Research Insight

CommSec

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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.

Feature Article

Our feature articles this week are:

- **Origin Energy Limited: Solid quarterly report**
- **Crown Limited: Upgrade to Buy on improved outlook for MPEL**
- **Amcor Limited: Hard work just beginning**

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

Origin Energy Limited: Solid quarterly report

Last traded: $16.40	Sector: Energy	Market cap: $14,115M
Hold		Price target: $16.70

Summary of previous report dated 01/02/10

Ahead of expectations

Origin Energy Limited's (ORG) 2Q production report came in ahead of expectations on the back of overall sales revenue of $286.1m (vs. $242.6m expected) and also higher realised oil prices ($92.6 $/bbl). The realised gas price was however lower than expected and lower than the prior quarter. We have subsequently made minor changes to earnings; however our price target, valuation and recommendation remain unchanged.

Ongoing weakness in share price is an opportunity to by a solid stock

Any ongoing weakness in the share price presents an attractive opportunity to buy a stock that offers solid EPS growth (>20% for FY10 and FY11), a strong balance sheet and defensive earnings. ORG would be expected to outperform the market during a period of consolidation.

Market Wrap

By and large investors are fixated on capital returns. For instance, sharemarket investors are focused on where share prices are likely to go over the next year or so. And residential property investors tend to focus on price first and rental returns second.

But have we got it the wrong way around? The researchers from MSCI Barra have dissected returns on shares over the past 35 years across key regions such as the US, Europe, Japan, Australia and the UK.

Interestingly, Australia came second to the UK over the full period and actually came out on top over the 'noughties' decade. But the other interesting result for Australia was the fact that dividend income was the main driver of returns. Over the noughties, returns on the MSCI Australia index rose by 9.1% with dividends contributing 4.1 percentage points, inflation 3.2 percentage points and capital returns providing the remainder.

Feature Article

Crown Limited: Upgrade to Buy on improved outlook for MPEL

Last traded: $7.85	Sector: Consumer Discretionary	Market cap: $3,844M
Buy		Price target: $8.98

Summary of previous report dated 03/02/10

Upgrade to Buy

MPEL released its 4Q09 results overnight with adjusted property EBITDA of USD2.7m and a net loss of USD89.7m. Adjusting for a lower-than-normal-range VIP win-rate (2.4% rather than 2.85%), adjusted property EBITDA increases to USD56m.

Business is on track

Subsequent to the MPEL's 4Q09 results overnight, our price target for Crown is up 9.5% to AUD8.98 (from AUD8.20) based on a 19% increase in our DCF valuation of Crown's stake in MPEL and an increase from 9x to 9.5x in the EV/EBITDA multiple we apply to Crown's Australian casinos. WE have also upgraded our recommendation for CWN to Buy (from Hold) with an $8.98 price target.

Following MPEL's 4Q09 results and plans to refinance existing debt facilities, we have comfort the business is on track to reach a sustainable level of earnings and repay debt facilities. We also expect the Australian casino assets to be rerated upwards in the medium term as the economy improves and the market re-focuses on the strength of these assets (ex-capex, monopoly markets).

Amcor Limited: Hard work just beginning

Last traded: $6.16	Sector: Paper & Packaging	Market cap: $7,418M
Buy		Price target: $7.55

Summary of previous report dated 02/02/10

Alcan Packaging acquisition

As expected, Amcor announced completion of the Alcan Packaging acquisition comprising the Global Pharmaceuticals, Global Tobacco, Food Europe and Food Asia divisions.

Following the announcement, we subsequently made some earnings changes, reflecting the stronger-than-expected Alcan earnings and lower purchase price. Our new price target is $7.55 (previously $7.30) and we maintain our Buy recommendation.

Maintain our positive view

Our positive view is supported by: expected strong medium-term earnings growth driven by the Alcan Packaging acquisition; a bottom forming in global packaging demand and raw material cost relief; an appropriately geared balance sheet; an improving trend in ROE; an above average dividend yield; and potential for a P/E re-rating subsequent to the company-transforming Alcan Packaging transaction.

Stocks at a glance

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

Stocks by sector

Consumer Discretionary

ALL[1,]
04/02/10

Summary of report dated 1/02/10

Aristocrat Leisure Limited: Beats consensus

Last Traded: $4.40	Market Cap: $1,937M	Sector: Cons. discretionary
Hold		Price target: $4.85

Pre-released FY09 numbers

ALL has released its FY09 unaudited NPAT pre-abnormals ahead of its FY09 result (due for release on 23 February), above consensus at $116m (consensus $99m; CBA $93m). Reported NPAT will be negative post-abnormals including a $187.3m (after tax) provision for expected damages associated with the US Convertible Bonds litigation.

Clarity required/short-term headwinds remain.

In the short term, we believe ALL continues to face earnings headwinds in the form of: (i) a credit-constrained US market; (ii) inconsistent game releases in Japan; and (iii) increased competition in the Australian market.

In the medium term, we are bullish on the earnings outlook for ALL taking the view that US casinos will recapitalise and look to upgrade gaming machines in 2H10 or 1H11. Expansion projects in Illinois and other US states also represent upside opportunities for the company. However, given uncertainty around timing, we maintain our Hold recommendation until further signs of a US recovery emerge.

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Insurance

IAG'
4/2/10

Summary of report dated 3/2/10

Insurance Australia Group Limited: Upgrading the low-ball guidance

Last Traded: $3.92	Market Cap: $8,203M	Sector: Insurance
Hold		Price target: $4.18

Insurance profit up

IAG announced that it expects a 1H10 insurance profit of $488m, vs. $227m in pcp. IAG also upgraded previous FY10 margin guidance to 11.5-13% (previously 9-11%). The one-offs that have plagued IAG results in recent periods were not there this time around and hence the true underlying performance was not pulled down. In this case it was actually boosted.

The one-offs that have plagued IAG results in recent periods were not there this time around and hence the true underlying performance was not pulled down. In this case it was actually boosted.

While we have increased FY10 earnings by almost 10%. There is negligible change to our underlying forecasts. We have subsequently made minimal changes to our price target $4.18 (up 3%) and valuation $4.40 (up 1%).

FY10 the turnaround year

We anticipated FY10 being the turnaround year for IAG, however in terms of FY11 we are slightly more cautious. We await detail on each business unit, noting that comments by management appear encouraging.

IAG's strong performer, Australian direct lines, faces increased pressure from numerous new entrants in this market. The turnaround of CGU may also be a slow task. We maintain our Hold recommendation.

While SUN and IAG have similar portfolios at a high level, we caution any expectation that SUN will experience similar upgrades to its 1H10 result. Especially when it is likely that some of the upgrades will come from the areas of difference between IAG and SUN.

Materials

BLD[1,] 04/02/10

Summary of report dated 29/01/10

Boral Limited: Banking on an Australian housing recovery

Last Traded: $5.50	Market Cap: $3,344M	Sector: Materials
Buy		Price target: $6.30

Initiate coverage with a Buy recommendation

We initiate coverage of Boral (BLD) with a $6.30 price target. Given this implies a 19% total shareholder return we have a BUY recommendation. Our positive view is supported by:

- CBA's very positive view on the Australian housing market. CBA's Economics team is forecasting 158k and 184k housing starts in FY10 and FY11 respectively. This should be supported by generally strong pricing discipline across the Australian building materials industry.
- Leverage to the expected subdued US housing market recovery through CY10 and CY11.
- Strong cost management through the downturn leading to upside margin risk in the upturn.
- Recent relative underperformance compared to other listed Australian building materials companies (BLD -7% over last three months vs. CSR +3% and JHX +9%).

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JHX[1,] 04/02/10

Summary of report dated 29/01/10

James Hardie Industries N.V: US housing concerns remain

Last Traded: $7.77	Market Cap: $3,446M	Sector: Materials
Hold		Price target: $8.80

Initiate coverage with a Hold recommendation

We initiate coverage of James Hardie (JHX) with an $8.80 price target. Given this implies a 12% total shareholder return we initiate with a Hold recommendation. Our Hold recommendation is a function of the following factors:

- A subdued recovery for the US housing market given continuing high unemployment, rising delinquencies and foreclosures, continued house price pressure and rising inventories.
- Continuing strong FY10 margins despite rising cost pressures.
- Increasing certainty on non-operational concerns specifically taxation litigation and asbestos funding.
- Currency-related valuation risk.

In short, the strength of the JHX business model is unquestionable. However, given the expected subdued US housing recovery and JHX's recent share price performance (+107% over the past 12 months) we are reluctant to take a more positive view at this stage.

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CSR' 4/2/10

Summary of report dated 3/2/10

CSR Limited: Policy, morality and disclosure derail demerger

Last Traded: $1.725	Market Cap: $2,857M	Sector: Materials
Sell		Price target: $1.70

Proposed demerger rejected

The Australian Federal Court rejected CSR's proposed demerger of its Australian Sugar and Renewables business from its Building Products and Aluminium businesses. The implications from this announcement are not immediately clear however we a see a number of possible scenarios unfolding.

- Scenario 1 could involve an initial appeal to the full bench of the Federal Court of Australia.
- Scenario 2 involves the pursuit of the trade sale process.
- Scenario 3 involves maintaining CSR in its existing form.

Our order of preference would be to pursue scenario 1 and scenario 2 concurrently. Without drawing any conclusions on the potential for success under scenario 1 we see it as necessary in order to protect potential value under scenario 2.

Against this backdrop it is worth highlighting under our $1.86 sum-of-the parts valuation we value CSR's sugar business at $1.3b assuming a USD0.138/lb sugar price and AUD/USD0.82 exchange rate. Scenario 3 would be our least-preferred option as the conglomerate discount would be maintained and growth opportunities potentially forgone given increased competition for limited funding.

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BSL' 4/2/10

Summary of report dated 29/1/10

Bluescope Steel: High leverage to steel market improvement

Last Traded: $2.68	Market Cap: $4,894M	Sector: Materials
Buy		Price target: $3.80

Initiate coverage with a Buy recommendation

We initiate coverage of BlueScope Steel (BSL) with a $3.80 price target. Given this implies a 44% total shareholder return we initiate with a Buy recommendation.

Our positive view is supported by:

- Expected strong medium-term earnings growth driven by BSL's significant earnings leverage to a steel market recovery, improved performance from the US and Asian operations and a moderating currency outlook.
- A solid balance sheet position.
- Significant offshore growth opportunities.
- BSL's significant underperformance versus Australian domestic steel peers, our Australian Basic Materials coverage and the broader ASX200.

BSL is our preferred stock within the Australian steel sector.

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OST'
4/2/10

Summary of report dated 29/1/10

OneSteel: Less leverage but valuation compelling

Last Traded: $3.23	Market Cap: $4,269M	Sector: Materials
Buy		Price target: $3.90

OST is less leveraged to a steel market recovery than its domestic peers.

Initiate coverage with a Buy recommendation

We initiate coverage of OneSteel (OST) with a $3.90 price target. Given this implies a 24.6% total shareholder return we initiate with a Buy recommendation.

Our positive rating is supported by:

- Forecast solid medium-term earnings growth supported by rising steel and iron ore prices, increasing utilisation levels and benefits of cost savings initiatives. However, OST is less leveraged to a steel market recovery than its domestic peers.
- Healthy balance sheet position.
- Limited growth opportunities notwithstanding continued progress of Project Magnet phase II.
- Upside risk to consensus FY10 forecasts.
- Compelling valuation metrics compared to domestic steel peers.

SGM'
4/2/10

Summary of report dated 29/1/10

Sims Metal Management: Consolidation remains a focus

Last Traded: $21.39	Market Cap: $3,545M	Sector: Materials
Hold		Price target: $25.00

Given SGM's earnings uncertainly we would be more positive on SGM should it trade at a larger discount to its long-term average of Y1 12.1x.

Initiate coverage with a Hold recommendation

We initiate coverage of Sims Metal Management (SGM) with a $25.00 price target. Given this implies a 16% total shareholder return we initiate with a Hold recommendation.

Our Hold recommendation is supported by:

- Expected strong medium-term earnings growth driven by improving global economic conditions, the US in particular. That said, visibility around primary earnings drivers, specifically volumes and margins, is limited.
- Strong balance sheet position.
- Abundant bolt-on growth opportunities.
- Our support of SGM's long-term strategy; however, given SGM's earnings uncertainly we would be more positive on SGM should it trade at a larger discount to its long-term average of Y1 12.1x.

ORI'
4/2/10

Summary of report dated 29/1/10

Orica: Rock solid

Last Traded: $24.55	Market Cap: $8,926M	Sector: Materials
Buy		Price target: $30.00

Initiate coverage with a Buy recommendation

We initiate coverage of Orica (ORI) with a $30.00 price target. Given this implies a 25% total shareholder return we initiate with a Buy recommendation.

Our positive view is supported by:

- ORI's demonstrated earnings resilience through the GFC.
- ORI's market-leading position in the attractive global explosives market (consolidated industry structure, limited raw material cost risk, resource volume leverage).
- The improving outlook for the Australian resource sector as highlighted by recent improvements in export coal demand, Queensland in particular.
- Balance sheet strength and potential for significant growth initiatives.
- Valuation appeal with potential for further P/E re-rating as the proportion of Mining Services earnings increases subsequent to a potential separation of the DuluxGroup.

Our positive view is supported by ORI's demonstrated earnings resilience through the GFC.

IPL'
4/2/10

Summary of report dated 29/1/10

Incitec Pivot: Fertiliser prices provide short term support

Last Traded: $3.38	Market Cap: $5,482M	Sector: Materials
Hold		Price target: $3.25

Initiate coverage with a Hold recommendation

We initiate coverage of Incitec Pivot (IPL) with a $3.25 target price. Although this implies a -5% total shareholder return we have a Hold recommendation.

Our Hold recommendation is a function of the following factors:

- Improving fertiliser pricing and domestic demand conditions.
- Medium term earnings growth underpinned by growth in the Explosives business, specifically, Project Velocity and Moranbah.
- Potential share price re-rating underpinned by an increasing Explosives contribution.
- Currency related earnings risk.

Although our price target implies a negative total shareholder return we are reluctant to take a more negative view at this stage. Over the next few months continued DAP pricing strength may result in market upgrades and share price strength.

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PPX'
4/2/10

Summary of report dated 29/1/10

PaperlinX: Improving external drivers moving into focus

Last Traded: $0.665	Market Cap: $422M	Sector: Paper & Packaging
Buy		Price target: $0.85

Initiate coverage with a Buy recommendation

We initiate coverage of PaperlinX (PPX) with a. $0.85 price target. Given this implies a 38% total shareholder return we initiate with a Buy recommendation.

Our positive view is supported by:

- A trough forming in both European and US paper demand.
- Increasing confidence about the Tas Paper outcome. — Increasing certainty around PPX's financial position.
- A conservative DCF valuation ($0.75) based on modest medium-term volume (1% growth) and pricing assumptions (zero growth).

We initiate coverage of PaperlinX (PPX) with a. $0.85 price target. Given this implies a 38% total shareholder return we initiate with a 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 ALL, AMC, BLD, BSL,COH, IPL, OST

[2] Members of the Commonwealth Group have received fees within the previous 2 years from CWN

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