

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 articles this week are:

- BHP & RIO: Earnings upgraded
- AXA Asia Pacific Holdings Limited: Trying to clean up the mess
- Sonic Healthcare Limited: Attractive bolt-on at a sensible price

The comments in the articles 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

BHP & RIO: Earnings upgraded

| | | |
|-------------------------------|-------------------|-----------------------|
| BHP: Last traded: \$42.47 | Sector: Materials | Market cap: \$141B |
| BHP: ACCUMULATE / OUT PERFORM | | Valuation: \$45.60 |
| RIO: Last traded: \$73.51 | Sector: Materials | Market cap: \$32,012M |
| RIO: ACCUMULATE / OUT PERFORM | | Valuation: \$75.10 |

Summary of previous report dated 30/11/09

Price targets up

Following upgrades to bulk commodities (met. coal and iron ore) and base metal forecasts we have upgraded our BHP and RIO price targets. BHP's price target is now AUD47 (from AUD44) and RIO's price target is now AUD76 (from AUD 70).

Recommendations maintained

Despite these increases, we retain our respective ACCUMULATE / OUT PERFORM recommendations for both stocks.

We continue to see significant medium-to long-term upside in both stocks

In the short term, there is a significant chance of a correction in over-exuberant commodity markets that have been driven by restocking activity in China. A correction in base metal prices is likely to flow through to equities.

In the long term, however the continued economic development of China coupled with a broader global economic recovery from the GFC will see strong demand growth for commodities. BHP and RIO will both be major beneficiaries of this demand growth.



Issue 139 3 December 2009 (4.30pm)

Market Wrap

The Australian sharemarket is on track for its best yearly gain in 16 years. That may seem remarkable given how weak the market was in the early months of the year. But the sharemarket is currently up 30% over 2009, and headed for the best gain since 1993.

The old adage is "time in, not timing". That is, it is the time in the market that is most important for investors rather than trying to time purchases and sales. And this old adage rings true once again.

Who could have predicted that global sharemarkets would have turned on a dime in March, and more importantly, consistently rallied from that point?

With the likely gain of 30% this year, the average growth for the Australian sharemarket over the past six years will lift to 13.5% pa. And the sharemarket has grown on average by 10% a year over the past decade. Once you add in dividends, it is clear that sharemarket investment returns have remained very good.

Matt Comyn
General Manager

Feature Article

AXA Asia Pacific Holdings Limited: Trying to clean up the mess

Last traded: \$5.82 Sector: Financials Market cap: \$5,694M
ACCUMULATE / OUT PERFORM Valuation: \$5.84

Summary of previous report dated 01/12/09

Encouraged by strategy to improve Australian and Hong Kong business units

Following AXA's annual strategy day on Tuesday 1 December which included presentations from each of the regional managers, we are encouraged by management's actions to improve the Australian, and to a lesser degree, the Hong Kong business units.

That said, we are still not convinced on the India and China story, with the rest of SE Asia being a minimal contributor to AXA's profits for some time to come.

No comments on AMP/AXA SA bid

While the strategy briefing excluded any questions on the AMP²/AXA SA bid, the briefing confirmed our previous comments that the bid should be increased to approximately \$6.10. Our valuation of AXA remains \$5.84.

We also still believe that the increased bid should come from the Australia component of the bid (ie AMP's share). The benefits of a merged Australian business will be beneficial for both AMP and AXA.

Based on our cautious comments surrounding Asia, the offer in place for this business is adequate for the risks involved.

Feature Article

Sonic Healthcare Limited²: Attractive bolt-on at a sensible price

Last traded: \$14.44 Sector: Healthcare Market cap: \$5,494M
BUY/OUT PERFORM Valuation: \$16.27

Summary of previous report dated 01/12/09

Acquisition of East Side Clinical Laboratory

SHL announced the acquisition of East Side Clinical Laboratory (ESCL) based in Providence, Rhode Island, US. ESCL generates annual revenues of ~USD30m. CBA estimates the acquisition was done at a price/revenue multiple of ~1.6x, implying a total cost of ~USD48m.

Following this small bolt-on acquisition we have made minor changes to our forecasts. FY10 EPS is up 0.5% and FY11 EPS is up 1%. Our DCF has increased by 0.5% to AUD16.27, however our price target remains unchanged at AUD14.36.

We expect further accretive acquisitions in the near term

We retain our BUY / OUT PERFORM recommendation on the stock given the favourable asset pricing environment and expectations of further accretive acquisitions in the near term, which is not factored into the share price.

Stocks at a glance

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

Stocks by sector

Financials

| | |
|---|--|
| <p>PPT 3/12/09</p> <p>Summary of report dated 2/12/09</p> | <p>Perpetual Limited: Small growth options</p> |
| | <p>Last Traded: \$34.55 Market Cap: \$1,380M Sector: Financials</p> <p>ACCUMULATE / MARKET PERFORM Valuation: \$44.40</p> <p>No change to FY10 guidance</p> <p>PPT held part two of its business update (part one was in June). This session focused on Private Wealth and Corporate Trust business units with no change to guidance previously supplied for FY10.</p> <p>While management outlined small growth options for the business and potential to diversify away from purely funds management, these areas are small in size.</p> <p>Further recovery in equity markets key driver of profits</p> <p>Over 75% of PPT's earnings are linked, to some degree, to asset movements, primarily equity markets. Further recovery in the equity markets will be the key driver of profits in the near term. We maintain our ACCUMULATE / MARKET PERFORM recommendation with a \$35.97 price target.</p> |

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| | |
|--|--|
| <p>WDC¹ 3/12/09</p> <p>Summary of report dated 27/12/09</p> | <p>Westfield Group: Weakness presents opportunity</p> |
| | <p>Last Traded: \$11.94 Market Cap: \$25,515M Sector: Financials</p> <p>ACCUMULATE / MARKET PERFORM Valuation: \$13.12</p> <p>Recommendation updated</p> <p>At current levels investors are presented with an attractive entry point into a high-quality, globally diverse retail portfolio which is well positioned to take advantage of acquisition or development opportunities when conditions improve. Consequently we have upgraded our recommendation to ACCUMULATE / MARKET PERFORM.</p> <p>Little downside to WDC's NTA</p> <p>In our view asset values for quality retail assets have bottomed, and as such we see little downside to WDC's NTA. We believe the current security price is attributing minimal value to the present or potential development pipeline.</p> |

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Industrials

| | |
|---|---|
| <p>AIO¹ 3/12/09</p> <p>Summary of report dated 1/12/09</p> | <p>Asciano Group: Plenty of growth in coal</p> |
| | <p>Last Traded: \$1.72 Market Cap: \$5,033M Sector: Industrials</p> <p>ACCUMULATE / MARKET PERFORM Valuation: \$1.75</p> <p>\$500m contract with Japanese trading company Idemitsu</p> <p>AIO has announced a 12-year, \$500m contract with Japanese trading company Idemitsu to haul coal from its Boggabri mine in the Hunter Valley. Our earnings forecasts, valuation and price target are unchanged.</p> <p>Trading close to fair value</p> <p>AIO stands to benefit from an economic recovery through FY11 principally through its container ports business. This positive outlook is priced in, however, with AIO continuing to trade around our blended valuation of \$1.75, we would look to more aggressively pick up the stock below \$1.60.</p> <p>A decision on the third stevedore at Port Botany and the 1H10 results will be the next major catalysts for AIO. Our recommendation remains ACCUMULATE / MARKET PERFORM.</p> |

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Regulated utilities

SKI
3/12/09Summary of
report dated
1/12/09**Spark Infrastructure: ETSA decision comforting but risks remain**

Last Traded: \$1.305

Market Cap: \$1,169M

Sector: Utilities

ACCUMULATE / MARKET PERFORM

Valuation: \$1.75

Slight adjustments to SKI forecasts

Following the Australian Energy Regulator's (AER) release of its Draft Decision for ETSA's five-year price reset commencing 1 July 2010 we have adjusted our SKI forecasts. SKI owns 49% of ETSA, CitiPower and Powercor.

Our price target has been increased to \$1.31 (+8cps) to reflect the lower regulatory and funding risks. Our valuation of \$1.75 is unchanged.

Risks remain

While SKI trades at a discount to others in the sector (FCF and distribution yield of 13.8% and 10.5% respectively), risks remain. The most significant risk for SKI remains its structure and the debt (\$425m) above the assets at the SKI level. This type of debt has proven problematic for other utilities, albeit more highly geared ones. The first tranche of this debt is due to be refinanced in December 2010.

Regulatory risks also remain given the Victorian assets (52% of EBITDA) are also subject to a reset from 1 January 2011. The draft decision for the Victorian assets will not be known until mid 2010. In our view, these considerations warrant a neutral recommendation.

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Happy investing!

Recommendation Definitions

SHORT TERM (over the next 6 months we expect the share price to):

| | |
|------------|---|
| BUY | Appreciate by >10% |
| ACCUMULATE | Increase between 2% and 10% |
| REDUCE | Increase by less than 2% or fall by up to 5% |
| SELL | Fall by >5% |
| REV | Company is under review - no recommendation available |

LONG TERM (over the next 24 months we expect the total return to):

| | |
|------------------------|---|
| Outperform (O / P) | Exceed market return by >5% |
| Market Perform (M / P) | Be in line with market return, +/-5% |
| Under Perform (U / P) | Be less than market return by >5% |
| REV | Company is under review - no recommendation available |

¹ Members of the Commonwealth Group hold: between 5 and 10% of AIO and WDC.

² Members of the Commonwealth Group have received fees within the previous 2 years from SHL and AMP.

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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End of Report