Week

14

Stories To Read From FNArena

Friday, 7 April 2017

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Challenges Continue For Bank Of Queensland

Bank of Queensland has flagged a more positive outlook for the second half but brokers believe this will not be without challenges.

-Net interest margins expected to improve but seen offset by lower fee income and expenses -Share price is envisaged to be building upside from expectations for mortgage re-pricing -Capital is strong but the bank may need a buffer to protect dividends

By Eva Brocklehurst

Bank of Queensland ((BOQ)) has promised net interest margins should expand in the second half but caution prevails among brokers. The expansion is expected to stem from abating competition in term deposits and this outlook was the main driver of an ultimately positive reaction in the share price after the first half results.

Ord Minnett upgrades to Hold from Lighten, now envisaging the risk/reward balance is more appropriate. The result marks the low point in the regional bank's earnings trajectory, in the broker's opinion, given the prospects for better margins, volumes and cost performance.

While the mortgage book again contracted in the first half, the broker cites recent evidence of reductions in front-book discounting by peers, as well as growth in the specialist book and a new Virgin Money-branded product, which suggests the bank will be better positioned to return to growth.

The main problem for brokers is the bank's vulnerability on non-interest income. Fee income remains under pressure and trading income has also been re-based.

Improving Margins

Deutsche Bank expects an improvement in margins in the second half should drive earnings growth, but remains concerned that the bank continues to lead on price in most of its markets, including retail deposits and Bank of Queensland branded mortgages. Moreover, the efforts to size the branch network appropriately are expected to drag on volumes.

Deutsche Bank considers the stock fairly valued. In the medium term, the broker is unsure whether the bank can successfully grow its lending book close to system levels, while maintaining margin control, for any length of time.

The key to success in this matter is better harvesting of deposits. Although management has pointed to better data analytics as a support, Deutsche Bank believes this will not be enough.

Morgan Stanley acknowledges the delicate balance of delivering on margin and mortgage volume but remains positive about the potential from repricing, a strong capital position and attractive dividend yield.

Mortgage application volumes are up around 30% over the past six weeks and, if sustained, the broker estimates around 4% annualised growth in home loans in the second half could materialise. The broker forecasts housing growth of around 3.5% annualised half on half and then a recovery, although that remains below system at around 5% in FY18 estimates.

Mortgage Re-pricing

The current share price appears to be building in upside from the repricing of mortgages, which Morgans asserts may not eventuate. Many of the bank's peers have repriced home loan books over recent weeks but the broker believes it unlikely that Bank of Queensland will reprice to the same extent, if it reprices at all.

The reason is that the bank's home loan price points appear to be sitting 20-30 basis points higher than its main competitors prior to the recent repricing. The gap has narrowed, allowing Bank of Queensland to be more competitive. Hence, the broker calculates, if the bank reprices to the same extent as peers, it will again risk its home loan book contracting in the second half.

The results were not unexpected, as Citi notes investors had braced for a poor result. The broker observes the BOQ share price had missed out on the recent optimism, brought about by current and expected mortgage repricing.

The broker believes the environment is rapidly changing for the bank, as other bank stocks have strengthened and, accordingly, left the broking community less bullish on their recommendations. In contrast, Bank of Queensland appears to have improved its fortunes and the benefit is yet to be recognised in the share price.

All major banks have repriced investor mortgages by an average of 25 basis points and Bank of Queensland is yet to move, although Citi believes it should eventually reprice higher, as new macro prudential measures for investor mortgages are implemented. This should disproportionately benefit the regional bank, as it has a highest portion of investor mortgages in the sector.

The mortgage book faces material headwinds, UBS believes. Owner-managed branches have fallen to 115 from 198 in FY12. As these branches are closed the loan and deposit books should begin to amortise at an accelerated rate, while many other loans are often refinanced around 3-5 years after origination.

To UBS, this is effectively the reverse of a "store roll out". While a pick up in front book applications should help alleviate the pressure, the broker believes it will be challenging for the bank to stabilise the declining proprietary mortgage book.

As a result, UBS believes Bank of Queensland will become increasingly reliant on brokers and the rolling out of Virgin Money Australia to prevent its mortgage book from continuing to shrink. An easing of competition and a tightening of underwriting standards by peers should help, but the broker believes any growth at all in the mortgage book will be a good outcome.

Macquarie agrees the uncertainty lies with the ability to grow volumes without sacrificing margins. The broker expects the front versus back book pricing gap will be a drag on profitability in the medium term. Macquarie expects regaining of confidence in the broker channel and running off of the portfolio from branch closures are likely to take time and, therefore, lending growth trends are likely to underperform in the near term.

Ultimately, the broker believes the bank should be able to grow ahead of system, if the flow from the broker channel increases towards the level of peers. Nevertheless, Macquarie believes the bank will need to address problems with its systems and offer more competitive and consistent pricing for this to improve.

While Bank of Queensland is yet to reprice variable investor mortgages, and this presents upside risks to earnings. Macquarie concurs with Morgans that regionals have less scope to continue to reprice because of their current elevated pricing.

The broker incorporates 10 basis points of investor repricing in May and an additional 15 basis points of interest-only investor repricing at the end of June.

Dividend Sustainability

Capital is strong at around 9.3% but Morgan Stanley expects Bank of Queensland to remain conservative until APRA clarifies “unquestionably strong” and may need a buffer to protect the dividend. Macquarie also expects no dividend growth until 2020, believing the pay-out ratio is unsustainably high at present.

UBS also suspects the bank will be unable to sustain its dividend over the next two years. The dividend pay-out ratio appears to the broker to be extremely elevated at 84%. The broker agrees the capital position is strong but highlights future rules around capital are still unclear.

With a falling profile of earnings per share UBS believes it will be challenging to maintain the dividend, especially if the bank is targeting growth in its loan book. UBS expects the dividend to be trimmed to $0.35 per share in the first half of FY18, from $0.38 previously.

Shaw and Partners believes the outlook is improving. While the bank is doing well on costs, capital and bad debts, the broker acknowledges the first half results were affected by softer top-line growth.

As the bank is guiding to a more favourable top-line outcome in the second half the broker calculates revenue growth rebounds to 4%. Shaw and Partners, not one of the eight monitored daily on the database, maintains a Buy rating and $12.10 target.

There is one Buy recommendation (Citi) on the FNArena database. There are six Hold and one Sell rating (UBS). The consensus target is $11.71, signalling -4.8% downside to the last share price. Targets range from $10.00 (UBS) to $13.25 (Citi). The dividend yield on FY17 and FY18 forecasts is 6.2%.

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Aurizon Should Recoup Debbie's Impact

While acknowledging early days, brokers estimate the impact on Queensland coal rail operator Aurizon from Cyclone Debbie.

-Disruptions are likely to be a net negative for FY17 earnings -Network likely to recover most of the loss from regulated price increases in FY19 -Most immediate financial impact may be felt in the FY17 dividend

By Eva Brocklehurst

The network of Queensland coal rail operator, Aurizon ((AZJ)), could be closed for an average of three weeks because of the damage from Cyclone Debbie. Peak flooding is still to eventuate in Rockhampton and there are landslips in the Goonyella system.

The company has indicated disruptions are likely to be a net negative for FY17 earnings but believes it is too early to assess whether a change to current guidance is required. More clarity is expected in the coming month. Group operating earnings (EBIT) guidance is $900-950m on above-rail volumes of 255-275mt.

Brokers expect that as the network business is regulated, it should recover much of the loss in this segment via regulated price increases in FY19.

Credit Suisse estimates the financial impact at around $100m of earnings in FY17. Around $80m of this amount is in the network business, which should largely be recovered. Above-rail earnings may be down by only around $23m because a portion of take-or-pay contracts deliver payment despite the company being unable to provide a service.

Nevertheless, the broker suspects the focus on recovery could delay cost reductions and the strategic review of the freight business.

The closure is estimated to have an impact of around -14.6-15.2m tonnes, in Macquarie's calculations, with a further -5mt associated with speed restrictions. The broker had forecast the network to carry 228mt against the regulated forecast of 222mt. Thus, instead of beating the 222mt hurdle, the broker expects volumes of around 206mt

Macquarie expects the FY17 earnings outcome will be below the company's guidance range, at around $875m, and the most immediate impact could be felt in the FY17 dividend. At this stage, the broker expects the dividend to be maintained at the FY16 level of around 24.6 cents.

Regulated Network

Macquarie highlights the defensive nature of the company's earnings, as its regulated network bears little risk associated with weather and production. With two months to go to the end of the financial year, the broker expects the company is most likely entering bond pricing for the subsequent re-setting. That said, while the regulated networks will continue to ensure value stability, Macquarie has factored in a tougher regulatory outcome.

On the other hand, the downside of the business is emphasised in the freight-exposed business by the cyclone. Interruptions to the northern track will require the company to replace trains with truck services in many cases, especially for perishables.

This will add to the cost base of a loss-making business and this cost is not recoverable, being priced into the original contract. As the intermodal asset is being written down, the broker continues to believe divestment is the most likely path.

Based on the guidance for timing of the re-opening, UBS estimates a -5% negative impact to FY17 coal haulage volumes. The broker estimates a -$25m negative impact on above-rail EBIT, which translates to a -3% negative impact to group EBIT.

The lack of evidence regarding major damage to the mines means it is likely the industry will seek to recover some of the lost output by maximising rail loadings after the networks re-open. This suggests to UBS that some of the impact in FY17 will be offset and the benefit should spill into FY18.

Cyclone Debbie

Cyclone Debbie has caused rail and mine closures on each of the systems in the company's central Queensland network as well as the major export port terminals. The company obtains half of its network revenue from the Goonyella and GAPE rail systems. Blackwater is expected to re-open by the end of this week.

The current flood peak is in the Fitzroy Basin, which affects the Blackwater, Moura and freight business between Rockhampton and Brisbane. The Fitzroy River is expected to peak at 9m on Wednesday in Rockhampton. Meanwhile, Goonyella has suffered the most damage so far and may take five weeks to re-open.

FNArena's database shows five Hold ratings and three Sell ratings. The consensus target is $4.80, signalling -6.0% in downside to the last share price. Targets range from $4.20 (Ord Minnett) to $5.10 (Deutsche Bank). The dividend yield on FY17 and FY18 forecasts is 5.1% and 5.3% respectively.

Navitas Guidance Reflects Confidence

Navitas has briefed investors on its commitment to building partnerships with universities and its focus on industry-based tertiary education.

-Financial goals out to FY20 could be conservative -But market likely to await execution on the targets -Structural tailwinds continue for core university business

By Eva Brocklehurst

Navitas ((NVT)) remains intent on building partnerships with universities and being involved in industry-focused tertiary education.

The company has briefed investors on its long-term strategic direction and provided financial goals out to FY20. Compound growth in revenue of 3% is forecast with university programs up 7% and the SAE division up 3%.

FY20 operating earnings (EBITDA) margins are expected to be 18% for the group. Management has confirmed that the loss of contracts in the Adult Migrant English Program (AMEP) will impact earnings by -$12-14m from FY18 onwards.

Deutsche Bank's updated forecasts for FY20 fall slightly below the company's guidance, with its forecast revenue 2.5% below and earnings 3% below the values implied by the company's targets. Given the continued risks associated with contract losses the broker remains comfortable with this position.

Deutsche Bank estimates that revenues will fall for the PEP division (which now incorporates AMEP) by 30% in FY18 as a result of lost contracts, and the earnings margin slip to 10.5% in FY18 from 14.5% in FY17.

Tough UK, US Environment

The broker highlights the tough regulatory environment in the US and the UK, with the US continuing to be affected by a sector-wide increase in visa rejection rates and the UK affected by ongoing restrictive student visas. The company is hopeful these restrictions will increase the flow of students into Australia and Canada.

Macquarie envisages significant upside to revenue growth targets, assessing these as conservative. The broker forecasts a higher growth rate, 3%, in terms of course prices compared with the company's 2% estimate, underpinned by industry feedback which highlights the strong inelasticity in demand.

The broker also expects significant upside potential from new contracts, new courses and scope for better enrolment growth. Macquarie envisages uncertainty surrounding the SAE business will have eased because of the provision of growth targets and strategic detail. Growth assumptions for SAE are increased and the broker adopts the company's 3% revenue growth target.

Navitas has expressed confidence that all 2017 contracts will be renewed. Macquarie considers the risk for more university pathway contract losses, an ongoing concern for prospective investors, is significantly reduced.

The most important feature of the investor briefing for Morgan Stanley is unchanged earnings guidance that suggests FY17 earnings will be in line with FY16 on a constant currency basis. Also unchanged is the estimated impact from the loss of the recent AMEP contract. The revenue growth targets are lower than Morgan Stanley's prior estimates while the margin targets are better.

The good news is that the loss of the Macquarie University contract is now out of the numbers and in the past. Morgan Stanley believes this was the most profitable contract in university programs and the company has worked hard to fill the subsequent earnings gap, which is why FY16-17 earnings is flat rather than sharply lower.

Upside Possible If Targets Met

If the company achieves its objectives, all else being equal, the broker estimates this could add $0.50 to $1.00 per share to discounted cash flow value. Morgan Stanley suspects the market will take a conservative approach to pricing in the upside and await further evidence of execution.

Valuation is not considered overly cheap compared with other growth stocks in the media/internet/technology sector. The broker suspects the opportunity for a substantial re-rating will eventuate if the company can return to double-digit growth in earnings per share.

Morgan Stanley asserts the company's traditional and core business, university programs, remains an excellent asset that is profitable, with structural tailwinds as well as being globally scalable. The outlook for this division remains the driver of earnings and valuation for the broker.

The Australian-based business has 35 pathway colleges/campuses across Australia, the UK, the US, Canada, Singapore, New Zealand and Sri Lanka.

FNArena's database shows two Buy recommendations, two Hold and one Sell. The consensus target is $4.63, signalling 5.2% upside to the last share price. Targets range from $4.00 (Credit Suisse) to $5.00 (Macquarie).

See also, Major Setback For Navitas? on March 8, 2017.

St Barbara Emerges As A Key Gold Pick

Interest in gold miner St Barbara has been reinvigorated following robust March quarter production.

-Debt retired in March quarter and cash flow yields strong -Maiden dividend could eventuate in FY18 -Management on the look-out for acquisitions -Could become a takeover target

By Eva Brocklehurst

Gold miner St Barbara ((SBM)) has come a long way over the past few years, such that broker interest has been reinvigorated. Citi reinstates coverage with a Buy rating.

The company was in a parlous situation after the debt-funded acquisition of Allied Gold in 2012 and, Citi observes, it was a mix of good management and good fortune that rescued St Barbara from near bankruptcy. Dial forward to 2017 and the company is now net-cash and looking to fund further growth. This also raises the potential for future dividends and acquisitions.

Macquarie notes the company retired the last of its debt during the March quarter, as strong operating cash flows allowed both repayments and an increase in cash at the bank. On the broker's gold forecasts, and at the current spot price for gold of US$1,255/oz, Macquarie expects the company to generate cash flow yields of 21% and 23% over FY17 and FY18 respectively.

Gold production is now heading for a beat on FY17 guidance of 350-370,000 ounces. St Barbara has one of the gold industry's lowest costs, Citi notes, at an all-in sustainable cost (AISC) of around $896/oz, which leads to strong cash flow. The broker estimates the free cash flow yield should be 17% and 14% in FY17 and FY18 respectively.

Canaccord Genuity suspects a guidance upgrade could be on the cards after the strong March quarter production numbers. Group production was 95,300 ounces, with record output at Simberi.

Citi expects a maiden dividend in FY18 at 20% of net profit. Even after dividends, the broker forecasts FY18 and FY19 cash balances of $300m and $522m respectively. If the estimated timing of the dividend is premature, Citi does not expect the board to wait too much longer before returning surplus cash.

Gwalia, Western Australia

Gwalia is entering a period of higher grades and, potentially, higher production. Grades currently being achieved at Gwalia are estimated to be above the reserve grade of 8.3g/t. Citi expects a steady fall in Gwalia gold grades to below current reserve grades by FY21, trending towards 6.3g/t.

Gwalia produced 64,916 ounces in the March quarter at a much higher grade of 11.2g/t than the 9.1g/t that Macquarie was expecting. The company has recently announced approval of the Gwalia Deeps extension project which will take 2-3 years to complete at an estimated cost of $100m.

This extension will allow mining to 2,000m in depth and extend the life to at least 2024. Macquarie notes the Gwalia extension is well understood but believes any extensions beyond the immediate plan are long dated.

Simberi, PNG

Simberi should remain tax-exempt for its current life of mine, Citi notes, which is expected to be 2-3 years. Grades at 1.2g/t continue to improve.

Macquarie believes the key to the mine's performance has been increased material movements, up 25% over the last 12 months. The broker increases mining and milling assumptions for Simberi, resulting in 13% and 9% uplift to earnings in FY17 and FY18 in respectively.

However, higher throughput will result in a shorter assumed mine life and this has a negative impact on FY19 estimates, the broker cautions.

Simberi is nearing the end of its oxide life and there are questions over the viability of processing the sulphide portion of the deposit. A recent review found that the $135m sulphide processing expansion was not currently viable.

The company conducted a sale process late last year without any success. Citi believes a second sale process is unlikely, which means the base case is for depletion of the oxide reserves and closure of the mine.

Management has signalled it will look at acquisitions and, given declining production and excess cash, the broker considers this prospect very likely. Moreover, with the company probably down to a single mine – Gwalia - in three years, it could be a potential corporate target.

The company's exploration projects are not expected to yield a mine in this time frame. Also, while the company has the capacity for an acquisition, with multiple cashed-up competing gold miners a value-accretive target may prove elusive and Citi suggests shareholders may prefer the safer option of a sale of the company with a takeover premium.

Outside of the improving operations and the expected build up in cash, Macquarie finds it hard to envisage any growth catalysts. The main challenge for management, the broker suggests, is managing growth expectations.

Canaccord Genuity also continues to envisage little valuation upside at current levels. The broker, not one of the eight monitored daily on the FNArena database, has a Hold rating and $2.55 target.

There are four Buy ratings on the database. The consensus target is $2.91, suggesting 11.0% upside to the last share price. Targets range from $2.60 (Credit Suisse) to $3.10 (Deutsche Bank).

Risks Seen To The Upside For JB Hi-Fi

JB Hi-Fi posted accelerating sales growth in its core business in the March quarter. Meanwhile, CEO of The Good Guys will leave at the end of April, to be replaced by a former JB Hi-Fi CEO.

-Momentum considered sustainable while guidance confirmed and risks envisaged to the upside -Amazon not expected to weigh on earnings for some time -Terry Smart as CEO of The Good Guys considered a positive move

By Eva Brocklehurst

Electronics retailer JB Hi-Fi ((JBH)) posted accelerating sales growth in its main business in the March quarter, above expectations, while sales growth for newly-acquired The Good Guys slowed, as was generally expected.

UBS observes the company has sustained momentum and market share gains in what appears to be an increasingly rational industry. The broker believes guidance is conservative, in that it implies second half sales growth of 8% versus the current 11% run rate.

The broker remains comfortable with forecasts slightly ahead of guidance and envisages upside to both FY17 and FY18 estimates if momentum can be maintained.

The business is one of the best consumer electronics retail models globally, in the broker's view, featuring high levels of productivity, lower costs and a strategy that aims to deliver the best value for consumers while maximising gross margins.

March quarter like-for-like sales for JB Hi-Fi grew 8.2% and total sales grew 10.8%. This is an acceleration from the 7.2% like-for-like and 9.8% total sales growth reported in January. The Good Guys posted 1.2% like-for-like sales growth in the quarter and 2.6% total sales growth. This is a slowdown from January when like-for-like sales growth was 3.5% and total growth 5.0%.

Industry checks by Deutsche Bank suggest January's strength for The Good Guys was boosted by unusually strong sales of cooling products. Assuming January is a larger sales month versus February and March - the broker estimates January was 20% larger - this implies February-March growth was probably flat and in line with guidance.

The Good Guys was a little weaker than Morgan Stanley expected but given poorer March weather and the disruption of the merger, the broker believes this is explainable. Ord Minnett suggests weakness highlights the execution risk following the conversion to corporate from joint-venture stores and a significant change in store personnel.

Previous guidance for 2017 total sales of $5.58bn and net profit of $200-206m has been reaffirmed. This signals to Ord Minnet there is little change likely at the upcoming investor conference.

The broker retains a view the risk to FY17 net profit is skewed to the upside and now becomes more probable, given the March quarter result. Nevertheless, the June quarter is the main quarter for the second half. The broker currently forecasts net profit to be above the top end of guidance.

Sales guidance is looking increasingly conservative to Morgans too, while guidance for The Good Guys is more realistic. Guidance implies 9.5% sales growth, on the broker's estimates, and, as Dick Smith left the electronics market back in April 2016, comparables may moderate from this point.

Citi believes the company is outperforming the broader industry and retains a clear preference for JB Hi-Fi over Harvey Norman ((HVN)), given the former's execution on operations and strong momentum in the core business.

Although the stock appears cheap on a price/earnings multiple basis the broker acknowledges risks to earnings in the medium term. These include a slowing in retail spending, increased competition, price inflation and the threat of new entrants.

Amazon

Amazon remains a concern for brokers with its mooted entry into Australia but is unlikely to weigh on the company's earnings for some time, in Deutsche Bank's view, given Amazon will need to ramp up. In the short term the consumer and electronics product cycle, a key driver of sales, is supportive as significant phone and gaming console releases are imminent.

While the threat of Amazon cannot be underestimated, UBS believes JB Hi-Fi is better equipped to mitigate the impact relative to offshore peers such as Best Buy.

Despite the recent de-rating and reasonable fundamentals, Morgans retains a Hold rating, largely because of the threat of Amazon's entry to the local market. That said, the broker expects the company to be reasonably well positioned to compete via a, now, more powerful global sourcing position.

The Good Guys CEO

Michael Ford has resigned as CEO of The Good Guys and will be succeeded by Terry Smart, who was previously CEO of JB Hi-Fi back in 2010-14. Michael Ford's departure, while a little earlier than expected, is not a surprise to most brokers.

Some uncertainty is expected to ensue in the business as it undergoes changes, although the return of Terry Smart suggests a known quantity and fit with the culture of JB Hi-Fi.

Ord Minnett considers the appointment of Terry Smart a significant positive, bringing back one of the best electrical retailers in Australia. Moreover, the broker believes he understands the distinctive features of The Good Guys and how this business can be enhanced and pursued.

The broker also believes The Good Guys provides a more capable competitor to Harvey Norman. Any improvement under Terry Smart, especially an effort to become a more premium business and make The Good Guys a location where suppliers can launch new products, would be a negative for Harvey Norman, in the broker's opinion.

On FNArena's database the consensus target is $30.28, suggesting 19.3% upside to the last share price. Targets range from $32.80 (Macquarie) to $26.49 (Credit Suisse). The dividend yield on FY17 and FY18 forecasts is 4.7% and 5.3% respectively. There are three Buy recommendations, four Hold and one Sell (Credit Suisse, yet to update on the quarterly sales).

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Material Matters: Coking Coal, Lithium & Gold

Coking coal and Debbie; manganese prices; lithium outlook; gold sector quarterlies.

-Metallurgical coal price rise may not be as substantial as in 2011 -Recent gains in manganese prices likely to be temporary -March quarter electric vehicle data critical to the outlook for lithium -Gold sector continues to present value to Deutsche Bank

By Eva Brocklehurst

Metallurgical (Coking) Coal

In the wake of Cyclone Debbie and heightened speculation regarding the upside for metallurgical coal, Morgan Stanley believes it is time for some perspective. The range of estimates for the tonnage lost post the cyclone is -13-19m tonnes. The supply side hit in terms of Queensland's 50% slice of global metallurgical coal trade, equates to around -4-6%, in the broker's calculations.

Assuming nothing is changed otherwise, this could lift metallurgical coal prices. That said, the broker is not suddenly a bull on metallurgical coal, the reason being that a bull case depends on nothing else changing and there are other supply-side issues.

Offsetting factors include the prospective delivery of a lot of coal down the supply chain and import inventory as a supply buffer. The general recovery from the cyclone could be quicker than the market expects while the US has reactivated supply with potentially 20-30mtpa of extra capability.

Ord Minnett is in a similar camp. The broker notes de-watering infrastructure installed at the mines post the 2011 flooding event has helped the majority resume operations more quickly. The broker estimates the outage created by the damage to the Goonyella line, which carries around 120mtpa, will result in around 15mt of lost exports. This equates to around a -5% interruption to seaborne trade.

The broker believes that while prices have already rallied, the ultimate impact from this cyclone will be less severe than the one in 2011, where open pit mines were filled with water and caused prolonged outages and caused prices to surge to US$330/t.

UBS also estimates the impact is around 15mt and that tighter markets should undoubtedly drive pricing higher. The scope for shipment diversions will depend on the access to spare trains, which is uncertain at this point in the recovery. The broker expects spot prices to lift meaningfully from current levels around US$155/t.

The broker contemplates a jump in spot prices in excess of US$100/t is entirely possible. A higher spot price will benefit those that sell spot coal such as South32 ((S32)), not affected by this weather event, while Whitehaven Coal ((WHC)), also unaffected, despite selling metallurgical coal on contract, is selling ramp-up tonnage from Maules Creek into the spot market.

Credit Suisse suspects Japanese negotiators may be feeling a little bitter about second quarter contract negotiations. They had the upper hand two weeks ago, haggling with producers over a US$5/t in a bid of a range of US$158-163/t, according to the broker's sources.

Second quarter contract offerings are now likely to be at a substantially higher price, although it remains unclear whether any Queensland mine could confidently offer supply in April. Credit Suisse expects at least 16mt of coal output will be lost, including 11mt of hard coking coal.

The broker expects prime hard coking coal spot prices to head towards US$180/t, which may be a negotiating level if the second quarter contract settles. This is the broker's assessment of price parity with China's price in Tangshan.

Manganese

Prices for manganese ore have rebounded but are unlikely to persist at current levels, Citi suggests. The current rally represents stabilisation rather than a sustained up-trend and Chinese steel production is expected to remain modest over the next few months.

The fundamentals are unchanged and the broker believes recent gains in price will be temporary. Prices have stabilised after the they fell by more than 50% between December and March. Citi calculates the market balance of manganese ore should be back in surplus by the September quarter of 2017. Key to this view is a persistent overhang of inventory at Chinese ports. This remains the biggest threat to prices.

While net additions at Chinese ports have slowed over the last month, any severe stock liquidation will be negative for the spot prices, although the broker believes this is unlikely in the short term. Price stabilisation after a steep fall has attracted traders and end-users that have waited for more comfortable price levels.

Lithium

Deutsche Bank notes Chinese domestic spot pricing for battery-grade lithium carbonate has been lifting in recent weeks and is now 7% above its 2016 lows.

Electric vehicle sales in January in China were disappointing although they recovered in February, the broker points out. February output of battery-grade lithium carbonate was down 18% month on month but production levels should have normalised in March.

The broker remains conservative in its estimates and assumes 650,000 tonnes of lithium will be sold in 2017, only 30% above 2016, which was 68% above the year before.

The broker estimates current lithium prices are well above incentive pricing, and if Chinese electric vehicle sales beat forecast to the upside and prices remain buoyant, the producers should likely outperform. Hence, the broker retains a Buy rating for the likes of Orocobre ((ORE)). Electric vehicle sales are traditionally weighted to the second half and March quarter data will be critical to the outlook.

Gold

Gold stocks under Deutsche Bank's coverage are up 6% since the beginning of the year. The broker still believes this sector presents value.

A solid March quarter is expected from Newcrest Mining ((NCM)), with Lihir and Cadia production rates increasing. OceanaGold ((OGC)) is expected to deliver production improvements from both Didipio and Macraes and commercial production is expected to be declared at Haile.

Alacer Gold ((AQG)) is expected to benefit from higher grades and strong results are also expected from Northern Star Resources ((NST)). Evolution Mining ((EVN)) will also report its first full quarterly contribution from Ernest Henry.

Those companies likely to disappoint in the current production quarterlies, in Deutsche Bank's view, include OZ Minerals ((OZL)) with a 5% decline in copper output forecast. Independence Group ((IGO)) is expected to report a mixed result, with Jaguar improving but grades at Tropicana falling. Orocobre's March quarter report is unlikely to improve investor sentiment, in the broker's opinion, but the stock is considered fundamentally cheap.

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Australian Banks And The APRA Impact

How will further lending restrictions now imposed by APRA impact on bank earnings and the housing market?

- Crack-down on interest only loans - Further repricing likely - Earnings impact a balancing act - More pressure on lofty housing market

By Greg Peel

Ever tried to catch a bubble? Any small child could tell you it's an impossible task. But it's the task APRA has taken on as fears grow among the RBA, ASIC and Treasury that Australia's housing market may be heading for inevitable collapse. Or at the very least, a pullback that would significantly impact on the Australian economy.

The latest data show Australian dwelling prices rising at an annual rate of 13%, with Sydney prices rising 19% and Melbourne 16%. The bulk of new mortgages are going to property investors, ahead of owner-occupiers, and very few are going to first home buyers. This is the biggest problem for politicians, being housing affordability.

Many policy measures have been touted as a possible way to improve housing affordability, but most suggestions around stamp duty and negative gearing would only see a pass-on into prices anyway, unless they are specifically limited to first home buyers. Suffice to say, the government really has no idea what to do.

Australia is currently suffering record low wages growth, largely as a result of a distinct shift to part-time work from full-time work in the economy. The RBA could address the problem, and a flow-on into weak consumer spending, by lowering rates. But households are already carrying record levels of debt. A rate cut would further fuel this bubble and the housing bubble to boot. So the RBA is hamstrung.

Why are investors so keen on Australian property (not counting foreigners who just think it would be a nice place to live and have the money)? We can cite a record low cash rate, an investment alternative, being the stock market, that has gone nowhere for years, and the lure of rising property values. The latter is of course a self-feeding beast.

On the other side of the equation is supply, and here we find a similar self-feeding beast. Economists had been expecting runaway property development to cool by now, and indeed had expected a -1% fall in building approvals in February. They rose 8%. There are fears of a glut of apartments. New apartment approvals rose 11%.

APRA took its first step in trying to rein in investor lending for housing by imposing a cap on banks' new investor loan growth of 10%. It worked, to begin with, but house prices just continue to go up. Investors are back again, happy to pay higher rates and higher prices.

Repricing Benefits

The banks have recently undertaken a round of out-of-cycle mortgage repricing, meaning they have increased the rate on variable mortgages irrespective of no change to the RBA cash rate. The increases to investor rates have been greater than those to owner-occupier rates in order to stifle marginal demand and keep investor loan growth below the required 10%. The banks were either prompted into raising by, or using as an excuse, the rate increase implemented by the US Federal Reserve last month.

The Fed rate hike, and promise of more to come, will eventually raise bank funding costs when next the banks issue bonds in the US. These are most often five-year maturities. As the US continues to tighten, the pressure will be on the RBA to ultimately follow suit lest the Aussie collapse as a result. But currently the RBA would rather be cutting than hiking and it would like to see the currency lower than where it is now.

In other words, the banks have bought themselves some time. Their bottom lines stand to benefit from increased rates in their mortgage back-books (existing variable mortgages) and by imposing greater rate increases on investors they are complying with APRA demands of lower growth and managing, for once, to avoid the ranting and raving of politicians.

Has anyone heard one typical outburst of bank bashing from the pollies over this latest round of mortgage price hikes?

It remains to be seen just what impact these higher rates will have on new investor demand. But APRA has decided not to wait to find out. Currently the signs are that Australia's investor-driven housing bubble is showing no sign of deflating.

Playing it Safe

One option open to APRA would have been to further limit investor loan growth, say to 5% from the current 10%. Bank analysts have considered such a move a possibility for some time. But the problem is, apartment blocks take a long time from the point of approval to the point of completion and settlement of sales. This lag means settlements from the peak period of apartment construction are just now being reached.

To that end, APRA suggested on Friday that the current 10% cap on investor loan growth was "continuing to provide an appropriate constraint in the current environment, balancing the need to continue to moderate new investor lending with the increasing supply of newly completed construction which must be absorbed in the year ahead". To further tighten restrictions would be to risk increased settlement defaults and reduced demand for new apartments that could set off a cascade of falling prices.

That would signal the beginning of the end of the housing boom, perhaps destructively so. The housing sector has almost single-handedly kept Australia's economy growing through the cycle of a significant decline in mining investment. There is no sign on the horizon of mining investment turning around again. There are now signs the housing market is cooling.

Morgan Stanley calculates some 45% of the market capitalisation of the ASX200 is in some way connected to housing. We can start with the developers and banks and move all the way down the chain from building material suppliers to the retailers of furniture and televisions. Not only is this 45% at risk were the housing bubble to spectacularly burst, it is well accepted an economy is more likely to grow when consumers believe their wealth to be growing, and the most valuable asset of the average consumer is property.

So what could APRA do?

On Friday the regulator played its master stroke, deciding not to go after investor lending in general but the types of loans that are popular with investors. In particular, interest-only loans.

The average owner-occupier is hoping to eventually own their home outright and as such take out a mortgage for which they pay both principal and interest, typically with a 20-25 year maturity. But investors are not typically looking that far ahead and hope to "flip" their property down the track for a tidy profit. They are not making a killing on rent, which is the other reason one would invest in property.

A principal and interest loan (P&I) does not actually reach the point of reducing principal until later in the life of the mortgage. In early years, borrowers are simply paying interest. So for both reasons, investors prefer interest-only loans (IOL). Indeed, some 65% of investors.

Between the GFC of 2008, in which the stock market lost half its value and the RBA began madly cutting rates, to 2014, when APRA first began tightening lending standards ahead of imposing the 10% investor growth cap, IOLs grew as a proportion of new mortgages from 30% to 45%, Ord Minnett notes. When the restrictions were imposed, that level fell back to 35%, however the recent resurgence in investor demand has seen a return to a level of 40%.

APRA has now imposed a growth cap on new IOLs of 30%.

The GFC came about largely as a result of the collapse of the US housing market, but the Australian housing market was not an innocent choir boy either. As is typical in boom times, bank lending standards were lax, and in order to compete with each other then banks continued to offer loans requiring lower and lower levels of deposit, in other words loans with high loan-to-value ratios (LVR). Citi notes the proportion of loans with LVRs of 80% or above has halved from 40% pre-GFC to 20% now.

But that's still 20%. And the risk of a low deposit, or high LVR, is compounded if that loan is also interest-only. To that end, APRA has added to its IOL 30% growth cap by insisting strict internal limits must be placed by banks on IOLs with LVRs of 80% or greater and "justification" has to be provided for loans with LVRs of 90% or more.

Furthermore, banks have been urged to review mortgage serviceability (the capacity of the borrower to make monthly payments) to ensure buffers are appropriate for the current conditions.

And finally, while leaving the 10% cap on investor loan growth in general untouched, APRA has qualified that cap by insisting loan growth must be "comfortably below" 10%.

APRA is good on the qualitative stuff. Caps of 10% growth here and 30% there are indisputably quantitative, but exactly what is "comfortably below", how strict are "strict" internal limits and exactly what levels of serviceability are required?

And what, exactly, is meant by "unquestionably strong", with regard bank balance sheets? APRA threw that one out there a couple of years ago and has still not answered the question.

APRA Measures Please The RBA

The implication here is the banks must be proactive in tightening investor lending or else APRA will tighten the screws even further.

The RBA is pleased with the new measures APRA has imposed, to the extent of making note in yesterday's policy statement:

"Growth in household borrowing, largely to purchase housing, continues to outpace growth in household income. By reinforcing strong lending standards, the recently announced supervisory measures should help address the risks associated with high and rising levels of indebtedness. Lenders need to ensure that the serviceability metrics that they use are appropriate for current conditions. A reduced reliance on interest-only housing loans in the Australian market would also be a positive development."

RBA governor Philip Lowe continued to praise APRA's decision when making the speech at a board dinner last night:

"Like the earlier 'speed limits' on investor lending, these new requirements should help the whole system pull back to a more sustainable position. A reduced reliance on interest-only loans in Australia would be a positive development and would help improve our resilience. With interest rates so low, now is a good time for us to move in this direction. Hopefully, the changes might encourage a few more people to think about the merit of taking out very large interest-only loans when interest rates are near historical lows.

"So the RBA welcomes these latest changes."

So will investors, as Dr Lowe suggests, rethink the risks they are undertaking? The risk to the banks is that these latest measures substantially reduce further demand for investor loans.

Bank analysts do not believe demand will be substantially reduced, rather marginally reduced. UBS, for one, is assuming the reduction to 30% IOL growth from 40% will see half of the difference, being 5%, take on a P&I loan instead and only the other half giving the game away. The latter would likely be multiple property speculators relying on interest-only and high LVRs, UBS suggests.

Deutsche Bank expects a "large proportion" of prior IOL borrowers will switch to P&I instead. On that basis, and other brokers concur, APRA has come up with just the right formula. Risk will be reduced across lending books but bank earnings will not be significantly impacted as a result. Nor will new restrictions be the trigger for a housing market collapse. Deutsche is forecasting a reduction in loan growth of 5% in FY18 and 4.5% in FY19.

So how will this impact on bank earnings?

Time Will Tell

As Citi suggests, the measures are likely to further fragment the already dislocated market and they could prove to be either positive or negative. The need to comply with new IOL restrictions will provide the banks with further repricing opportunities, brokers attest, and thus another increase in net interest margins beyond that provided by recent repricing initiatives. On the other hand, demand for new loans will abate.

Citi believes it will be six to twelve months before the ultimate impact is clear. Among the Big Four, Commonwealth Bank ((CBA)) and Westpac ((WBC)) currently hold the highest level of IOLs, Macquarie notes, both close to 40%, while ANZ Bank ((ANZ)) is at 37% and National Bank at 32%. Hence NAB has the easiest task among the four of cutting back to the new 30% restriction.

The next question is: will APRA's new measures actually work? The prior 10% cap on investor loan growth in general only worked for a brief period.

Morgan Stanley believes APRA's measures reflect a level of caution and could struggle to have a sustained impact on investor lending growth or the rise in household leverage. However, there was clearly an upswing in investor activity over the summer, the analysts note, and investor appetite should be tempered by the banks' recent repricing of mortgages and the rationing of IOLs that is to come.

UBS suggests that if these new measures don't lead to a slowing in Sydney-Melbourne house price rises, further policies may be implemented, such as higher capital requirements for riskier loans. Morgan Stanley goes a step further:

“Looking further out we see it as very likely that the next (more permanent) round could be through increases to risk weights for investor lending, potentially as soon as mid-year.”

It is at this time the broker believes APRA will finally qualify “unquestionably strong” capital requirements, despite the negotiations over new Basel IV requirements being beset with disagreement and delays.

Morgan Stanley is also concerned that the level of restrictive measures continues to build as the housing cycle begins to show signs of stress, citing recent stories in respected publications such as “Brisbane apartments offered at 39pc discount in disputed fire sale” and “Off-the-plan buyers seeing losses and lacklustre growth”.

Macquarie is of a similar mind, believing ongoing tightening of lending standards, coupled with a rising global rates outlook, suggests near term risk around the housing market appears to be increasing. Because of this risk, and given relatively full bank valuations, Macquarie remains Neutral on the sector.

Citi remains cautious, given the recent rally in bank shares prices driven by the round of mortgage repricing.

Morgan Stanley is Underweight the banks, noting valuations are at a peak while growth seems hard to come by. The broker also advises limited exposure to those other sectors impacted by a housing slowdown – developers, building materials and consumer discretionary.

Overvalued?

FNArena last published an update on the banking sector on March 23 (Australian Banks: Risks And Valuations), in the wake of earnings updates and prior to the recent round of mortgage repricing. At that point, bank share prices were trading 4-6% above consensus target prices.

In FNArena’s experience, when the banks start to pull away from target prices a correction will inevitably follow, unless analysts are given cause to raise their target prices. Bank share prices are no higher than they were, in a response to said mortgage repricing. But analysts have also responded by raising their targets.

The net result is bank share prices are still 4-6% above consensus targets.

Technical limitations

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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 March 27 to Friday March 31, 2017 Total Upgrades: 3 Total Downgrades: 5 Net Ratings Breakdown: Buy 43.90%; Hold 42.21%; Sell 13.89%

The week ending Friday, 31st March 2017, generated more stockbroker downgrades than upgrades for individual ASX-listed stocks; five down against three up. All upgrades ended at Neutral, but then three out of five downgrades only went down to Neutral as well. Two of such downgrades were reserved for Tox Free Solutions.

Dulux Group and Metcash were the only ones to receive a downgrade to (an equivalent of) Sell.

It was fairly quiet in terms of changes to stockbroker price targets as well. WiseTech Global stands firm on top of the week's table for positive revisions, but it only took a gain of 2.8%. The other three gainers for the week are hardly worth mentioning.

Even less action was shown on the negative side. GWA was worst off with a price target decline of -2.39%.

Out-of-season financial reporting meant a little more action in terms of adjustments to earnings forecasts. Brickworks crowned itself top achiever for the week, enjoying an average gain of +18.5%, followed by Sigma Pharmaceuticals (+14.15%) and FAR ltd (+6%).

On the other side of the ledger we find Syrah Resources receiving a blow of -29.1%, followed by AusNet Services (-6.7%) and Iluka Resources (-5.5%).

Investors' and stockbroking analysts' attention will now shift to local banks as share prices remain above consensus price targets and Bank of Queensland's result turned out weaker than expected, though management had a positive outlook for the market.

Upgrade

BANK OF QUEENSLAND LIMITED ((BOQ)) Upgrade to Hold from Lighten by Ord Minnett .B/H/S: 1/6/1

First half earnings underwhelmed Ord Minnett but are believed to be a low point in the earnings trajectory, with improved prospects for margins, volumes and costs.

The broker expects the bank to look for further cost savings with FY17 result and now believes the risk/reward balance is more appropriate.

Ord Minnett raises its recommendation to Hold from Lighten. Target is $11.00.

SENEX ENERGY LIMITED ((SXY)) Upgrade to Neutral from Sell by Citi .B/H/S: 3/3/0

Last month, Citi downgraded to Sell because the share price was too high. Following a retreat, the analysts have decided it is time to upgrade to Neutral/High Risk.

Senex should be one of main beneficiaries from a tight domestic gas market, over time, through its Western Surat Gas Project, predict the analysts. They also think it is too early to pay up for that prospect just yet. Target unchanged at 35c.

WESTERN AREAS NL ((WSA)) Upgrade to Neutral from Sell by UBS .B/H/S: 1/5/1

UBS updates its valuation to include the Odysseus pre-feasibility study. The broker notes potential for mine life to be extended towards 10 or more years.

The broker believes the market has previously provided no value for this project and, given how short the market is on the stock, there is growing risk to the upside.

UBS upgrades to Neutral from Sell, believing the risk/reward is more balanced. Target is raised to $2.58 from $2.38.

Downgrade

DULUX GROUP LIMITED ((DLX)) Downgrade to Sell from Neutral by UBS .B/H/S: 0/4/4

There's no doubting Dulux' superiority and solid market share in paint, and as such the stock deserves a premium multiple, UBS suggests. But the non-paint business continues to show subdued prospects and a turnaround seems some way off.

A cooling in the housing market also suggests paint earnings may have seen a peak. On 7% outperformance against the index in the past month, UBS downgrades to Sell, retaining a $6.10 target.

METCASH LIMITED ((MTS)) Downgrade to Lighten from Hold by Ord Minnett .B/H/S: 3/1/2

Ord Minnett reviews its investment thesis and downgrades to Lighten from Hold. The broker does not believe the stock price adequately reflects the risks associated with the food & grocery division.

The broker acknowledges the benefits from cost savings and the upside from the hardware division as well as a strongly performing liquor business.

Earnings per share forecasts are modestly raised and the target lifted to $2.10 from $2.00. Nevertheless, the broker believes the risk-reward equation is not attractive post the recent share price performance.

SUNCORP GROUP LIMITED ((SUN)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 4/3/1

Macquarie assesses that premium rate increases across the insurance market are being led by claims cost inflation. As insurers get costs under control price rises should again moderate across of market, in the broker's view.

The broker downgrades expectations for Suncorp's gross written premium growth based on its analysis. Rating is downgraded to Neutral from Outperform. Target is reduced to $13.60 from $14.33.

TOX FREE SOLUTIONS LIMITED ((TOX)) Downgrade to Neutral from Outperform by Macquarie and Downgrade to Equal-weight from Overweight by Morgan Stanley .B/H/S: 0/4/0

The company's waste services contract with Chevron will cease by the end of FY17. Macquarie notes this was the largest contract during the peak of construction. The company retains its contract with the balance of Chevron operations.

The loss of this particular part of the contract will affect FY18 EBITDA by -$1-2m. The broker downgrades to Neutral from Outperform, requiring earnings estimates to stabilise to put a floor under the share price.Target is raised to $2.45 from $2.42.

The loss of a Chevron contract suggests to Morgan Stanley margin pressure in the resources market continues. The broker envisages the trough in earnings per share will be pushed out to FY18 and, although earnings quality is improving, the valuation now appears full.

That said, the broker notes the company's resources exposure continues to reduce and the initial performance of Daniels appears on track. Morgan Stanley downgrades to Equal-weight from Overweight and reduces the target to $2.25 from $2.75. Industry view: In-line.

Total Recommendations Recommendation Changes

Broker Recommendation Breakup

Broker Rating Order Company New Rating Old Rating Broker Upgrade 1 BANK OF QUEENSLAND LIMITED Neutral

Sell Ord Minnett 2 SENEX ENERGY LIMITED Neutral Sell Citi 3 WESTERN AREAS NL Neutral Sell UBS Downgrade 4 DULUX GROUP LIMITED Sell Neutral UBS 5 METCASH LIMITED Sell Neutral Ord Minnett 6 SUNCORP GROUP LIMITED Neutral Buy Macquarie 7 TOX FREE SOLUTIONS LIMITED Neutral Buy Macquarie 8 TOX FREE SOLUTIONS LIMITED Neutral Buy Morgan Stanley Recommendation Positive Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 SXY SENEX ENERGY LIMITED 50.0% 33.0% 17.0% 6 2 EVN EVOLUTION MINING LIMITED 100.0% 86.0% 14.0% 7 3 MQA MACQUARIE ATLAS ROADS GROUP 67.0% 60.0% 7.0% 6 4 LNK LINK ADMINISTRATION HOLDINGS LIMITED 25.0% 20.0% 5.0% 4 Negative Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 WTC WISETECH GLOBAL LIMITED 33.0% 50.0% -17.0% 3 2 SUN SUNCORP GROUP LIMITED 31.0% 44.0% -13.0% 8 3 DLX DULUX GROUP LIMITED -50.0% -38.0% -12.0% 8 4 GWA GWA GROUP LIMITED -60.0% -50.0% -10.0% 5 5 MTS METCASH LIMITED 7.0% 14.0% -7.0% 7 6 PPT PERPETUAL LIMITED -14.0% -13.0% -1.0% 7 Target Price Positive Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 WTC WISETECH GLOBAL LIMITED 5.617 5.463 2.82% 3 2 EVN EVOLUTION MINING LIMITED 2.546 2.504 1.68% 7 3 MTS METCASH LIMITED 2.263 2.241 0.98% 7 4 MQA MACQUARIE ATLAS ROADS GROUP 5.508 5.480 0.51% 6 Negative Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 GWA GWA GROUP LIMITED 2.528 2.590 -2.39% 5 2 SUN SUNCORP GROUP LIMITED 13.635 13.726 -0.66% 8 3 LNK LINK ADMINISTRATION HOLDINGS LIMITED 8.253 8.292 -0.47% 4 Earning Forecast Positive Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 BKW BRICKWORKS LIMITED 123.750 104.400 18.53% 4 2 SIP SIGMA PHARMACEUTICALS LIMITED 6.730 5.896 14.15% 4 3 FAR FAR LIMITED -0.397 -0.423 6.15% 3 4 SGM SIMS METAL MANAGEMENT LIMITED 68.637 67.209 2.12% 7 5 SYD SYDNEY AIRPORT HOLDINGS LIMITED 15.725 15.492 1.50% 7 6 EVN EVOLUTION MINING LIMITED 18.224 18.067 0.87% 7 7 QAN QANTAS AIRWAYS LIMITED 55.601 55.351 0.45% 7 8 MTS METCASH LIMITED 19.354 19.269 0.44% 7 9 PMV PREMIER INVESTMENTS LIMITED 71.078 70.778 0.42% 6 10 WBC WESTPAC BANKING CORPORATION 238.775 237.788 0.42% 8 Negative Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 SYR SYRAH RESOURCES LIMITED -4.436 -3.436 -29.10% 4 2 AST AUSNET SERVICES 7.315 7.840 -6.70% 7 3 ILU ILUKA RESOURCES LIMITED 8.482 8.982 -5.57% 7 4 FBU FLETCHER BUILDING LIMITED 50.427 52.434 -3.83% 6 5 FMG FORTESCUE METALS GROUP LTD 115.650 119.324 -3.08% 8 6 MQA MACQUARIE ATLAS ROADS GROUP 31.282 31.842 -1.76% 6 7 SBM ST BARBARA LIMITED 29.500 29.833 -1.12% 3 8 ALQ ALS LIMITED 22.401 22.651 -1.10% 7 9 SUN SUNCORP GROUP LIMITED 88.814 89.557 -0.83% 8 10 TPM TPG TELECOM LIMITED 48.014 48.389 -0.77% 8 Technical limitations

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Uranium Week: Soft Month

By Greg Peel

The Japanese nuclear industry was on the winning side for once last week, with two court rulings going in favour of idled reactors.

The Osaka High Court dismissed an injunction that had left Kansai Electric's Takahama units 3 and 4 unable to operate despite having been cleared for restart by the regulator. The reactors are now expected to restart within a month or so.

Meanwhile a district court has dismissed an injunction request from local residents to shut down Shikoku Electric's Ikata unit 3, which was restarted last August to bring the number of operating Japanese reactors to five (notwithstanding scheduled maintenance shutdowns).

The news out of Japan was nevertheless not all good last week. Nuclear reactor construction firm Westinghouse Electric Co, which is a division of Toshiba, has filed for bankruptcy with fiscal year losses totalling potentially in excess of US$9bn. Increasing costs of construction in the US have been blamed. Toshiba will nevertheless continue to build reactors outside of the US.

Uranium industry consultant TradeTech reports the month of March saw a pick-up in demand interest from utilities looking for medium and longer term delivery contracts, but such demand interest did not translate into the spot market. Indeed, last week saw only two spot market transactions recorded for a total of 200,000lbs U3O8 equivalent.

With utilities largely absent, spot trading has been the domain of intermediaries and speculators of late, and low volumes have led to price volatility. TradeTech's weekly spot price indicator ended March at US$23.25/lb, down -US75c from a week earlier and -US50c from end-February. In the year to date, spot transactions have actually increased in number by 15% over the same period last year to 68, but volumes are down -1.2%.

The spot price fell -7% over the month of March but remains +15% higher for the year. The month saw a total of 21 transactions representing around 2mlbs U3O8 equivalent.

The Short Report

Guide:

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

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

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

Summary:

Week ending March 30, 2017

Last week saw the ASX200 rally up to 5900 before meeting resistance, fuelled to a great extent by a flood of dividend payments that needed reinvestment.

There were some sizeable moves at the top of the 10% plus table last week but not enough to much shuffle around the top five most shorted stocks. Orecobre ((ORE)) shorts rose to 20.1% from 19.1% and Syrah Resources ((SYR)) shorts to 15.3% from 13.9%, while shorts in Western Areas ((WSA)) fell to 17.6% from 18.8%, Aconex ((ACX)) to 16.6% from 17.6% and Myer ((MYR)) to 13.1% from 14.7%.

The shorters continue to build positions around the battery theme (Orocobre, Syrah) while Myer continues to fall on speculation Solomon Lew's Premier Investments ((PMV)) may be priming for a takeover.

On the subject of takeovers, last week saw Spotless Group ((SPO)) fall out of the 5% plus table altogether, from 6.5%, as one might expect following the sizeable bid from Downer EDI ((DOW)). Downer shorts have fallen to 5.0% from 8.6% on a steep drop in share price.

One might have expected Debbie would have done Ardent Leisure ((AAD)) no favours, but Ardent, too, is now the subject of takeover speculation. Ardent shorts jumped to 8.6% last week from 6.4%.

I noted last week that Harvey Norman ((HVN)) had suddenly appeared in the table at 7.4% shorted having come from oblivion. Last week had Harvey shorts at 8.0%. With a bullet?

Weekly short positions as a percentage of market cap:

10%+

ORE 20.1 WSA 17.6 ACX 16.6 SYR 15.3 MYR 13.1 QIN 11.4 VOC 11.4 NEC 10.8 DMP 10.6 MTS 10.2 MYX 10.0

In: MYX Out: IGO

9.0-9.9%

ISD, IGO In: IGO Out: MYX, OFX

8.0-8.9%

OFX, ILU, PRU, AAD, BAL, FLT, HVN

In: OFX, AAD, BAL, HVN Out: DOW, NWS

7.0-7.9%

GTY, NWS, RWC, NXT, MND, BGA

In: NWS, BGA Out: BAL, HVN, A2M

6.0-6.9%

IPD, A2M, RFG, EHE, BDR, CSV, HSO, SGH, IFL, PDN, KAR, MYO, MTR, JHC, MSB

In: A2M, JHC Out: AAD, BGA, SPO, GXL, IVC, BEN

5.0-5.9%

CTD, GXL, SEK, AAC, AWC, RIO, IVC, BEN, CSR, BKL, OSH, AWE, WOR, LNG, SUL, DOW

In: DOW, GXL, IVC, BEN

Out: JHC, SRX

Movers and Shakers

Diversified contractor Downer EDI made a takeover bid for catering (among other things) company Spotless Group at a substantial premium and as is typically the case in a takeover situation, the share price of the target soared and of the suitor fell. In this case Downer shares fell quite hard, given analysts could not come up with anything positive to say about the move.

As we might expect, shorters of Spotless had to scramble to cover hence shorts in the company have now fallen to below 5% from 6.5% prior. We can only assume that the sharp fall in Downer's share price was sufficient to prompt profit-taking among shorters given Downer shorts have fallen all the way to 5.0% from 8.6%.

Or maybe the ASIC data is wrong. We'll keep an eye out next week.

Having suffered the tragedy at Dreamworld, then surprising the market with weak results from its flagship Main Event business in the US, you'd think the last thing Ardent Leisure needed was a tropical cyclone and Gold Coast floods. But Ardent shares rose 15% last week.

The reason is a move by property investor Ariadne Australia ((ARA)) on Ardent's register, taking the company's stake to over 6%. Naturally this sparked takeover speculation, prompting the subsequent jump in share price.

Ariadne has hosed down suggestions of a takeover, preferring, apparently, to work closely with Ardent's board. Solomon Lew initially denied any interest in Myer as well. It appears the shorters are taking Ariadne on its word as they has increased, rather than covered, shorts in Ardent to 8.6% from 6.4%.

ASX20 Short Positions (%)

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

IMPORTANT INFORMATION ABOUT THIS REPORT

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

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

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

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

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

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

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

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

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The Wrap: TV, Supermarkets, Banks And Gold

Free-To-Air TV; supermarket chains; regional banks; global gold; Credit Suisse's Asian Investment Conference.

-SWM and TEN difficult investment propositions for Credit Suisse -Woolworths turnaround suggests sales growth might exceed Coles -Regional bank outlook envisaged improving for the second half -Goldman Sachs returns Newcrest to the major league of gold companies -Credit Suisse comfortable being overweight commodity stocks after conference

By Eva Brocklehurst

Free-To-Air TV

Credit Suisse believes a shake-up in the free-to-air television industry is looming. Ten Network's ((TEN)) financial position appears increasingly difficult. The company expects an operating earnings (EBITDA) loss of -$20-30m in FY17 and its bank facility expires at the end of December.

The broker forecasts the TV ad market to decline, while Ten's ratings have weakened early this year and the step-up that is likely in the cost of Big Bash cricket rights could add to the pressure.

The broker suspects the company will have to make some strategic changes to try and return to profitability, and doubts the backers will want to invest further in programming in a declining market. Credit Suisse considers the company's shares as un-investable for most investors and has a Neutral rating and $0.55 target.

The broker believes Seven West Media ((SWM)) will benefit from any decline in Ten's revenue share. Nevertheless, this stock remains a difficult investment proposition because of its print exposure and relatively high debt levels. Neutral retained. Target is $0.81.

Credit Suisse suggests Nine Entertainment ((NEC)) is the best way to play the TV theme. The broker estimates there is potential for a 2-4.5% uplift in sustainable market share above current forecasts.

Therefore, there is a possible $55-120m in upside to longer-term earnings. This would add $0.30-$0.70 per share to the valuation. Credit Suisse has an Outperform rating and $1.50 target for Nine.

Supermarkets

Citi suspects like-for-like sales growth at Woolworths ((WOW)) is likely to exceed Coles ((WES)) for the next six months. The main debate for both supermarkets is the long-term earnings outlook. From its analysis, Citi concludes that Woolworths should be able to sustain a 5.5% earnings margin, versus Coles at 4.9%, by FY20.

The broker expects gross margins at Woolworths to expand to 28.9% by FY20, driven by lower levels of stock losses, range rationalisation and better buying terms, offset by price investment. This is in stark contrast to Coles, where price investment is lowering gross margins.

Citi has resumed coverage of Woolworths with a Neutral rating and $27.40 target. The broker believes the chain is in the early stages of a multi-year recovery and momentum should surprise to the upside over the next six months. The broker retains a clear preference for Woolworths over Wesfarmers, for which it has a Sell rating and $42.30 target.

UBS also finds tangible signs of a turnaround at Woolworths after its latest survey. Traffic, spending and overall customer perception have all improved. Moreover, Coles, Aldi and IGA ((MTS)) all softened across key customer spending drivers versus the broker's prior survey in June 2016. This is been largely to the benefit of Woolworths.

UBS continues to believe the risk of a price war is waning but, if momentum at Coles slows further in the current quarter, when softer comparables are cycled, the risk increases. The survey suggests 2-4% upside risk to Woolworths' FY17 earnings per share estimates.

Regional Banks

Goldman Sachs believes the outlook for regional banks is healthier in the second half. The broker envisages better prospects for volume momentum and a spot margin environment which is much improved on the first half. There is nothing in the forward-looking measures which suggest a surprise in terms of negative asset quality.

Once APRA delivers its "unquestionably strong" announcements in coming months, Goldman Sachs believes there will be greater clarity on the prize that is gained from advanced accreditation. Suncorp's ((SUN)) bank is well placed for such an environment, the broker suggests, given its more robust revenue growth trajectory and more sustainable cost reduction opportunities.

Goldman Sachs believes that Bank of Queensland ((BOQ)) is fairly valued at current levels and there is further downside for Bendigo and Adelaide Bank ((BEN)). The broker does not believe the current price/earnings ratio adequately reflects that bank's Homesafe risks and the weak capital position.

Global Gold

Goldman Sachs observes the reward for Newcrest Mining ((NCM)) turning around its operations and balance sheet in the past three years has been a return to the major league of gold companies. The broker believes the stock now provides a credible alternative to Barrick, Newmont and Goldcorp for global gold investors.

The broker also believes long mine life is a less tangible, but equally crucial, part of the investment thesis. Of the 36 assets owned by the big four gold miners only four have a mine life of more than 20 years, and two of those are owned by Newcrest - Cadia and Lihir. Of the remaining 32, only five have life of more than 10 years, which illustrates the scarcity of mine life amongst gold assets.

While many argue the lack of asset diversification is a potential negative for Newcrest, Goldman Sachs asserts this is generally only a valid point when assessing investment appeal, and having an asset of the quality of Cadia makes the issue irrelevant.

Asian Investment Conference

Credit Suisse found plenty of news that was relevant to Australian investors at its annual Asian Investment Conference. The consensus from the conference was to be underweight Australian equities and Australian now ranks in the bottom three markets in the region after being in the top four last year.

Despite this, the broker notes investors were bullish or neutral on sectors that make up 55% of the Australian market i.e. financials and materials. The main concern was a rise in trade protectionism by the US, whereas last year the biggest concern was excessive leverage in China.

The broker notes Chinese developers were in a positive frame on mine starts but more cautious on prices and sales for 2017. Tightness in steel and coal supply may cause prices to overshoot this year, the broker contends.

Meanwhile the development of a Western-style healthcare system in China may involve outbound mergers & acquisitions. Also, international travel by Chinese is expected to continue rising substantially, driven by wealth creation in the tier-3 cities. Large road projects are set to launch in Malaysia and Pakistan as well.

Credit Suisse came away from the conference comfortable with an overweight position in commodity stocks. Economic growth is expected to remain strong and go beyond China's borders, and this should be positive for Australian companies with businesses abroad.

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New Website: A Sophisticated Search Engine

"Search Stocks & Stories" it reads on the far right of the FNArena website. Behind the simple looking, rectangular input field attached to a blue button that says "Search" hides a wealth of information for the investor looking to broaden his insights on a specific topic, sector or ASX-listed company.

Type in "LNK" (for Link Administration Services) and a page appears showing "Most relevant stocks from your search", which, in this case, means you have been directed to Link, but also to Macquarie Group (MQG), AMP (AMP) and Perpetual (PPT). Further below are "Related Stocks" which includes the likes of Bravura Solutions (BVS), Class (CL1), GBST (GBT) and Iress Market Technology (IRE).

This all makes a lot of sense if one considers Link is far more than simply IT, or a software services company, or a shareholders registery, a definition most commentators and labeling services elsewhere would use for the company. As a major back office services provider for super funds and professional funds managers in Australia, FNArena thinks showing Link in connection with Macquarie, Bravura and Iress is a far more accurate environment for investors researching this company and its shares.

To be able to offer this level of sophistication, FNArena has developed its own corporate sectors structure and proprietary algorithms, and both are subjected to regular reviews and amendments. This should ensure that investors looking for in-depth research into the companies of their interest will find the Search facility on the FNArena website is the ideal starting point.

News stories and broker updates that populate Search results stretch out more than ten years. Results are ranked by "relevancy" (again, another algorithm), though settings can be changed to rankings per "date" if that suits better.

To accommodate easier and higher quality researching, Search outcomes include direct access to FNArena's Stock Analysis, not just for the ASX code entered, but for all related peers.

So if you agree that "Amcor" and "BHP Billiton" have very little in common, even though both are included in the S&P/ASX 200 Materials index, and that Seek (SEK), Carsales (CAR) and REA Group (REA) should no longer be grouped together simply because they all originate from what once were print media's "rivers of gold', than you are likely going to enjoy researching your stocks, and the share market, through the FNArena Search engine.

Do note this very much remains work-in-eternal-development. All feedback for further improvements and adjustments are at all times appreciated and welcome.

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ERM Power Turns Up Voltage On Guidance

Success with its strategy has meant power retailer and generator, ERM Power, is able to upgrade guidance for FY17 and provide a better-than-expected outlook for FY18.

-Reduced competitive pressure as wholesale electricity prices rise -Benefit from in-the-money contracts and hedge book -Brokers envisage long-term value if pricing and offtakes align

By Eva Brocklehurst

Power retailer and generator, ERM Power ((EPW)), has pulled off a win in the complex and volatile electricity market. The company has revised its FY17 gross margin outlook to $3.50/megawatt hour from $3.00/MWh and provided FY18 guidance of $3.50/MWh.

This FY18 guidance compares with Macquarie's original estimate of $2.70/MWh. The broker finds predicting the company's retail business challenging, as visibility is low and a function of the company's hedge book. In just one month, following first half guidance, there has been a positive swing of around $9m pre-tax. As load contracts are already written, the primary variable is the cost of supply.

The broker suspects the company has obtained a benefit of being long power over the Queensland summer and that it covered some of the Callide C coal-fired power station hedge when one of the participants went into administration, but with the hedge actually not being closed out. Macquarie estimates the gain could be as much as $4-5m.

The other driver of the improved guidance, the broker suspects, is likely to be the hedge book, which has performed favourably relative to customer demand and market volatility. What is less clear is how the guidance affects later years, which will be a function of contracting.

Over the medium term, Macquarie's forecast remains at the lower end of the company's annualised $2.60-4.00/MWh gross margin range. The upside offset will emerge if the capital intensity of the business diminishes. All up, Macquarie finds enough positives to upgrade to Neutral from Underperform. The broker calculates a minimal premium is being paid for the stock.

Citi also upgrades, to Buy/High Risk from Sell/High Risk. The broker believes the guidance upgrade is because of reduced competitive pressure in the commercial and industrial (C&I) market as wholesale electricity prices rose, while volatile prices created opportunities within the hedge book, with the company coming out ahead.

The exit from administration of a party to the Callide C joint venture means ERM obtains cheap wholesale purchase contracts, struck before the recent run-up in electricity prices, versus much higher current costs. The broker believes the company's strategy has paid off, with high electricity prices and state government support continuing to move renewables projects forward.

That said, Citi cautions that this is not always the case and cost blow-outs are experienced every once in a while, but at this point in time the risk is well factored in at current share prices.

Morgans agrees that ERM's prior outlook would have presumed, prudently, that the electricity hedge contracts from Callide C with the counter-party in administration would cease. As this appears not to be the case, the broker expects the company to be significantly in the money as a result of the substantial increase in forward electricity hedge prices.

Hamilton

The 57MW Hamilton solar project has reached final investment decision and Citi suspects this could add 15% per annum to free cash flow once it operates. If the company can sign a further 250MW of offtake, as planned, for five years, this could add a further $0.25 per share to the broker's valuation.

Value

Citi envisages long-term value in the stock and further upside risk, if pricing and timing on renewable offtakes align with expectations for the delivery of US margin/volumes that are ahead of the broker's conservative estimates.

Citi lifts FY17 operating earnings (EBITDA) estimates by 13% by linking to the company's updated Australian gross margin guidance. The broker rates the stock high risk to reflect its low interest cover because of off-balance sheet finance that supports the retail business.

While this finance can be supported by earnings, there are risks to valuation from retail competition, commercial electricity demand and wholesale electricity prices. Also, if the company can no longer pay a third party to provide security to electricity market operators in the US this could materially increase the capital required by the business.

Morgans believes there is potential upside surprise to the dividend and the solid dividend yield may be enticing for some income investors. Nevertheless, uncertainty surrounds a number of key value drivers such as the sustainability of the gross margin, the maturity of the Australian C&I book and growth in the US retail initiative. If a track record of delivering earnings growth is developed and there are further positive earnings surprises Morgans expects a share price to respond positively.

History

ERM Power operates in three business segments: electricity sales, power assets, and other energy solutions. Historically, the business is Australian but in 2015 the company entered the US retail electricity market by acquiring Source Power & Gas in Texas.

There is one Buy rating (Citi) and two Hold ratings on FNArena's database. The consensus target is $1.30, suggesting 1.2% upside to the last share price. Targets range from $1.20 to $1.46. The dividend yield on FY17 forecasts is 6.4% and on FY18 forecasts 6.2%.

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88 Energy Primed For Alaskan Venture

Oil and gas explorer 88 Energy has captured the attention of DJ Carmichael as it begins an extensive exploration program in Alaska.

-Encouraging results from de-risking of the Icewine project -Icewine#2 to be spudded in the second quarter 2017
-Generous incentives for Alaskan explorers

By Eva Brocklehurst

88 Energy ((88E)), an oil and gas explorer, has begun a comprehensive exploration and appraisal program in its Alaskan Holdings and DJ Carmichael researchers take a closer look at the stock.

The company has a 77.5% working interest in over 271,119 gross acres on the Alaskan central North Slope. North Slope is one of the last remaining significant oil shale plays in the US. The company is partnering with US-based Burgundy Xploration which is headed by Paul Basinski, a key player in the discovery of the prolific Eagle Ford shale in Texas.

There have been encouraging results in the de-risking of the Icewine project, which is located 35 miles south of Prudhoe Bay and in proximity of very large conventional oil discoveries. The company has determined, from the Icewine #1 core testing program, that the rock mechanics of the shales are conducive to fracturing.

The key to success in extracting liquids from shale is that the oil moves through the newly created fractures towards the well bore. The lower the viscosity of the oil, the easier it will be to move it under pressure, and that improves recoveries and results in improved well economics.

The company believes the ground has potential for conventional accumulations of oil and is working to mature promising leads into drill targets. A comprehensive 2D seismic survey was recently completed and the company subsequently announced it had identified a potential 1.14bn barrels of net mean un-risked prospective resources. Several of these leads could be stacked as a play, which would allow for the testing of multiple zones from a single well.

Icewine #2

Icewine #2 is a vertical well and spudding is set for the second quarter in 2017. After drilling, the well will be hydraulically stimulated and flow tested. The primary purpose of this well is to hydraulically stimulate the HRZ/Hue interval to test if it is possible to produce hydrocarbons and increase the dataset. The company estimates will take 30-40 days to drill, log and conduct micro stimulation. Flow test results are expected mid 2017.

Value

A capital raising of $17m was undertaken recently, which adds to a cash balance of $43m. DJ Carmichael values the stock at 8.5c a share and initiates coverage with a Speculative Buy rating.

Because of the high fixed capital cost of an unconventional development, small changes in the oil price can have a big impact on the project value. At an oil price of US$55 a barrel on the analysts assumption the project is worth US$1.1bn on an un-risked basis. An oil price of US$48/barrel is the break-even spot in the scenario. Hence, if oil retreats to its mid 2016 lows the project will not be economic.

While the stock is compelling, in DJ Carmichael's view, from a technical and market perspective, it remains a high-risk play. Several of the key risks, such as rock mechanics and flow rates, should be addressed through the drilling and the hydraulic fracturing of Icewine#2. Nevertheless, Alaska is a high cost environment because of its weather conditions and remoteness, and while costs have fallen it is unlikely that costs will be the same as in the lower states of the US.

Background

DJ Carmichael notes that oil production has been on a long-term decline in Alaska because of the maturity of the Prudhoe Bay fields. To offset this trend by attracting explorers to the region and help offset the high cost of exploration, the state government has historically offered very generous incentives to companies.

The refunding of a large portion of exploration costs on the slope has proven to be an attractive incentive for explorers, especially to smaller players with small balance sheets, the analysts observe.

The company's area of exploration is situated within a favourable infrastructure setting, with the Icewine project astride the Dalton Highway and the Trans-Alaskan Pipeline System. TAPS passes through the acreage and includes pumping stations. The pipeline is underutilised as oil production Alaska has fallen over the years, which will allow for exports directly from the field to Valdez in the south where the pipeline terminates.

Galaxy's Mt Cattlin Hitting Targets

Lithium producer Galaxy Resources has made a positive impression on Canaccord Genuity after a site visit to Mt Cattlin.

-Improvements being contemplated could lift production towards 240,000 tpa -Crushing feed is finer than desired and could lead to higher yields -Will demand be strong enough to incentivise Sal de Vida development?

By Eva Brocklehurst

Lithium producer Galaxy Resources ((GXY)) has made a positive impression on Canaccord Genuity (Australia) after a site visit to the Mt Cattlin operation in Canada.

The main operating parameters of the mine are running in line with expectations and the broker considers production guidance of 160,000 tonnes per annum is achievable, based on conservative recovery assumptions.

Improvements currently being contemplated could lift production towards 240,000tpa. These include optical ore sorting to lift concentrate grades, recovery of spodumene from DMS middlings that are currently being stockpiled, and treatment of fines material via lower cost screening.

Canaccord Genuity expects the June quarter will be more representative of a steady-state cost profile and, in the interim, incorporates a higher strip ratio and higher processing costs into assumptions. This increases life-of-mine average production cost estimates to $430/t concentrate.

Plant Throughput

The plant has reached 90% of nameplate in terms of throughput and the broker currently models 32,500 tonnes of spodumene concentrate for the March quarter. The broker believes reaching design throughput rates of 210 tonnes/hour within the coming months is a realistic expectation.

The company has also indicated that feed from the contract crushing is finer than desired, which if optimised could lead to increased yields through capturing "near size" material that is currently delivered to the middlings product stockpile.

The tantalum circuit is largely unaltered. The broker continues to assume tantalum pricing of US$60/lb, with revisions to production estimates resulting in by-product revenue percentages decreasing to 11-12% from 15%. Similarly, this would lead to a -$30/t reduction in estimated by-product credits.

Based on the revisions to production forecasts and cost estimates, the broker's project net present value falls by -3% to $708m, taking overall net asset value down by -3% to $0.72 per share. The broker has a Buy rating and $0.75 target. Canaccord Genuity (Australia) Limited has received a fee as the lead manager to the Galaxy Resources placement which raised $61 million in February 2017.

The company made its first shipment of spodumene concentrate in January 2017. Galaxy Resources has secured offtake of 120,000t of spodumene for 2017 at a 5.5% lithium benchmark price of US$830/t with a $15/t bonus for every 0.1% of lithium above the specification. A US$40m debt facility will provide working capital and refinance the outstanding $16m of the pre-existing debt facility.

Sal de Vida

Macquarie, while noting the successful re-design and re-commissioning of Mount Cattlin and expectations of a large amount of new supply over the near term, questions whether the longer term demand conditions will be strong enough to provide an incentive for the construction of the company's other project, Sal de Vida in Argentina.

The company is preparing site works for Sal de Vida, which is one of the world's largest and highest quality undeveloped lithium brine deposits. The broker values that project at $0.10 per share. Macquarie has an Underperform rating and $0.46 target.

James Bay

The company also has a lithium pegmatite project at James Bay, Quebec, which contains indicated resources of

11.75m tonnes grading at 1.3% lithium dioxide.

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SMSFundamentals: Can An SMSF Invest In Gold?

SMSFundamentals is an ongoing feature series dedicated to providing SMSF trustees with valuable news, investment ideas and services, in line with SMSF requirements and obligations.

For an introduction and story archive please visit FNArena's SMSFundamentals website.

By Eleanor Tjondro, Townsends Business & Corporate Lawyers

Can an SMSF invest in gold?

Gold jewellery and gold coins/medallions will certainly come under the stricter rules prescribed by SIS Regulations

A recent client enquiry led us to take a closer examination of whether an SMSF can invest in gold.

A recent client enquiry led us to take a closer examination of the types of assets an SMSF can invest in. The enquiry concerned the acquisition of gold as an allowable investment under superannuation laws.

To ascertain whether an SMSF can invest in gold, we firstly need to look at legislation governing SMSFs. These are: the Superannuation Industry (Supervision) Act 1993 ("the SIS Act") and the Superannuation Industry (Supervision) Regulations 1994 ("the SIS Regulations").

The investment must firstly comply with s62 of the SIS Act. This section refers to the sole purpose test: that the sole purpose of the SMSF is to provide retirement benefits to its members. If an investment does not provide such benefits, it will not be an allowable SMSF investment under superannuation laws.

The value of gold has the ability to increase over time, similar to investing in shares, and therefore it can be argued that it can provide retirement benefits for the SMSF's member.

Secondly, s109 of the SIS Act states that any investment transaction done by the SMSF must be at arm's length, that is, on a commercial basis. For example, an asset acquired by the SMSF must be purchased at market value, and not lower, to comply.

Furthermore, s62A of the SIS Act states that certain investments made, held or realised by the SMSF may come under stricter rules as prescribed by the SIS Regulations. The investments listed under s62A relate to items that are likely to be kept for personal use or enjoyment.

What is of interest here is the inclusion of 'jewellery' and 'coins and medallions' as gold can take those forms. Gold jewellery and gold coins/medallions will certainly come under the stricter rules prescribed by the SIS Regulations.

Gold in the form of jewellery is likely to be regarded as a personal use item and gold in the form of coins or medallions as a collectible. Both forms must comply with regulation 13.18AA of the SIS Regulations, which details how these items are to be to be stored if acquired as an SMSF investment. This is to ensure that the acquisition of these items appears, to a third party, to be a commercial transaction.

Gold in its basic physical form, such as gold bars, however, is unlikely to be subject to those stricter regulations. The fundamental rule would appear to be that if the form of the precious metal has a value separate from the raw price of the metal itself then it is most likely an item of personal use or a collectible. If on the other hand the value of the item is simply the spot price of the precious metal constituting the item then the item is not a personal use item or a collectable but simply an investment in precious metal.

Although superannuation laws do not prohibit investing in gold, this does not necessarily mean that your particular SMSF is able to. If your trust deed does not contain the relevant power to invest in precious metals, your SMSF is unable to invest.

It is extremely important that you carefully review your trust deed to ensure that the relevant investment power is there.

Finally, as trustee of an SMSF, you need to be aware of whether this investment is in line with your SMSF's investment strategy.

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Distributed by Chris Hocking Strategies

Quality Is Making A Come-Back

In this week's Weekly Insights:

-Quality Is Making A Come-Back -Sequel: Quintis Versus Californian Short Sellers -Conviction Calls: Bell Potter, Goldman Sachs, Shaw and UBS -New Website: A Sophisticated Search Engine -2016 - L'Année Extraordinaire -All-Weather Model Portfolio -Rudi On TV -Rudi On Tour

Quality Is Making A Come-Back

By Rudi Filapek-Vandyck, Editor FNArena

One swallow does not a summer make but it appears the upward trending share market in Australia became more inclusive in March in terms of high quality, premium priced corporate success stories.

Stocks like CSL ((CSL)), Ramsay Health Care ((RHC)) and Amcor ((AMC)) used to be the beez kneez, with everyone wanting to be on board, until mid last year when laggards turned into champions and vice versa, and all of a sudden nobody wanted to get on board anymore; everybody wanted to jump ship instead.

It has been a tough few months for yesterday's share market champions since. There was a brief recovery rally in December, but otherwise the post-Trump election rally has been all about banks, resources, and deep value cyclicals. Many an investor learned the hard way that industrial companies of exceptional quality like CSL and Ramsay might be the better performers in the long run, and through the cycle, but they do not perform always and all the time.

March seems to have changed the market's attention, at least a little bit. Consider, for example, that Amcor shares appreciated by more than 7% during the month. CSL added a further 6% on top of the +17% in the first two months. Pact Group ((PGH)) gained 5% and so did REA Group ((REA)). Bapcor ((BAP)) and Link Administration ((LNK)) are not far behind.

Ramsay's 0.2% gain doesn't look like much, but the shares made a remarkable come-back after plunging to $62.5 in the middle of the month.

Ex-dividends, the ASX200 advanced some 2.7% in March, or circa 3.6% including dividends. All of the above mentioned industrial All-Weather Stocks outperformed the broader market in March, which raises the question: what does it mean?

Why have investors again included expensive looking, more defensive-oriented growth stories when deciding where to allocate fresh money?

Is it because materials (read: mining stocks) and telecom stocks put in a rather disappointing performance? Is it maybe because all Big Four Banks are trading circa 6% above consensus price targets? Or is it because of the general pre-occupation with the ASX200 seemingly poised to sprint to 6000 and the but logical conclusion that the banks cannot possibly achieve this target on their own?

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Maybe some of the answers we are looking for can be found in recent surveys of institutional investors by Citi and by Goldman Sachs.

The Citi survey is limited to institutional clients of the international financial services provider in the USA. It shows institutional investors remain confident and positive, but less so than in December. The majority view seems to point to benign gains for the year ahead, with remarkably less emphasis on value stocks than in the initial phase of this rally.

In Australia, a survey into active fund managers by Goldman Sachs reveals a rather unusual overweight position for both banks and resources, but also a return to quality stocks now that the huge gap that existed between deep value and quality industrials has narrowed considerably. Active funds managers have thus far stopped short of embracing "junk", or "low quality stocks", reports Goldman Sachs. They've started buying quality again instead.

Equally noteworthy, the present combination of active fund managers being net long Resources and Banks at the same time has occurred less than 4% in such surveys over the past twelve years, reports Goldman Sachs.

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Another observation to make is that equity investors worldwide seem to have become more comfortable with the outlook for US interest rates, and, by extension, the future trajectory for US bond yields. No more are the gloomy predictions that were doing the rounds in 2016, as well as the panicked selling that saw shares in bond proxies dive by -15-20% within a brief time span.

Within this framework, I note shares in Transurban ((TCL)) are back within rallying distance from their all-time highs reached last year. In between, the shares sunk -24% and paid out two half-yearly dividends. Go figure. Sydney Airport ((SYD)) shares have rallied some 13% since March 7. Shares in Goodman Group ((GMG)) posted a new post-GFC high at the end of March.

Quality is back on investors' radar, or so it appears.

This possibly bodes well for investors whose portfolios contain a chunk of mid to small cap industrial growth stocks that have failed to fully participate in this global upswing since August last year.

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The FNArena/Vested Equities All-Weather Model Portfolio is built around the concept of owning high quality, industrial growth stocks for the longer term. The portfolio owns many of the stocks mentioned. We welcome the return of upward momentum for many of the stocks included in the portfolio and choose to ignore the noise about whether the ASX200 might reach 6000, or not, and if so, when?

I remain critical about whether 6000-plus is justified on the basis of local dynamics, this early in the calendar year. The Model Portfolio recently reduced exposure to Australian equities and increased its cash on the sidelines.

For more information about the All-Weather Model Portfolio: send email to info@fnarena.com

Paid subscribers can access a dedicated section to All-Weather Performers on the FNArena website. All price data have been updated until March 31st.

Sequel: Quintis Versus Californian Short Sellers

Last week I wrote about US-style of activist short sellers making their presence felt in Australia and little, hapless Quintis ((QIN)), formerly known as TFS Corp, had become their first public target.

With devastating consequences for existing shareholders, at least in the short term. The Quintis share price is doing its best to trade above $1, but only a few weeks ago it was trading at $1.47 and in December it was trading at $1.70.

Events have unfolded in quick succession and it is but fair to say this story already has generated sufficient intrigue to attract interest from aspiring Hollywood script writers. After the frontal attack-research report released by Glaucus Research, otherwise known as "the evil short sellers", the company responded by requesting a trading halt, and then releasing an official rebuttal that left quite a number of questions unanswered. A few hours later founder and CEO Frank Wilson had abandoned his position, officially to work on a potential take-over offer with a well capitalised but anonymous corporate suitor.

Stranger things have happened, no doubt, but we fail to remember a large number of precedents. Wilson is still a large shareholder in the company. Private equiteers at KKR are rumoured to have been circling for a while with, apparently, a lesser quality of sandalwood crop ready to merge with Quintis'. But is a financial bid realistic? Or is Quintis simply repeating the experience of board and shareholders at SurfStitch ((SRF)) in 2016?

SurfStitch shares are trading around $0.15 this month compared with $2 (not a typo) at the end of 2015, hence shareholders in Quintis in particular will be hoping any parallels between the two are purely coincidental, and temporary.

The company's ASX response contained the admission its largest customer in China, Shanghai Richer Link, hasn't placed one single order yet in 2017. A major embarrassment for the company who profiles itself as a pioneer in the industry, no two ways about it. Glaucus Research, for its part, followed up with yet another, super-dismissive research report, containing the following sentence: "When we called Shanghai Richer Link and asked them about TFS, at first the representative was confused, then said "we don’t do that business anymore."

Following the admission, credit rating agency Moody's placed Quintis' outlook on "negative" from "stable".

It now has also emerged that Quintis initiated a court case in 2014 against Adelaide-based stockbrokers Taylor Collison for an unpublished, critical research report, titled "A Foray into Sandalwood Accounting". The company, back then still operating as TFS Corp, lost the court case. The fact that sandalwood remains an opaque market, with Quintis seemingly an all-dominant player, does not make the company's case any clearer. Nor the fact it ended up outbidding all other participants in a number of auctions in recent years.

Irrespective of the ultimate outcome for suffering Quintis shareholders, it is most likely more ASX-listed companies might find themselves at the centre of short sellers' attention in the months, possibly years ahead. Here's hoping none of the future targets are found in any of our long term investment portfolios today.

Conviction Calls: Bell Potter, Goldman Sachs, Shaw and UBS

Stockbroker Bell Potter has a short list of Champion Stocks. These are high quality, ASX-listed entities whose business models have been tried and tested, at all points during the economic cycle, and management tends to enjoy a favourable standing throughout the local investment community.

Another way of looking at these stocks is by viewing them as Bell Potter's version of All-Weather Performers; solid, dependable, predictable, robust, must have, longer term portfolio members. Bell Potter's selection of ten members of this rather exclusive list of names was recently reduced to nine with the removal of Tatts ((TTS)) due to its proposed corporate "merger" with Tabcorp ((TAH)).

The nine remaining stocks on the list are: APA Group ((APA)), Transurban ((TCL)), Lend Lease ((LLC)), Challenger ((CGF)), Sonic Healthcare ((SHL)), Goodman Group ((GMG)), Link Administration Services ((LNK)), CSL ((CSL)) and Brambles ((BXB)).

FNArena subscribers can read up on All-Weather Performers (or: All-Weather Stocks) through the dedicated section on the FNArena website. The quickest way runs probably via the drop down menu starting with Analysis & Data on the grey-ish horizontal bar on the front page.

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Strategists at Goldman Sachs removed Hotel Property Investments ((HPI)) from their Australia/NZ Buy List after a rally in the share price, which has triggered a downgrade to Neutral by the analysts covering the stock.

Over the past ten months, explain the analysts, the shares have outperformed their REITs peers in Australia by some 10%. Equally important, Goldman Sachs does not think there's a lot additional upside left, at least not from a fundamental/valuation point of view.

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Amidst all the hullabaloo about new highs and further upside potential in this equities bull market, Shaw and Partners' head of research, Martin Crabb, remains stoic in his view: investors better not have too high expectations with the index at what appears to be stretched valuation. Twelve month return from current level is unlikely to exceed 5%, predicts Crabb, and that includes dividend payouts in the interim.

Stock picking and low expectations are thus key, in Crabb's view. He draws an analogy of picking up pennies in front of a steamroller. Meanwhile, staying overweight Resources stocks makes sense, in his view, as does owning banking shares.

It also makes sense to add global currency exposure to the portfolio, says Crabb, and as such he has increased exposure to QBE Insurance ((QBE)) and to Magellan Financial ((MFG)), while removing Perpetual ((PPT)) and Telstra ((TLS)).

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UBS strategists David Cassidy and Dean Dusanic have tried to find any remaining laggards in the ASX100 that should still be able to (potentially) return 20% or more in the year ahead. Their preferred selection includes BlueScope Steel ((BSL)), BHP Billiton ((BHP)) and Boral ((BLD)), as well as turnaround story Origin Energy ((ORG)).

A closer look into their research reveals Cassidy and Dusanic still see plenty of opportunities to achieve above market returns on the ASX. Candidates include JB Hi-Fi ((JBH)), Healthscope ((HSO)), Domino's Pizza ((DMP)), Harvey Norman ((HVN)), Rio Tinto ((RIO)), Flight Centre ((FLT)), Iluka Resources ((ILU)), Primary Healthcare ((PRY)), Evolution Mining ((EVN)), Crown Resorts ((CWN)), Santos ((STO)), Vocus Communications ((VOC)), Magellan Financial ((MFG)) and Fortescue Metals ((FMG)).

Stocks the duo absolutely dislikes include: Newcrest Mining ((NCM)), Fairfax Media ((FXJ)), Treasury Wine Estates ((TWE)), Seek ((SEK)), Bendigo and Adelaide Bank ((BEN)), Cochlear ((COH)), Perpetual ((PPT)), Ansell ((ANN)), DuluxGroup ((DLX)) and Bank of Queensland ((BOQ)).

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Note to readers: This is the fifth consecutive update on brokers' Conviction Calls. The previous four can be found in Weekly Insights from March 27, March 20, March 13 and March 6 which can be accessed via Rudi's Views on the FNArena website.

New Website: A Sophisticated Search Engine

"Search Stocks & Stories" it reads on the far right of the FNArena website. Behind the simple looking, rectangular input field attached to a blue button that says "Search" hides a wealth of information for the investor looking to broaden his insights on a specific topic, sector or ASX-listed company.

Type in "LNK" (for Link Administration Services) and a page appears showing "Most relevant stocks from your search", which, in this case, means you have been directed to Link, but also to Macquarie Group (MQG), AMP (AMP) and Perpetual (PPT). Further below are "Related Stocks" which includes the likes of Bravura Solutions (BVS), Class (CL1), GBST (GBT) and Iress Market Technology (IRE).

This all makes a lot of sense if one considers Link is far more than simply IT, or a software services company, or a shareholders registery, a definition most commentators and labeling services elsewhere would use for the company. As a major back office services provider for super funds and professional funds managers in Australia, FNArena thinks showing Link in connection with Macquarie, Bravura and Iress is a far more accurate environment for investors researching this company and its shares.

To be able to offer this level of sophistication, FNArena has developed its own corporate sectors structure and proprietary algorithms, and both are subjected to regular reviews and amendments. This should ensure that investors looking for in-depth research into the companies of their interest will find the Search facility on the FNArena website is the ideal starting point.

News stories and broker updates that populate Search results stretch out more than ten years. Results are ranked by "relevancy" (again, another algorithm), though settings can be changed to rankings per "date" if that suits better.

To accommodate easier and higher quality researching, Search outcomes include direct access to FNArena's Stock Analysis, not just for the ASX code entered, but for all related peers.

So if you agree that "Amcor" and "BHP Billiton" have very little in common, even though both are included in the S&P/ASX 200 Materials index, and that Seek (SEK), Carsales (CAR) and REA Group (REA) should no longer be grouped together simply because they all originate from what once were print media's "rivers of gold', than you are likely going to enjoy researching your stocks, and the share market, through the FNArena Search engine.

Do note this very much remains work-in-eternal-development. All feedback for further improvements and adjustments are at all times appreciated and welcome.

2016 - L'Année Extraordinaire

It was quite the exceptional year, 2016, and I did grab the opportunity to write down my observations and offer investors today the opportunity to look back, relive the moments and draw some hard conclusions about investing in the world today.

If you are a paid subscriber to FNArena, and you still haven't downloaded your copy, all you have to do is visit the website, look up "Special Reports" and download your very own copy of "Who's Afraid Of The Big Bad Bear. Chronicles of 2016, A Veritable Year Extraordinaire" (in PDF).

For all others who still haven't been convinced, eBook copies are for sale on Amazon and many other online channels. You'll have to visit a foreign Amazon website to also find the print book version.

All-Weather Model Portfolio

In partnership with Queensland based Vested Equities, FNArena manages an All-Weather Model Portfolio based upon my post-GFC research. The idea is to offer diversification away from banks and resources stocks which are so dominant in Australia, while also providing ongoing real time evidence into the validity of my research into All-Weather Performers.

This All-Weather Model Portfolio is available through Self-Managed Accounts (SMAs) on the Praemium platform. For more info: info@fnarena.com

Rudi On TV

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

-Tuesday around 11.15am, Skype-link to discuss broker calls -Thursday, 12.00-2.00pm, co-host in the studio -Thursday, between 7-8pm, interview on Switzer TV -Friday around 11.15am, Skype-link to discuss broker calls

Rudi On Tour

Your Editor has been invited to present at the Australian Shareholders Association's (ASA) 2017 Securing Your Investing Future Conference to be held at the Grand Hyatt Melbourne from 15-16 May.

The conference details - www.australianshareholders.com.au/conference-2017

Speaker information - www.australianshareholders.com.au/speakers

Program information - www.australianshareholders.com.au/program

Those who register before 31 March 2017 will receive $70 off the registration fee. Telephone: 1300 368 448

(This story was written on Monday 3rd April, 2016. It was published on the day in the form of an email to paying subscribers at FNArena).

(Do note that, in line with all my analyses, appearances and presentations, all of the above names and calculations are provided for educational purposes only. Investors should always consult with their licensed investment advisor first, before making any decisions. All views are mine and not by association FNArena's - see disclaimer on the website.

In addition, since FNArena runs a Model Portfolio based upon my research on All-Weather Performers it is more than likely that stocks mentioned are included in this Model Portfolio. For all questions about this: info@fnarena.com or via the direct messaging system on the website).

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