Research Insight

CommSec

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.

Issue 134 **15 October 2009 (4.30pm)**

Feature Article

Our feature articles this week are:

- **Dexus Property Group: The value play**
- **Asciano Group[1]: Emerging competition in rail dampens growth outlook**
- **Mirvac Group[1]: Big Brother is watching**

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

Dexus Property Group: The value play

Last traded:	$0.83	Sector:	Financials	Market cap:	$3,855M
BUY / OUT PERFORM				Valuation: $0.98	

Summary of previous report dated 12/10/09

Event

- We initiate coverage on DXS with a BUY / OUTPERFORM recommendation.
- 12 month price target: $1.04.

Investment view

- DXS offers investors the most attractive relative return in our coverage universe and in our view has clear valuation support. This view is supported by the following:
  - A 11.0x FY10 P/E multiple which is well below its 5 year average (12.4x) and the average for our coverage universe (14.3x). This is also despite DXS's 3 year EPS CAGR being in line with our universe average (6.1%).
  - The highest FY10 yield in our coverage universe at 6.5% (versus a universe average of 5.6%). Furthermore this is based on a conservative 70% payout ratio.
  - A 20.8% discount to stated NTA, the largest discount in our universe. This is despite our view that asset values are likely to stabilise in the near term.

Market Wrap

The Aussie dollar evokes different emotions and reactions from consumers, investors and businesses. For consumers the high level of the currency is viewed positively, the perception being that it will translate to cheaper international travel and cheaper imported goods.

But the strong Aussie certainly isn't viewed as an unambiguously positive event by investors and businesses. Retailers benefit from a firmer currency as do media companies. But for those companies with substantial overseas operations, the firmer Aussie dilutes foreign revenues and profits.

And for Australian businesses more broadly, the higher currency creates challenges for the rural and tourism sectors, manufacturers and exporters more generally.

Some may believe that the firmer currency is a temporary development. But a reality check is in order. The long-term average of the Australian dollar since it floated is US72 cents. However in the past three years, the Aussie has averaged US82 cents. Investors and businesses may have to redo their sums, factoring in a higher dollar.

Matt Comyn
General Manager

- In addition, we are attracted to DXS in light of the following:
  - Its high quality domestic office portfolio that is well placed to take advantage of a recovery in domestic office markets.
  - It has de-risked its two major developments with large pre commitments and by selling down ownership interests.
  - Increasing sources of capital as demonstrated by its inaugural issue in the 144a bond market.

Feature Article

Asciano Group[1]: Emerging competition in rail dampens growth outlook

Last traded:	$1.665	Sector:	Industrials	Market cap:	$4,901M
ACCUMULATE / MARKERT PERFORM				Valuation: $1.75	

Summary of previous report dated 15/10/09

Import recovery in FY11 to drive container ports

- With the outlook for a stronger economic recovery than previously expected, Asciano (AIO) stands out as the most leveraged transport stock (outside of the airlines) to benefit.
- Higher imports will drive a rebound in container volumes in FY11. The import recovery will be driven by restocking of inventories, a lift in Gross National Expenditure led by solid consumer demand and continued strength in the AUD:USD (forecast by CBA to rise to 0.98 by June 2010 with upside risks).
- Given an estimated 62% of costs in container ports are fixed, much of the higher turnover will flow through to operating earnings. We forecast container ports' EBITDA to increase by 20.5% in FY11 and 12.2% in FY12.

The emergence of Freightliner will take away some of the upside in coal

- Following the Xstrata win, Freightliner's chances of truly establishing itself as a third operator in coal haulage should be taken seriously. Freightliner has significant international experience in coal haulage and coal companies appear increasingly willing and able to sponsor competition.
- We factor in Freightliner gaining 15% of the Hunter Valley rail market by FY12. Its presence will also curtail some of the price growth being targeted by AIO and QR as contracts are renewed. In particular, we assume only $20m of the $30m in repricing benefits targeted by AIO are achieved in FY11.
- We are less concerned about ports competition in the next 12 months. Exclusive negotiations are underway for a third operator at Port Botany. Even if Hutchison wins at Sydney, it will struggle to win sufficient volumes without a terminal at Melbourne (where a third terminal is unlikely until at least 2017).

Earnings and valuation revisions

- We have upgraded our NPAT forecasts by between 23% and 31% during FY10-FY12. These upgrades incorporate upgraded EBITDA but also now exclude acquisition amortisation of $50m pa from underlying NPAT.
- Our valuation is upgraded to $1.75 (from $1.46), an average of our DCF ($1.66) and sum of parts ($1.83) valuations. The price target is $1.88 (was $1.62).

	FY10			FY11			FY12		
	Old	New	Δ	Old	New	Δ	Old	New	Δ
EBITDA	712.0	717.3	0.7%	836.3	893.4	6.8%	906.1	948.4	4.7%
NPAT post acquistion amortization	169.2	157.7	-6.8%	244.6	271.0	10.8%	286.2	312.5	9.2%
Underlying NPAT ($m)	169.2	207.7	22.8%	244.6	321.0	31.2%	286.2	362.5	26.6%
Underlying EPS (cps)	6.2	7.3	18.8%	8.6	11.0	27.2%	10.1	12.4	22.7%

Investment view

- AIO's leverage to an economic recovery is now priced into market expectations with our EBITDA forecasts for FY11 now around consensus.
- Further contract wins by Freightliner in the next 12 months are a key risk.
- Our recommendation is retained at ACCUMULATE / MARKET PERFORM.

Feature Article

Mirvac Group[1]: Big Brother is watching

Last traded: $1.59 Sector: Financials Market cap: $4,350M

ACCUMULATE / OUT PERFORM Valuation $1.73

Summary of previous report dated 12/10/09

Event

- MGR announced its intention to acquire the remaining units in Mirvac Real Estate Investment Trust (MRZ) it does not already own (75.4%) for $0.50 per unit via a trust scheme of arrangement.

Implication

- The transaction increases MGR's recurring income through additional Australian investment grade asset ownership.
- It is 3.2% accretive to MGR's FY10 EPS, and 2.3% accretive to NTA.
- However, the transaction will dampen the contribution from the corporation and hence slightly lessen the earnings impact from a residential recovery.

Earnings and valuation revisions

- No change to price target ($1.85), valuation or recommendation.

Investment view

- No change to our ACCUMULATE / OUTPERFORM recommendation. In our opinion, this is a logical transaction that will benefit MGR in the medium term given:
  - It will decrease MGR's earnings volatility due to an increased contribution from the trust's recurring income stream.
  - MGR will benefit from redevelopment opportunities within the MRZ portfolio that MRZ couldn't undertake given its restrictive balance sheet.
  - MGR is likely to benefit from a credit rating perspective.

- While MGR appears expensive from a multiples perspective, we note:
  - MGR is trading at a -9.4% discount to revised NTA, accounting for the proposed transaction.
  - MGR has operating leverage to a residential recovery and an upswing in the cyclical office markets.

Stocks at a glance

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

Stocks by sector

Real estate

CFX[3]
15/10/09

Summary of report dated 12/10/09

CFS Retail Property Trust: A rock solid performer

Last Traded: $2.08 | Market Cap: $4,179M | Sector: Financials
ACCUMULATE / MARKET PERFORM | Valuation: $2.10

Event

- We initiate coverage on CFX with an ACCUMULATE / MARKET PERFORM recommendation.
- 12 month price target: $2.19.

Investment view

- CFX is a well managed, high quality Australian focussed retail property trust that consistently delivers solid organic earnings growth, with low volatility.
- In our view CFX will remain supported at current levels given:
  - A 6.2% FY10 yield versus 5.5% for our coverage universe.
  - Its portfolio cap rate (6.5%) appears conservative when compared to its peers (i.e. WDC's Australian portfolio at 6.0%). As such we see the risk to current NTA as shifting to the upside.
  - Its A/A-1 S&P credit rating - this is the highest of all A-REITs.
  - A very resilient portfolio that consistently has very high occupancy levels and strong comparable NOI growth through the economic cycle.
  - It remains well placed to acquire assets given its competitive cost of capital.
  - A solid development pipeline that should create long term shareholder value.
- A key risk to our recommendation is investors' risk appetite. Given CFX lacks leverage to a cyclical recovery, if investors become more confident that a sustainable recovery is on the way, then CFX may underperform on a relative basis as investors are likely to favour higher risk stocks. However, if the market falters then we would expect CFX to outperform given its defensive characteristics.

Given CFX lacks leverage to a cyclical recovery, if investors become more confident that a sustainable recovery is on the way, then CFX may underperform on a relative basis as investors are likely to favour higher risk stocks. However, if the market falters then we would expect CFX to outperform given its defensive characteristics.

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CPA[2,]
15/10/09

Summary of report dated 12/10/09

Commonwealth Property Office Fund: Vacancy risks dissipating

Last Traded: $1.01	Market Cap: $1,867M	Sector: Financials
ACCUMULATE / MARKET PERFORM		Valuation: $1.04

Event

- We initiate coverage on CPA with an ACCUMULATE / MARKET PERFORM recommendation
- 12 month price target: $1.11

Investment view

- The immediate operating environment for CPA remains challenging due to the vacancy lag from increased unemployment. CPA should, however, be relatively well placed for a recovery in domestic office markets given:
  - Downward revisions to the forecast peak in unemployment
  - Upward revisions to GDP growth expectations to reflect close to trend growth
  - Constrained supply in most Australian office markets.
- In addition, in our view CPA has valuation support given it is trading:
  - At a 15.2% discount to NTA. While we believe asset values will stabilise in the near term, CPA's low gearing limits the impact on NTA from any further asset value declines if they were to eventuate.
  - On a 5.4% FY10 yield (in line with our coverage universe average) based on a conservative payout ratio.
- However, key risks to our view include:
  - A sluggish recovery in the Sydney and Melbourne office markets
  - 175 Pitt St remaining vacant
  - Its largest tenant, CBA, relocating staff to non-CPA owned assets.

The immediate operating environment for CPA remains challenging due to the vacancy lag from increased unemployment. CPA

GMG[1,]
15/10/09

Summary of report dated 12/10/09

Goodman Group: Back in the game

Last Traded: $0.685 Market Cap: $4,026M Sector: Financials
ACCUMULATE / MARKET PERFORM Valuation: $0.68

Event

- We initiate coverage of GMG with an ACCUMULATE / MARKET PERFORM recommendation.
- 12 month price target: $0.73

Investment view

- In our view, post its capital raising initiatives, GMG is well placed to grow earnings as the global economy recovers given:
  - Demand for logistical space should increase as the global economy returns to trend levels
  - Its exposure to global industrial markets (UK, Europe, Asia and Australasia)
  - Strong relationships with global investors and tenants. This places GMG as a developer of choice when the cycle is recovering
  - Margin expansion and volume growth due to reduced competition as a consequence of the global financial crisis.
- In addition, we believe GMG is fair value given:
  - A 11.8x one-year forward P/E, which is slightly above its five-year average (11.6x)
  - A modest three-year EPS CAGR (2.2%), largely due to dilution from its recent equity raising initiatives
  - A 5.0% 12-month forward yield versus our coverage universe 5.5%. However, we note GMG has adopted a conservative payout ratio (~60%)
  - A 25.0% premium to NTA. While this is the highest in the sector, this is well below its historical average 98.6%, and in our view justified given GMG's business model.

GMG has strong relationships with global investors and tenants placing it as a developer of choice when the cycle is recovering

GPT[1,]
15/10//09

Summary of report dated 12/10/09

GPT Group: Lagging behind

Last Traded: $0.665	Market Cap: $5,690M	Sector: Financials
REDUCE / UNDER PERFORM		Valuation: $0.65

Event

- We have initiated coverage on GPT with a REDUCE / UNDERPERFORM recommendation.
- 12 month price target: $0.68

Investment view

- While GPT has one of the highest quality domestic portfolios, particularly in the office sector, our recommendation is predicated on:
  - GPT continuing to de-lever through asset sales. While we believe this will make GPT a more attractive investment proposition in the future, growth in the near term is likely to be muted.
  - Our view that GPT will adopt a more conservative payout ratio for FY10, thus reducing yield support.
  - Continued development risk at One One One Eagle St Brisbane, as the project remains without a tenant pre-commitment.
  - GPT has the longest portfolio valuation lag (11.5 months) in our universe.
- In our view, valuation support is not compelling given:
  - GPT's 14.5x one-year forward P/E multiple which is above its five-year historical average (12.2x) and the average for our coverage universe (14.3x). This is despite a lower growth profile than the average of our coverage universe.
  - The possibility of a reduced yield due to a reduction in the payout ratio.
  - The -7.7% discount to NTA.
- In our view, a key risk to our recommendation is a takeover by Stockland which currently holds a ~13.1% interest in GPT. While a takeover from an SGP perspective makes strategic sense, a takeover in the near term is unlikely, in our opinion.

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MGR[1,]
15/10/09

Summary of report dated 12/10/09

Mirvac Group: The leverage play

Last Traded: $1.59 | Market Cap: $4,350M | Sector: Financials
ACCUMULATE / OUT PERFORM | Valuation: $1.73

Event

- We initiate coverage on MGR with an ACCUMULATE / OUTPERFORM recommendation.
- 12 month price target: $1.85

Investment view

- In our view, MGR offers investors the greatest EPS leverage in our coverage universe to a cyclical recovery given:
  - Its residential exposure. In our view a residential recovery should be supported by: 1) a low interest rate environment; 2) increased affordability; 3) increasing rents; 4) an undersupply of housing; and 5) government incentives.
  - Its exposure to a potential recovery in office markets, supported by downwardly revised unemployment forecasts, and supply constraints.
- While MGR appears expensive from a multiples perspective, we note:
  - MGR is trading at a -3.5% discount to NTA. This compares to MGR's historical average of a 13.1% premium, and SGP trading at an 11.4% premium to NTA.
  - MGR is well placed to make accretive acquisitions to enhance its EPS/DPS profile. A clear example would be an acquisition of satellite vehicle MRZ. We estimate this could boost FY10 EPS by up to ~4.5%
  - MGR has the highest three-year EPS CAGR (9.8)% in our coverage universe (5.9% average).

MGR is well placed to make accretive acquisitions to enhance its EPS/DPS profile. A clear example would be an acquisition of satellite vehicle MRZ. We estimate this could boost FY10 EPS by up to ~4.5%

SGP[1,]
15/10/09

Summary of report dated 12/10/09

Stockland: From defence to attack

Last Traded: $4.07 | Market Cap: $9,604M | Sector: Financials
ACCUMULATE / MARKET PERFORM | Valuation: $3.95

Event

- We initiate coverage on SGP with an ACCUMULATE / MARKET PERFORM recommendation.
- 12 month price target: $4.19

Investment view

- SGP is well placed for strong earnings growth as it is leveraged to a residential recovery. However, our relative return expectations place SGP toward the middle of our coverage universe.
- From a valuation perspective we note:
  - Despite factoring in a strong residential recovery, SGP is trading on a 13.1x FY11 P/E multiple. This is in line with SGP's one-year forward five-year average (13.1x).
  - SGP is trading at a 11.4% premium to NTA. While still well below its historical

SGP's very strong balance sheet (16.0% gearing) and competitive cost of equity have positioned SGP to enhance its EPS/DPS profile through acquisition. However, in our view, an acquisition of GPT in the near term is unlikely.

average (26.1% premium), it is above the 6.0% premium for our coverage universe, and peer Mirvac.

- SGP's one-year forward yield is approximately in line with the average for our coverage universe (5.4% v 5.5%).
- SGP has the second-highest three-year EPS CAGR in our coverage universe (8.6% versus sector average 5.9%).

- SGP's very strong balance sheet (16.0% gearing) and competitive cost of equity have positioned SGP to enhance its EPS/DPS profile through acquisition. However, in our view, an acquisition of GPT in the near term is unlikely.

WDC[1,]
15/10/09

Summary of report dated 12/10/09

Westfield Group: Waiting for the development pipeline to re-emerge

Last Traded: $13.29 Market Cap: $27,844M Sector: Financials
REDUCE / MARKET PERFORM Valuation: $13.14

Event

- We initiate coverage on WDC with a REDUCE / MARKETPERFORM recommendation.
- 12 month price target: $13.66

Investment view

- While we recognise that WDC has a proven track record, a very high quality global portfolio, and diverse funding sources, we believe WDC appears fully priced at current levels relative to our coverage universe.
- At current prices we note WDC is trading on:
  - A 20.7% premium to NTA. Furthermore, if we exclude the deferred tax liability (given it is unlikely to be crystallised), the premium to NTA (11.6%) remains well above the average for our coverage universe.
  - A ~6.15% implied portfolio cap rate. This implies 30bp in cap rate tightening, which in our view is unlikely in the near term.
  - A 5.3% FY10 yield, 20bp below our coverage universe, despite WDC's three-year EPS CAGR being in line with our coverage universe (5.6%).
- In addition, WDC's development pipeline, a traditional growth engine, has been significantly reduced. Based on our estimates we believe the NPV of the current pipeline to be ~$0.45 per security.
- Therefore, we believe a key catalyst for outperformance will be when WDC is once again able to increase its development pipeline to levels pre the GFC.

WDC's development pipeline, a traditional growth engine, has been significantly reduced. Based on our estimates we believe the NPV of the current pipeline to be ~$0.45 per security.

Regulated utilities and telecos

TCL'
15/10/09

Summary of report dated 12/10/09

Transurban Group: M2 widening attractive

Last Traded: $4.39 | Market Cap: $5,466M | Sector: Industrials
ACCUMULATE / MARKET PERFORM | Valuation: $5.60

TCL remains our preferred toll road ahead of MIG and CEU given its strong balance sheet and organic growth options

Event

- TCL announced that it has reached an in-principle agreement with the NSW Government to upgrade the M2. We analyse the metrics of the proposed upgrade and also adjust forecasts for 1Q traffic.

Implication

- *Clever structure*. The structure involves a four-year concession extension, higher tariffs on completion, new on/off ramps and increased traffic projections. This reduces the risk particularly if traffic forecasts do prove to be bullish (albeit considered an unlikely scenario).
- *Delivers mid teens equity IRR*. Based on the traffic and capex forecasts provided, we estimate an equity IRR of 12% with upside depending on funding mix and traffic forecasts. Further, some upside for the M7 Westlink could be expected.
- *Bodes well for M5 negotiations.* With in-principle agreement on the M2 reached, the M5 negotiations are likely to accelerate. While TCL has the cash to fund the M2 widening, it is likely to wrap in the M5 widening and come to market for equity. Given likely favourable project economics, this is expected to be well supported.

Earnings and valuation revisions

- CBA has made upwards revisions to our traffic forecasts to account for the stronger than expected 1Q traffic and also broader Australian economy. Valuation is $5.60 (up 2%) and price target $4.75 (up 2%).

	FY10			FY11			FY12		
	New	Old	% chg	New	Old	% chg	New	Old	% chg
EBITDA ($m)	647.6	623.7	4%	663.3	637.0	4%	729.4	699.6	4%
CFAD (cps)	24.6	23.0	7%	22.7	20.9	9%	24.2	22.0	10%

Investment view

- TCL remains our preferred toll road ahead of MIG and CEU given its strong balance sheet and organic growth options. We now expect FCF per share growth of 11.8% in FY10.
- FY11 FCF, however, is expected to fall ~8% due to the expiring M4 concession (Feb 2010) together with maturing infrastructure bonds more than offsetting upside expected from the Citylink upgrades. Growth beyond FY11 is expected to be strong.
- Despite valuation support, unless there is a pull back in the broader market or a growing appetite for an inflation hedge, it is hard to see TCL outperforming.

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, DXS, GPT, GMG, MGR, SGP and WDC

[2] Members of the Commonwealth Group hold more than 10% of CPA

[3] Members of the Commonwealth Group hold more than 10% of CFX

Glossary of frequently used investment terms

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

Disclosure and Disclaimer

End of Report