Week

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Stories To Read From FNArena

Friday, 16 August 2019

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James Hardie Discount Difficult To Justify

Brokers note James Hardie is trading at a discount to industrials peers, which appears increasingly difficult to justify in the wake of a robust first quarter.

-Primary demand growth is now at the top end of target -Risks to margins considered to the upside -Slowing Australian housing likely to drag on the business

By Eva Brocklehurst

James Hardie ((JHX)) strode ahead of its competition in delivering solid growth in North America in the first quarter. Brokers observe management is starting to enjoy success as it rolls out the transformation program (LEAN) across its 10 North American plants. This provided momentum at what is arguably a bottoming of the US housing market, Citi contends, calculating that if the company delivers on targets, three-year compound growth could reach 20%.

Earnings (EBIT) in North America constituted US$113m out of the total US$124.4m on margins of 25.1%, ahead of the company's target range of 20-25%. Moreover, primary demand growth (PDG) of 5% was at the top end of the FY20 target of 3-5%.

Credit Suisse points out management claimed there was nothing unusual in this report, yet did not raise guidance. The broker acknowledges there is always variability in quarterly results, and receivables did increase versus the prior comparable quarter, implying some normalisation. Credit Suisse increases its estimate for PDG marginally to 4.0%.

The stock's PE multiple de-rated over the past year as concerns grew regarding the sustainability of PDG and market share in the US, along with weak housing activity. On the back of this result, UBS notes confidence has improved. Nevertheless, growing at above-market rates is likely to be more difficult and costly in time.

Morgan Stanley believes the result will satisfy any concerns around the PDG target. Despite the strong response in the share price, Morgan Stanley still assesses James Hardie is trading at a discount to its industrials peers, which is difficult to justify. The company has now delivered on the key pillars of its investment thesis - PDG and margins - and, hence, the broker suspects the discount will continue to close.

Exterior volumes grew 5% while interiors were down -3% over the quarter. Macquarie believes the strength in exteriors, which surprised some investors, was partially explained by the company's sub-regional exposure to markets that were comparatively solid. There was also a strong performance for renovations in the north-east of the US.

Macquarie also notes James Hardie is making headway in commercial initiatives and although it is shedding some base business, this is occurring at a diminishing rate. The broker believes a realigned engagement with the retail channel is having a moderating impact on the weakness experienced in interiors in the quarter.

Volume growth has been partly the result of better control of distribution channels and management highlighted its success, having noted there was some PDG loss from negative perceptions previously. The company also emphasised that the improvement was not a result of channel stuffing or a pulling forward of sales.

Margins

The company has now upgraded earnings margins for FY20 to the top of its target. Citi lifts margin estimates to 25.5% for FY21 and 25.8% for FY22, stemming from the cost savings expected. The company has confirmed that it is on track to deliver US$100m in cost savings over FY20-21. Morgan Stanley believes margin should at least be maintained, with the risk to the upside.

Australasia/Europe

In Australia local currency earnings eased -5%. Approvals for detached houses for the June quarter were down -17% and the alterations and additions market volume was down by -1%. NZ earnings also fell in the first quarter, primarily because of unfavourable plant performance and higher input costs.

Volumes rose 11% in the Philippines as a result of further market penetration. In Europe, building product sales were up 7% and earnings margins were 10.7%. Europe was disappointing, in Macquarie's view, as price and volume outcomes were weaker than expected. Nevertheless, the integration of Fermacell is progressing and costs are within budget.

The company plans to introduce its LEAN to the five European plants, beginning in the third quarter of FY20. James Hardie has provided a 10-year target for the European business which UBS notes includes no real growth within the next three years. However, the broker envisages some upside in the short term.

Ord Minnett assesses the stock has had a good performance for the year to date and FY20 guidance is likely to be conservative. Investor briefings over the next month in Europe and the US should improve sentiment further.

Macquarie points out, while still a headwind in the June quarter, if spot prices prevail in this should mean solid reductions in pulp pricing benefit the company. However, gains in terms of freight costs will moderate as the year progresses if spot prices prevail.

The stock is trading on a PE multiple of 18x 1-year forward earnings (excluding asbestos), at a discount to historical averages, Ord Minnett notes. As pulp prices are now moving more favourably and there is benefits from the transformation program, the broker believes there is plenty of room for savings to drop to earnings and/or be reinvested to accelerate PDG.

UBS agrees this is the case and upgrades to Buy from Neutral, noting the company is back near a market multiple but there is still room for re-rating higher and James Hardie has both the financial capacity and the right strategy.

FNArena's database shows six Buy ratings for James Hardie. The consensus target is $24.39, suggesting 8.2% upside to the last share price. This compares with $21.28 ahead of the results. Targets range from $23.50 (Ord Minnett) to $25.35 (Macquarie).

Slow Start To FY20 For REA Group

REA Group withstood a significant downturn in listings volumes in FY19 and, while FY20 is off to a slow start, a recovery is expected in the second half.

-Subscription price increases and further penetration of Premier All underpinned FY19 -Listings expected to decline in the first half and revenue to be weighted to the second half -Ability to pull the lever on costs a major advantage

By Eva Brocklehurst

REA Group ((REA)) is expected to continue dominating Australian residential property market listings despite recording no revenue growth in the final quarter of FY19. Management is confident a recovery is on the way, amid increased buyer activity, lower interest rates and an easing of lending restrictions.

Ord Minnett agrees the worst of the property listings decline is likely in the past and REA Group should emerge relatively unscathed, upgrading to Hold from Lighten. The broker is still cautious about the stock, which is already trading at a significant premium to peers.

The positive aspect generated from the FY19 results centres on the company overcoming a significant downturn in listings volumes over the year to still post modest earnings growth. This stemmed from subscription price rises and increasing penetration of the Premiere All subscription packages. REA Group was forced to ease the terms of its Premiere All subscriptions to increase volumes but still believes subscriptions can expand without cannibalisation.

Industry advertising volumes remain negative, although Morgan Stanley points out leverage to a recovery will be significant. The first half of FY20 is off to a slow start, with listing volumes in July down -19%, including Sydney down -31% and Melbourne down -29%. Credit Suisse has feedback from agents which indicates that volumes for spring are likely to be down.

UBS expects revenue outcome in FY20 will be volatile. Listings are likely to decline in the first half and revenue will be heavily weighted to the second half. While delaying the timing of an assumed rebound in listings to the second half, Morgans asserts REA Group needs a rebound in listings volumes to avoid another downgrade to market expectations.

Yet Credit Suisse suggests REA Group can get away with a subdued outcome in listings because its key competitor is also exposed to the weakness and will need to cut back on marketing in particular.

Revenue grew 8.3% over FY19 with operating earnings (EBITDA) up 8.1%. No earnings guidance was provided. Listings weakness in the Australian market caused the results to underperform most expectations. Yet Asia was also affected by competitive pressures and the financial services business produced lower revenue because of tighter lending conditions as well as the subdued property market.

Morgans considers Asia a problem. Returns from the former iProperty business remain low, highlighting the intensity of competition in the region. The company has also reduced the carrying value of the Elara Technologies business, which operates three property portals in India. The broker suspects an injection of new capital in FY20 is inevitable.

Developer and commercial business has defied the cycle, Macquarie points out. Developer business has benefited from increased penetration longer duration of marketing campaigns and depth take up in commercial areas has been strong. There are opportunities in rental areas as REA Group is not monetising landlord-managed listings as yet.

Cost Freeze

Management has begun tightening its belt, freezing costs. Profit margins are expected to grow again in FY20, albeit modestly, and not be spread evenly over the year.

Macquarie finds this commitment to flat costs a key positive, delivering operating earnings leverage if volumes improve and protecting earnings if this does not eventuate. Barring a full-year decline in listings that outpaces the rate of price increases, Ord Minnett also believes the ability to pull on the cost lever is a major advantage.

Valuation

Morgans expects the company could deliver more years of double-digit earnings growth and achieve high levels of free cash generation with strong growth in dividends. Nevertheless, the broker's share price target implies a negative total shareholder return and a Reduce rating is maintained.

The stock is trading broadly in line with historical multiples and, amid a lower bond rate environment, UBS assesses the valuation is fair. To the extent that listings growth is positive overall for FY20, the broker considers there is upside for revenue.

UBS is also impressed with the early agent lead conversions but suspects monetisation will be long dated. The company is expected to give away leads for free in FY20. Then, with leads priced at $150-200, subsequent revenue contributions should grow and become more material.

Three Buy ratings, three Hold and one Sell (Morgans) are on FNArena's database. The consensus target is $95.65, suggesting -4.2% downside to the last share price targets range from $90 (Morgan Stanley, Ord Minnett) to $107 (Macquarie).

See also, REA Group Resisting Hostile Environment on May 13, 2019.

Global Production Risks Dent Ansell Outlook

Ansell is confident sales can recover in FY20 after a weak period affected by divestments and restructuring, although brokers consider the global environment poses risks.

-Negative impact on body protection manufacturing from trade issues and slowing industrial production -Acquisitions, more aggressive buyback can push EPS to the top of guidance -Value envisaged from strong balance sheet and transformation program

By Eva Brocklehurst

Brokers hope the protective glove manufacturer Ansell ((ANN)) will be a clearer business to assess in FY20 after a complicated year when the sexual wellness division was divested and the remainder restructured. Management is confident that organic sales can recover in FY20, although several brokers suspect this is optimistic, even allowing for the positive trend in healthcare sales.

This is because of the company's exposure to the unpredictable and increasingly negative impact of trade issues and an associated slowdown in industrial production. Citi is relatively upbeat, suggesting the global nature of the product range and the reliance on industrial production across many markets means there are always ups and downs at the top line.

The broker points to solid revenue growth in the healthcare segment and management's comment that market share has increased. Morgan Stanley also notes Ansell's exposure to non-cyclical industries and healthcare is encouraging for the outlook. The broker expects a turnaround in raw material inputs, which negatively affected FY19, should provide a tailwind in FY20 and Ansell should at least trade in line with historical averages.

The company is targeting earnings per share (EPS) in FY20 of US$1.12-1.22 and management expects growth will be forthcoming, despite the deterioration in the global economy and the uncertainty over trade. The guidance, at the mid point, does not appear to be a stretch to UBS, which calculates US$1.18.

Acquisitions and a more aggressive buyback also have the potential to push EPS to the top of the guidance range, although one key assumption is that there is no further deterioration in the global economy.

Ansell envisages 3-5% sales growth in FY20 but, with no sign of improvement in the macro environment, Credit Suisse forecasts a miss to this target in the first half and suggests FY20 is likely to be all about cost reductions and the buyback. Macquarie agrees the macro economic trends present downside risk to FY20, despite favourable raw material pricing trends and the benefits from the transformation program.

Cost adjustments muddied the FY19 result and underwhelmed brokers. FY19 net profit of US$150.9m was up 2.9%. Sales from continuing operations rose 0.6%. The quality of earnings was affected by significant transformation costs, a provision release and a lower tax rate.

Buyback

After buying back US$176m worth of shares in FY19, Morgan Stanley estimates net debt/operating earnings of around 0.6x, versus the company's target range of 1.5-2.0x. Management has signalled that excess cash will be deployed for either acquisitions or buying back shares.

Ord Minnett forecasts similar weak growth in FY20 amid signs that economic conditions are deteriorating. A 4% lift in the health division is expected while flat sales are expected in the industrial division. Despite some misgivings, the broker envisages limited downside for the stock because the balance sheet offers potential support to earnings via further capital management or acquisitions.

Morgans includes a 10m share buyback in forecasts for FY20, with 5m in FY21-22, driving growth in earnings per share of up to 6%. The broker notes channel partnerships continue to expand and the transformation program is delivering ahead of plan, while there was solid growth in emerging markets.

EMEA Support

A recovery in Russia and Brazil and growth in China and Mexico, as well as price increases and product mix, should underpin FY20, in Citi's view. Automotive manufacturing is the largest industrial segment for the company so the broker was not surprised that Europe, Middle East and Africa (EMEA) were weak.

The Ringers acquisition in January 2019 is expected to add to growth in FY20 and there is the potential for an expansion of the product range sold in the oil & gas industry to more geographies as well as mining and heavy machinery.

Currently, these products are mainly sold in the US and to a lesser extent the Middle East. As the company has a global footprint, Citi assesses that possible there is upside risk to the 10% revenue growth expected from the acquisition, although does not include this in forecasts.

UBS believes management should be commended for handling a very patchy global growth environment in FY19 as it implements a large restructure. Nevertheless, the broker looks forward to FY20 where non-recurring items feature less, allowing for more meaningful analysis of performance.

Credit Suisse downgrades to Neutral from Outperform, given the strength in the share price in the wake of the results. The broker continues to envisage merit in the transformation program and strong balance sheet but remains cautious about continued weakness in the global environment and the implications for revenue and earnings.

FNArena's database shows two Buy ratings and five Hold. The consensus target is $28.29, signalling 3.2% upside to the last share price. This compares with $27.56 ahead of the results. Targets range from $25.69 (Morgans) to $31.60 (Morgan Stanley).

Investors Focus On Aurizon's Buyback Plans

Investors are expected to focus on the prospect of sustained capital management as rail freight operator Aurizon seeks to gear up operations following a legal restructure.

-New contracts and extensions to be of benefit in FY20 -Queensland approval of UT5 undertaking should underpin improved outlook -Network and above-rail to be combined under a holding company

By Eva Brocklehurst

Rail freight operator Aurizon ((AZJ)) used its FY19 results to announce a new capital structure and a $300m on-market buyback. Brokers note the outlook has considerably improved over the past year, although a lot of the improved fundamentals are deemed reflected in the share price.

Investors are expected to focus on the prospect of sustained capital management going forward as the company seeks to gear up its above-rail (operations) following a legal restructure.

A new deal with miners and additional coal volumes, as well as a turnaround in bulk freight has meant earnings (EBIT) are expected to be more sustainable in FY20, with guidance for $880-930m. At the mid point this implies underlying earnings growth of 9%.

Guidance also implies a turnaround in the bulk business and coal returning to growth as higher maintenance and operating costs are normalised and revenue from new volumes is delivered from the first half onwards.

UBS finds potential upside from three areas beyond the aforesaid factors, including a successful defence of the Wiggins Island rail project appeal, further cost reductions in the network and new contract announcements.

Aurizon has announced a number of contract extensions and additional volumes with Glencore, particularly in the Newlands corridor, which pushes out the contract expiry to FY24. The contract with Jelinbah has also been extended to FY28.

Some contracts were renewed without price reductions, management points out, as customers valued flexibility ahead of price. The price levels on coal contracts which expire over the next three years are at elevated levels but management also stated this is equivalent to only 13% of coal contracts by annual volume.

A year ago, Credit Suisse notes, this was 23% of higher margin contracts and, as a result, margin risk is reduced. FY20 earnings are expected to be largely driven by sustained iron ore prices with the Kararra contract being renegotiated. The company will also benefit from the re-opening of the Mount Isa line.

Despite the fact that FY19 results were solid and there is leverage from additional volumes from new contracts and precision railing, some price pressure and network re-pricing is still more than likely, given low bond rates, Macquarie asserts.

The broker downgrades to Underperform from Neutral, assessing Aurizon as the least attractive of infrastructure assets amid a stretched valuation. Unlike other infrastructure stocks, the company's operations face re-sets in FY22/23, reflecting falling bond rates on a regulated asset base that is flat.

Network

The company reported network underlying earnings of $400m in FY19, which included a -$60m impact from the implementation of the UT5 final decision. Citi suggests the outlook for FY20 could be very different, should the Queensland Competition Authority approve the company's UT5 Draft Amending Access Undertaking (DAAU) with miner customers, expected to occur in the first half of FY20.

Overall, underpinning forecasts for total volumes of 248mt is QCA accepting the company's undertaking, but this could be subject to changes pending a review.

Above-rail

Morgan Stanley forecasts a three-year compound growth rate for above-rail earnings of 8%, noting the potential upside should "precision railing" deliver meaningful cost benefits.

Above-rail recorded underlying earnings of $425m in FY19, characterised by a weaker contribution from coal and amid higher maintenance costs. Bulk (iron ore) performance was more insulated by strong market conditions and cost management.

Restructure

The network and above-rail operations will be combined in a legal restructure as sibling entities under a holding company. This will allow for $1.2bn in additional debt capacity in the above-rail business, taking gearing to 1.5x from near zero, while maintaining independent credit ratings for each segment

Morgan Stanley notes the company's credit rating agencies have effectively dropped thresholds for the BBB-plus/Baa1 ratings, anticipating headroom for additional growth and/or capital management initiatives as a result.

The vertical integration review concluded that avoiding separation was the best way forward and Credit Suisse believes this is the right decision. This enables easier implementation and better execution of operating improvements and avoiding overhead duplication, which the company estimates accounts for around 10-15% of earnings.

A more efficient capital structure could be implemented as well, regardless of vertical integration. The only potential enduring benefit of separation would be an improved regulatory environment for the network business and this has already been achieved, in the broker's view, in the commercial deal with coal miner customers.

The company had considered separate ownership of the network and above-rail businesses but the majority of stakeholders were either ambivalent or preferred the current structure.

Capital Management

Adding in sale proceeds from the rail grinding business and Acacia Ridge, Aurizon now has $1.5bn or more to deploy into buybacks and reduce its share count by around -15% over the next four years. Credit Suisse includes $1.5bn of buybacks in forecasts for the next 2.5 years.

The broker assesses the company's funding capacity could potentially stretch to $2bn. Citi envisages scope for Aurizon to repurchase up to 10% of its outstanding share base, should the gearing of the operations business reach the $1.2bn flagged by management.

Macquarie was interested to note that, because franking levels are low, Aurizon would prefer a share buyback to a dividend when ascertaining capital management options.

The broker notes new enterprise bargaining agreements are nearly complete. The largest from Queensland coal is awaiting approval and represents 55% of the workforce while the Queensland bulk contract continues to be in the negotiation phase. The broker notes, on completion of the two agreements, this will end a sustained period of industrial action across the company's businesses.

FNArena's database shows one Buy (Credit Suisse), four Hold and two Sell ratings. The consensus target is $5.44, signalling -9.5% downside to the last share price. The dividend yield on FY20 and FY21 forecasts is 4.4% and 4.9%, respectively.

Challenger Snagged By Weak Yields

Wealth manager Challenger has potential for growth in the longer term but the short term is considered to be difficult.

-Challenges in finding yield in a low interest rate environment -Japanese annuity growth could offset the disruption to domestic sales -Adviser disruption may delay the benefits of demographic trends, means testing

By Eva Brocklehurst

The main concern for brokers in the FY19 results from wealth manager Challenger ((CGF)) lies with the use of capital, as lower bond yields in FY20 are expected to place further pressure on domestic annuity demand.

The range for FY20 pre-tax profit guidance of $500-550m is unusually wide, which Citi believes reflects the level of uncertainty overhanging the operating environment. It also allows for lower normalised growth assumptions for equities, distribution, product and marketing initiatives.

There is potential for growth in the longer term but brokers suggest the short-term is difficult. Ord Minnett's main concern is whether there is an appropriate risk-adjusted return to shareholders. Management has asserted that lower interest rates are not necessarily an issue for annuity sales, although there are challenges in the shape of the yield curve where cash rates are higher than one-year swap rates.

Growth outside of Japan is softer for the company because of structurally lower yields and industry disruption. While the balance sheet is robust, Morgan Stanley, too, finds it hard to believe shareholder funds will not suffer as yields decline.

For now, as term annuities roll off, and the tenor of the company's book is extended, there will be support from lower costs and the benefits of mix, the broker acknowledges, noting Challenger still expects to deliver a post-tax return on equity of more than 10.7%.

UBS is not so sure this will be achieved easily, and suspects Challenger is looking to ease pressures from lower interest rates by either supporting spread margins or recycling higher risk asset returns into annuities in order to assist sales.

Macquarie agrees and suspects management has been searching for higher yields, given portfolio allocation changes. While management reiterated a focus on return on equity (ROE) and asset risk premiums the broker believes now is an "interesting time in the cycle" to start increasing the risk profile.

While disappointed with Japanese sales of $38m in the fourth quarter, Macquarie is heartened by management's revelation that the trend has reversed in July following the start of a new US dollar product. Sales in July have already exceeded total sales for the fourth quarter of FY19. Macquarie anticipates net book growth of 5% in FY20 as longer-duration Japanese annuities more than offset the disruption to domestic sales.

Adviser Disruption

Sales were worse than Citi expected in the fourth quarter, reflecting adviser disruption. The broker suspects this may worsen in the near term, creating uncertainty for the growth trajectory and delaying the benefits of upside from demographic trends and new means-testing rules. Retail annuity sales were down -22% in the fourth quarter. The company noted significant adviser churn, with a -9% reduction in adviser numbers since December 2018 and the major hubs down -16%.

Morgans is increasingly confident that the earnings profile has largely re-based but concedes the stock faces headwinds as sales momentum in Australia deteriorates on the impact of adviser disruption. The downside risks, in the broker's view, include an inability to maintain strong sales and net growth in its book.

Credit Suisse concedes the valuation of the stock is starting to become more appealing but to obtain further confidence in the growth story domestic sales need to demonstrate signs of recovery, and the timing of this is unclear.

Capital Intensity

Given Challenger had promised to invest proceeds from the disposal of property in high-grade fixed income, thereby implying a reduction in capital intensity, Citi was surprised to find capital intensity rose 80 basis points in the second half.

This appears to be on the back of a sharp reduction in liquid assets in the fixed income portfolio over the second half. Citi suspects that most of the sell-down of property has gone to equities/alternatives, limiting the reduction in capital intensity. Further property sales should take the allocation to property down slightly to 17% in FY20 but Citi is wary of predicting a corresponding reduction in capital intensity.

Net profit was at the lower end of the company's target range, at $548m in FY19. Losses in retail property valuations turned property investment negative, despite gains on office buildings. To Citi, this implies downside risks to the asset book, which are borne solely by shareholders.

Citi expects margins to contract -13 basis points in FY20 and at a reduced pace thereafter. The difference between front and back book margins now appears to be around 30 basis points, which signals to to the broker there is only limited margin downside going forward - unless credit spreads contract further.

While recognising the challenges of low interest rates, Macquarie believes offsets will come on the funding side as margin pressures will be less significant going forward. Moreover, while domestic sales remain anaemic because of industry disruption, net book growth will still benefit from Japanese sales volumes increasing materially in FY20.

Challenger has one Buy rating (Macquarie), five Hold and one Sell (Ord Minnett) on FNArena's database. The consensus target is $7.22, signalling 5.8% upside to the last share price. The dividend yield on FY20 and FY20 one forecasts is 5.1% and 5.0% respectively.

Magellan Financial Reflects Lofty Expectations

Magellan Financial has outlined a plan to increasingly use a partnership model to engage directly with retail investors.

-Brokers generally consider the stock too expensive -Closed-end fund improves the quality of earnings -Magnitude and potential success of opportunities remain unclear

By Eva Brocklehurst

Magellan Financial ((MFG)) has called attention to its future growth initiatives with the launch of a closed-end fund and an equity raising. The company intends to increasingly use and leverage its partnership model with direct investors, raising capital to invest in listed products with loyalty bonuses funded by the manager in order to maintain an increasingly sticky retail base.

The partnership offer will capitalise on the gap in the retail wealth segment created by the exit of the banks, and Morgan Stanley also suggests this provides an alternative to the growing strength of industry super funds.

Nevertheless, more capacity is required to deliver on its growth aspirations. To this end Magellan Financial has announced a $275m institutional share placement with proceeds to be directed towards a high conviction trust as well as to seed new investment strategies. Is?

This includes $50m to support a new retirement income product. Details are limited and the company has reiterated that the retirement product will not be capital intensive nor an annuity so Citi adopts a wait-and-see approach.

While the deployment of capital to fund investor discounts for such funds makes strategic sense, the increasing capital intensity of flows is also an indication to UBS that Magellan Financial is entering a more mature growth phase. With partnership costs becoming a more recurring feature and the stock trading at 28x FY20 price/earnings (PE) estimates the broker envisages downside risks to valuation.

Morgan Stanley suspects the capital raising could dilute earnings per share and, given a PE ratio around such levels, considers the stock too expensive. A closed-end fund may improve the quality of earnings but the broker points out the retirement income product is light on capital and will not require an APRA licence, while also being 6-12 months away.

Growth Driver?

A competitive response is also expected should the product be successful. Ord Minnett supports the strategy but believes the manager-funded priority offer will be no more than an incremental driver of growth, taking into account the company's $90bn funds under management base.

Still, the company maintains an ability to deliver solid inflows over FY20/21 on the back of sustainable US strategies and US$6bn of remaining capacity in the infrastructure fund, Morgans suggests, while acknowledging the stock is susceptible to any meaningful pullback in the market. Morgans retains a Hold rating given the quality of earnings and the growth options.

Credit Suisse upgrades earnings estimates following the announcement of the opportunity inherent in the launch of the trust and retirement product. The broker acknowledges, with the share price up over 150% to date in 2019, a substantial increase in its target price, to $49.30 from $42.90, may be simply chasing the trend.

Growth opportunities appear compelling and Credit Suisse believes there are a number of initiatives that have the ability to significantly increase funds under management. Nevertheless, the stock is trading at a 60% premium to the market and the magnitude and potential success of the opportunities remains unclear.

Citi and Ord Minnett have downgraded to Sell ratings. Ord Minnett's target rises to $49.60 from $40.33 on marking to market amid strong flows and the potential of the new fund. Yet this implies a negative total shareholder return of -13.5% and the broker assesses there is a slim margin of safety, while the market is paying up for success.

Citi agrees expectations are lofty, although acknowledges the high conviction trust is an innovative approach that brings an element of recurring acquisition costs to the business, albeit with newly raised funds effectively locked in and future earnings potentially capitalised at over 20x PE.

High Conviction Trust

The partnership model will be expanded with the launch of the Magellan High Conviction Trust which includes a 7.5% loyalty bonus to eligible share and unit holders, around 70,000 in total, a 2.5% IPO bonus for new investors and nil brokerage.

Net profit in FY19 was $377m and ahead of broker estimates. UBS assesses this purely reflected one-off unrealised asset gains. The broker expects funds management margins, ex performance fees, should remain resilient at around 50 basis points of average assets under management in FY20, before slowly contracting.

FNArena's database shows one Hold (Morgans) and five Sell ratings. The consensus target is $49.03, suggesting -14.1% downside to the last share price. This compares with $44.69 ahead of the results. Targets range from $38.50 (Morgan Stanley) to $57.80 (Morgans).

CSL Retains Superior Position In Plasma

A superior position in plasma collections in the US has delivered benefits to CSL in FY19 and, while competitors are gearing up, brokers believe the outlook for FY20 remains firm.

-Competitors lagging with flu vaccine supply -Competition heightened, particularly for Berinert and Haegarda -Is there further upside for the stock?

By Eva Brocklehurst

CSL ((CSL)) has benefitted from a tight plasma market as competitors are having difficulties meeting demand. The company continues to gain market share as a result of its multi-year investment in collection centres.

Citi expects revenue growth in the plasma industry of 8-10% until 2025 and CSL to increase its market share. Macquarie also highlights the competitive advantage of the collection centre network.

Collections may be above market levels and accelerating but as competitors are increasing their capacity, Morgans is more cautious. The broker maintains a Hold rating and waits for a better entry point, believing the stock is expensive.

Based on the company's recent relative share price performance UBS downgrades to Neutral from Buy. The broker believes the stock screens as fair value when compared with large cap listed Australian healthcare peers and, while the business remains a high-quality franchise, this is reflected in current trading multiples.

Management has guided to FY20 net profit of US$2.05-2.11bn. Seqirus, the flu vaccine, remains on track to hit FY20 guidance for earnings of US$200m. Management has noted competitors are lagging with flu vaccine supply because of a change in the strain and, as Macquarie points out, CSL's cell-based flu vaccine can be manufactured more rapidly than traditional egg-based vaccines.

Guidance implies around 15% underlying net profit growth and UBS concedes this is a realistic target, although it will likely require continued improvement in specialty product growth.

Morgan Stanley notes FY19 results were aided by a low tax outcome but expects FY20 will be robust. Furthermore, the broker believes the market will pay a premium to traditional valuation methodologies for CSL as there is a scarcity of large cap growth stocks on ASX, and there are high returns on equity. There is also relatively low leverage on the balance sheet.

Ord Minnett asserts a strong consistent earnings growth profile warrants a premium, and solid double-digit earnings are expected in FY20 and beyond. The broker highlights the tightness in the market for immunoglobulin, confirmed by recent statements from the US Food and Drug Administration. This raises the risk of rationing, although underpins the ongoing opportunity for CSL, as long lead times limit competitor ability to respond rapidly.

Specialty

Citi asserts that specialty products are the most unpredictable business line in terms of forecasts. While expecting continued growth, the broker is conscious there are competitors for Haegarda and Kcentra. Morgan Stanley, too, envisages some temporary constraints on the company's ability to supply specialty products as the competitive dynamics evolve.

Credit Suisse is another broker that highlights the increased competition facing the specialty portfolio, particularly for Berinert and Haegarda, and retains conservative estimates for the specialty division, expecting 5% sales growth.

While Haegarda and Kcentra have both experienced moderation, Macquarie assesses momentum for Idelvion and Seqirus is positive and should underpin earnings growth, in combination with immunoglobulin.

In immunoglobulin in FY19, Privigen and Hizentra revenue increased 23% and 22% respectively. Meanwhile, albumin also recovered materially in the second half because of a rebound in growth in China after temporary restrictions on imports in the first half. This was partially offset by subdued trends in the US.

More Upside?

Credit Suisse upgrades to Outperform from Neutral, believing there is more upside in the share price, noting CSL is trading at a discount to key Australian healthcare peer Cochlear ((COH)) and in line with ResMed ((RMD)).

The broker expects earnings to be supported by the company's leading position in a tight immunoglobulin market where competitors are experiencing shortages and disruptions. Stronger growth in Chinese albumin is also expected in the first half.

An item of interest Macquarie notes from the results is the company's acquisition of a saline and sodium citrate manufacturing facility, which vertically integrates the company supply chain.

FNArena's database shows three Buy ratings and four Hold. The consensus target is $241.56, suggesting 4.4% upside to the last share price. This compares with $213.40 ahead of the results.

Find out why FNArena subscribers like the service so much: "Your Feedback (Thank You)" - Warning this story contains unashamedly positive feedback on the service provided.

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

Material Matters: Galloping Gold, Iron Ore, Zircon, And Oversupply

Predictions for gold, iron ore and coal prices; zircon stable; base metals oversupplied.

-Interest rate cuts, trade war, market doubts send gold spiralling up -Iron ore miners set to rise as ore price prepares to bounce back -Coking coal faces long-term slide despite short-term recovery -Zircon import prices in China to find balance when slight oversupply subsides -Precious metals in strong demand, while base metals struggle with oversupply

By Nicki Bourlioufas

Gold climbs as investors seek safety from trade tensions and equity markets

Gold has posted major price gains in recent weeks as investors seek a safe haven from tumbling interest rates, US-China trade war, and turmoil in the equity markets. With the metal shooting above US$1500 an ounce in the first week of August, Citi Research boosted its 6-month to 12-month COMEX gold target price to US$1,600 an ounce.

The US Federal Reserve Board cut its benchmark interest rate at the end of July by 0.25% to a range of 2%-2.25%. Citi said the gold market appears to be pricing in two more cuts by the Fed in 2019, moves that would indicate the Fed expects economic activity to slow. Gold miners have rallied to multi-year or record highs in Australia and offshore.

US President Donald Trump has threatened to impose a 10% tariff on US$300bn worth of Chinese imports that were previously untaxed from September 1. In response, China let its currency depreciate, sparking fears of a slowdown in world trade. It all makes gold look like a good place to ride out the storm.

Citi Research said purchases of gold bullion by central banks in the first half of 2019 totalled 374 tonnes, the strongest first-half total this decade. The buying trajectory suggests gold purchases by the central banks in 2019 will top the all-time high of 651t achieved in 2018.

While Citi is upbeat on the gold price, not all experts are. Credit Suisse has a forecast US$1,343 for calendar year 2019 and US$1,350 for 2020. Morgan Stanley too is more downbeat than Citi, forecasting the price will fall back to US$1,350 by the second quarter of 2020.

Iron ore price crash may be overdone; miners tipped to do well

Credit Suisse says the collapse of the iron ore in August below US$110/t is a short-term phenomenon and the price will rebound to US$110/t, where it was trading for most of July. The fall was a reaction to China's currency devaluation, which made iron ore more expensive to Chinese importers.

However, Credit Suisse says the price will gradually unwind, likely hitting US$95/t by the end of the year. A major factor will be the end of the supply squeeze, as Brazil's Vale brings idled operations back into production.

On the positive side, the market could be buoyed up by demand out of China, where the government is expected to continue its domestic stimulus in the face of higher US tariffs. China infrastructure investment was up 4% in the first half of calendar 2019 and the government is targeting 8% for the full year.

But Credit Suisse expects the China Iron and Steel Association, which represents state-owned and large privately-owned producers, to put pressure on small steel mills to cut over-production. Such cuts will likely reduce Chinese steel output in the second half.

Citi Metals and Mining is tipping good gains for Australia's major iron ore miners over the coming year. It set a target price of $44 for BHP Group ((BHP)) compared to around $37 on August 12 and $110 for Rio Tinto ((RIO)) compared $86. It set $8.00 for Fortescue Metals Group ((FMG)) compared to $7 and US$14.00 for NYSE-listed Brazilian giant Vale, compared to US$11.55.

Citi modelled a scenario in which the iron ore price would fall to US$60/t in calendar 2020. Under the scenario, 2019-20 Net Profit After Tax (NPAT) would fall by -21% for BHP, by -32% for RIO and by -35% for FMG.

While this may sound like a lot, Citi argues that "the downside case is not far from what most would consider through cycle commodity prices". If the sell-off continues, "investors may get an opportunity to reweight into the miners”.

Coking coal set for short-term recovery, but long-term slide

Morgan Stanley says the market for metallurgical coal will likely remain oversupplied in the medium term, holding the price at around the current $160/t where it has settled after falling from $200/t in July. Met-coal, or coking coal, is used to produce coke, the primary source of carbon used in steel-making.

Morgan Stanley says the met-coal price will recover to $175/t at the end of this year due to some disruptions to Australian supply and the resumption of buying from India after its usual June-September monsoon season lull. The price will then slump again to $165/t in 2020 and $141/t in 2021 on rising seaborne supply.

Over the medium term, demand out of China is expected to slow. Morgan Stanley says the Chinese coke industry appears to be well stocked with coal, import restrictions are still being applied at major coking coal ports Jingtang and Caofeidian, and steel production is expected to slow in the second half.

Zircon import prices in China stable, despite temporary oversupply

Morgan Stanley reported that checks with a Chinese mineral sands information provider suggest seaborne zircon import prices have remained stable at about US$1,595-1,630/t and are expected to remain steady, with demand remaining in line with customer orders.

China’s zircon stocks are slightly out of balance, with concentrators holding 1.5 months’ worth of stock and downstream users such as ceramics factories experiencing slight oversupply. At the same time, there is some risk that new mining rights may not be approved for zircon sands from China's coastal Hainan province as Hainan develops its tourism industry, and this could lead to a fall in supply.

Precious metals looking good; base metals struggle on oversupply

Morgan Stanley’s Metals & Mining Commodity Thermometer rates 15 major traded minerals with ratings range from 6 for “bullish” to 1 for “bearish”. In the latest thermometer, only gold is awarded a 6, on the strength of falling real interest rates, a negative outlook for the US dollar and an uncertain macroeconomic outlook.

Copper and palladium are rated 5 on concerns about supply shortages, and silver is also rated 5 on expectations it will rise along with gold. A slight oversupply of nickel sees it rated a 4. Aluminium is also a 4, with some recovery seen as possible given that the price has now fallen so far that smelters may cut production.

Platinum, alumina and thermal coal all scored a 3 on concerns about oversupply, and iron ore a 2. Cobalt, manganese ore, zinc, lithium carbonate and metallurgical coal were all rated 1, also for reasons of oversupply.

Macquarie Wealth Management says the recent decision by Glencore to wind down production at world’s largest cobalt mine, Mutanda, by the end of this year due to reduced economic viability “will have a stark tightening effect, slashing nearby oversupply and pushing the market into deeper deficits sooner. Cobalt’s price prospects have thus brightened.” Macquarie is calling for more mines to drop out to solve the oversupply problems for cobalt.

Weekly Ratings, Targets, Forecast Changes - 12-08-19

By Rudi Filapek-Vandyck, Editor FNArena

Guide:

The FNArena database tabulates the views of seven major Australian and international stock brokers: Citi, Credit Suisse, 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 August 5 to Friday August 9, 2019 Total Upgrades: 9 Total Downgrades: 5 Net Ratings Breakdown: Buy 37.65%; Hold 44.61%; Sell 17.74%

At face value, stockbroking analysts have started zooming in on undervalued laggards resulting in -finally- more upgrades being issued than downgrades for individual ASX-listed stocks.

For the week up until Friday, 9th August 2019, FNArena counted nine recommendation upgrades versus five downgrades. Most changes on both sides of the ledger ended in Neutral territory.

Only four of the upgrades moved to Buy with Navigator Global Investments (FY19 release), Domino's Pizza, ALS ltd and AP Eagers the lucky receivers. AGL Energy's FY19 report was good for two upgrades and one downgrade. That one downgrade marked the sole fresh Sell rating for the week.

Not much has been happening in terms of valuations and target prices, yet. AP Eagers crowned itself as greatest beneficiary for the week, enjoying an increase in target of no less than 18.38% (merger with Automotive Holdings), easily beating Breville Group and Xero, then follows a whole heap of nothing.

More names are on display on the negative side, but with equally only a few names worth pointing out. Pilbara Minerals tops the week's table for largest reduction, followed -at a distance- by Reliance Worldwide, AMP (FY19) and Cooper Energy. Next comes a whole heap of nothing.

There is a lot more happening with earnings estimates where battle-weary Pact Group finally enjoyed a rare moment under the sun, topping the week's ranking for largest positive amendment to earnings forecasts, followed by Pinnacle Investment Management (FY19), Suncorp (FY19), Telstra and Kathmandu (trading update).

The negative side of the ledger is over-populated with many suffering double-digit percentage reductions to forecasts. The table is led by AMP, AGL Energy, Xero, Nufarm, and Aveo Group. Other profit report updaters seem to have ended mostly on this side of the ledger, with Insurance Australia Group, Coronado Global Resources, CYBG and Rio Tinto all represented.

The local reporting season picks up pace this week, ahead of the true seasonal onslaught as the end of August approaches.

Upgrade

AGL ENERGY LIMITED ((AGL)) Upgrade to Neutral from Sell by UBS and Upgrade to Hold from Lighten by Ord Minnett .B/H/S: 0/3/4

FY19 net profit was ahead of UBS estimates. The broker expects there will be some support for the share price from the $650m buyback in FY20, although challenges will arise from retail regulation and lower forecast long-term wholesale electricity markets.

The broker believes the Perth Energy acquisition confirms some retail growth potential in the west but the company needs new material growth projects to fill the earnings gap that is expected to emerge by FY22.

Rating is upgraded to Neutral from Sell and the target raised to $18.50 from $18.35.

FY19 results were slightly ahead of Ord Minnett's estimates. The broker's concerns were confirmed, nonetheless, as FY20 guidance implies earnings are set to decline -17-25%.

The broker notes there is some evidence of share gains, with electricity retail customer numbers increasing in FY19. Rating is upgraded to Hold from Lighten as the stock is now in line with the revised valuation.

The broker estimates the stock now offers a dividend yield in excess of 5% which compares favourably with most ASX-listed utilities and infrastructure stocks. Target is reduced to $18.90 from $19.75.

See also AGL downgrade.

ALS LIMITED ((ALQ)) Upgrade to Buy from Neutral by Citi .B/H/S: 3/3/0

First half guidance signals weaker trends in geochemistry and Citi continues to envisage a near-term risk to commodities earnings. However, the broker upgrades to Buy from Neutral as the valuation is considered attractive.

Moreover, there is potential upside to FY21 forecasts from higher exploration expenditure, because of recent strength in the gold price. Target is reduced to $7.90 from $8.10.

AMP LIMITED ((AMP)) Upgrade to Equal-weight from Underweight by Morgan Stanley .B/H/S: 0/6/1

First half underlying profit was below Morgan Stanley's estimates. The $650m capital raising should fast-track the company's strategic overhaul, in Morgan Stanley's view, as it seeks to exit the life business, divest New Zealand and transform its wealth operations.

The revised deal with Resolution Life surprised the broker as it is a cleaner transaction - $2.5bn cash and 20% equity - expected to be completed in the first half of 2020. The proceeds will pay down debt and fund separation costs as well as provide funding for the company's strategy.

In wealth, the broker notes if successful, AMP will have a contemporary platform without the legacy overhang. The new 40-60% cash net profit pay-out ratio suggests AMP is seeking a more aggressive growth setting.

Rating is upgraded to Equal-weight from Underweight and the target is raised to $1.65 from $1.50. Industry view is In-Line.

AP EAGERS LIMITED ((APE)) Upgrade to Overweight from Equal-weight by Morgan Stanley .B/H/S: 3/1/0

Morgan Stanley upgrades to Overweight from Equal-weight, believing an opportunity now exists to buy a quality operator at cyclical lows. AP Eagers has become bigger and more relevant now it has merged with Automotive Holdings.

The broker also envisages more synergies will emerge from consolidating the footprint and advertising/promotions but does not include these items in its estimate for synergies of $115m. Target is raised to $12.80 from $7.00. Industry view: In-Line.

BREVILLE GROUP LIMITED ((BRG)) Upgrade to Neutral from Underperform by Credit Suisse .B/H/S: 1/3/0

Credit Suisse believes Breville is unlikely to disappoint at its upcoming result release, given persistent guidance of 11% earnings growth despite overall weakness in retail. Yet nor is the stock likely to re-rate given it is already expensive as far as the broker is concerned.

The broker has lifted its target to $16.44 from $12.59 (February) and on balance moves back to a Neutral stance from Underperform.

DOMINO'S PIZZA ENTERPRISES LIMITED ((DMP)) Upgrade to Buy from Neutral by UBS .B/H/S: 3/2/1

UBS believes the market has priced in the earnings risk and a slower ramp up in the EU.

Domino's Pizza has underperformed the ASX 200 by -18% over the last three months and, while earnings risk is still envisaged into the FY19 results, the broker believes this has been well flagged.

Rating is upgraded to Buy from Neutral amid a strong growth opportunity. Target is steady at $48.50.

NAVIGATOR GLOBAL INVESTMENTS LIMITED ((NGI)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 2/0/0

FY19 results were in line with the recent trading update. Macquarie observes the outlook is stabilising and the risk has shifted to the upside.

The company continues to invest in a proprietary platform and management is progressing with marketing, confident in its opportunity and product offering.

Hence, the broker upgrades to Outperform from Neutral and raises the target to $3.63 from $3.62.

TECHNOLOGYONE LIMITED ((TNE)) Upgrade to Hold from Lighten by Ord Minnett .B/H/S: 0/3/1

Ord Minnett upgrades to Hold from Lighten, believing upgrades to management's stated targets are not needed to justify the current valuation.

The company has highlighted a slightly faster and stronger cloud conversion profile than the broker has forecast and, while this is likely to play out, Ord Minnett would like more evidence before reviewing its assumptions. Target is raised to $6.90 from $6.80.

Downgrade

AGL ENERGY LIMITED ((AGL)) Downgrade to Reduce from Hold by Morgans .B/H/S: 0/3/4

FY19 results were slightly better than Morgans expected. However, guidance for FY20 underlying net profit has missed forecasts. The broker believes the fundamentals paint a bleak picture over the long-term.

Risks from regulation and the increasing age of the generation fleet are expected to weigh on the stock, despite the short-term support from the buyback.

The company has announced a share buyback of up to 5% of outstanding capital. The broker suspects AGL will need to increase its debt to pay for the buyback as well as its expansion plans.

Rating is downgraded to Reduce from Hold and the target reduced to $16.86 from $18.33.

See also AGL upgrade.

ARB CORPORATION LIMITED ((ARB)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 0/4/0

Macquarie observes cyclical headwinds are weighing on the business and likely to persist amid a soft retail environment, with weakness in utility vehicle sales and construction sector activity. The broker downwardly revises FY19-20 estimates by -1-3%.

While the business is considered quality, Macquarie downgrades to Neutral from Outperform, envisaging earnings risks are skewed to the downside. Target is reduced to $18 from $20.

RELIANCE WORLDWIDE CORPORATION LIMITED ((RWC)) Downgrade to Equal-weight from Overweight by Morgan Stanley .B/H/S: 3/3/0

Morgan Stanley suspects the outlook has deteriorated since the company downgraded its FY19 guidance in May. Headwinds ensue from Brexit, US tariffs and weak Australian housing construction.

Envisaging that commentary at the results may be disappointing, Morgan Stanley downgrades to Equal-weight from Overweight. Increased tariffs on goods from China are likely to place further pressure on the company's US margins in FY20.

The broker also suspects the risks are to the downside for underlying economic activity in the UK and ultimately to margins for the John Guest operations. Target is reduced to $3.75 from $5.00. Industry view is Cautious.

SUPERLOOP LIMITED ((SLC)) Downgrade to Equal-weight from Overweight by Morgan Stanley .B/H/S: 1/1/0

The company has downgraded guidance several times ahead of the FY19 results, reducing FY20 guidance for operating earnings (EBITDA) by -50% because of a slower ramping up in sales.

Morgan Stanley downgrades to Equal-weight from Overweight. Industry view is In-Line. Target is reduced to $1.10 from $1.75.

TPG TELECOM LIMITED ((TPM)) Downgrade to Equal-weight from Overweight by Morgan Stanley .B/H/S: 1/2/3

Morgan Stanley expects the shares will be detached from the fundamentals over the next 6-12 months and trade on the probability of outcomes in the Federal Court case of the proposed merger with Vodafone.

The broker envisages little risk to the company's FY19 guidance of $800-820m in operating earnings (EBITDA), given the strong first half.

Rating is downgraded to Equal-weight from Overweight and the target is lowered to $6.85 from $7.15. Industry view is In-Line.

Total Recommendations Recommendation Changes

Broker Recommendation Breakup

Broker Rating Order Company New Rating Old Rating Broker Upgrade 1 AGL ENERGY LIMITED Neutral Sell UBS 2 AGL ENERGY LIMITED Neutral Sell Ord Minnett 3 ALS LIMITED Buy Neutral Citi 4 AMP LIMITED Neutral Sell Morgan Stanley 5 AP EAGERS LIMITED Buy Neutral Morgan Stanley 6 BREVILLE GROUP LIMITED Neutral Sell Credit Suisse 7 DOMINO'S PIZZA ENTERPRISES LIMITED Buy Neutral UBS 8 NAVIGATOR GLOBAL INVESTMENTS LIMITED Buy Neutral Macquarie 9 TECHNOLOGYONE LIMITED Neutral Sell Ord Minnett Downgrade 10 AGL ENERGY LIMITED Sell Neutral Morgans 11 ARB CORPORATION LIMITED Neutral Buy Macquarie 12 RELIANCE WORLDWIDE CORPORATION LIMITED Neutral Buy Morgan Stanley 13 SUPERLOOP LIMITED Neutral Buy Morgan Stanley 14 TPG TELECOM LIMITED Neutral Buy Morgan Stanley Recommendation Positive Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 BRG BREVILLE GROUP LIMITED 13.0% -13.0% 26.0% 4 2 APE AP EAGERS LIMITED 63.0% 38.0% 25.0% 4 3 XRO XERO LIMITED -8.0% -25.0% 17.0% 6 4 ALQ ALS LIMITED 42.0% 25.0% 17.0% 6 5 AMP AMP LIMITED -14.0% -29.0% 15.0% 7 6 DMP DOMINO'S PIZZA ENTERPRISES LIMITED 21.0% 7.0% 14.0% 7 7 TNE TECHNOLOGYONE LIMITED -25.0% -38.0% 13.0% 4 8 AGL AGL ENERGY LIMITED -57.0% -64.0% 7.0% 7 9 A2M THE A2 MILK COMPANY LIMITED 21.0% 17.0% 4.0% 7 Negative Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 PLS PILBARA MINERALS LIMITED 33.0% 67.0% -34.0% 3 2 COE COOPER ENERGY LIMITED 67.0% 100.0% -33.0% 3 3 TPM TPG TELECOM LIMITED -42.0% -25.0% -17.0% 6 4 RWC RELIANCE WORLDWIDE CORPORATION LIMITED 42.0% 58.0% -16.0% 6 5 NAB NATIONAL AUSTRALIA BANK LIMITED 7.0% 21.0% -14.0% 7 Target Price Positive Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 APE AP EAGERS LIMITED 9.338 7.888 18.38% 4 2 BRG BREVILLE GROUP LIMITED 15.505 14.543 6.61% 4 3 XRO XERO LIMITED 58.250 55.250 5.43% 6 4 TNE TECHNOLOGYONE LIMITED 7.258 7.233 0.35% 4 Negative Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 PLS PILBARA MINERALS LIMITED 0.700 0.800 -12.50% 3 2 RWC RELIANCE WORLDWIDE CORPORATION LIMITED 4.425 4.633 -4.49% 6 3 AMP AMP LIMITED 1.830 1.907 -4.04% 7 4 AGL AGL ENERGY LIMITED 18.186 18.877 -3.66% 7 5 COE COOPER ENERGY LIMITED 0.583 0.600 -2.83% 3 6 TPM TPG TELECOM LIMITED 6.225 6.275 -0.80% 6 7 NAB NATIONAL AUSTRALIA BANK LIMITED 26.986 27.114 -0.47% 7 8 ALQ ALS LIMITED 7.905 7.938 -0.42% 6 Earning Forecast Positive Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 PGH PACT GROUP HOLDINGS LTD 23.010 -8.215 380.10% 4 2 PNI PINNACLE INVESTMENT MANAGEMENT GROUP LIMITED 20.033 16.533 21.17% 3 3 SUN SUNCORP GROUP LIMITED 86.257 76.086 13.37% 7 4 TLS TELSTRA CORPORATION LIMITED 20.257 18.543 9.24% 7 5 KMD KATHMANDU HOLDINGS LIMITED 22.890 21.020 8.90% 3 6 MGR MIRVAC GROUP 17.467 16.967 2.95% 5 7 BEN BENDIGO AND ADELAIDE BANK LIMITED 81.033 79.517 1.91% 6 8 URW UNIBAIL-RODAMCO-WESTFIELD 56.437 55.385 1.90% 4 9 WPL WOODSIDE PETROLEUM LIMITED 212.431 208.617 1.83% 7 10 SCP SHOPPING CENTRES AUSTRALASIA PROPERTY GROUP 16.480 16.260 1.35% 5 Negative Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 AMP AMP LIMITED 5.914 18.443 -67.93% 7 2 AGL AGL ENERGY LIMITED 128.443 154.443 -16.83% 7 3 XRO XERO LIMITED 10.559 12.467 -15.30% 6 4 NUF NUFARM LIMITED 23.387 27.473 -14.87% 6 5 AOG AVEO GROUP 8.400 9.400 -10.64% 3 6 IAG INSURANCE AUSTRALIA GROUP LIMITED 38.414 42.329 -9.25% 7 7 COE COOPER ENERGY LIMITED 0.503 0.550 -8.55% 3 8 CRN CORONADO GLOBAL RESOURCES 57.646 62.050 -7.10% 3 9 CYB CYBG PLC 47.050 48.860 -3.70% 3 10 RIO RIO TINTO LIMITED 1000.503 1030.330 -2.89% 7 Technical limitations

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

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Uranium Week: Complete Standstill

Not one transaction was reported in uranium markets last week.

-Trump explains 232 decision -Uranium traders hit the beach

By Greg Peel

Donald Trump wrote to Congressional leaders last week to explain why he had rejected the Department of Commerce's recommendation to go ahead with section 232 intervention into the US uranium production market, suggesting "A fuller analysis of national security considerations with respect to the entire nuclear fuel supply chain is necessary at this time".

Presumably this means the section 232 recommendation is not yet dead and buried, but it could be argued that Trump had no choice but to establish a Working Group to examine the whole nuclear fuel cycle given any move to support US uranium miners would impact on US nuclear power generators and vice versa.

But what it does mean is a uranium market which had to wait so long to learn of Trump's 232 decision is again back in waiting mode. And it's summer vacation time in the northern hemisphere.

Hence last week saw no transactions reported in the uranium spot or term markets. Not one.

Industry consultant TradeTech's weekly spot price indicator remains unchanged at US$25.25/lb, while term market prices remain unchanged at US$28.50/lb (mid) and US$31.00/lb (long).

The two transactions reported in the spot market late the week before means August has seen a total of two transactions to date compared to an August average of 15 transactions totalling 2.7mlbs U3O8 equivalent.

It's going to be a long summer.

Today's Financial Calendar

The FNArena Calendar is compiled on a best endeavours basis and cannot be relied upon to be undeniably accurate. Australian companies are not legally obliged to notify of intended reporting dates nor adhere to dates previously suggested. The Calendar is sourced from calendars compiled by stockbrokers which more often than not will contradict each other. FNArena apologies for any inaccuracies that appear from time to time in its own compilation. The Calendar should be viewed by readers as a guide and not a definitive source.

Significant Scheduled Events For 14 August, 2019:

(AU) - wage price index, Q2 (AU) - Westpac consumer confidence, Aug (CH) - fixed asset investment, Jul (CH) - industrial production, Jul (CH) - retail sales, Jul (EZ) - industrial production, Jun (EZ) - GDP, Q2 (revision) (UK) - CPI&PPI, Jul (AYK) - ex-div 88c (41%) (AYZ) - ex-div 89c (74%) (CBA) - ex-div 231c (100%) (COH) - earnings result (CPU) - earnings result (CSL) - earnings result (DXS) - earnings result (GBT) - earnings result (HT1) - earnings result (NAB) - quarterly report (NGI) - ex-div 13.4c (PGH) - earnings result (RMD) - ex-div 3.92c (RYD) - ex-div 3c (100%) (SCG) - ex-div 11.3c (SUN) - ex-div 44c (100%) (TAH) - earnings result (VCX) - earnings result (WPL) - earnings result

The Short Report - 15 August 2019

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 August 8, 2019

Last week saw the ASX200 tank in line with Wall Street on China currency fears before grinding out a modest recovery. Today is a different story.

In last week's Report I suggested the run to the high itself might explain why there was a lot more red than green on the table below, yet this week we see all red in the downturn bar one stock.

While a drop in CSR ((CSR)) shorts would reflect last week's sympathy rally after peer James Hardie ((JHX)) posted a very strong earnings report, elsewhere it would appear most short increases are in anticipation of earnings reports to come. AMP ((AMP)) is the only stock to have already reported (poorly).

It is worth noting that of the 14 stocks shorted by 10% or more, four are battery-related, reflecting the volatility in the EV/battery demand versus lithium/graphite/etc supply argument, and four are agriculture-related. Top two shorted Inghams Group ((ING)) and Nufarm ((NUF)) reflect the drought story while Bellamy's ((BAL)) and Bega Cheese ((BGA)) are more about Chinese risks.

Nufarm shorts rose to 19.2% last week from 17.8% and Bega's rose to 10.7 from 9.7%.

Harvey Norman ((HVN)) shorts rose to 10.6% from 9.6% to put it in the 10% club alongside peer JB Hi-Fi ((JBH)) on 14.4%, but JB Hi-Fi reported the day after and sparked a short-covering rally. Stay tuned for next week.

Shorts in nickel miner Western Areas ((WSA)) jumped to 8.6% from 7.3% on a supply-side related rally for the nickel price some analysts see as only temporary.

The earnings season will begin to have more of an impact in next week's report before the last two weeks of August bring an absolute flood of results. And this before a macro backdrop of escalating volatility. Could get interesting for the shorters.

That about covers it. No Movers & Shakers this week.

Weekly short positions as a percentage of market cap:

10%+ ING 19.4 NUF 19.2 BAL 16.0 ORE 16.0 GXY 15.9 JBH 14.4 NXT 14.0 SYR 13.6 BWX 12.1 DMP 11.8 PLS 11.7 HUB 11.3 BGA 10.7 HVN 10.6

In: BGA, HVN

9.0-9.9

BIN, RWC, MTS, IFL, SGM, BOQ, AMP, KGN

In: BOQ, AMP, KGN Out: BGA, HVN 8.0-8.9%

PPT, WSA, IVC, SDA, GWA, SUL

In: WSA, GWA Out: AMP, BOQ, KGN, CSR

7.0-7.9%

BKL, CLH, CGC, CSR, MYR, CGF, DCN

In: CSR Out: WSA, GWA

6.0-6.9%

GEM, NEC, ELD, A2M, NCZ, GMA, COE

In: NCZ, COE

5.0-5.9%

CTD, LNG, SFR, CLQ, SAR, MSB, OML, SXY, NWL, CUV

In: CUV Out: NCZ, COE

Movers & Shakers

See above.

ASX20 Short Positions (%)

Code Last Week Week Before Code Last Week Week Before AMC 0.9 0.9 RIO 4.7 4.4 ANZ 0.7 0.7 S32 1.4 1.4 BHP 3.0 2.9 SCP 0.7 0.6 BXB 0.3 0.2 SUN 0.5 0.3 CBA 1.1 1.1 TCL 0.8 0.8 COL 1.0 1.0 TLS 0.4 0.3 CSL 0.3 0.3 WBC 1.1 1.0 IAG 0.4 0.4 WES 1.1 1.2 MQG 0.7 0.7 WOW 1.8 1.6 NAB 0.6 0.6 WPL 0.9 0.9 To see the full Short Report, please go to this link

IMPORTANT INFORMATION ABOUT THIS REPORT

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

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

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

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

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

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

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

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

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

Nick Scali Dependent On Housing Turnaround

It's a tough year ahead for Nick Scali as conditions are subdued and the furniture retailing business is dependent on a turnaround in housing activity.

-Noticeable decline in the same-store sales trends -Attractive dividend yield and undemanding P/E ratio -Management reluctant to discount in order to drive sales

By Eva Brocklehurst

Furniture retailer Nick Scali ((NCK)) is facing a tough year ahead as sales momentum turned negative in FY19. Conditions for retailers do not appear to have improved since the federal election, Wilsons points out.

Foot traffic has eased and earnings growth is expected to be driven by new store openings, with management now targeting 85 in the long term. The company continues to adopt a measured approach to rolling out stores, while a move offshore is considered unlikely in the near term.

FY19 operating earnings (EBITDA) of $65m were in line with expectations. Still the quality of the result pleased Macquarie, as cash flow was strong and inventory was cleared. No FY20 guidance was provided. Same-store sales trends softened, with a noticeable decline in the fourth quarter amid weak housing turnover. A material improvement in trading is not expected until housing and renovation activity improve.

Wilsons was disappointed with like-for-like sales and customer deposit outcomes, particularly given elevated trading multiples heading into the result, and has a Hold rating and $6.56 target. Customer deposits declined -0.5% and based on the updated split of products this implies expenditure on lounges declined -3.3% year-on-year.

Citi acknowledges some investors, prepared to look through another potential downgrade, may be attracted to the undemanding FY20 price/earnings ratio of 12x, an 8% dividend yield and an improving housing outlook, yet retains a Sell rating and $5.97 target.

Management remains reluctant to discount in order to drive sales, Macquarie points out, but still plans to remain competitive and focus on marketing and improved conversion strategies. Market consolidation is also expected following recent competitor closures.

Citi envisages downside risk to earnings will increase in FY20 as the store roll-out is likely to be slower, and a higher store base means upside from the roll-out will be smaller. Downside pressures are also emerging from a weaker Australian dollar.

The broker expects first half sales to decline by -2.5% and the decline moderate to -1% in the second half, on the assumption that housing starts to improve and there is a pick up in consumer confidence from lower interest rates.

While the result may have been commendable, in the wake of challenging conditions, Macquarie accepts better conditions are required to drive a re-rating of the stock and maintains a Neutral rating with a $6.15 target.

Moreover, the broker suspects short covering may have played a part in the market reaction to the results as the stock had eased beforehand. A minor contraction in earnings is expected in FY20 but the healthy dividend yield and balance sheet should provide valuation support.

Radio Advertising Market Pivotal For HT&E

Radio advertising markets are now pivotal for HT&E and the environment remains tough in the second half of 2019, although the third quarter could be a nadir.

-Comparables for the Australian Radio Network become easier from September -Significant buyback capacity retained -Potential takeover target in consolidating media environment

By Eva Brocklehurst

HT&E ((HT1)) acknowledges conditions in its Australian Radio Network are weak and suspects advertising market revenue will be down by mid single digits in the third quarter. Nevertheless, the company is holding its market share in a tough environment, viewed by brokers now as a play on the radio advertising market, after the sale of its outdoor assets in 2018.

The company has flagged first half operating earnings (EBITDA) of $38m but, as Canaccord Genuity points out, this reflects the impact of accounting changes and, adjusting for this, puts the figure at $30.3m. Australia Radio Network revenue declined by -3.8%.

Media industry trading conditions have been weak since the federal election, although comparables will become significantly easier from September and UBS suspects the third quarter could be a nadir. However, costs growth will be above trend in the second half and the broker reduces estimates by -2-3% for 2019-20.

The company has also increased its dividend policy to 60-80% of net profit, from 40-60%, amid the resignation of the Chief Financial Officer and General Counsel as part of the initiatives to reduce corporate costs. The former CFO of Adshel has been appointed CFO.

HT&E retains a focus on its audio investments, with other parts of the business under review, excluding the Hong Kong outdoor segment. The second half outlook for the Hong Kong business is considered uncertain, given the impact of civil unrest.

No revenue has been affected to this point but Macquarie suggests there is a risk to second half numbers, as forward bookings are not that strong. Hong Kong outdoor operating earnings on a like-for-like basis were up 203% in the first half. The company will also close down Gfinity Esports, in which it has a 35% stake, unwilling to commit the necessary capital to develop the business.

Soprano Design

Soprano Design is a provider of mobile messaging technology for mobile network carriers that has demonstrated impressive revenue growth. HT&E provided more visibility regarding the financials for Soprano Design and UBS suspects the $15m carrying amount understates the true value of the business.

Soprano Design is already profitable, recording 22% growth in revenue and 13% growth in operating earnings over the past 12 months. UBS now includes $50m for the company's 25% stake in the business. Macquarie suggests HT&E could look at unlocking value for its stake, given this is not a core operation.

Given the increased disclosure provided for Soprano Design, in particular, Credit Suisse also wonders if an IPO (initial public offer) of this business may again be on the cards, as it was back in 2016.

Buyback Capacity

Canaccord Genuity suspects a further buyback could be used to buttress the stock against significant downward pressure. Attractive valuation metrics and the buyback capacity - the balance sheet is extremely healthy - persuade the broker to retain a Buy rating and a $2.20 target.

Canaccord Genuity, not one of the seven monitored daily on the FNArena database, lowers 2019 operating earnings forecasts by -5% based on the commentary regarding soft radio market conditions and the prospect of higher costs.

Macquarie agrees there is potential for further capital management in 2020. Cost growth in the second half is likely to exceed revenue growth, the company has acknowledged, given an inability to repeat the savings of 2018. If poor market conditions continue Macquarie, too, expects another wave of cost cutting initiatives.

In terms of the dispute with the Australian Taxation Office there was no update regarding a change in interest or penalties. The company has previously paid a $50.7m deposit in relation to claims being pursued. A final resolution could take several years, Macquarie points out, and this is costing the company $2m per annum. The broker believes HT&E is a potential takeover target in a consolidating media environment.

FNArena's database shows one Buy rating (Credit Suisse), two Hold and one Sell (Morgan Stanley). The consensus target is $1.78, signalling 3.2% upside to the last share price the dividend yield on 2019 and 2020 forecasts is 5.6% and 5.3% respectively.

August Reporting Season: Early Progress Report

Dear time-poor reader: early update on corporate results, plus a longer-term assessment of CSL.

In this week's Weekly Insights:

-Financial Joke -August Reporting Season: Early Progress Report -CSL Challenge: The Key Ingredient -Rudi Talks -Rudi On Tour

By Rudi Filapek-Vandyck, Editor FNArena

Financial Joke

Question: what is a stock that has fallen by -90%?

Answer: that's a stock that falls by -80%, and then the share price halves.

August Reporting Season: Early Progress Report

August is local reporting season for Australian listed companies, but the pace of corporate results releases is so much skewed to the second half of the month that as half-way approaches on the calendar, it remains way too early to draw any definitive conclusions or make far-reaching assessments.

As at Monday, 12th August 2019, the FNArena Corporate Results Monitor still only contains 30 corporate updates. Considering that by month's end the total will have exceeded 300 updates, we have an urge to feel sorry for ourselves. After all, those 300 corporate releases will have to be covered, followed up, updated and summarised. And the slower the season ramps up... you get the idea.

A few early assessments won't go astray (we hope). Corporate Australia clearly is doing it tough. Corporate updates thus far either reveal declining profits, or negative sales growth, or downward pressure on margins, or all three combined.

Subsequent share price responses are often left to management's guidance for the year ahead, potentially supported or negated by hedge funds and other traders taking position prior to the results release.

As such we witnessed Suncorp ((SUN)) releasing a weak result, but with the share price moving higher, and on Friday REA Group ((REA)) missed market expectations, but its share price since put in a notable rally higher. In contrast, CommBank ((CBA)) shares were initially punished upon the release of a weak financial report card, but buyers have since shown themselves.

No such buyers' interest has revealed itself for Insurance Australia Group ((IAG)), whose shares are down quite heavily in a short time, including following the release of disappointing FY19 numbers, and the same observation can be made for Cimic Group ((CIM)), Janus Henderson ((JHG)) and GUD Holdings ((GUD)), whose share prices are all trading significantly below levels prior to the respective results releases.

In the lead-up to August, I predicted investors were most likely to witness a multi-layered experience. The first two weeks are already showing plenty of evidence for this thesis.

We also had a number of major beats, with subsequently solid share price rallies for James Hardie ((JHX)), Pinnacle Investment Management ((PNI)), and Navigator Global Investments ((NGI)). Both ResMed ((RMD)) and REA Group once again proved quality High PE stocks are not necessarily toast, as they have done for many years now.

Continuing on my forecast of a multi-layered August reporting season, Macquarie analysts note companies with direct exposure/leverage to the local housing market have all revealed "headwinds" and tough operational challenges, with each of James Hardie, REA Group, Transurban ((TCL)), CommBank, Mirvac ((MGR)) and Nick Scali ((NCK)) talking the same talk.

But not all housing related business models are similarly vulnerable or operationally exposed with James Hardie and REA Group arguably in a better position than CommBank and Nick Scali.

Macquarie, by the way, continues to recommend investors should buy the dip in selected housing-related businesses, including REA Group, Nine Entertainment ((NEC)), Stockland ((SGP)), James Hardie, CSR ((CSR)), National Australia Bank ((NAB)) and Westpac ((WBC)).

Macquarie's reasoning is that housing will stabilise and subsequently improve on the back of continued RBA rate cuts.

In continuation of recent years, reporting season these days is heavily coloured with capital management (special dividends and share buy backs), as well as with capital raisings. A-REITs in particular are once again using the opportunity to raise fresh capital, but Nufarm ((NUF)), Transurban and AMP ((AMP)) equally have announced fresh raisings.

In terms of general trends, FY19 average EPS growth might not come out too far off the zero mark, predominantly because of another booming performance from resources, in particular iron ore producers and gold miners.

Banks are expected to extend their negative growth period and international industrials are projected to perform significantly better than domestic industrials.

FNArena continues to provide daily updates on Australian corporate updates: https://www.fnarena.com/index.php/reporting_season/

The early data are far from encouraging with decisively more "misses" than "beats" (40% versus 30%) but, as every optimist will tell us, it remains early days.

See also:

"August Preview: Lower Rates & Lower Growth"

https://www.fnarena.com/index.php/2019/08/08/august-preview-lower-rates-lower-growth/

"Corporate Earnings Still Matter In 2019"

https://www.fnarena.com/index.php/2019/07/25/corporate-earnings-still-matter-in-2019/

CSL Challenge: The Key Ingredient

The prior update for the CSL Challenge zoomed in on the significant rewards that await shareholders who are able to identify a high quality, structural growth story such as CSL ((CSL)), and then stay on board for the long run instead of losing focus because of temporary and intermediary distractions.

Ever since my share market research focused on finding those exceptional All-Weather Performers in the Australian share market, CSL has been a proud and prominent inclusion of my limited selection. As far as I am concerned, this is by far the greatest corporate success story that has ever sprung from Australian soil. Full stop.

Gamblers seldom decide upon which jockey will be riding the horse; instead they punt on which horse is most likely to win the race. Does anyone remember the names of any of the jockeys that had the pleasure to sit on top of Winx lately?

In similar vein, any quality company can only grow into a true All-Weather Performer thanks to a supportive industry structure. This does by no means imply that only monopolists and oligopolists, largely protected from disruptive competitors, can truly provide investors with sustainable longer term rewards.

But the best video shop can only achieve so much when the industry as a whole remains on its way to ultimate extinction. Similarly, if the world tomorrow would have significantly lesser need for blood plasma, that quality label that CSL has carefully built up over the past 25 years wouldn't account for much in the share market.

Luckily for my research, and for loyal shareholders, global demand for blood plasma has been strong over the past decades, and it is expected to remain strong. Because of ongoing strong demand, the industry as a whole is struggling to keep up with supply, which has exerted itself as one of the key growth limitations for the major players in this market.

CSL has developed into the true market leader in a global competitive segment of the healthcare industry that has been growing at circa 9% per annum in sales/revenues since 2007. At face value, there doesn't seem to be an economic moat to protect CSL's market leading position, but practice has shown otherwise.

Primary access to blood plasma remains key and CSL remains the sole top player who is able to source 100% of supply in-house. It operates the largest and most efficient network of collection centres, which apart from obvious sunk investment and operational costs, comes with above average security checks and regulations.

Moreover, it takes nine months between collection of the blood plasma, treating it and ultimately selling for it to be used for medical purposes. This implies ample of cash flows are required to keep the business running in the meantime.

On top of this all major players allocate circa 10% of annual revenues to R&D plus hundreds of millions on investments in new plants and collection centres. It should surprise no-one this industry has consolidated firmly since the time CSL listed on the ASX in 1994.

It still makes for a highly competitive, but rational environment. Such has been the platform that has allowed CSL to expand its market share and to showcase the qualities of management and staff, providing large and sustainable rewards for all stakeholders.

The continuous investments made in R&D are a key part in this success story as the industry continues to find and develop new treatments and medical products for often rare diseases and life-threatening medical conditions.

To understand the industry and CSL, it is important to appreciate the continuous drive towards new discoveries and further innovation. Outside of the CSL business, there is always someone somewhere trying to develop an alternative therapy or competing product.

The fact that CSL has managed to stay on top of the sector, and to retain largest market share in the two key market segments -immunoglobulins and albumin- is a major statement underlining the company's achievement since incorporation in 1991. CSL has now also become a top two player in the global market for flu vaccinations, which simply further complements the company's cabinet of medals and trophies.

For investors: note the key factors that make CSL a very different beast from, say, Telstra. CSL pays out less than 50% of its profits in the form of dividends to shareholders, but those dividends have steadfastly grown and are projected to continue growing in the years ahead on the back of ongoing improvements in sales and profits.

To keep the comparison with lower quality Telstra going for a little longer: a smart cookie elsewhere once established that if at the time of Telstra's initial ASX-listing in the late 1990s, investors had bought shares in CSL instead, and kept them until today, they would have collected more dividends over the period than loyal Telstra shareholders. And that's not mentioning the sharp difference in share price performances.

CSL spends a big chunk of the other half of the profits it doesn't pay out to shareholders on developing new products; effectively finding new avenues for growth and defending (or increasing) its margins and market share. This is not dissimilar from well-entrenched policies at companies including Cochlear ((COH)) and ResMed ((RMD)). No surprise thus, they too are included in my select list of ASX-listed All-Weather Performers.

Of course, an investment in CSL is by no means risk-free. The industry collects most of its supply in the USA, where it pays for donations. Irrespective, American donors couldn't possibly keep up with global demand increases into infinity. US donors already satisfy two-thirds of global demand. The limitations on supply are currently being examined by governments and regulators in Europe. A small group of European countries already allows for plasma donors to be paid.

China commands that all plasma is collected on the ground, not imported from elsewhere. Luckily for the industry, this is opening up a new source of supply (albeit directly linked to demand in one geographical region). The Chinese market is rapidly growing in importance for CSL and its peers. Rapid growth in China underpins current expectations for the sector globally. As China grows in importance, it also shifts the sector's risk profile.

According to a recent report by Citi analysts, the $4bn Chinese plasma protein market is expected to post a five-year sales CAGR of around 15%, versus less than 10% for the $10bn US plasma market, excluding recombinants.

As a rule of thumb, demand growth as it currently stands, is projected to average circa 8% per annum globally for the decade ahead. This is slightly down from 9% over the decade past. As blood plasma, and its many offshoots, enjoy a multiple in applications and therapies that feed into, and support such expectations, there seems to be a lesser chance for major disappointment attached to these projections.

Investors should note all major players in the industry are by now investing heavily in additional collection. If for whatever reason demand slows significantly, or is being disrupted, this would open up the risk for oversupply at some point in the future.

Again, it has to be noted, CSL has been planning and operating ahead of the curve, enjoying most of the industry benefits in years past when supply was unable to keep pace with growth in demand. On current forecasts, demand will be 40% greater by 2023 and current expansion plans industry wide would simply barely keep up. CSL's own expansion plans imply 40% larger capacity by 2023; plans involve opening 30-35 new centres each year.

Apart from continuously addressing new conditions and diseases, the industry's demand outlook continues to be underpinned by aging populations, and growing awareness still, while lower unemployment rates result in more people paying for health insurance in the largest market, the USA.

On simplistic assumptions, assuming supply keeps up with projected growth in demand, and prices continue to increase in line with inflation each year, while all else remains unchanged, then CSL should be able to grow its revenues by double digit percentage each year.

The task lays then with management to not overspend and keep the costs contained, and shareholders should see 10% or more growth coming their way, year-in, year-out.

Of course, things are never that simple. Products go in and out of fashion, or battle a new competitor or an alternative therapy. Not every major investment might generate the hoped for success or projected return on investment. Not every year delivers a nasty flu season. And so forth.

On current expectations, and with CSL expected to deliver yet another year of double digit percentage growth in FY19, stockbroking analysts are currently predicting FY20 will be a year of slow growth only. This is not that uncommon. It has happened in the past, and should by no means be interpreted as a bad omen for future years.

Analysts at Citi, for example, who have set the highest price target for CSL among the seven stockbrokers monitored daily by FNArena, at $239.60, anticipate virtually no growth next year, but then a jump to 24.5% EPS growth in FY21. Beyond the year ahead, Citi remains convinced CSL is ideally placed to grow faster than the industry, and thus take market share, on a three to five year horizon.

All shall be revealed and updated on Wednesday when CSL is scheduled to release FY19 financials.

In case you read this and you still haven't joined the CSL Challenge, do know you can join at any time, from any place of your own choosing.

Here's more info about it: https://www.fnarena.com/index.php/2019/01/14/rudis-view-join-the-csl-challenge/

Also, paid subscribers have access to my eBooks and other writings about CSL and All-Weather Performers, see the dedicated section on the FNArena website.

Rudi Talks

Video interview with Peter Switzer and Julia Lee on Monday last week:

https://www.youtube.com/watch?v=03jqw77Owgg&t=1102s

Rudi On Tour In 2019

-AIA and ASA, Perth, WA, October 1

In 2020:

-ASA Hunter Region, near Newcastle, May 25

(This story was written on Monday 12th August 2019. It was published on the day in the form of an email to paying subscribers, and again on Thursday as a story on the website. There will be no Part Two this week).

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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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