

Research Insight

News from CommSec research

Welcome to this week's edition of the CommSec Research Insight. Each week we share the unique insights of the CommSec Equities Research team based on the research we prepare for institutional clients (ie fund managers). We provide you with a quick wrap on the state of our share market, a few feature articles on the most interesting recent research reports we've issued and snippets on stocks and sectors that have been making the news.

Feature Article

Our feature article this week is:

A-REIT Sector – Real Estate: Earnings bottom but whose can bounce

The comments in the article below are an abbreviated restatement of our analysts' reports.

A glossary of frequently used investment terms can be found at the end of this report

Feature Article

A-REIT Sector – Real Estate

ASX Code	Last Traded	Price Target	Recommendation	Market Cap
CMW	\$0.74	\$0.76	Hold	\$675m
CQO	\$3.26	\$2.85	Sell	\$1,608m
DXS	\$0.86	\$0.96	Buy	\$4,162m
GMG	\$0.705	\$0.76	Buy	\$4,860m
GPT	\$3.10	\$3.03	Sell	\$5,752m
IOF	\$0.59	\$0.60	Hold	\$1,610m
MGR	\$1.28	\$1.42	Hold	\$4,372m
SGP	\$3.76	\$4.62	Buy	\$8,960m
WDC	\$9.71	\$10.59	Buy	\$22,420m
WRT	\$2.70	\$2.90	Hold	\$8,246m

Summary of previous report dated 03/03/2011

Earnings bottom but whose can bounce

We have made adjustments to our sector preferences post-reporting season. Our Buy recommendations are DXS, GMG, SGP and WDC. Our Sell recommendations are CQO and GPT. We have upgraded GMG and WDC to Buy from Hold, and downgraded MGR to Hold from Buy.



Issue 199

10 March 2011 (4.30pm)

Market Wrap

One of the biggest issues currently is rising food prices. The United Nations Food and Agriculture Organisation (FAO) has recently released its February data and the food price index hit fresh record (20-year) highs in both real and nominal terms.

The FAO expects that a combination of higher global demand and lower supply will lead to a fall in global cereal stocks, underpinning the sharp lift in prices recorded over the past year.

Now for those in developed or advanced nations, tight grain supplies and record prices is a concern but hardly a big deal. In the US, food represents just 7 per cent of household spending. In the UK this proportion stands at 9 per cent while food is 11 per cent of household consumption in Australia.

But in developing nations, the issue of rising food prices is far more significant. Even in the second largest economy – China – food represents 33 per cent of household spending. More broadly across Africa and Asia food holds between 30-50 per cent of household consumption.

So it is understandable that record food prices have led to unrest across the developing world. And when you combine that with young populations that are more likely to agitate for change, widespread access to social media and autocratic governments, you have a volatile mix.

Stephen Karpin
Managing Director

Offshore exposure is no longer the Achilles heel for A-REITs. The trend in operating metrics is clearly improving, indicating the worst of the conditions have passed. This is positive for DXS, GMG and WDC.

Residential margin expansion offsets volume declines. Residential earnings from MGR and SGP were pleasing, particularly given the impact from poor weather conditions during 1H11. Continued margin expansion and a recovery in volumes should result in strong residential contributions for FY11.

Sydney office recovery unlikely. We believe market conditions have not improved over the past 12 months given: (1) high incentive levels, ~30%, and (2) new leases excluding market rent review clauses. Further, we believe supply levels are underestimated, given an estimated 200,000sqm of uncommitted refurbished stock is returning to the market in CY11.

High-end retail rents run too far. The gap between sales growth and rental growth has diverged to such a degree that occupancy costs aren't far away from levels that would be considered unsustainable. Therefore, unless there is a sudden increase in retail sales, we see rental growth declining, particularly for A-REITs with super regional and region malls.

We are more optimistic on the A-REIT sector post-reporting season as earnings momentum has turned positive, real estate markets continue to recover, and funding costs stabilise.

Our preferences remain A-REITs with operating leverage to the recovery, and post reporting season A-REITs with offshore exposure.

We remain cautious on the domestic office sector, and are less enthusiastic on the premium retail sector, particularly those with passive income streams.

Stocks at a glance

Following is a summary of a selection of recent reports distributed by CommSec research.

Stocks by sector

Consumer Discretionary

NWS
10/03/11

Summary of
report dated
04/03/11

News Corporation

Last Traded: \$17.65 Market Cap: \$44,644m Sector: Consumer Discretionary
Buy Price target: \$19.80

BSkyB deal one step closer

The UK government has decided that as long as Sky News is spun off into a separate company, it will not refer the NWS/SKY takeover to the competition commission. This opens the way for a revised bid from NWS. We view this as a positive step, but will need to see the final offer by NWS before assessing the deal fully.

BSkyB acquisition makes sense. Our view for some time has been that the deal makes sense given: (1) we like the strong cashflows and defensive earnings stream of BSkyB, (2) NWS will control BSkyB's full cashflows rather than just receiving dividends, (3) NWS has typically performed better when it is more capital constrained (ie less M&A fear), and (4) consolidating BSkyB would reduce the percentage of our NWS valuation derived from minority investments from 14% to 5%.

Reiterate Buy with AUD19.80 price target. We retain a Buy given continued strong revenue growth and margin expansion for NWS' Cable assets, improvements in its broadcast TV assets from re-transmission, exposure to the global cyclical recovery, and the potential for the BSkyB deal to allay M&A fears and boost NWS' cashflows.

Industrials

QAN
10/03/11

Summary of
report dated
09/03/11

Qantas Airways Limited

Last Traded: \$2.28 Market Cap: \$5,164m Sector: Industrials
Buy Price target: \$3.25

Another increase to international fuel surcharges

Qantas has once again increased international fuel surcharges in response to higher fuel prices (last increase was 3 February). The new surcharges on one-way fares (ex Australia) purchased from 17 March are:

- UK and Europe: \$190 (\$145 at 3 February, \$95 previously)
- North and South America, South Africa, India: \$150 (\$115 at 3 February, \$85 previously)
- Asia, Pacific, Honolulu: \$105 (\$75 at 3 February, \$55 previously)

No earnings changes. Similar to the previous change in surcharges, we see this increase in yields as part of the yield growth we had already expected from FY11 to FY12. Qantas has reiterated fuel expense guidance for 2H11 of approximately \$2b.

Buy recommendation maintained. Social unrest in the Middle East has driven up fuel costs to such an extent that Qantas is now trading below NTA. While the outlook remains uncertain, we expect that an easing of tension in the Middle East will lead to a rapid and significant rebound in the Qantas share price.

Materials

BHP
10/03/11

BHP Billiton Limited

Last Traded: \$44.63 Market Cap: \$233,941m Sector: Materials
Buy Price target: \$61.00

Summary of
report dated
07/03/11**Spending wisely? Spending lots!**

BHP has announced its intention to spend USD80b on growth projects to 2015. We examine where this capital will be spent and the impact on BHP's asset base, valuation, earnings and cashflow.

Our earnings revisions incorporate a number of factors: (1) final revisions post the 1HFY11 result (FY11 up on low tax), (2) capital management, (3) the Fayetteville shale acquisition, (4) mark-to-market commodity prices, and (5) additional capex for growth projects.

We upgrade our valuation from USD51ps to USD59ps. Our price target increases from AUD56ps to AUD61ps.

We consider BHP outstandingly cheap – trading on 9.4x FY12E earnings. BHP represents 12% of the ASX200 index; and with our price target 32% above today's share price, we believe investors should put in place an overweight position in BHP.

Telecommunications

TLS
10/03/11

Telstra Corporation Limited

Last Traded: \$2.68 Market Cap: \$33,347m Sector: Telecommunications
Buy Price target: \$2.99

Summary of
report dated
04/03/11**ACCC pricing for fixed access services**

The ACCC has published Interim Access Determinations (IADs) for pricing and non-pricing based terms for declared fixed services.

EPS declines are modest, down 0.5% in FY11 and 0.2% in FY12, and our valuation reduces from \$3.00 to \$2.99ps. We already had significant price reductions factored into our forecasts but increased clarity on CY11 pricing means we have changed wholesale and some retail ARPU assumptions which reduce revenue by ~\$30m in both FY11 and FY12. We note further downgrades could occur if Telstra's competitors choose to pass on all savings to end-users (unlikely in our view), with Telstra forced to lower retail prices further.

Buy recommendation with \$2.99 price target. Telstra faces considerable operational challenges and uncertainties, including the impact of the NBN and regulated prices for fixed services. Despite this, with more confidence in operational momentum, finalisation of the \$11b NBN deal, the 28¢ dividend and potential capital management, we expect outperformance.

Happy investing!

Recommendation definitions

CBA Institutional Equities Investment recommendations are determined by the covering analyst and reflect the analyst's assessment of a stock's expected total shareholder return (TSR). TSR is calculated as the difference between the analyst's 12-month price target and the current share price plus the forecast dividend yield.

Buy: Stocks with a Buy recommendation represent the most attractive stocks under the analyst's coverage. They are forecast to generate significantly positive expected total shareholder returns.

Hold: Stocks with a Hold recommendation are less attractive than Buy rated stocks. They are forecast to generate flat to slightly positive expected total shareholder returns.

Sell: Stocks with a Sell recommendation are the least attractive stocks. They are forecast to generate flat or negative expected total shareholder returns.

Glossary of frequently used investment terms

2P	proved plus probable	FUM	funds under management
3P	proved, probable and possible	GEP	gross earned premiums
ABARE	Australian Bureau of Agricultural and Resource Economics	GJ	gigajoule
ACCC	Australian Competition and Consumer Commission	GWP	gross written premiums
AGM	annual general meeting	JV	joint venture
APRA	Australian Prudential Regulation Authority	LNG	liquefied natural gas
ARTC	Australian Rail Track Corporation Ltd	L-R	long run
ATO	Australian Taxation Office	MAT	moving annual total
bbl	billions of barrels	Mboe	thousands of barrels of oil equivalent
bbls	barrels	mom	month on month
bp	basis points	MOU	Memorandum of understanding
CAGR	compounded annual growth rate	MRET	mandatory renewable energy target
CCGT	combined-cycle gas turbine	NAV	net asset value
CEO	chief executive officer	NPAT	net profit after tax
COGS	cost of goods sold	NPV	net present value
cps	cents per share	NTA	net asset backing per share
cpu	cost per unit	OCGT	open-cycle gas turbine
CSG	coal seam gas	OIP	oil in place
CSM	coal seam methane	OTC	over the counter
DCF	discounted cash flow	P/E	price-earnings ratio
D&A	depreciation and amortisation	pcp	prior comparable period
DRP	dividend reinvestment plan	ppt	percentage point
EBIT	earnings before interest and tax	PSI	offering into pipelines
EBITDA	earnings before interest, tax, depreciations, amortisation	SOTP	sum of the parts
EPCM	Engineer Procure Construct Manage	TEUs	twenty equivalent units
EPS	earnings per share	VWAP	volume-weighted average price
ETS	emissions trading scheme	WACC	weighted average cost of capital
EV	enterprise value	WIH	work in hand
FTA	free to air	y-o-y	year on year

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More information on our research methodology, organisation structure, summary documenting frequency and recommendations can be obtained at research.commsec.com.au

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End of Report