

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.



Feature Article

Our feature articles this week are:

- Origin Energy Limited
- Woolworths 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

Origin Energy Limited

Last traded: \$14.77

Sector: Energy

Market cap: \$13,007m

Buy

Price target: \$16.71

Summary of previous report dated 25/05/10

APLNG free

We have assessed the downside in ORG following its de-rating and also the potential impact of the RSPT on APLNG. We have subsequently made slight downgrades to earnings reflecting slightly lower retail forecasts and higher interest expense/depreciation. Furthermore our price target/valuation has been lowered to \$16.71 per share (-73cps) due to a lower APLNG valuation. Price target is based on a probability weighted valuation for APLNG: RSPT unchanged (20%), improved RSPT (30%), no RSPT (50%). Note we continue to apply an overall 50% weighting to our APLNG valuation.

We move to a Buy recommendation given:

- The current share price attributes little value to ORG's 50% stake in APLNG. Our valuation of ORG (ex APLNG) is \$13.90/share suggesting limited downside.
- AGK and ORG now trade on a similar FY12 PE yet ORG has a superior growth profile, balance sheet and management team warranting in our view a PE premium.

We expect ORG to re-rate as clarity on the RSPT (and to a lesser extent CPRS and NSW privatisation evolves over coming months.

Issue 162 27 May 2010 (4.30pm)

Market Wrap

If there has been one issue that has dominated attention over the past month it is the proposed resource super profits tax. The actual name is a misnomer – it's a resource rent tax (RRT) – a tax that applies to above-normal or 'super' profits. But such has been the war of words that has been going on between the Government and the mining industry that a different label has been used for the tax.

Much of the debate has centred on issues such as whether the mining sector is currently paying its fair share of tax. And then there are the theoretic discussions about the proposed features of the RRT.

But at the end of the day it will come down to the principle of 'fairness'. If the government and mining industry can agree on a tax that provides a fair share of any future super-normal mining profits for the Australian people – and it doesn't cause mining investment to be affected – then the tax will proceed.

Most investors just want the uncertainty to be resolved – and quickly.

**Stephen Karpin
Managing Director**

Feature Article

Woolworths Limited

Last traded: \$26.53

Sector: Staples

Market cap: \$32,915m

Hold

Price target: \$30.30

Summary of previous report dated 24/05/10

Let the home improvement games begin...

WOW has acquired a number of Tasmanian hardware assets, including retail home improvement stores and specialist timber trade and manufacturing facilities for a total cost estimated at \$50m. There are no earnings or valuation implications given the small scale of the acquisition. We maintain our valuation of \$28.49 and price target of \$30.30.

Supermarkets remain the main game with 80% of WOW FY10 forecast EBIT is derived from Australian food, liquor and convenience and this remains the key driver of value and sentiment for WOW.

Earnings resilience making an impact on outlook

At current levels, WOW is offering a three-year EPS CAGR of 10% and is trading on an FY11 PE of 14.8x. This compares to the ASX200 Industrials, which has recently had earnings forecast downgrades. It now offers 9.6% three-year forecast EPS CAGR and is trading on 13.4x FY11 EPS. On this basis, WOW has actually seen a reduction to its premium to the XJI from 20% to 10% in the last month despite outperforming the index.

Stocks at a glance

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

Stocks by sector

Financials

SUN ² , 27/05/10	Suncorp-Metway Limited	
Summary of report dated 21/05/10	Last Traded: \$8.01 Market Cap: \$10,263m Sector: Financials Hold Price target: \$9.32	
The six-year integration – ‘trust us’		
On Friday, 21 May SUN held an investor day outlining the strategy for the general insurance business. We have subsequently increased our price target by 1.2% to \$9.32, in line with earnings adjustments.		
While SUN appears cheap with 16.5% upside from its current share price, we note that SUN's share price has fallen 13% in the past month, in line with the general fall in the market.		
<ul style="list-style-type: none"> ■ Currently we see no reason why SUN will outperform the Financials sector and hence we maintain our Hold recommendation. ■ There is upside with a three-year view, however, the risk for SUN remains in the shorter term. In the general insurance business the long integration process continues with the re-pricing of the portfolio posing a significant risk. On the banking side there remains clear risk from quarterly volatility and the potential for negative surprise from SUN's relatively large commercial and development loan book (~20.9% of group loans). ■ On the capital front, pending regulatory uncertainty any potential for capital management is likely to remain in a holding pattern 		

We see no reason why SUN will outperform the Financials sector and hence we maintain our Hold recommendation.

Materials

ORI ¹ , 27/05/10	Orica Limited	
Summary of report dated 26/05/10	Last Traded: \$24.33 Market Cap: \$8,786 Sector: Materials Buy Price target: \$30.50	
DuluxGroup uncertainty increases		
WYL (not covered) received a \$1.30 indicative, non-binding and confidential proposal to be acquired by an unnamed offshore company. Reports are suggesting the unnamed company is US paint manufacturer, Valspar. From ORI's perspective this development represents a modest negative as it increases operational and strategic risks surrounding the DuluxGroup. We however maintain our positive view on ORI supported by its 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.		

We maintain our positive view on ORI

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 IAG, GNS

² Members of the Commonwealth Group have received fees within the previous 2 years from SUN, ANZ

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	Mbboe	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

Commonwealth Securities Limited ABN 60 067 254 399 AFSL 238814 ("CommSec"), is a wholly owned, but non-guaranteed, subsidiary of the Commonwealth Bank of Australia ABN 48 123 123 124 AFSL 234945 ("the Bank"), and both are incorporated in Australia with limited liability.

This document is published, approved and distributed by CommSec. This document is only for distribution in Australia.

CommSec Research is a unit of the Commonwealth Bank Group of Companies (The Commonwealth Bank Group).

This document has been prepared without taking account of the objectives, financial situation or needs of any particular individual. Any individual should, before acting on the information in this document, consider the appropriateness of the information, having regard to the individual's objectives, financial situation and needs and, if necessary, seek appropriate professional advice.

We believe that the information in this document is correct and any opinions, conclusions or recommendations are reasonably held or made, based on the information available at the time of its compilation, but no warranty is made as to accuracy, reliability or completeness. To the extent permitted by law, the Commonwealth Bank Group does not accept liability to any person for loss or damage arising from the use of this document. Any valuations, projections and forecasts contained in this document are based on a number of assumptions and estimates and are subject to contingencies and uncertainties. The inclusion of any such valuations, projections and forecasts in this document should not be regarded as a representation or warranty by or on behalf of the Commonwealth Bank Group or any other person that such valuations, projections and forecasts or their underlying assumptions and estimates will be met. Past performance is not a reliable indicator of future performance.

The Commonwealth Bank Group have effected or may effect transactions for their own account in any investments or related investments referred to in this document, including selling to or buying from clients on a principal basis. The Commonwealth Bank Group may engage in transactions in a manner inconsistent with this research document. In the case of certain products the Bank is or may be the only market maker. No inducement has been or will be received by the Commonwealth Bank Group or the research analyst from the subject of this document or its associates to undertake the research or make the recommendation. The research staff responsible for this document receive a salary and a bonus that is dependent on a number of factors including their performance and the overall financial performance of the Commonwealth Bank Group. The Commonwealth Bank Group provides, or seeks to provide, services to the subject of the document and its associates. Our Analysts, and their associates, hold interests in the companies named in this document.

This document is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation or which would subject the Commonwealth Bank Group to any registration or licensing requirement within such jurisdiction. All material presented in this document, unless specifically indicated otherwise, is under copyright to the Commonwealth Bank Group. None of the material, nor its content, nor any copy of it, may be altered in any way, transmitted to, copied or distributed to any other party, without the prior express written permission of the Commonwealth Bank Group.

More information on our research methodology, organisation structure, summary documenting frequency and recommendations can be obtained at research.commsec.com.au

Unless agreed separately, we do not charge any fee for any information provided in this presentation. You may be charged fees in relation to the financial products or other services CommSec provides, these are set out in the CommSec Financial Services Guide (FSG) and relevant Product Disclosure Statements (PDS). Our employees may be eligible for an annual bonus payment. Some representatives' bonus payments may be up to 50% of initial fees, and 10% of ongoing fees and commissions that CommSec receives from the placement of a financial product. Bonus payments are discretionary and based on objectives that include business outcomes, customer service, people engagement, special tasks and people principals. Our employees may also receive benefits such as tickets to sporting and cultural events, corporate promotional merchandise and other similar benefits. If you have a complaint, CommSec's dispute resolution process can be accessed on 13 15 19.

End of Report