Bargain hunters eye Rivercity

Small caps
Brendon Lau

The Brisbane toll road operator Rivercity Motorway could be a good short-term play for traders as the stock has attracted bargain hunters on Monday following a disastrous week.

The stock was the worst performer on the S&P/ASX Small Ordinaries Index last week with a fall of 20 per cent when the index only dipped 0.6 per cent.

Its fall from grace is largely due to the disappointing maiden traffic numbers on its Clem Jones Tunnel with average daily trips coming in at 20,602 — a 65 per cent plunge from the first three weeks when commuters could travel free on the motorway.

The decline was worst than expected and reminded investors of the struggles that plagued Melbourne-based ConnectEast Group, which runs the EastLink Tollway. Early traffic data from EastLink failed to meet prospectus forecast at a time when credit dried up for such infrastructure projects.

But the Royal Bank of Scotland thinks it's too early for Rivercity investors to panic as this is only the first week of data on a 41-year lease.

Rivercity is also actively promoting the benefits from using Clem7 and there is a very real chance that management could deliver a big upside surprise down the road. Beating market expectation might not be as difficult as one might suspect too as the stock has been sold off to well under RBS' target price of 25¢ a share.

However, the stock is only suited for those with a good appetite for risk as investors will want to see Rivercity's investment in marketing the tollway pay off before the stock has any hope of meeting that target price.

For this reason, RBS appears reluctant to change its "hold" call on the stock and all other brokers polled on Bloomberg also appear to share this scepticism as they are divided between a "hold" or "sell" recommendation on Rivercity.

Consensus estimates is only forecasting a swing to profit for Rivercity sometime after financial year 2013. The stock rose 0.11¢ to 9.3¢ yesterday.

Once they had to pay, motorists spurned Brisbane's Rivercity Motorway. Photo: GLENN HUNT

The apparel and bedding accessories distributor Pacific Brands is another that suffered last week. It fell a further 2.8 per cent to $1.23 yesterday.

However, Pacific Brands could soon be attracting bargain hunters as well, as most brokers believe the risk to the stock lies to the upside.

Credit Suisse ranks the stock as one of its top small caps picks as it calls the stock a "structural change in earnings opportunity" and is forecasting about a 25 per cent lift in earnings before interest and tax in financial year 2011 from the height of the crisis in 2008-09.

Following the company's restructuring that saw most of its manufacturing move offshore to China, Pacific Brands has the potential to grow earnings faster than historically has been the case, noted the broker.

"Outsourcing and brand rationalisation are running to plan and are almost complete, minimising operational risk," said Credit Suisse.

"The company is ahead of schedule on cost reduction, with $80 million to $90 million cost savings expected for FY10 versus a $50 million forecast."

The group's second half result is likely to pleasantly surprise as well with an upside of $20 million probable, suspects the broker, who is calling investors to buy the stock.

Most brokers polled on Bloomberg are also bullish on the stock as it is trading on a forward price-earnings multiple of about nine times, which is arguably too cheap considering that brokers are expecting earnings per share growth of more than 40 per cent for the current financial year and a further 15 per cent for the year after to 16.4¢.

Credit Suisse has a price target of $1.80 a share.

Bradken's investors are also likely to be pleasantly surprised at the next reporting season, according to some experts.

The earthmoving and mining consumables supplier warned investors in February to expect weaker earnings before interest, tax, depreciation and amortisation (EBITDA) in the current financial year ending June 30 from FY09 due to the strong Australian dollar and tough trading conditions as it tries to dust off the economic turmoil.

But Goldman Sachs JBWere is predicting a record second half for Bradken that is driven by restocking of mining supplies and equipment by major customers that had run down inventory and shed resources in the six months to the end of December 2009.

A decline in interest cost should also bolster its bottom line as management is aggressively playing down debt and is targeting to shave off more than $100 million in total group debt to $300 million for FY10.

GSJBW is urging investors to buy the stock with a price target of $9.50 a share and has pencilled in a net profit of $69 million for the full year, about 4 per cent above consensus expectations.

Almost all brokers polled on Bloomberg also believe the stock is undervalued on a one-year forward P/E of about 13 times.

The stock fell 3.4 per cent yesterday to $7.70 but is up more than 16 per cent in the past two months.

Aviation earnings under review

Justin Bailey

Shares in domestically-listed aviation related stocks could take a hit if flights in and out of Europe remain closed indefinitely, forcing analysts back to the drawing board to reassess earnings estimates.

A number of brokers have already begun to put a price tag on the disruptions, but note that for certain aviation-exposed stocks, the impact should be minimal.

White Funds Management investment analyst Will Seddon warned, though, that "if these stoppages continue for a reasonable period it is obviously going to start eating into their profits".

"At this stage it is relatively minor, but if the flights don't resume soon you would have to start looking at the earnings impact".

The UK route is important for Qantas because it accounts for a large proportion of the company's flights, Mr Seddon said.

"The key unknown is what proportion of business class travel will be cancelled" one analyst said, "but that's something only Qantas knows at this stage".

Most analysts will cast their eyes over the numbers again after the cancellations, the analyst said, warning about making a "knee jerk reaction" given the limited amount of information available.

For certain aviation-exposed stocks, the impact should be minimal.

Citigroup estimate the disruption is costing Qantas $1.5 million to $2.5 million a day in earnings before interest and tax . But they are keeping their "buy" rating on the stock. The carrier finished 2 per cent lower at $2.92 yesterday.

Flight Centre was the second worst performer in the consumer discretionary sector yesterday shedding 2.8 per cent to $20.80. Deutsche Bank, which is retaining its "buy" rating, said there would be minimal impact on the company's earnings.

MAp, which operates airports in Brussels and Copenhagen, fell a relatively mild 1.3 per cent to $3. It is still unclear what impact, if any, the lengthy flight delays will have on earnings.

Virgin Blue slumped 4.6 per cent to 62.5¢. Mr Seddon said it had little exposure to the trouble in Europe: "There is a minor impact, they do indirectly have flights that go to the UK and France, but there is a really small exposure there."

However, market watchers put the magnitude of Virgin Blue's stumble yesterday to speculation that it might not win as much share of a tender for the reorganisation of the government's travel arrangements as previously thought.

Volcanic ash from an eruption in Iceland has forced the cancellation of thousands of flights in and out of a Europe since Friday, making it the biggest air travel shutdown since the terrorist attacks of September 2001.

The International Air Transport Association estimates the financial impact on airlines is more than $US200 million a day in lost revenues. The IATA said lost revenues would be compounded by re-routing of aircraft, care for stranded passengers and stranded aircraft at various ports.

Analyst says stocks are set to dive

David Coe

The market's recent push through 5000 may have given some investors a confidence boost, but for one analyst the level has prompted him to tell clients to start selling.

Falls in the Chinese and the US markets to end last week have convinced him the 60 per cent rise in share prices since March 2009 was just a huge bear market rally.

"We won't see these levels again for a while," said David Hunt, the economic strategist at Adest and vice-president of the Australian Professional Technical Analysts Association.

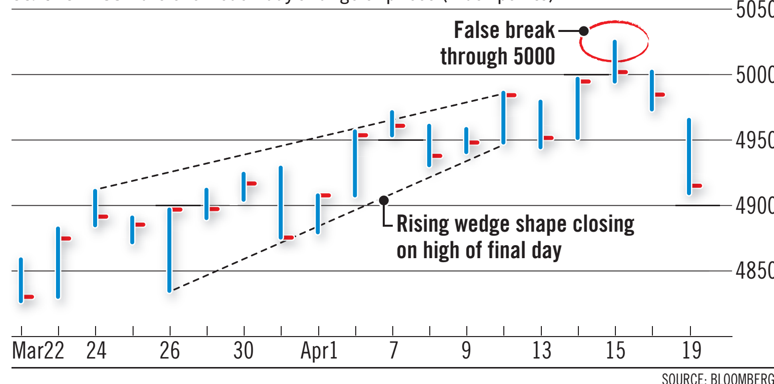
As the S&P/ASX 200 went through 5000 points and reversed last week, Mr Hunt said "it's time for investors to reduce their exposure to equities".

Mr Hunt, who has been successful in picking the market's major turning points since its November peak in 2007 said "the Australian market has topped, China has topped, and the US is topping".

His view is supported by the guru of sharemarket wave theory, US-based Robert Prechter. His organisation, Elliott Wave International, told clients after Wall Street closed down 1.6 per cent on Friday that the breadth of the sell-off suggested the market had changed and the potential for the start of a major market decline was high.

Mr Hunt said days before the sell-off that "there is a lot of evidence that when the index hit 4968 last Monday — the target I gave you last year — it was in its last gasps".

Signs of exhaustion



As the graph shows, it formed a rising wedge shape and closed on its high of the day, which chartists regard as a sure sign that a rally has petered out. The close at 4968.1 was just 0.1 points above where Mr Hunt last December told *The Australian Financial Review* it would end. And he had been eyeing 5000 points as far back as February 2009, when he correctly forecast that the market's 3603-point fall was then about to end ahead of a major upward correction.

He said yesterday that "sentiment is very high and extremes in sentiment accompany major tops and bottoms".

"As well, there's a curious situation in the options market that indicates smart players are preparing for big falls while the general public is serenely expecting the market to keep rising.

"Put options [which rise in price when markets fall] are relatively expensive but the number of call options [which rise in price when markets rise] being written relative to put options is near record highs. This shows the smart players are buying puts while the public is buying calls."

Now he expects the S&P/ASX 200 to head down towards 4250 at least, in part because the topping of the Chinese market had huge implications for BHP Billiton and Rio Tinto, and by implication the Australian economy.

"The switch for going down the rest of the year has been flicked so it's time to get out of equities," he said.