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:

- **CSL Limited**
- **Asciano Limited[1]**

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

CSL Limited

Last traded: $35.18	Sector: Healthcare	Market cap: $19,311m
Buy		Price target: $37.18

Summary of previous report dated 09/11/10

Blood starting to pump – upgrade to Buy

We have become more positive on the medium term plasma market outlook following our recent tour of CSL's US facilities as well as our assessment of recent results from CSL's major competitors and their implications for the state of the plasma products market. Robust IVIG demand growth is returning, plasma collections are being managed tightly and there is cost efficiency upside from increased automation at CSL's facilities. PPTA IVIG data for the September quarter revealed 8.2% growth on the pcp after modest growth in early CY10. Despite concerns about Baxter 'touching up prices', data sets show stable pricing across most product categories. CSL and its peers claim it is 'too early' to comment on the implications of the Octapharma recall. That said, Baxter is factoring in around $10m in additional sales globally in 4Q10. Ultimately, the longer the recall drags on, the better it will be for existing players.

Early signs of positive demand momentum

Looming capacity bottlenecks in plasma fractionation for Talecris and the ongoing impact of the Octapharma recall point to a positive medium term outlook. The stronger AUD and CHF will continue to provide both a transactional and translational headwind for CSL's FY11 earnings, however for longer term investors, it also presents a good entry point to buy into a high quality stock.

Issue 185 11 November 2010 (4.30pm)

Market Wrap

It's amazing what a topsy-turvy world we live in. Over the past few weeks, central banks from China, India, and our own Reserve Bank here in Australia, have tightened monetary policy. The aim being to prevent economies from growing too strongly, therefore keeping inflation in check.

Contrast this with the US where the Federal Reserve has applied another dose of quantitative easing. In effect this is akin to printing money. The aim of the exercise has been to keep the US economy growing and to prevent deflation – falling prices from taking hold.

The dichotomy currently existing on inflation in different parts of the world is clearly interesting. In the US, the annual rate of core consumer prices is at 40-year lows. But in the developing world there is a healthy dose of 'agflation' occurring – rising prices of agricultural commodities.

Textiles, livestock, foodstuffs and raw industrial material prices have all rebounded smartly over 2010. This is Commodity boom Mark II with the Commodity Research Bureau spot index of commodity prices at record highs, up 63% from the February 2009 lows.

While good news for commodity producers, it just adds to the pressure on profits for other businesses that are finding it hard to pass on the higher costs.

Stephen Karpin
Managing Director

Feature Article

Asciano Limited[1]

Last traded: $1.63	Sector: Transport	Market cap: $4,770m
Buy		Price target: $2.00

Summary of previous report dated 11/11/10

Initiation of coverage

We initiate coverage of AIO with a buy recommendation. Asciano has high quality assets in industries with attractive market structures such as ports, coal freight and intermodal rail. The company also has considerable operating leverage and it will benefit more than most transport-related cyclical stocks from recovery of the Australian economy. The biggest issue facing Asciano over the next five years will be the likely introduction of a third operator at Australian container ports. The ports of Brisbane and Sydney are already preparing to accommodate a new stevedore and we expect the ports of Melbourne and eventually Fremantle to follow suit. A third stevedore will generate capacity expansion of between 41% (based on berths) and 55% (based on quayline) and we anticipate the new entrant to win market share of 31% over a five year period, in line with its capacity. More importantly, the new entrant is likely to create downward pressure in stevedoring prices. Stevedoring is a fixed cost business and any new capacity is likely to be aggressively bid into the market. A 6% decline in prices from FY14 is plausible. However we believe the impact of this third operator is mostly already priced into the AIO share price which is trading 82c below the value of comparable port assets that do not face increased competition.

Excellent exposure to improving economic conditions

Asciano will benefit from its high exposure to improving conditions in the Australian economy and also through its exposure to Asian coal demand via its Pacific National coal operations in NSW and Queensland. While the third stevedore represents a risk to future earnings we think adopting an overly cautious approach on this is also risky. Our price target for AIO of $2.00 incorporates our estimate of the impact of a third stevedore.

Sector wraps

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

Team	Sector report		
11/11/10	BHP: Last Traded: $44.59	Market Cap: $235,880m	Sector: Materials
	RIO: Last Traded: $87.36	Market Cap: $146,840m	Sector: Materials
	NCM[1]: Last Traded: $43.05	Market Cap: $32,911m	Sector: Materials
	OZL: Last Traded: $1.80	Market Cap: $5,746m	Sector: Materials
	AWC: Last Traded: $2.18	Market Cap: $5,320m	Sector: Materials
	WPL: Last Traded: $42.74	Market Cap: $33,483m	Sector: Materials
	STO: Last Traded: $13.41	Market Cap: $11,186m	Sector: Materials
	OSH[1]: Last Traded: $6.57	Market Cap: $8,626m	Sector: Materials
Summary of report dated 09/10/10	BHP: Buy		Price target: $54.00
	RIO: Buy		Price target: $108.00
	NCM: Buy		Price target: $47.60
	OZL: Hold		Price target: $1.65
	AWC: Hold		Price target: $2.18
	WPL: Buy		Price target: $54.00
	STO: Hold		Price target: $14.40
	OSH: Hold		Price target: $6.70

Tight commodity markets; USD weakness – onwards and upwards for resource stocks

We recently visited about 20 firms in China across the steel, coal, aluminium and energy sectors. A consistent picture emerged of demand strength for bulks, base metals and energy coupled with ongoing supply-side constraints that will see China depend even more heavily on imports. On top of fundamental supply/demand strength, ongoing USD weakness is translating through to higher USD commodity prices. CBA currency strategists expect the USD to remain weaker for longer, and recently extended their forecast period to 2020. We make substantial upward revisions to earnings forecasts, valuations and price targets across the sector. The changes largely reflect significant upward revisions to commodity prices, although this is partially offset by a higher AUD/USD exchange rate and higher operating costs. Ongoing fundamental tightness in commodity markets (particularly bulks and copper) coupled with USD weakness will see USD commodity prices remain much stronger than previously expected. Our preferred stocks remain BHP, RIO, NCM and WPL. On our new forecasts, RIO is trading on just 8.7x CY11 and BHP on 9.6x FY12 earnings. Our upward revisions to AWC and OZL largely bring the valuations and price targets in line with recent share price movements. We downgrade our recommendation on OZL from Buy to Hold – the stock has risen 75% from recent July 2010 lows.

Key stocks

- BHP will be generating enormous free cash flow in the next 3-5 years and is already operating with an under-geared balance sheet. We have not factored in unsanctioned organic growth capex, but on current estimates, BHP will have about USD70b in surplus cash on the balance sheet by 2015 unless it makes acquisitions or buys back capital.
- The impact of the commodity price revisions has increased RIO earnings by about USD3.6b in CY11, partially offset by currency and higher costs. The biggest impacts on earnings are from the iron ore and aluminium price increases.
- 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.
- On balance – WPL remains our preferred exposure in the oil sector. The biggest near-term driver of Woodside shareholder value will be expansion of the Pluto facilities and success will drive continued re-rating of the stock. The recent sale by Shell of a 10% WPL stake may create short-term underformance as the market digests the extra stock, however in the longer term this is a positive as WPL achieves improved management and stakeholder alignment.

Stocks at a glance

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

Stocks by sector

Industrials

BKN' 11/11/10

Summary of report dated 0911/10

Last Traded: $8.61	Market Cap: $1,202m	Sector: Industrials
Hold		Price target: $8.39

Bradken back from the brink

BKN's stellar share price performance from its listing in 2004 to its peak in late 2007 delivered a compound return to shareholders of 60% pa. The unwinding of the growth premium in late 2007 and concerns over gearing though the GFC saw a sharp reversal in performance with the stock hitting a low of $0.95 in March 2009. BKN has since had a spectacular share price recovery as fears over gearing dissipated and the global mining cycle resumed its strong upward trajectory. The company again has a favourable outlook. BKN's Mining Products and Rail divisions, which account for 66% of earnings, are leveraged to a highly favourable cycle of increasing expenditure in the sector that looks set to continue over the foreseeable future. BKN is a well run business that navigated the GFC exceptionally well, limiting margin declines and maintaining cash flow through good cost management. The company's resistance to a dilutive capital raising through the downturn points to a solid board and management team with a strong focus on shareholder returns.The loss of the Esco product license in June 2011 however will leave an earnings gap and increased import competition in the rail division is also expected to result in earnings declines within that division. We expect FY12 earnings to decline but beyond that believe that the strength of the cycle can support increased competition and that BKN can deliver solid earnings growth over our forecast period.

Investment view

We expect that FY12 earnings weakness will weigh on the share price over the short term, Our $8.39 price target implies a 12 month forward PER of 14.1 times, a 1% premium to the small ords, which we believe is appropriate. We initiate coverage with a Hold recommendation.

BKN is a well run business that navigated the GFC exceptionally well, limiting margin declines and maintaining cash flow through good cost management. The company's resistance to a dilutive capital raising through the downturn points to a solid board and management team with a strong focus on shareholder returns.

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 AIO, NCM, OSH

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