamco-Westfield ((URW)) in the Australian Broker Call Report on Tuesday and accept these tectonic changes are slowly developing for a long time, before kicking into acceleration.

I think I'll include this quote in my next set of PowerPoint slides, unless I discover a better one before then.

In addition, followers of my research into All-Weather Performers (see also website and further below) already know I put a lot of value on company quality.

Of course, there is no general consensus about what exactly corporate quality actually means or how it it is measured, but every time someone has an attempt to pick a similar selection of High Quality Stocks in Australia I cannot help but noticing their list has a large overlap with mine.

Rob Tucker's of Chester High Conviction Fund is the latest of such lists I have come across, and my observation has once again been confirmed.

Tucker's selection of the best quality businesses among large cap stocks in Australia consists of the following: CSL ((CSL)), Seek ((SEK)), ASX ((ASX)), REA Group ((REA)), Macquarie Group ((MQG)), ResMed ((RMD)), Aristocrat Leisure ((ALL)), Xero ((XRO)), and Transurban ((TCL)).

No Weekly Insights Next Week

Next week, starting Monday 20th May, I am visiting Toowoomba in Queensland (first time ever) to present to local investors. Hence there will be no Weekly Insights that week. The next update will be written and published in the week May 27-31.

Also, in case you missed it, Australia's one and only business & finance TV channel, Your Money, will broadcast its final hour on Thursday this week (16th May). This also gives me the opportunity to move back to the original rhythm of writing Weekly Insights on Monday.

FNArena's Corporate Reporting Monitor

Just a reminder to all, FNArena is running a Corporate Results Monitor, which gets extremely busy throughout February and August, but the overview with regular updates runs all-year around and can be visited (even without a paid subscription) at its designated section on the website:

https://www.fnarena.com/index.php/reporting_season/

For those who like to go back to, and analyse, past Reporting Seasons, there is a special section with past reports, data and updates. This section is accessible by paying subscribers only.

June Rebalance For ASX200 Index

Standard & Poor's will be making announcements about changes to Australia's most followed share market index on the morning of Friday, June 14. Past experience teaches us that inclusions and exclusions for that index in particular can have a noticeable impact on relevant share prices.

Such impact, remind analysts at Morgan Stanley, can be felt and measured from up to twenty days prior to the event.

On Morgan Stanley's assessment, the June rebalancing of the ASX200 is likely to see the inclusion of Clinuvel Pharmaceuticals ((CUV)) with most likely loser graphite disappointer Syrah Resources ((SYR)). Other possible inclusions are Cooper Energy ((COE)) and/or Service Stream ((SSM)) which means Seven West Media ((SWM)) and Emeco ((EHL)) could lose their spot as well.

Morgan Stanley also thinks the ASX100 could be equally due a few changes with Altium ((ALU)) likely to be included in a swap for Adelaide Brighton ((ABC)) with lower probabilities ascribed to potential inclusion of Beach Energy ((BPT)) and/or Afterpay Touch ((APT)) which would likely translate into wealth managers Pendal Group ((PDL)) and/or Janus Henderson ((JHG)) being kicked out of the Top100.

Morgan Stanley is not anticipating any changes to the S&P/ASX20 or 50, while the S&P/ASX300 is only reveiwed semi-annually in March and September.

Conviction Calls

[This section is largely a repeat from Part One, with two last minute additions about Macquarie on ReadyTech Holdings and stockbroker Morgans' list of stocks to avoid]

"Market-leading student management, attitudinal assessment and profiling systems for tertiary education and training providers";"Mission-critical people management software for educators and employers" and "Ready for the Future of Work" are just a few quotes from the corporate website of newly listed ReadyTech Holdings ((RDY)).

The shares listed on the ASX on April 17 with a price of $1.78 only to subsequently fall to $1.65 but, apparently, appearances do mislead or maybe this is simply a case of bad timing? Earlier press reports had it that the company had been aiming for a listing in 2018, but a severe change in the overall investment climate put that idea to bed at the time.

Analysts at Wilsons initiated coverage this week and immediately added the stock to their select list of Conviction Buys. Wilsons sees double digit growth and expansion in PE multiples ahead.

At face value, the company does have several buzzwords to offer that sound extremely attractive in the present context, including 85% recurring revenues, Software-as-a-Service (SaaS), mission critical nature of software, uncommonly high operating margins and, not to be dismissed, provider of education and employment software.

Wilsons sees a robust growth outlook, starting from an attractive valuation. The maiden Buy (with Conviction) rating is accompanied by a twelve month price target of $2.35. The two lead managers of the company's float were Macquarie and Wilsons. It'll be interesting to note whether Macquarie's initiation -no doubt not far off- is able to match the bullish enthusiasm at Wilsons.

ReadyTech Holdings is profitable and on Wilsons projections will grow earnings per share (EPS) by 114% and 34.7% in the two years ahead (FY20 and FY21) while the company is also expected to start paying out annual dividends from next year onwards (100% franked).

LAST MINUTE ADDITION: On Friday morning, Macquarie released their own initiation of coverage report, starting off with a Buy recommendation accompanied by a price target of $2.20.

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Meanwhile, portfolio managers at stockbroker Morgans reported they have been reviewing several positions, including in major banks, Transurban ((TCL)), Cleanaway Waste Management ((CWY)), Corporate Travel ((CTD)) and Rio Tinto ((RIO)), and ultimately decided to not make any changes, at least not for the Balanced Model Portfolio.

In addition: "Cash holdings remain flexible enough to capture any opportunities on weakness."

The stockbroker's Growth Portfolio added ANZ Bank ((ANZ)), AP Eagers ((APE)) and more of Treasury Wine Estates ((TWE)) while trimming positions in Rio Tinto and Megaport ((MP1)), the latter post SPP.

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LAST MINUTE ADDITION: Stockbroker Morgans has also released three lists of stocks it considers either a downright Sell, too expensive or "no need to be there".

Stocks considered a Sell are:

-ASX ((ASX)) -AGL Energy ((AGL)) -Fortescue Metals ((FMG)) -Newcrest Mining ((NCM)) -TechnologyOne ((TNE)) -Villa World ((VLW))

The list of "no need to be there" stocks includes:

-NextDC ((NXT)) -JB Hi-Fi ((JBH)) -GWA Group ((GWA)) -Coca Cola Amatil ((CCL)) -Bellamy's Australia ((BAL)) -Blackmores ((BKL)) -Vocus Group ((VOC)) -Sandfire Resources ((SFR))

And the list of stocks deemed too expensively priced, with Morgans explicitly recommending investors should at least trim holdings and take some profits:

-APA Group ((APA)) -Transurban ((TCL)) -Magellan Financial ((MFG)) -Aurizon Holdings ((AZJ)) -Atlas Arteria ((ALX)) -Coles Group ((COL)) -InvoCare ((IVC)) -Ramsay Health Care ((RHC)) -Ansell ((ANN)) -a2 Milk ((A2M)) -Inghams Group ((ING)) -Orica ((ORI)) -Centuria Industrial REIT ((CIP)) -Hotel Property Investments ((HPI)) -Nanosonics ((NAN))

AIA Conference Special

Following on from my regular attendances in years past, I shall be participating in the upcoming Australian Investors Association's (AIA) National Conference at the Marriott Resort and Spa, Surfers Paradise, Qld, July 28-31.

I will be busy too. Apart from a one hour presentation on the approaching August reporting season, I am part of the share market panel "Buy, Sell or Hold" on Monday evening, as well as co-host of the Conference Dinner on Tuesday.

FNArena subscribers and readers who like to attend can do so through a Special Promotion offered by the AIA, but which expires on May 31st. The Special Offer includes three months of free AIA membership and a discount on entry tickets to the Conference.

To take up this offer, investors need to Join using this link https://administration.investors.asn.au/civicrm/?page=CiviCRM&q=civicrm%2Fcontribute%2Ftransact&reset=1&id=3.

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