Research Insight

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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 190 **16 December 2010 (4.30pm)**

Feature Article

Our feature articles this week are:

- **Newcrest Mining**
- **Westfield Group**

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

Newcrest Mining

Last traded: $41.46	Sector: Materials	Market cap: $31,588m
Buy		Price target: $47.60

Summary of previous report dated 10/12/10

Goswong grade, key to NCM performance

NCM held an analyst visit to its Gosowong operation in Indonesia where NCM plans to double the operations resource base through an accelerated exploration program. Gosowong is NCM's highest grade, lowest cost operation, making up 15% of FY11 forecast group earnings. However, it is in the operations capacity to act as NCM's swing shift producer and make up for shortfalls elsewhere across the group that underscores Gosowong's strategic value to NCM. With Cadia and Telfer at capacity, the introduction of block caving limiting operational flexibility and Lihir Island awaiting plant expansion, NCM is in a period of heightened transformational and transitional risk. Gosowong has consistently delivered around 25% of NCM's production, and NCM's commitment to accelerate exploration work at Gosowong coupled with its capacity to ramp up production through its high-grade ore zones, provide added certainty to group performance. Gosowong is also extending its active mining fronts beyond the existing Kencana underground mine, ensuring even greater optionality to ore supply and grades.

Investment view

We see ongoing strength in gold prices and our forecast assumes Gosowong maintains current production levels to 2020. NCM's market leading cost of production, long life diversified asset base and exceptional growth prospects mean NCM will continue to benefit from ongoing strength in gold prices, supported by a substantial copper by product contribution. Our price target is unchanged at $47.60 per share.

Market Wrap

One of the biggest furphies in 2009 was the claim that Australia had a 'bubble' in the housing market. It didn't and still doesn't but to some extent you can understand where some commentators were coming from with the claims. In Europe and the US, home prices generally tanked in 2009 but Australian home prices softened, didn't crash and then began to grow again. The view was that the day of reckoning had merely been delayed.

Where the commentators got it wrong was by glossing over a key fundamental determinant of housing demand – population. In most advanced nations population growth is very modest. In fact in many European economies population is barely growing or is flat. In Japan, the population is actually contracting and in the US, annual population growth is around 1%.

But in Australia, population growth had been steadily lifting since the mid noughties. In the year to December 2008, over 300,000 extra migrants came to our shores. Now given that the 'normal' number of homes built in Australia each year is around 150,000, a lift in annual migration numbers of around 200,000 would be expected to have a big impact. Hopefully we will hear a lot less about 'bubbles' in 2011.

Stephen Karpin
Managing Director

Westfield Group[1]

Last traded: $9.88 | Sector: Property | Market cap: $22,155m

Hold | Price target:$10.59

Summary of previous report dated 13/12/10

Re-rate fails to materialise

We have updated our price target, valuation and earnings post WDC's recent restructure and 50% sale of Stratford. A key part of the rationale for the restructure was a multiple re-rate for WDC, given its increased ROE and earnings growth outlook. While it is still very early days, the market appears reluctant to pay up, as WDC's P/E 12.9x (based on operational earnings) is now below that of WDC's P/E pre the restructure announcement. The multiple de-rate is reflective of WDC reducing its exposure to its best performing portfolio (Australia). While WDC's business model is moving back towards Westfield Holdings, its ROE is nonetheless unlikely to return to the Westfield Holdings levels. We have derived WDC's ROE target as 15% (currently 12.5%), which is well below Holding's ROE of 20% to 25%, and believe this could be achieved prior to FY14 if substantial asset sales are achieved (US assets most likely via introduction of JV partners). Therefore, we see WDC as a hybrid of its recent past. In our view, the major catalyst for WDC from here is US asset sales to further lighten the balance sheet and improve ROE. However, we believe this is unlikely in the near term given asset pricing is likely to reflect the challenging operating environment in the US.

No change to our Hold recommendation

Our WDC valuation post the restructure is $10.09 and price target $10.59. In our view, the move towards a reduced asset base and higher ROE A-REIT is a positive move, which will attract greater investor attention. However, at current levels, we believe this is already reflected in WDC's security price, and believe a multiple re-rate will occur over time, but not before further asset sales are completed.

Sector wraps

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

Banks — Bank reforms

16/12/10

ANZ: Last Traded: $23.76	Market Cap: $61,013m	Sector: Banks
CBA: Last Traded: $50.94	Market Cap: $78,219m	Sector: Banks
NAB: Last Traded: $24.44	Market Cap: $52,265m	Sector: Banks
WBC[2]: Last Traded:$23.15	Market Cap: $69,000m	Sector: Banks
BEN: Last Traded: $10.14	Market Cap: $3,558m	Sector: Banks
BOQ[2]: Last Traded $10.67	Market Cap: $2,378m	Sector: Banks

Summary of report dated 13/12/10

ANZ	Buy	Price target: $26.08
NAB	Hold	Price target: $27.26
WBC[2]	Hold	Price target: $24.70
BEN	Hold	Price target: $9.13
BOQ[2]	Hold	Price target: $11.28

Lots of headlines, limited drag

Swan released the government's package of banking reforms for a more competitive and sustainable banking system; it includes 13 initiatives grouped into three streams: empowering consumers, supporting smaller lenders, and securing the long-term safety and sustainability of the financial system.

Limited competitive impact on the majors...and with some benefits

The package contained plenty of headline claims and proposed initiatives, yet we do not believe the overall impact will be that material in terms of competitive pressure for the majors, with the proposal excluding some of the more significant potential reforms. Some of the initiatives benefit the majors including: the introduction of covered bonds; the removal of mortgage exit fees (more of an issue for smaller lenders); a permanent deposits guarantee and additional disclosure requirements/costs with the majors better placed to absorb these than smaller lenders.

- As well there appears to be no significant game changing initiatives to make smaller lenders much more of a competitive threat. There is no Post Bank, no guarantees for Residential Mortgage Backed Securities, no new term funding guarantee, and no levelling of the charges for old term funding guarantee.
- Given a lack of funding and distribution advantages for smaller players versus the majors we see limited downside with regards to substantial churn away from the majors with the initiatives announced quite limited in their ability to change the competitive landscape. These include an investigation into portability, a small top-up to AOFM funding ($4b); consumer education campaign and a modest impact from mortgage fee removal.
- Government support for covered bonds benefits all ADIs, not just small lenders, in terms of funding diversification and modest cost savings, enhanced ability to meet new liquidity reforms and a general boost to overall funding capacity.

Investment view

Major banks: With risks from substantial government intervention better understood and the majors' strong competitive position intact, we expect further modest share price support as investors gravitate to a more neutral sector position. That said, material upside is limited until greater clarity on an expected rebound in business credit emerges. ANZ remains our top pick, followed by NAB, and then WBC.

Regional banks: Expectations from government support have run too far at the regionals, and we believe further softness is likely as regional banks retreat toward a discount to the majors.

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Stocks at a glance

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

Stocks by sector

Consumer discretionary

HVN
16/12/10

Summary of report dated 09/12/10

Harvey Norman Holdings Ltd

Last Traded: $3.01 | Market Cap: $3,208m | Sector: Consumer discretionary
Buy | Price target:$3.80

Going for a song

We have revisited HVN's earnings outlook after the sector continues to battle against headwinds across numerous categories. Value growth in the audio visual (AV) and IT businesses has deteriorated in 2Q11 and the drivers of this industry performance (deflation and volume growth declines across a number of categories) are likely to remain into 3Q11. Competitive pressure across the industry has stepped up as suppliers and retailers push for revenue growth through lower prices. At the margin level, HVN is exacerbating the problem by paying tactical support to franchisees and we have factored in bottom-of-the-cycle margins on this basis in line with the previous cycle (FY06). This confluence of issues will not persist forever as the conditions experienced by consumer electrical retailers has been unusual over 2H10 and we believe the recent de-rating is an overreaction.

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Valuation over earnings momentum

While we expect the current headwinds to impact profitability into 3Q11 and have revised down our earnings forecast and valuation accordingly, we also anticipate an eventual recovery as conditions normalise over 2011. HVN is trading at record low multiples on bottom-of-the-cycle earnings and its enterprise value is underpinned by $1.8b in property assets. While earnings momentum may look ill in the short term, we believe the current valuation presents an attractive buying opportunity. We maintain our Buy recommendation.

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.

[1] Members of the Commonwealth Group hold between 5% and 10% of WDC

[2] Members of the Commonwealth Group have received fees within the previous 2 years from BOQ, WBC

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

Disclosure and Disclaimer

End of Report