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.

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Feature Article

Our feature articles this week are:

- **QBE Limited: Doing everything right and macro upside - Buy**
- **Spark Infrastructure Limited: FY09 result –Launches strategic review**

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

QBE Limited

Last traded: $20.10	Sector: Financials	Market cap: $20,862M
Buy		Price target: $24.60

Summary of previous report dated 1/03/10

Doing everything right and macro upside – Buy

On Friday, 26 February QBE reported its FY09 results with an NPAT of $1.97b versus our forecast of $2.0b. Consequently we decreased forecast profit before tax by 5.4% in FY10; however, this has been exactly offset by a reduction in our tax rate assumption to 20% as per management guidance.

Upside in earnings from current levels

QBE's share price was down 7% following the result because of the underwriting performance in FY09 and cautious guidance in FY10. However, QBE has survived two very tough years and while the recovery is not immediate, we see upside in earnings from current levels.

The sentiment in QBE is likely to be weak following this result and the share price may remain volatile but we believe that this will create buying opportunities with significant upside on a 12–24 month view.

We upgrade our recommendation to Buy with a $24.60 price target and 12- month total return of 20%.

Market Wrap

You may have heard of the 'two speed' economy. Well if you haven't, then you certainly will over the course of 2010. More specifically the phrase reflects a view that resource states like Western Australia and Queensland will power forward over 2010 and beyond, underpinned by strong demand for commodities from China. By comparison states like NSW and Victoria may experience far slower growth rates.

Certainly the Reserve Bank Governor has made no secret of his belief in the 'two speed' economy saying recently that geographical and industry differences will "re-emerge with a vengeance."

The implications are far reaching. Certainly it will make it harder to set monetary policy. But it also means that manpower and investment will be dragged from states like NSW. And those companies that are in high growth regions will thrive.

It may also mean that investors end up spending more time looking at where companies are headquartered than in the past.

Feature Article

Spark Infrastructure Limited

Last traded: $1.245	Sector: Utilities	Market cap: $1,118M
Hold		Price target: $1.40

Summary of previous report dated 26/02/10

FY09 result: Launches strategic review

Spark Infrastructure released its FY09 result which was broadly in line with expectations at an operational EBITDA and free cashflow level. The result, however, was overshadowed by the announcement of a strategic review.

Subsequent to the result announcement we have made minor changes to our FCF forecasts. Valuation unchanged $1.75; price target $1.40 (+9cps). We have flat-lined distributions at 13.6cps given the strategic review.

Strategic review is the key to the stock

The key to the stock is progress on and ultimately the outcome of the strategic review. At this stage, there is little guidance as to the timing of the outcomes of the review.

While a CKI buyout is a possibility and speculation may drive the stock higher in the short term, given the drivers of the review are gearing and capex funding, a capital raising and distribution cut in our view seem the most likely scenario. We remain comfortable with our Hold recommendation.

Sector wraps

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

Insurance	Insurance sector report		
04/03/10	IAG[1]: Last Traded: $4.06	Market Cap: $8,265M	Sector: Financials
	QBE: Last Traded: $20.10	Market Cap: $20,862M	Sector: Financials
	SUN[2]: Last Traded: $8.50	Market Cap: $10,815M	Sector: Financials
Summary of report dated 02/03/10	IAG[1]: Hold		Price target: $4.16
	QBE: Buy		Price target: $24.60
	SUN[2]: Buy		Price target: $8.89

NSW CTP: A changing market

The MAA's (Motor Accidents Authority quarterly premium report as at 31 December 2009 further supports the conservative stance on SUN. We appreciate that SUN's GIO brand is picking up some of the lost business, however at a premium of more than 6% below AAMI we question the margins coming out of this supposedly niche player.

Preferences: QBE, IAG, SUN

While we have made no changes to earnings or valuation we take opportunity to reiterate our sector view. With a Buy recommendation QBE is clearly our number one pick in the sector. While we do not allow for organic growth in the Australian personal lines market, further white labelling for new players would not be out of the question.

We prefer IAG over SUN. IAG's business is in much better shape than SUN's and hence is more able to combat the potential impact of new players. In saying that, we are cautious on the impact that new players could have on reducing organic growth from current levels.

Basic materials	Chemical sector report		
04/0310	IPL[1]: Last Traded: $3.58	Market Cap: $5,674M	Sector: Materials
	ORI: Last Traded: $25.14	Market Cap: $9,127M	Sector: Materials
Summary of report dated 03/03/10	IPL[1]: Hold		Price target: $3.40
	ORI: Buy		Price target: $30.00

US explosives demand remains soft

Following recent commentary regarding weakness in the US non-residential construction sector, we have reviewed current conditions in the US explosives market. Reflecting our modestly weaker US explosives volume outlook we have made some minor changes to both our IPL and ORI forecasts.

ORI over IPL

Incitec Pivot (IPL). Over the next few months continued DAP pricing strength and potential currency weakness are likely to result in market upgrades and potential share price appreciation. Given our concerns around medium-term DAP pricing should the share price approach $3.80 we may look to take a more negative view. Our IPL price target has remained unchanged at $3.40 although we would highlight some upside risk given our average valuation is now nudging towards $3.50

Orica (ORI). 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; and 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 Dulux Group.

Stocks at a glance

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

Stocks by sector

GICs sector

PAG'
04/03/10

Summary of report dated 26/02/10

PrimeAg Australia Limited

Last Traded: $1.045 | Market Cap: $156M | Sector: Financials

Hold | Price target: $1.13

Still no catalysts on the horizon

PAG has reported a disappointing but reasonably well-flagged $4.4m loss in 1H10. We have reduced our crop yield and price forecast following the 1H10 result and our forecast FY10 operating NPAT is within the reduced guidance (now $0–3m PBT).

Current share price implies unrealistically low land values for PAG's portfolio

We believe in the long-term fundamental drivers of soft commodity demand and that scarce water rights are likely to appreciate over the next five years. The current share price also implies unrealistically low land values for PAG's portfolio. However, we maintain the Hold recommendation because PAG's portfolio capital appreciation generally takes time to translate into investor returns; a share buyback has been virtually ruled out by PAG; and CBA forecasts that a genuine soft commodity recovery will be at least 12 months away.

We leave our price target unchanged at $1.13 per share, which is the average agribusiness EV/EBITDA multiple (7.6x) now applied to PAG's forecast FY11 EBITDA.

We believe in the long-term fundamental drivers of soft commodity demand and that scarce water rights are likely to appreciate over the next five years.

Utilities

AGK
04/03/10

Summary of report dated 26/02/10

AGL Energy

Last Traded: $14.41 | Market Cap: $6,532M | Sector: Utilities

Hold | Price target: $15.00

1H10 result: Wind set to blow

AGL Energy (AGK) reported its 1H10 result. It was much stronger than expected with underlying NPAT 13% higher than our expectations. We have made changes to our earnings and consequently we have increased our valuation to $15.14 (+2%); our price target is $15.00 (+7%) based on a 50:50 blend of FY11 earnings (15x) and our valuation.

Upside from here expected to be limited

Just when we thought that the key strategic drivers of the business were working against AGK, the government makes a surprise announcement proposing to change the design of the REC market.

While AGK has delivered a much stronger 1H10 result, it trades on an FY10 PE of >15x (inclusive of wind farm development profits). So upside from here is expected to be limited warranting our Hold recommendation.

Just when we thought that the key strategic drivers of the business were working against AGK, the government makes a surprise announcement proposing to change the design of the REC market.

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 IPL Limited and IAG Limited.

[2] Members of the Commonwealth Group have received fees within the previous 2 years from Suncorp-Metway Limited.

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