

Week
11

Stories To Read From FNArena

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NextDC On Track Despite Unpredictable Sales

NextDC performed poorly in the wake of the first half results and several brokers believe the numbers and the company's strategy have not been well understood.

-Investor expectations need to adjust to a growth profile that remains healthy -Melbourne the laggard in sales, needs to improve to drive re-rating -Hyper-scale market exposes the company to buyer concentration and lower returns

By Eva Brocklehurst

NextDC ((NXT)) has confounded brokers over recent months after a first half result that Citi described as both "beautifully boring" and "genuinely exciting". New accounting standards muddied the waters, with the company electing not to restate comparable numbers in its first half results for FY19, but the broker assesses the company is exactly where it wants to be at this point in time, investing for further growth.

The market may have been disappointed by the disclosures associated with the results, and the stock was knocked down after only one megawatt of new capacity sales were made in the second half of FY18. The shares have performed poorly since the latest results, despite a record half of newly-contracted volumes. The company had downgraded revenue guidance for FY19, because of lower distribution and interest income as a result of the acquisition of Asia Pacific Data Centre.

Morgans suspects some investors were expecting a much larger increase in sales activity in the first half, yet customer numbers have increased 25% year-on-year and customers continue to buy increasingly more connectivity. Interconnections increased 34% and accounts for 7.7% of total recurring revenue.

Nevertheless, Morgans is conscious investors have high hopes and continues to envisage share price risk over the next few years, as expectations need to adjust to healthy growth as opposed to "hockey stick" growth.

Canaccord Genuity estimates that operating earnings (EBITDA) were up more than 25% in the first half and, thanks to a record sales period in Sydney, the company has also approached 14MW, which is 27% of its total contracted capacity. As this is not yet being billed it offers significant indications of revenue and earnings.

Assuming a lower price per megawatt for the non-billing contracted capacity, and adding \$6m in annualised project revenue, the broker estimates over \$217m in annual revenue is on the cards, 36% above equivalent guidance for FY19.

Canaccord Genuity suggests operating earnings have become a less useful measure of the performance of the business, with the adoption of new accounting standards that affect project revenue and rent payment.

Rather than recognising project fees upon completion, this is now amortised over the life of the contract or lease, and rent payments have been disaggregated into finance and depreciation charges. These two items, by chance, appears set to cancel each other out. In the past, project revenue was volatile and, while the new standards mean a deferred revenue liability will be recorded, it should also reduce the volatility of the profile, the broker suggests.

UBS also looks beyond the "noise", and concedes FY19 was always going to be a transition year, as the company incorporates costs associated with new data centres that should contribute from FY20. The broker is still positive about the outlook, although marginally slows its trajectory for active utilisation.

Citi agrees that FY19 is another year of investment and FY20 will be the year when it all makes sense, as the financials absorb the annualisation of higher depreciation charges. Operating leverage should emerge in FY21.

Melbourne

Melbourne continues to be the company's largest market in terms of earnings but will soon be surpassed by Sydney because of strong sales momentum in the latter. One of the issues regarding sales in Melbourne, Canaccord Genuity suspects, has been a relative lack of available inventory.

Melbourne continues to be a lag in terms of sale capacity, with only 3.4 MW secured in the last 3.5 years. By contrast, almost seven times that amount has been contracted in Sydney over the same timeframe.

Canaccord Genuity now believes, with the opening of Melbourne's second data centre (M2) in late 2017, the picture changed markedly and there is now over 40 MW available for sale in Melbourne. Still, based on the slow sales, the broker takes a cautious stance on revenue development. Macquarie asserts that weakness in Melbourne needs to improve in order to drive a re-rating of the stock.

Hyper-scale

Regardless of the headline earnings multiples, which are high, Canaccord Genuity believes there is significant scope for growth and finds it hard to believe M2 will not snare a hyper-scale contract at some point.

To Deutsche Bank, this is exactly what is at issue. The broker downgraded to Sell at the first half result, believing the increased exposure to the hyper-scale market exposes the company to a concentration of buyers and lower returns on invested capital, as well as an unpredictable sales cycle.

The broker also believes sales velocity has decreased because the more complex nature of hyper-scale contracts. Moreover, because the company is incurring significant expenditure to achieve its growth ambitions this has led to elevated debt and interest levels.

Citi asserts large-scale deployments take time and patience is required, although acknowledges any delays in asset delivery could impact the company's reputation and this poses downside risks to forecasts. There is also increased competition from Equinix, which has focus on large cloud customers.

Canaccord Genuity estimates international peers are trading on multiples of 18.1x for average June FY19 estimates. Accordingly, the broker values NextDC shares at \$7.50 each, comprising \$4.00 for existing operations and the balance sheet and \$3.50 for the new facilities. The broker, not one of the eight monitored daily on the FNArena database, retains a Buy rating with a \$7.50 target.

The database has four Buy ratings, two Hold and one Sell (Deutsche Bank). The consensus target is \$7.64, suggesting 23.1% upside to the last share price. Targets range from \$5.50 (Deutsche Bank) to \$9.20 (Morgan Stanley).

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Appen Enhances Scale With Figure Eight

Appen is enhancing its data analytics technology with the acquisition of Figure Eight, which promises a recurring revenue base, increased scale and improved productivity.

-Automated annotation tools should improve Appen's operating leverage -Appen well-placed for high-quality analytics -Main risk is that 88% of Appen's revenue is derived from five customers

By Eva Brocklehurst

Data analytics and language technology provider, Appen ((APX)), is enhancing its reach and scale, acquiring Figure Eight, a machine learning platform that transforms unstructured text, image and audio data into customised training data.

The business is based in San Francisco and there are several aspects to the transaction, Citi observes. Whereas the previous LeapForce acquisition added scale, Figure Eight should open up a capability gap between Appen and its competitors. Figure Eight is a complementary business that will provide the technology, platform and expertise for material scale as well as improved productivity.

The automated annotation tools of Figure Eight should improve the company's operating leverage by increasing the efficiency of the "crowd". A 5% saving on the "crowd" cost approximates the entire Appen 2018 corporate cost, on the broker's calculations.

Platform revenue of around \$25m should also increase revenue visibility over time. Appen will pay US\$175m for Figure Eight with a placement and share purchase plan. There is an earn-out to a maximum of US\$125m, which will be funded via a debt facility.

Citi calculates that long-term synergy savings of around \$14m could equate to around 10% of 2021 earnings estimates. The broker expects the margin to be diluted in 2019 to 17.3% from 19.7% in 2018, and fully recover in 2021.

UBS considers the deal strategically positive but requires further analysis of the numbers before altering forecasts. Initial calculations indicate around -23% dilution to earnings per share in 2019, which reduces to around -8% in 2020.

Still, the acquisition makes sense as this is a high-quality, self-serviced platform. Appen was expected to invest in its own annotation tools, but with Figure Eight there is a recurring base of around 60% of 2018 revenue and a relatively low customer churn rate. UBS has a Neutral rating and \$24 target.

Citi upgrades the stock to Buy from Neutral, with a \$28.04 target. The broker still values Appen on a PE (price/earnings ratio) basis but, should its level of recurring revenue increase materially, then an EV/EBITDA (enterprise value/operating earnings) and/or EV/sales multiple will be used. On both these metrics Appen does not appear expensive, although it has far lower recurring revenue versus comparable companies.

Citi sums up the sector by stating that the winner will be one that can analyse the most amount of data, with the highest quality analytics, in the shortest amount of time, at a competitive price. In this analogy, Appen appears well-placed.

The risk is that 88% of the company's revenue is derived from its top five customers and the loss of one of them would have a substantial impact. Customers can also terminate existing projects with short notice.

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Will Red Chris Add Value To Newcrest?

Brokers perceive Newcrest could add significant value to the Red Chris copper-gold project, in which it has acquired a 70% stake.

-Natural fit for Newcrest as few miners have its expertise in block caving -Opportunity for improvement also lies with better metal recoveries -Is this an opportunistic sideshow?

By Eva Brocklehurst

Newcrest Mining ((NCM)) has opened up a sizeable opportunity via a copper-gold mine in Canada, acquiring a 70% stake in Red Chris for US\$806.5m, a potential tier-1 mine. A tier-1 mine is defined as over 300,000 ounces per annum, with costs of less than US\$800/oz and a life of at least 15 years.

It is clear that Red Chris is not yet in this position, but Newcrest is confident it can add value through optimising the current open pit, which is underperforming, and expediting the transition to block caving.

Brokers believe the mine is a natural fit for Newcrest, as few miners, globally, have its expertise in block caving. Moreover, Morgan Stanley points out the company's coarse ore processing technology could help improve recoveries, which are considered sub-optimal.

UBS notes the sale process was a competitive one and other buyers may have envisaged the potential in optimising the open pit, although the real driver of long-term value will occur if a block cave is developed. This is where Newcrest has the ability to affect a change in the value of the asset which others may not be willing, or able, to do.

Based on the company's assessment of what constitutes a tier-1 asset, and given the low grade of Red Chris, UBS asserts Newcrest will need to significantly expand the size of the mine. Shaw and Partners, not one of the eight stockbrokers monitored on the FNArena database, likes the acquisition and believes the value of the project should improve markedly over time.

Productivity Enhancements?

UBS estimates a lift in productivity and recoveries could raise open pit output to 36,000tpa from 27,000tpa and cut costs to around US\$1.50-1.60/lb. Productivity enhancements and the company's global supply chain sourcing may also add value.

Newcrest proposes a two-stage plan for Red Chris. Firstly, plant and mine optimisation will be implemented and supply chain costs reduced, which should deliver near-term value.

A clear opportunity for improvement lies with better recoveries, which have average 75% for copper and 45% for gold. Over time, the resource will offer more gold at depth and UBS estimates the mine can shift from the current 80:20 copper:gold split towards a block cave resource split of around 0.55:0.45 copper:gold.

Another opportunity, Macquarie assesses, is likely to be in scheduling, particularly when a move to block caving is factored in. Macquarie notes copper is the dominant metal at the mine and, given the high co-product credits, assesses that Red Chris will be able to achieve Newcrest targeted cost position.

However, assuming just the high-grade portion of the resource results in a mine life of just six years. Hence, either exploration success in the form of additional high-grade, or mining of a global grade inventory, is required.

Citi suspects that Newcrest is less interested in the Red Chris pit and more in the large-scale porphyry resource that is attached to the project. Admittedly grades are low. The broker expects the company will start building the cave before open pit strip ratios in the current plan increase to more than 2:1 in 2023, both to save on mining waste and maximise the amount of the orebody available to the cave.

As a useful comparison, Citi notes the Cadia East block cave took Newcrest \$2.66bn and the better part of three years to build. Building the same thing today could cost, roughly, US\$1bn per 10mt at Red Chris. Shaw and Partners asserts, if the value trajectory of Cadia is any guide, Red Chris could turn out to be a suitable tier-1 asset. The broker has a Buy rating and \$25.50 target.

Long-dated Option?

This would be Newcrest's fifth tier-1 exposure, after Cadia, Wafi Golpu, Lihir and Fruite Del Norte and would meet its target of having five by 2020. However, Macquarie believes this is an opportunistic sideshow, and the real prize for Newcrest is the Newmont Australia business, which has been earmarked for divestment.

Furthermore, acquiring Red Chris does not hamper the company's capacity to bid for the Newmont assets. The broker acknowledges the company's belief that this is a tier-1 geology and the large deposit is amenable to block caving, but asserts it is just another long-dated development option.

FNArena's database shows one Buy rating (Citi), three Hold and four Sell. The consensus target is \$23.56, signalling -5.2% downside to the last share price. Targets range from \$20.30 (Credit Suisse, yet to comment on the acquisition) to \$29.00 (Citi).

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Ausdrill Set To Ramp Up Activity

Accelerating mining activity is expected to quickly lead to improvement for Ausdrill's business as it consolidates recent mergers.

-Improved cost synergies expected from the merger with Barminco -Underground business viewed more favourably versus open pit work -Rising gold price and better capital markets should underpin sentiment

By Eva Brocklehurst

Mining contractor Ausdrill ((ASL)) is reorganising, lining up its fleet to take advantage of a resurgent mining sector. Brokers believe this should result in a significant lift in operating performance, capital efficiency and cash flow.

Accelerating mining activity should quickly lead to improvement for the business. Even now, Wilsons observes Ausdrill is showing double the sector earnings (EPS) growth rate while trading at a steep discount across a range of multiples.

The broker suggests investors should position for the benefits of renewed discipline and remains highly convinced of the outlook. Initial guidance from management implies FY20 net profit growth of over 25% on the current run rate. This is before any new contracts or expansion of scope. Wilsons envisages a solid buying opportunity and maintains a Buy rating and \$2.40 target.

Canaccord Genuity has welcomed the substantial changes which have been made over the last six months. The company has incorporated the Barminco acquisition and adjusted African Underground Mining Services from an equity accounted joint venture to a fully integrated business. AUMS is tracking ahead of the broker's expectations.

Ausdrill has guided to net profit of \$98m. The underground business is viewed more favourably, versus open pit work where the company signalled it has a more conservative view on revenue growth.

Positive Catalysts Ahead

Cost synergies relating to the merger with Barminco are now expected to be of benefit to the tune of \$11m in FY20, versus prior guidance of \$5m per annum. The stock has rallied 60% from its lows of last December and Canaccord Genuity believes it is now approaching fair value.

Regardless, the broker suggests a rising gold price and better capital markets should support sentiment in the short term and there are positive catalysts in the form of new contract potential.

The broker assesses Ausdrill should trade at a small discount to ASX contract to peers because of capital intensity, geopolitical risk and integration risk. However a current discount of around -28% on an FY20 PE of 8.2x is considered its excessive. Canaccord Genuity maintains a Buy rating and \$1.84 target.

Moelis believes the company's strategy of reallocating capital towards higher returns and higher skilled work, such as underground mining, is sound. The underground division includes Barminco and the consolidated AUMS.

Moelis, too, does not consider the valuation demanding but until there is a stabilising of the surface business and confirmation of key contract renewals the risk/reward is looks to be balanced. Hence, a Hold rating with a target of \$1.82.

Deutsche Bank hopes the company will disclose the individual businesses in its reports and continues to model AUMS and Barminco as individual entities. The broker has a Buy rating and \$2.04 target.

UBS believes the risks for FY20 earnings are skewed to the upside as its estimates indicate minimal organic growth in the second half of FY19. In light of this the valuation is attractive and UBS has a Buy rating and \$2.35 target. Moreover, the opportunity pipeline remain strong.

Despite supply chain challenges and wet season impacts on mining services in the first half, UBS expects minimal turnaround delays into the second half and the clean outlook should provide upside risk.

Meanwhile, underground mining margins are higher, the broker notes, up 200 basis points on the prior corresponding half. There are few contracts up for renewal in the near term, although one risk is Iduaprierm, due December 2019, because of less favourable operating conditions for non-local contractors in Ghana.

Ausdrill provides drill & blast services, grade control, water well drilling and equipment sales, hire and parts to the mining industry.

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ESG Focus: The Coal Story (Part II)

Part Two in a two-parts insight about the disjointed future of thermal coal as a key source for energy in a carbon-conscious world. Part One was published on 8 March 2019.

-India is dark horse in outlook for thermal coal -ESG regime still offers loopholes medium term -Competition potential from traditional non-renewables sector

By Sarah Mills

India is the dark horse. India's political landscape differs sharply to China and it has considerably less financial muscle and is behind on the industrialisation front. India's demand for power is expected to double over the decade. India surpassed the United States in 2015, becoming the second-largest coal consumer in the world.

Coal supplied 80% of India's total power mix in 2016-2017, according to an investigation by Forbes, and Indian demand is forecast to rise 5% out to 2023, according to the IEA. On the flipside, the country's National Electricity Plan is calling for this demand for energy to be met by sources other than coal.

"Renewable energy costs have fallen 50% in two years and are forecasting to continue dropping apace," says Forbes. "New wind and solar installations in India are now 20% cheaper than existing coal-fired generation's average wholesale power price, and 65% of India's coal power generation is being sold at higher rates than new renewable energy bids in competitive power auctions."

In 2016-2017, the number of renewable installations in India surpassed coal for the first time, adding twice the capacity. Most Indian coal plants also violate India's new air pollution policy. However, India is building its first high efficiency, low emission coal (HELE) generators, which may bring coal within the country's air pollution parameters.

The Adani family certainly has faith in coal's future, funding the Carmichael mine at their own expense after being rejected by financiers, and one assumes they have a finger on the political pulse. Still, the economics of coal production versus renewables may yet outweigh politics.

HELE plants are more expensive to build than traditional plants (which are already more expensive than renewables). They emit roughly -30% to -50% (the latter figure comes from the Minerals Council) less carbon emissions than traditional plants, meaning that, while competitive with gas, they still have much higher emissions than renewables (which, as we have already noted, are cheaper to build and run). As an aside, Japan, Australia's largest coal customer, has committed to building 45 HELEs.

Another wildcard is that Asian countries do have considerable wiggle room under an ESG regime. While major manufacturers will need to report on the carbon consumption of their supply chains in the West's reporting systems, meaning products from high-carbon consuming suppliers will be penalised either through capital flows or direct penalties, that is only problematic for exported products. Industrialising nations can channel electricity demand through to domestic consumption (to electric cars for transport and heating, cooling, lighting and appliances), reserving renewable energy for industry.

This loophole can and no doubt will be closed by placing a "sovereign rating" on products produced in high-emission-producing countries, but it's early days yet. In addition, the SASB standards have only just been adopted and it is doubtful that the disclosure net will tighten sufficiently within the next five years - purely on the practical grounds of the world catching up - to make a significant difference.

Five Year Forecasts

Which leads us to the five-year forecast for coal prices. The fate of the coal price over the next five years depends very much on who you talk to. The Minerals Council of Australia is predicting a revival in coal consumption in 2019 and has commissioned a report that showed demand for coal would jump 50% between now and 2030. The report doesn't hazard a guess at coal prices.

The International Energy Agency estimates prices will be stable and expects coal's contribution to the energy mix to fall to 25% from 27%. The Institute for Energy Economics Australasia expects more downgrades saying a survey of 10 economic forecasters by Focus Economics predicts a -2% decline in the coal price.

KMPG expects Newcastle benchmark thermal median coal price to fall from an average of about US\$106 per tonne in 2018 to about US\$80 tonne by 2022. Its most bearish forecasts for thermal coal are about \$US75 a tonne, and its

most bullish about US\$109.50 per tonne. The Australian Government's Office of the Chief Economist forecasts thermal coal prices will drop to a real price of US\$73 per tonne by 2020.

The coal price, however, is really a moot point. The fact of the matter is that the industry is between a rock and a hard place. Falling prices are unlikely to excite investors without sharply rising demand, yet stronger demand could increase prices, which in turn will reduce coal's competitiveness with other energy sources, accelerating its own demise. Add to that the ESG and financial risk profile of coal investments and it is clear to see why investors are cautious.

Indeed, growth in demand, tightening supply and temporary problems with China's hydro plants, pushed coal prices higher prices in 2018. But higher demand did not lead to investment in new mines because of the ESG uncertainty. Seaborne trade is another issue for coal. Transport traditionally contributes to about 5% of pricing in most products. However, that is likely to rise given the International Maritime Organisation's ruling to reduce sulphur levels in shipping fuel and to force the shipping industry to clean up its environmental act on other fronts. This will further damage coals competitiveness with renewables.

Coal also faces competition from the traditional non-renewables sector. Natural gas is expanding market share thanks to the US' move to coal seam gas and countries dependent on nuclear power are likely to remain loyal for the foreseeable future. Heavy investment is being poured into fusion nuclear energy, which produces relatively short-lived radioactive waste (about 100 years).

China just last November heated plasma to 100 million degrees - hotter than the sun - and a massive fusion reactor, the International Thermonuclear Experimental Reactor, is being built in France. These developments may all sound a bit experimental, but it is clear that there is strong momentum on every conceivable front to develop alternatives to coal, reiterating the sense of urgency expressed in the SDG climate goal 13.

It is not a matter of if the coal industry will decline, but when. The next few years will be critical. The pace of decline will reveal itself out to 2023, so investors have good reason to hedge their bets.

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Weekly Ratings, Targets, Forecast Changes

By Rudi Filapek-Vandyck, Editor FNArena

Guide:

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

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

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

Summary

Period: Monday March 4 to Friday March 8, 2019 Total Upgrades: 8 Total Downgrades: 8 Net Ratings Breakdown: Buy 42.22%; Hold 43.15%; Sell 14.63%

Overall, activity among stockbroking analysts has taken a massive step back now that the February reporting season is over and dealt with. Though, of course, investors shouldn't forget corporate results are being issued all-year around and the week past saw no less than five companies releasing financial updates, of which Myer is the highest ranking on the ASX.

See FNArena's ongoing monitoring.

Irrespective of declining activity, FNArena still registered eight upgrades and eight downgrades for individual ASX-listed stocks for the week ending Friday, March 8, 2019.

Six upgrades moved ratings to Buy, including for Cochlear, Fortescue Metals Group, and Myer. Six downgrades moved to Neutral, including for ANZ Bank, Cimic Group, and Rio Tinto. Senex Energy and Tabcorp received one downgrade to Sell each.

Not much movement has been occurring in valuations and price targets, unless for Myer whose financial update was good for a 20% increase in consensus price target. The next one to follow on the week's table is Charter Hall, with a 2% increase.

With exception of Myer, the reductions in consensus targets show larger numbers led by Vicinity Centres (-4%), followed by Senex Energy and Nufarm. Unibal-Rodamco-Westfield is also still suffering reductions to targets, as is GUD Holdings.

Further adjustments to earnings estimates can look uncharacteristically huge for companies on low numbers, with lots of complex accounting or maximum leverage to commodity prices which explains the large adjustments on show for Atlas Arteria, Unibail-Rodamco-Westfield, Mineral Resources, Senex Energy, and new arrival Coles.

A similar observation applies to the negative side where NextDC's forecasts take a ginormous tumble, followed by Galaxy Resources, Western Areas, Freedom Foods Group, and Bingo Industries.

Myer's financial result puts the company on the positive side of the week's ledger, but it's insufficient to keep the balance of forecasts trending further south.

Upgrade

CHARTER HALL GROUP ((CHC)) Upgrade to Accumulate from Hold by Ord Minnett .B/H/S: 3/1/0

Ord Minnett raises estimates, expecting operating margins in funds management to increase to 53% over the next five years.

The broker believes the potential for increased economies of scale is strong and the company also enjoys a favourable portfolio composition.

Charter Hall is also becoming more capital efficient and there should be enough cash to sponsor the growth of the funds business.

Rating is upgraded to Accumulate from Hold and the target is raised to \$9.75 from \$9.00.

COCHLEAR LIMITED ((COH)) Upgrade to Buy from Neutral by Citi .B/H/S: 1/3/3

Citi downgraded to Neutral on February 20, but has now used a general sector update to reverse that decision on the basis of share price weakness that has gone too far, in the analysts' view.

Underpinning the decision to upgrade to Buy from Neutral is the prediction (conviction?) that the market share issue in the Americas will be resolved, and implant growth will resume in 2H20. Target price lifts to \$198 from \$190 on slightly higher forecasts.

FORTESCUE METALS GROUP LTD ((FMG)) Upgrade to Buy from Hold by Ord Minnett .B/H/S: 2/3/3

Ord Minnett raises assumptions for iron ore prices and now expects the disruption to Vale's production to last for around three years, post the most-recent tailings dam disaster and the acceleration of government shutdowns of a number of dams.

The broker believes the stars now align for lower-grade iron ore, with compressed discounts in a rising market. Spot prices for the Fortescue blend are US\$70/t, only a -17% discount to the 62% iron benchmark.

The broker believes investors can still make money buying the stock, despite a strong rally in the year to date. This leads to an upgrade to Buy from Hold and an increase in the target to \$7.30 from \$6.70.

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

Deutsche Bank found some positive signs in the Myer first half result. Operating costs declined and sales trends improved.

The broker still believes the business is challenged and remains unconvinced that sales and gross margin can move in the right direction at the same time.

Still, the risk/reward is more balanced and the rating is upgraded to Hold from Sell. Target is raised to \$0.50 from \$0.36.

NUFARM LIMITED ((NUF)) Upgrade to Buy from Hold by Deutsche Bank .B/H/S: 5/1/0

After upgrading to Hold in January Deutsche Bank has now upgraded Nufarm to Buy, as the stock is now trading at a -16% discount to valuation.

The broker's valuation does not yet ascribe any value to Omega-3 canola and some delay for the acquired earnings to flow has also been allowed.

Nufarm is now trading at a -23% discount to the 10-year average of the one-year forward relative operating earnings (EBITDA) multiple, and at a -20% discount on a relative PE multiple basis.

SHOPPING CENTRES AUSTRALASIA PROPERTY GROUP ((SCP)) Upgrade to Neutral from Underperform by Credit Suisse .B/H/S: 1/2/2

Following the decline in the share price Credit Suisse now believes the stock is trading at fair value and upgrades to Neutral from Underperform. Target is steady at \$2.25.

TPI ENTERPRISES LIMITED ((TPE)) Upgrade to Add from Hold by Morgans .B/H/S: 1/0/0

2018 results were below expectations and guidance. Profit was affected by several negative items including lower capacity utilisation, softer manufacturing throughput and inadequate staffing, Morgans observes.

Nevertheless, the company appears to be making progress and was profitable in the fourth quarter and the broker also expects volume gains to continue and further operating efficiencies to drive profitable growth.

While 2019-21 forecasts are lowered the broker's estimates for earnings remain in the black.

Rating is upgraded to Add from Hold and Morgans considers the current trading levels attractive for more speculative investors. Target is reduced to \$1.31 from \$1.71.

VILLAGE ROADSHOW LIMITED ((VRL)) Upgrade to Outperform from Neutral by Macquarie .B/H/S: 1/3/0

Macquarie finds positive momentum as the company turns around its business and executes on key initiatives. In theme parks, price increases and channel management drove a 34%-plus increase in ticket yield, offsetting declines in attendance.

Stronger second half earnings are also expected in cinema. The broker assesses the stock is "under-owned" at an institutional level because of historical governance concerns.

Hence, there is an opportunity for incremental buying over time, supported by restoration of the balance sheet. Macquarie upgrades to Outperform from Neutral and raises the target to \$3.80 from \$2.00.

Downgrade

AUSTRALIA & NEW ZEALAND BANKING GROUP ((ANZ)) Downgrade to Neutral from Buy by Citi .B/H/S: 3/5/0

Citi analysts have used a general sector review to downgrade ANZ Bank to Neutral from Buy, with a slightly reduced price target of \$30 (-50c). Earnings estimates have been lowered.

Citi's updated view is now that ANZ Bank is facing a prolonged period of revenue weakness. This, coupled with a likely pause in capital returns, implies the bank lacks positive catalysts on a 12 month view, explain the analysts.

Citi's sector pecking order is now Westpac ((WBC)) and National Australia Bank ((NAB)) on top as most preferred, followed by ANZ Bank and CommBank ((CBA)).

CIMIC GROUP LIMITED ((CIM)) Downgrade to Neutral from Outperform by Macquarie .B/H/S: 1/4/0

Macquarie downgrades to Neutral from Outperform as the stock is now trading close to its target. The broker believes the share price has also caught up with the traditional correlation to earnings. Target is raised to \$50.90 from \$50.26.

Macquarie forecasts growth of 8% in FY19 and believes this is attractive, considering the broader market is challenged. The broker believes the recent difficulties in the sector have strengthened the company's competitive position.

CIMIC is also cooperating with the US Department of Justice in relation to possible breaches of its code of ethics. This first emerged in 2011 and an Australian Federal Police investigation has been ongoing since 2012. Macquarie suspects the US development may expedite potential AFP outcomes.

GARDA DIVERSIFIED PROPERTY FUND ((GDF)) Downgrade to Hold from Add by Morgans .B/H/S: 0/1/0

First half results were in line and distribution guidance is reiterated at \$0.09 per security. Morgans notes some good leasing activity during the half.

The company offers exposure to east coast office/industrial property with weighted average rent reviews around 3.3% per annum. Morgans updates forecasts to account for new industrial developments and does not assume any divestments.

The broker moves to FY21 as a base year for capturing the income from developments. Given the strong appreciation in the security the broker downgrades to Hold from Add. Target is raised to \$1.35 from \$1.29.

RIO TINTO LIMITED ((RIO)) Downgrade to Neutral from Buy by UBS .B/H/S: 2/6/0

Rio Tinto's balance sheet is in a strong position and the company is committed to returning free cash flow to shareholders.

In this regard, UBS believes increased dividends are more likely than share buybacks, given the 15% cap imposed on the Chinalco holding approaches as buybacks are undertaken.

The stock has rallied 23% in the year to date, supported by a strong iron ore price and a solid 2018 result. UBS does not consider the stock expensive by long-dated standards but it is fully valued.

Rating is downgraded to Neutral from Buy and the target raised to \$94 from \$88. The main risk to the broker's call is the iron ore market and further disruptions in Brazil as a result of the Vale tailings dam failure in January.

SMILES INCLUSIVE LIMITED ((SIL)) Downgrade to Hold from Add by Morgans .B/H/S: 0/1/0

There were grim faces at Smiles Inclusive after a disappointing first half result. Integration issues, practice underperformance and a lack of management oversight have brought loan covenants into question, Morgans notes. The bank is now working with the company.

With the CFO departing and CEO stepping down it's an unsettling time for investors and while the broker has taken on board lowered FY guidance, previously assumed further acquisitions have been removed from valuation modelling until the broker is confident the business is back on track.

Target fall to 14c from \$1.01. Downgrade to Hold from Add.

SENEX ENERGY LIMITED ((SXY)) Downgrade to Lighten from Hold by Ord Minnett .B/H/S: 3/1/0

Ord Minnett has reviewed the company's assets and finds them of lower quality relative to other CSG assets.

Well flow rates at the Western Surat Gas Project, in particular, are expected to be only 200-250gj/d per well versus the average in the area of 700gj/d per well.

Capital expenditure is to be deployed on a compression plant and pipeline and the broker questions the economic viability of the project.

Ord Minnett does not find much corporate appeal in Senex Energy and downgrades to Lighten from Hold. Target is reduced to \$0.34 from \$0.40.

TABCORP HOLDINGS LIMITED ((TAH)) Downgrade to Lighten from Hold by Ord Minnett .B/H/S: 5/0/0

Ord Minnett downgrades earnings estimates, driven by weakness in the company's wagering division. The broker notes growth in lotteries is being offset by persistent competition in wagering and the point of consumption tax (POCT) will reduce industry turnover in wagering revenue.

The integration with Ubet systems is also taking longer than anticipated. Ord Minnett downgrades to Lighten from Hold and reduces the target to \$4.20 from \$4.50.

VICINITY CENTRES ((VCX)) Downgrade to Neutral from Outperform by Credit Suisse .B/H/S: 1/2/0

Credit Suisse takes a more conservative view and continues to envisage a tightening of cap rates across DFO assets in the company's portfolio.

Regional, sub-regional and neighbourhood centres are expected to also experience heightened levels of scrutiny from valuers, nevertheless, and expansion of cap rates is factored in across the tail of the portfolio.

Rating is downgraded to Neutral from Outperform and target reduced to \$2.67 from \$3.00.

Total Recommendations Recommendation Changes

Broker Recommendation Breakup

Broker Rating Order Company New Rating Old Rating Broker Upgrade 1 CHARTER HALL GROUP Buy Neutral Ord Minnett 2 COCHLEAR LIMITED Buy Neutral Citi 3 FORTECUE METALS GROUP LTD Buy Neutral Ord Minnett 4 MYER HOLDINGS LIMITED Neutral Sell Deutsche Bank 5 NUFARM LIMITED Buy Neutral Deutsche Bank 6 SHOPPING CENTRES AUSTRALASIA PROPERTY GROUP Neutral Sell Credit Suisse 7 TPI ENTERPRISES LIMITED Buy Neutral Morgans 8 VILLAGE ROADSHOW LIMITED Buy Neutral Macquarie Downgrade 9 AUSTRALIA & NEW ZEALAND BANKING GROUP Neutral Buy Citi 10 CIMIC GROUP LIMITED Neutral Buy Macquarie 11 GARDA DIVERSIFIED PROPERTY FUND Neutral Buy Morgans 12 RIO TINTO LIMITED Neutral Buy UBS 13 SENEX ENERGY LIMITED Sell Neutral Ord Minnett 14 SMILES INCLUSIVE LIMITED Neutral Buy Morgans 15 TABCORP HOLDINGS LIMITED Sell Neutral Ord Minnett 16 VICINITY CENTRES Neutral Buy Credit Suisse

Recommendation Positive Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 AIZ AIR NEW ZEALAND LIMITED -25.0% -50.0% 25.0% 4 2 SCP SHOPPING CENTRES AUSTRALASIA PROPERTY GROUP -30.0% -50.0% 20.0% 5 3 GUD G.U.D. HOLDINGS LIMITED 88.0% 70.0% 18.0% 4 4 MYR MYER HOLDINGS LIMITED -42.0% -58.0% 16.0% 6 5 NUF NUFARM LIMITED 83.0% 67.0% 16.0% 6 6 COH COCHLEAR LIMITED -31.0% -44.0% 13.0% 8 7 CHC CHARTER HALL GROUP 63.0% 50.0% 13.0% 4 8 FMG FORTECUE METALS GROUP LTD -13.0% -25.0% 12.0% 8

Negative Change Covered by > 2 Brokers Order Symbol Company New Rating Previous Rating Change Recs 1 ALX ATLAS ARTERIA 33.0% 83.0% -50.0% 6 2 VCX VICINITY CENTRES 17.0% 63.0% -46.0% 3 3 CIM CIMIC GROUP LIMITED 10.0% 30.0% -20.0% 5 4 CMW CROMWELL PROPERTY GROUP -33.0% -17.0% -16.0% 3 5 ANZ AUSTRALIA & NEW ZEALAND BANKING GROUP 31.0% 44.0% -13.0% 8 6 RIO RIO TINTO LIMITED 25.0% 38.0% -13.0% 8 7 URW UNIBAIL-RODAMCO-WESTFIELD -25.0% -13.0% -12.0% 4 8 SXY SENEX ENERGY LIMITED 50.0% 60.0% -10.0% 5 9 TAH TABCORP HOLDINGS LIMITED 75.0% 83.0% -8.0% 6 10 MYO MYOB GROUP LIMITED -33.0% -25.0% -8.0% 3

Target Price Positive Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 MYR MYER HOLDINGS LIMITED 0.453 0.377 20.16% 6 2 CHC CHARTER HALL GROUP 9.505 9.318 2.01% 4 3 FMG FORTECUE METALS GROUP LTD 6.200 6.125 1.22% 8 4 RIO RIO TINTO LIMITED 91.737 91.023 0.78% 8 5 COH COCHLEAR LIMITED 169.113 168.113 0.59% 8 6 CIM CIMIC GROUP LIMITED 48.326 48.198 0.27% 5 7 ALX ATLAS ARTERIA 7.087 7.082 0.07% 6

Negative Change Covered by > 2 Brokers Order Symbol Company New Target Previous Target Change Recs 1 VCX VICINITY CENTRES 2.690 2.830 -4.95% 3 2 SXY SENEX ENERGY LIMITED 0.464 0.476 -2.52% 5 3 NUF NUFARM LIMITED 7.730 7.905 -2.21% 6 4 URW UNIBAIL-RODAMCO-WESTFIELD 11.610 11.810 -1.69% 4 5 GUD G.U.D. HOLDINGS LIMITED 13.603 13.812 -1.51% 4 6 TAH TABCORP HOLDINGS LIMITED 5.025 5.075 -0.99% 6 7 MYO MYOB GROUP LIMITED 3.200 3.230 -0.93% 3 8 ANZ AUSTRALIA & NEW ZEALAND BANKING GROUP 28.663 28.725 -0.22% 8

Earning Forecast Positive Change Covered by > 2 Brokers Order Symbol Company New EF Previous EF Change Recs 1 ALX ATLAS ARTERIA 45.357

23.373 94.06% 6 2 URW UNIBAIL-RODAMCO-WESTFIELD 46.964 33.509 40.15% 4 3 MIN MINERAL RESOURCES LIMITED
 98.967 80.967 22.23% 3 4 SXY SENEX ENERGY LIMITED 1.375 1.125 22.22% 5 5 COL COLES GROUP LIMITED 66.929
 58.714 13.99% 8 6 MYR MYER HOLDINGS LIMITED 3.690 3.560 3.65% 6 7 OZL OZ MINERALS LIMITED 59.799 57.798
 3.46% 8 8 MHJ MICHAEL HILL INTERNATIONAL LIMITED 6.367 6.175 3.11% 4 9 VCX VICINITY CENTRES 17.720 17.300
 2.43% 3 10 STO SANTOS LIMITED 46.984 46.129 1.85% 8 Negative Change Covered by > 2 Brokers Order Symbol
 Company New EF Previous EF Change Recs 1 NXT NEXTDC LIMITED -0.033 0.133 -124.81% 7 2 GXY GALAXY RESOURCES
 LIMITED 1.267 3.468 -63.47% 5 3 WSA WESTERN AREAS NL 2.526 6.538 -61.36% 6 4 FNP FREEDOM FOODS GROUP
 LIMITED 8.933 11.300 -20.95% 3 5 BIN BINGO INDUSTRIES LIMITED 7.767 8.700 -10.72% 3 6 ORE OROCOBRE LIMITED
 10.913 11.555 -5.56% 8 7 SGM SIMS METAL MANAGEMENT LIMITED 81.033 83.617 -3.09% 7 8 NUF NUFARM LIMITED
 39.934 41.134 -2.92% 6 9 CMW CROMWELL PROPERTY GROUP 7.567 7.700 -1.73% 3 10 GUD G.U.D. HOLDINGS LIMITED
 70.550 71.610 -1.48% 4 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: Even More Complicated

Congress has now weighed into the 232 debate, potentially further delaying a decision from the White House.

-Congress moves to curb presidential power -Uncertainty constraining uranium market volumes

By Greg Peel

Last week the chairman of the US Senate Finance Committee, Republican Charles Grassley, directed his staff to work with senators on both sides of the aisle to produce a bill aimed at restricting the president's national security tariff powers.

For a brief recap of the Section 232 issue and its current constraint on uranium markets, see last week's report.

Earlier this year, another Republican senator, Rob Portman reintroduced the Trade Security Act of 2018, which would allow Congress to negate trade restrictions imposed by the US president under section 232 if it passes a joint resolution of disapproval.

Note that US tariffs imposed to date on China and others have been implemented under section 232, which deals with matters of "national security".

Back in January, another Republican senator, Pat Toomey, introduced the Bicameral Congressional Trade Authority Act, which would give Congress 60 days to approve section 232 actions and, notably, allows Congress to review restrictions imposed within the last four years.

Two uranium producers have petitioned the US government on the basis of national security, ie section 232.

232 uncertainty has been hanging over uranium markets since January 2018 and 2019 to date was dominated by an onerous Department of Commerce questionnaire, which industry participants submitted the week before last. Presumably it will now take the DoC some time to wade through responses before formulating a recommendation for the president, who then has months to make a decision.

Weighing into the debate is the Washington-based Nuclear Energy Institute. The NEI last week wrote a letter to the DoC suggesting policy recommendations in response to the ongoing section 232 investigation into uranium imports. NEI's proposal, which brings together recommendations by separate supplier and utility groups, outlines solutions with the stated aim of helping to maintain a domestic mining infrastructure.

Let's just say no one in the industry will be expecting resolution any time soon. The outcome may have a significant impact on the price US utilities will have to pay for uranium supply.

Limbo

Uncertainty has led to lower volumes in uranium markets, as utilities curb their longer term supply demand pending an outcome. Last week saw six transactions included in the spot market totalling 800,000lbs U3O8 equivalent, industry consultant TradeTech reports.

TradeTech's weekly spot price indicator has fallen -US5c to US\$28.10/lb.

One small transaction was concluded in term markets. TradeTech's term price indicators remain at US\$30.00/lb (mid) and US\$32.00/lb (long).

The question must be asked as to just how much 232 risk is priced into the market currently. Were the US government to act in accordance with the petition then US utilities would be forced to purchase 25% of their uranium requirements from domestic producers, who have complained that they cannot compete with cheaper imports from the likes of Russia and Canada.

In other words, utilities would have to pay more for their uranium than they do now, and at current prices they are mostly uncompetitive in the electricity market anyway. That would suggest it might be a good idea to buy uranium now at cheaper prices were 232 to be invoked in this case. Unless the government were to reject the petition, and prices fall in response.

Uncertainty reigns.

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

The Short Report

Guide:

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

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

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

Summary:

Week ending March 7, 2019

Last week saw the ASX200 rally on the bad-news-is-good-news theme, as a weak GDP result prompted anticipation of a pending RBA rate cut. The index peaked out on the final day once the market realised the whole world was slowing down.

It was the first week beyond the end of result season although we did see a late result from Myer ((MYR)) that prompted quite a share price pop on the day but little change in short position.

Otherwise, as the table below suggests, shorters either took a break or decided to wind down positions possibly held for result releases. We see no less than six stocks falling off the 5%-plus shorted table and only one, ARB Corp ((ARB)), making a return.

The total number of short positions of 5% or more has been quietly diminishing from late last year.

There were no moves of one percentage point or more up or down last week so no Movers & Shakers to speak of.

About the only move worth noting is another step-up for shorts in Bingo Industries ((BIN)), now into the 6% bracket.

Weekly short positions as a percentage of market cap:

10%+ ING 17.2 SYR 17.2 GXY 15.8 JBH 13.1 ORE 12.2 BWX 11.2 MTS 11.1 NXT 11.1 IVC 11.0 BAL 10.3 MYR 10.1 SDA 10.1

No changes

9.0-9.9

DMP

No changes 8.0-8.9%

SUL, IFL, HVN, PLS

No changes

7.0-7.9%

BKL, BOQ, HUB, MSB, AMP, LYC, AMC, NUF

In: HUB, LYC Out: BEN, SGM

6.0-6.9%

SGM, DHG, BEN, RWC, BIN, CGF, A2B, RSG

In: SGM, BEN, RWC, BIN Out: HUB, LYC, CGF, A2B

5.0-5.9%

CSR, APT, A2B, CCP, BGA, CGF, CAR, NAN, KDR, WSA, GMA, ARB

In: A2B, CGF, ARB

Out: RWC, BIN, HT1, CLH, PGH, MLX, KAR, LNG Movers & Shakers

No Movers and Shakers this week, see above.

ASX20 Short Positions (%)

Code Last Week Week Before Code Last Week Week Before AMC 7.2 7.2 RIO 4.6 4.1 ANZ 1.6 1.7 S32 0.9 0.8 BHP 3.5 4.2 SCP 0.6 0.7 BXB 0.3 0.4 SUN 0.8 0.8 CBA 2.0 2.2 TCL 1.3 1.5 COL 2.3 2.3 TLS 0.7 0.8 CSL 0.3 0.2 WBC 2.0 2.0 IAG 0.5 0.2 WES 1.8 1.6 MQG 0.4 0.3 WOW 2.7 2.7 NAB 1.4 1.2 WPL 0.6 0.7 To see the full Short Report, please go to this link

IMPORTANT INFORMATION ABOUT THIS REPORT

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

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

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

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

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

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

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

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

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The Wrap: Telcos, Builders, Casinos & Insurers

Weekly Broker Wrap: telcos; building; diagnostic providers; casinos; insurance; and consumer stocks.

-UBS expects little improvement in mobile industry earnings and cash flow -Construction materials sector retains a positive outlook -Crown Resorts' Sydney casino could actually grow the gambling market, Credit Suisse asserts -Local insurers could be vulnerable in home and motor markets -Australian companies increasingly seeking to expand offshore

By Eva Brocklehurst

Telecoms

The main issues for the telecommunications sector in 2019 centre on mobiles and the NBN. In terms of mobiles, UBS believes revenue share has been the main goal of Optus and, significantly, the first half of FY19 was the first period in over three years in which the company did not materially grow its share of mobile revenue.

UBS estimates the company's share rose to 30.7% in the first half of FY18 but has been steady ever since. The offset was higher-value subscribers, causing a lift in mobile earnings. The broker wonders whether Optus may now be prioritising earnings and cash flow over market share.

UBS suggests mobile returns are attractive for Telstra ((TLS)), the number one operator, but much more modest for the number three, Vodafone Hutchison Australia. Little improvement in mobile industry earnings and cash flow is expected. Mobile revenue growth in the first half was misleadingly robust, UBS believes, as hardware revenues provided a substantial proportion of the growth and offer negligible margins.

The broker suspects one of the main reasons the ACCC approved the merger of Vodafone and Hutchison in 2009 was that these entities were unlikely to significantly invest in mobile broadband/network capacity on a stand-alone basis.

With current delays to the merger decision of TPG Telecom ((TPM)) with Vodafone Hutchison Australia the broker suspects a similar debate could be occurring at present, i.e. would a stand-alone TPG or Vodafone invest enough to be an effective competitor to Telstra and Optus?

On the NBN, UBS believes an eventual reduction in wholesale prices is the most likely outcome for the industry. Vocus Group ((VOC)) has announced it is prepared to cede NBN market share and prioritise yield and profitability, and the broker believes this is part of a wider strategy to prioritise fixed wireless products over the NBN.

Building

UBS wonders whether the growth in non-residential and engineering construction can offset the fall in residential activity. Around 37% of Australian construction expenditure is on residential and housing approvals were down over the last seven consecutive months.

Boral ((BLD)) expects flat growth and Adelaide Brighton ((ABC)) envisages stable volumes. CSR ((CSR)) has reiterated guidance, and BlueScope ((BSL)) appears the only one expecting detached housing construction will moderate. Most expect infrastructure work to mitigate the housing impact in the short term, although the broker is less certain.

To offset housing declines, engineering work needs to grow by around 10%. Hence, UBS believes it is too early to become positive on the earnings trajectory, as the overall outlook for the Australian building materials volumes and prices remains weak.

Diagnostic Providers

UBS believes the latest review of diagnostic medicine carries downside risk for providers. Potential changes to referral criteria for several pathology and diagnostic imaging tests have been recommended.

The recommendations focus on reducing low-value testing in areas such as vitamin B12 testing, iron/folate studies, shoulder ultrasounds and lower back MRI. If implemented, UBS believes the changes could lead to a reduction in referral volumes for operators such as Sonic Healthcare ((SHL)) and Healius ((HLS)).

Casinos

In assessing the impact of the Crown Resorts ((CWN)) Sydney casino when it opens in 2021, Credit Suisse concludes that both this property, and the new Star Entertainment ((SGR)) Sovereign Room, will grow the gambling market more than originally expected, estimating the premium mass market may grow 11%.

This means the revenue erosion projected for The Star may not be as bad. The broker models a -10% decline for premium mass and flat VIP revenue over FY21-23. On the other hand, Credit Suisse increases Crown Sydney's projected FY22 operating earnings (EBITDA) to \$175m and then to over \$200m in FY23.

The broker sees Star Entertainment as cheap, upgrading to Outperform from Neutral. The analysis provides improved confidence in the expansion of the Australian gambling market and this should drive the stock towards fair value. Meanwhile, Crown Resorts is considered fully valued and a Neutral rating is maintained.

Insurance

Macquarie believes local insurers could be vulnerable in their most profitable home and motor markets as new entrants win business in the (supposedly) unprofitable broker channel.

Increasing pressure in the insurance broker channel could provide opportunities for insurers that are focused on the direct channel, as the cost bases of Insurance Australia Group ((IAG)) and Suncorp ((SUN)) are exposed.

A slowing economic cycle reduces new business volumes across the market and the broker believes both insurers will need to extend cost reductions to support margins. While expecting underlying margins will improve, Macquarie believes consensus expectations are elevated. The broker retains Underperform recommendations on both stocks.

Macquarie notes both companies have been losing volumes in the Australian home and personal motor markets and, unlike the prior decade where new entrants were intent on the direct channel, the latest entrants are homing in on the much maligned broker channel.

AIG has been underwriting mass-market home and motor products in Australia for the last 18 months while Blue Zebra (Zurich) and Chubb are also pushing into the mass market. Macquarie suspects these businesses will achieve scale quickly.

Consumption

Morgan Stanley suggests, increasingly, Australia's consumer cycle is becoming less relevant, as a greater proportion of companies deploy capital offshore or export their premium brands. Also, structural pressures that have originated offshore, derived from Amazon and brands selling direct, are tending to drive trading multiples.

Morgan Stanley suspects Australian consumer companies will increasingly seek to expand offshore, given the relatively soft outlook for Australian consumption. Companies that have developed clear competitive advantages or unique products, such as Domino's Pizza ((DMP)), Treasury Wine ((TWE)), a2 Milk ((A2M)), Bellamy's ((BAL)) and Blackmores ((BKL)) have the best chance for success, in the broker's opinion.

Theoretically, these businesses should trade at a lower multiple, as earnings that are shifted offshore no longer generate franking credits, so the after-tax return to Australian investors is lower. Additionally, Morgan Stanley believes these companies should be less inclined to pay a dividend and implement more buybacks, as dividends from international earnings would effectively be double taxed.

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Midway Well Placed In Buoyant Fibre Market

Favourable demand/supply dynamics underpin wood fibre exporter Midway, which has impressed brokers with its expansion plans.

-Decline in Oz dollar, lower transport costs and price increases underpin outlook -Supply network increased to meet wood fibre demand from Asia -Unnecessarily large discount to domestically-exposed agricultural peers

By Eva Brocklehurst

Australia's largest hardwood and softwood fibre exporter, Midway Ltd ((MWY)) has a buoyant outlook, as demand soars for higher quality packaging, as well as rayon for clothing. The company's strategic priority is to expand and diversify into complimentary forestry verticals, and to this end has made two acquisitions to obtain a presence in Western Australia.

Midway has also secured additional production assets on Melville Island, creating efficiencies that enable its management of the entire wood fibre supply chain. The company has invested for the longer term and now boasts multiple areas of growth, providing operating efficiencies as well as diversification into the log export market.

Current trading conditions are favourable, given an 11% increase in blue gum eucalyptus prices for Chinese and Japanese customers. Shaw and Partners notes Midway is effectively the de facto price setter in the Australian market. The decline in the Australian dollar has helped as well as lower transport costs from falling oil prices, and dry weather has improved the bone dry wood content.

Shaw and Partners assesses a large addressable market is available to Midway and the company has impressive operating earnings (EBITDA) compound growth of 14% over the next four years. Free cash flow is increasing and maintenance expenditure requirements are low.

A slower than expected start to the restructured operations at Plantation Management Partners was caused by a breakdown of equipment. Maintenance has been undertaken and new equipment is expected to rectify the issue, funded out of a capital raising.

The track record of growing wood fibre supply to meet customer demand in Asia has been assisted by the expansion of the company's supply network. Supply arrangements and commitments have increased FY21 production estimates to 3880 tonnes.

Midway supplies an estimated 7% of the total volume of Asian hardwood fibre imports. Shipments are made from the network of port facilities located in Geelong, Portland, Brisbane, Bell Bay and Melville Island. The company sources its logs from private plantation owners in Victoria, South Australia, NSW, Queensland and Tasmania.

Attractive Yield

Bell Potter, which has a Buy rating and \$3.94 target, observes there is an attractive dividend yield on offer, around 7%, as well as potential corporate appeal in the stock. Shaw and Partners agrees that, despite a highly fragmented and capital intensive industry, Midway is providing high returns.

The timber supply is secure, with contracts ranging out to 10 years. There is a constrained global supply, Shaw and Partners notes, and a 4mt deficit is expected by 2020 in hardwood. The company also has strong customer relationships with major importers in China and Japan.

Shaw and Partners points out the company survived with an Australian dollar at over US\$1 some years ago, while peers struggled. Currently, the stock trades at a significant -25% discount to domestically-exposed agricultural peers. The broker accepts Midway should trade at a discount to peers but believes the quantum is too large.

Tailwinds are significant and are expected to remain well into FY20. Traditionally, sales are higher in the second half, as winter conditions in south-west Victoria constrain the ability to source wood fibre in some locations. Shaw and Partners retains a Buy rating and \$4.00 target.

Morgans agrees the company has a bright future amid positive industry fundamentals. As new growth projects do not fully contribute until FY20, the broker focuses on this particular year, reiterating an Add rating and \$3.90 target and assessing further acquisitions or growth opportunities as being the next catalyst.

Growth projects and acquisitions have strengthened the volume outlook and the company continues to replant existing land, secure contracts with third parties and invest in plantation expansion to maintain its long-term fibre supply. The company is actively assessing acquisition opportunities in Tasmania.

Ord Minnett believes the company is poised for additional upside after the full year result in August as rises in woodchip prices taking affect from January 1, 2019 will be realised. The broker forecasts revenue from wood fibre processing to reach \$325m in FY19. Ord Minnett has a Buy rating and \$4.37 target.

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

Business Boost Expected For 1300SMILES

Dental chain 1300SMILES has become more upbeat, expecting the typical surge in economic activity in North Queensland in the wake of the floods will boost its business.

-Activity could also be augmented by a recovery in central Queensland -Small benefit from recent initiatives by Medibank Private -Flexible payment strategies underpinning demand

By Eva Brocklehurst

Brokers are pleased that dental chain, 1300SMILES ((ONT)), has escaped the flooding in North Queensland with only minor interruptions to its business in the major centre, Townsville.

Moreover, the company has become more upbeat, indicating that a surge in economic activity has often been the case following such events, as the area is rebuilt and refurbished, and this should provide a boost to second half earnings and into FY20.

All seven of the company's centres in Townsville (there are 11 in North Qld) were affected to some degree by the flooding, although none were damaged by rising water or mud. No expensive equipment was damaged and insurance is covering any interruption and repairs.

Furthermore, Baillieu notes this activity could also be augmented by a nascent recovery in central Queensland. Wilsons, too, expects the focus to remain on regional Queensland amid a pick up in activity in the resources industry.

Baillieu retains a Buy rating with a target of \$7.55, which it believes is supported by the company's track record of growth in earnings, at a 13-year compound rate of 10%, as well as the maintenance of progressive dividends.

Despite there being no acquisitions in the first half, current activity in this regard is described as "intense" and the company has flagged a significant announcement is imminent. To this end, Baillieu describes debt levels as modest.

Morgans considers the business is tracking well and in line to achieve its forecasts, recently upgrading to Add from Hold because of share price weakness. Morgans has a price target of \$6.85.

The broker considers 1300SMILES the best operator within the listed segment, although opportunities for growth have, historically, been hard to find. The company has embarked on a new greenfield development. This development, in Morayfield southern Queensland, is co-located with a GP super clinic and several similar projects are under consideration, Wilsons points out.

Morgans assesses competitive pricing pressures in a low-growth environment are holding back the business in the short to medium term, but the stock is trading well below historical averages on a PE basis.

Wilsons has a Hold rating and \$6.15 target and likes the stock as an investment. Should consolidation on a national level ramp up, 1300SMILES will have a strong part to play, in the broker's view.

Practices which were acquired in FY18 have performed well and there has been a small benefit from the recent initiatives by insurer Medibank Private ((MPL)) in promoting preventative dentistry. Flexible payment strategies are also seen underpinning demand. Wilsons models modest mid-to-high single digit growth in earnings per share in its forecasts, and while these contain little formal M&A activity, this should provide upside potential.

1300SMILES is primarily located across Queensland, with 27 dental centres. There are four in NSW and one in South Australia.

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Treasure Chest: Slowdown Ahead For a2 Milk?

FNArena's Treasure Chest reports on money making ideas from stockbrokers and other experts. Consensus projections imply a2 Milk will grow its infant formula business at a stellar rate, but is this the case?

-A number of headwinds developing in e-commerce, infant formula -New product launches would help the business, particularly in the US -Ingredient costs escalating, margins seen narrowing in China direct business

By Eva Brocklehurst

Have growth estimates become too aggressive for a2 Milk ((A2M))? Current views suggest the business will continue to grow at a start-up pace with compound revenue growth forecasts over FY18-21 of over 27%, on Bell Potter's calculations.

Assuming sales growth in the fresh dairy and adult nutrition categories can be sustained at over 25%, which was achieved over the last 12 months, then this would imply infant formula sales growth should continue at around 28% per annum.

Bell Potter finds a number of risks attached to current FY19-21 consensus estimates and asserts it is increasingly hard to justify the stock's 75% premium to its global peer group. Citi agrees there are a number of headwinds developing in e-commerce with increased competition, while declining birth rates will affect momentum in infant formula demand.

If the risks are borne out, a combination of earnings and multiple compression could occur simultaneously. Bell Potter is already witnessing signs of a dislocation between the refill of inventory, trade order fill and ultimate sales.

There are also rising ingredient costs and a need to invest. If the previously outlined assumptions for sales growth are achieved, the broker estimates this would make a2 Milk a \$1.5bn turnover business in infant formula within the next two years.

Given around 90% of what the company sells in Australia ultimately gets consumed in China, this suggests it would become one of the largest infant formula companies in China, doing so as a single unit (SKU) operator when the majority of participants of that scale have product offerings across the value spectrum.

On reflection, the broker found the most disappointing aspect of the first half result was sales growth in China. Chinese sales per average store fell -21% in local currency terms. Given an increasing reliance on sales outside of the internet in China for future growth, Bell Potter would have expected accelerating growth rates on a per store basis.

UBS had no such qualms after the first half results, finding no sign of slowing demand in China and a strong customer response to the a2 brand. The broker also believes the benefits of marketing expenditure should come into view in FY20.

UBS retains a Neutral rating and remains concerned that there is just a single a2 brand and a rich valuation for the shares. The broker concedes new product launches would help the business, particularly in the US, which is considered an under-appreciated opportunity.

Bell Potter asserts current projections imply that a2 Milk will become a market leader in the Chinese infant formula category, rivalling Danone and Nestle. The problem is this growth is likely to occur against a background of weakening demand, amid declining birth rates, and at a time when the Canterbury (New Zealand) milk source is reaching capacity.

Hence, the broker assesses consensus growth rates imply a scenario where the company can achieve both a rapid expansion in its distribution points and sell-through rates, while absorbing market shrinkage, cost inflation and a higher cost to serve.

The cost of ingredients has sustained a meaningful uplift in recent weeks. Bell Potter estimates a 12% rise in the first half of FY19 and a 27% lift in the second half. The majority of this increase is likely to be absorbed in FY20.

Moreover, as the business transitions to a direct model in China the cost to serve should climb. Doing the maths, the broker finds margin growth on Chinese business has slowed and a lower margin at the group level is projected versus historical levels.

Bell Potter, not one of the eight stockbrokers monitored daily on the FNArena database, has a Sell rating and \$11.50 target for a2 Milk. Morgan Stanley is the only one of the eight with an equivalent rating, Underweight.

While first half sales and earnings beat that broker's expectations, on the basis that the sustainability of sales via the daigou (external shopping agents) channel are slower, this was considered a low quality result.

The stock sustained downgrades by two brokers on the database in the wake of the first half result, largely because of the outperformance of the share price. While considering the expansion in China very promising, Morgans reduced its rating to Hold and Credit Suisse downgraded to Neutral.

The database shows two Buy ratings, four Hold and one Sell (Morgan Stanley). The consensus target is \$13.63, signalling -1.8% downside to the last share price.

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Treasure Chest: ANZ Vulnerable To Pressures

FNArena's Treasure Chest reports on money making ideas from stockbrokers and other experts. ANZ Bank is facing challenges in its Australasian retail & business banking leading a number of brokers to downgrade the stock.

-Likely to take time to turn mortgage volume growth around -Capital management likely to pause until more clarity on RBNZ proposals -Challenge ahead in keeping costs from rising

By Eva Brocklehurst

Over the course of the Hayne Royal Commission the smallest of the four major banks, ANZ Bank ((ANZ)), appeared to withstand the scrutiny and subsequent criticism better than its peers.

However, a difficult operating and regulatory environment has created execution challenges and, as Morgan Stanley points out, housing loan and deposit growth is below system. ANZ's mortgage volume growth turned negative in the first quarter of FY19, amidst changes to responsible lending policy and a renewed emphasis on owner-occupied principal & interest loans.

Credit Suisse does not believe ANZ's subsequent announcement that it has been too conservative in its approach to mortgage lending is an immediate inflection point for growth and the earliest there is likely to be a change is at the end of this year.

Morgan Stanley forecasts around 1.5% underlying revenue growth in FY19, despite assuming a 10% rebound in markets income, higher wealth revenues and flat banking fees. The bank's credibility on cost management has been enhanced recently but is still unlikely to beat the broker's forecasts for a -1% decline in underlying expenses this year.

ANZ has lowered its risk profile, with fewer Asian retail, emerging corporates and Australian consumer unsecured loans. Yet, Morgan Stanley expects loan losses to rise as the bank's collective provisions coverage is lower than peers and the Australian economic outlook is weak. The stock's multiples provide little margin for error, in the broker's view, making it vulnerable to downgrades.

Challenging trends within the Australian division present a risk to revenue, in Macquarie's opinion, and the bank needs to improve its performance to deliver underlying revenue growth that is in line with its peers. The broker accepts more conservative lending standards have been a driver of lost market share and proactive steps to reduce expenses could also have played a role.

Capital Uncertainty

ANZ's CET1 ratio should reach 11.5% in FY19 but the capital proposals from across the Tasman at the Reserve Bank of New Zealand create uncertainty, several brokers believe. Credit Suisse, in reflecting on the RBNZ proposals, believes that at a minimum, ANZ's future capital management will be paused until there is greater certainty.

While additional capital in a subsidiary does not necessarily require additional capital at a group level, the application of a risk weight floor and associated increase in risk weights does flow through to the group, the broker asserts.

ANZ, Citi assesses, is likely to have a relatively larger increase in capital because it has a lower mortgage risk weight versus its NZ peers. The broker revises down estimates for FY19 earnings by -1% to reflect softer revenue because of lower volumes. FY20/21 estimates are reduced by -5% to reflect this, as well as the impact of delayed capital returns. However, the broker's expectations for long-term capital returns are unchanged.

Morgan Stanley agrees there will be a pause in ANZ's capital management after the existing \$3bn buyback concludes this month, and any further buybacks or capital management initiatives will be delayed until 2020.

Costs

Macquarie has been pleased with the way ANZ managed its expenses in FY18 and expects expenses will be maintained at a broadly similar level in FY19. Still, pressure on expenses is likely to re-emerge later in the year and may require ongoing restructuring charges.

In the light of how potential litigation and conduct costs can quickly add up, Bell Potter has come to the view that its operating expense forecast for ANZ after 2020 may be on the low side. Hence, taking a conservative tack, the broker increases these forecasts by around 5% from 2021 to maintain the overall cost base at \$9.2-9.3bn.

This maintains the elevated cost base trend in line with Commonwealth Bank ((CBA)) and Westpac ((WBC)). The net impact is a -4-5% downgrade to continuing cash net profit in the outer years. The broker, not one of the eight monitored daily on the FNArena database, reduces the target to \$28.50 from \$29.80 and a downgrade to a Hold rating from Buy is now considered more appropriate.

Morgan Stanley is the most recent on the database to downgrade the stock, to Underweight from Equal-weight, following downgrades to Neutral by Macquarie, Citi and Credit Suisse within the past month.

The database still has two Buy ratings (Morgans, Ord Minnett), with five Hold and one Sell (Morgan Stanley). The consensus target is \$28.29, suggesting 6.3% upside to the last share price. The dividend yield on FY19 and FY20 forecasts is 6.0% and 6.1% respectively.

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