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 146 **25 February 2010 (4.30pm)**

Feature Article

Our feature articles this week are:

- **Sonic Healthcare Limited**
- **CSR Limited**
- **Tassal Group Limited**

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

Sonic Healthcare Limited[2]

Last traded: $13.51	Sector: Healthcare	Market cap: $5,360M
Buy		Price target: $15.36

Summary of previous report dated 23/02/10

Decent value, acquisition upside – upgrade to Buy

SHL reported 1H10 NPAT of $155.2m. This was broadly in line with CBA ($153.8m) but below consensus ($168.1m). Sales revenue was up 3.5% to $1.5b and EBITDA was up 5.1% to $275.2m. The key drivers were strong organic growth and acquisitions in pathology offset by FX movements.

SHL confirmed its FY10 NPAT guidance of 10–15% growth (using average FY09 FX rates). This guidance also excludes the recent acquisitions of East Side in the US and the Medhold Group in Belgium.

We have upgraded SHL to a Buy on the grounds that: 1) it is trading on an attractive forward PE of 14.3x given EPS growth of 11.3% in FY11 and 10.7% in FY12. 2) It has upside from acquisitions with beachheads set up in the US, Germany and Belgium, headroom of ~$507m in its facilities (post its interim dividend payment) and potential upside from a weaker AUD.

Market Wrap

The profit-reporting season has ended for another year, and by and large the results were encouraging.

Unfortunately cost cutting was a key driver of bottom-line profits. But there was enough in the outlook statements, as well as recent economic data, to suggest that revenues will generally be lifting in the second half of the financial year.

The key question for many companies after cutting debt and issuing more shares over the past year is what to do with all the extra cash. Investors give some leeway but they will eventually punish 'lazy' companies.

The good news for investors is that the recent flat line performance for the sharemarket, together with stronger earnings, have caused valuations to move to the most attractive levels in six months. In fact the historic PE ratio has fallen from around 15.4 to 13.4 in just over a month.

Feature Article

CSR Limited

Last traded: $1.635	Sector: Industrials	Market cap: $2,555M
Hold		Price target: $1.65

Summary of previous report dated 24/02/10

Upgrade to Hold

We have upgraded our CSR recommendation to Hold from Sell. This follows CSR's recent share price weakness and modest changes to our forecasts on the back of higher corporate costs, higher coking coal assumptions, and recent revisions to CBA's currency outlook. Our new price target is $1.65 (previously $1.70).

Emerging pressure on sugar prices

Despite CBA's positive views on residential housing we are reluctant to hold a more positive view given emerging pressure on sugar prices currently trading at USD0.244/lb (down from peaks of USD0.299/lb) and significant separation uncertainty.

CBA believes sugar prices are likely to be capped at the commencement of the Brazilian cane crush in March followed by significant downward pressure at the start of the Indian cane crush around October. CBA is forecasting sugar prices to decline to USD0.19/lb at the end of CY10 and USD0.13/lb at the end of CY11.

Feature Article

Tassal Group Limited

Last traded: $1.61	Sector: Consumer Staples	Market cap: $163M
Buy		Price target: $2.60

Summary of previous report dated 23/0210

A question of fixed cost leverage

TGR reported a disappointing 1H10 result (NPAT down 11.8%) based on higher costs (feed and Superior Gold import costs), tight export margins and increasing retail rebates. A 4cps dividend was declared.

We have reduced our FY10 forecasts in line with the lower 1H10 result but left future years' forecasts largely unchanged. We have increased our net debt to $91.2m (up $20m) and removed our assumption around three years of underwritten DRPs (now assume 2H10 only). Our new DCF valuation and price target is $2.60 per share (down 5.5%).

TGR well positioned to expand its margins

While the increased cost of finished goods and retail expenses surprised on the upside in 1H10, it was clear before the result that 1H10 would be a difficult earnings period. Over the long term TGR is well positioned to expand its margins through the benefit supplying Superior Gold and the increased fish biomass from the new hatchery. Domestic salmon volume growth continues to show no signs of abating.

In light of the long-term positive outlook and the steep discount to market (9.1x FY10 EPS, 57% discount) that TGR is currently trading on, we retain our Buy recommendation.

Stocks at a glance

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

Stocks by sector

Financials

SUN[2,]
25/02/10

Summary of report dated 24/02/10

Suncorp-Metway Limited

Last Traded: $8.43	Market Cap: $10,955M	Sector: Financials
Hold		Price target: $8.89

Remains a complex turnaround

On Wednesday, 24 February SUN reported its 1H10 results with an NPAT of $364m, in the middle of its $355–375m range. Following revisions to our forecasts we have increased our price target by 5.8% to $8.89. This allows for the roll-forward of earnings and the adjustments to future earnings.

Upgrade to a Hold

We upgrade SUN from a Sell to a Hold, following an increase in our price target and the fall in the share price. Our price target remains 15% below our valuation, with near-term risks still presenting downside risk to earnings.

As highlighted by the result, the bank remains in a delicate position with some time yet before we are likely to see healthy earnings. The major restructures going through the GI business are a positive for the company; however, they alone present some significant integration risks. Add to this the threat of new players, and the next six months still look tough.

The bank remains in a delicate position with some time yet before we are likely to see healthy earnings.

NHF[,]
25/02/10

Summary of report dated 22/02/10

NIB Holdings Limited

Last Traded: $1.295	Market Cap: $627M	Sector: Financials
Hold		Price target: $1.29

No waiver of waiting period here

Following the release of NHF's 1H10 results with NPAT of $43.1m, we have increased our FY10 NPAT by 11% or $6.6m. However, considering that 1H10 was $8.9m above our forecasts, we have effectively decreased our 2H10 assumptions.

We have made minimal changes to forward earnings as a result of the 1H10 numbers – FY10 up but primarily due to 1H10 one-offs, offset to a degree by a decrease in our 2H10 assumptions. Our price target is down 7% to $1.29 as we adjust 2H10 earnings and wait another 12 months for a solution to the capital position.

No reason to enter the stock at current levels

It is becoming clear to us that management is hoping to use the excess money for an acquisition; however, the company is struggling to find an appropriate acquisition to suit its needs.

It is becoming clear to us that management is hoping to use the excess money for an acquisition; however, the company is struggling to find an appropriate acquisition to suit its needs.

On the one hand it is positive that management is acting prudently and not willing to acquire at any cost. However on the flip side, the lazy balance sheet may well be held up another 12 months before it is returned.

With the share price closing at $1.32 on the day of the result, we see no reason to enter the stock at current levels and maintain our Hold recommendation.

Materials

RIO
25/02/10

Summary of report dated 19/02/10

Rio Tinto Limited

Last Traded: $69.40 Market Cap: $30,645M Sector: Materials
Buy Price target: $78

Bulk commodities lead the charge

We have updated our RIO model following the 2009 result. Forecast 2010 earnings increased by 5% and our price target increased to AUD78. 2010 NPAT and EPS forecasts have increased by 5.3%. The revisions are predominantly driven by increases to iron ore and coal prices as foreshadowed in our note on 11 February 2010.

The outlook for 2010 and 2011 looks strong

We upgraded RIO to Buy on 11 February in anticipation of these upgrades. The outlook for 2010 and 2011 looks strong. Iron Ore and Coal prices are set for substantial price increases, copper markets are likely to tighten and RIO has begun to ramp up its organic growth projects now that the balance sheet repair process is largely complete.

The outlook for 2010 and 2011 looks strong. Iron Ore and Coal prices are set for substantial price increases, copper markets are likely to tighten and RIO has begun to ramp up its organic growth projects now that the balance sheet repair process is largely complete.

PPX
25/02/10

Summary of report dated 19/02/10

PaperlinX Limited

Last Traded: $0.645 Market Cap: $415M Sector: Materials
Buy Price target: $0.85

Operationally weak but increasingly financially sound

PPX reported a 1H10 NPAT loss of $26.5m ($6.6m loss pcp) which was ahead of our expectations and the market's. PPX reported significant items of $148.8m related to redundancies, remediation, impairments and an additional loss on sale of Australian Paper.

Maintain our positive view on PPX

Our positive view is supported by:1) a trough forming in both European and US paper demand 2) increasing confidence about the Tas Paper outcome 3) increasing certainty around PPX's financial position 4) a conservative DCF valuation ($0.75) based on modest medium-term volume (1% growth) and pricing assumptions (zero growth).

PPX reported a 1H10 NPAT loss of $26.5m ($6.6m loss pcp) which was ahead of our expectations and the market's

Utilities

DUE
25/02/10

Summary of report dated 19/02/10

Duet Group

Last Traded: $1.82 Market Cap: $1,270M Sector: Utilities
Buy Price target: $2.07

1H10 result: Falls short but upside remains

DUE's1H10 result was below our expectations with proportionate asset EBITDA at $304.9m vs $331.2m. As a result, cash released from the assets to DUE was similarly lower. The lower FY10 forecasts are due to the lower United Energy distributions. Our valuation is reduced to $2.30 (-17cps) on the back of a lower Duquesne valuation and our price target is $2.07 (-3cps).

Retain our Buy

We retain our Buy recommendation on DUE with a price target of $2.07. Our positive view on DUE is supported by: 1) a dividend yield of >11% which is comfortably covered from free cashflow in FY10 and potential upside to forecast distributions should debt markets continue to improve. 2) A balance sheet that is in shape with gearing gradually reducing. 3) Growth in free cash underpinned by the advanced metering roll out at United Energy and the stage 5b expansion of the Dampier to Bunbury Natural Gas Pipeline.

DUE has a dividend yield of >11% which is comfortably covered from free cashflow in FY10 and potential upside to forecast distributions should debt markets continue to improve

HDF' 25/02/10 Summary of report dated 19/02/10	**Hastings Diversified Utilities Fund**

Last Traded: $1.19 | Market Cap: $557M | Sector: Utilities

Buy | Price target: $1.32

FY09 Result: Strategic review to unlock value

HDF announced its FY09 result which was slightly ahead of our expectations. We have made some moderate changes to our EBITDA and free cash flow forecasts. Valuation $1.47 and price target $1.32 unchanged.

We see considerable upside in the stock from current prices

The announcement of a strategic review is expected to unlock value for shareholders in HDF. The sale of a stake in a UK water company (Southern Water) in 2009 does bode well for a potential sale of South East Water during 2010.

There is also likely to be substantial interest in Epic Energy – in particular, there are sound strategic reasons for APA to own Epic Energy and the regulatory hurdles to any deal are not considered insurmountable. There is also the potential for HDF to be wound up completely.

Together with a dividend yield of 10.8%, we see considerable upside in the stock from current prices. CBA therefore retains its Buy recommendation on HDF with a price target of $1.32 per security.

We see considerable upside in the stock from current prices. CBA therefore retains its Buy recommendation on HDF with a price target of $1.32 per security.

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 Insurance Australia Group

[2] Members of the Commonwealth Group have received fees within the previous 2 years from Sonic Healthcare and Suncorp Metway

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