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 195 **10 February 2011 (4.30pm)**

Feature Article

Our feature articles this week are:

Commodities: Energy spotlight - Oil: Six factors driving prices in 2011

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

Oil: Six factors driving prices in 2011

Summary of previous report dated 08/02/11

CBA oil price view: Towards USD100/bbl in 2011 and 2012

We expect WTI crude prices to keep pushing through USD100/bbl in 2011 and 2012, as ongoing world recovery replaces the weak USD as a key driver of oil prices from mid-late 2011.

We expect six key themes to drive oil markets in 2011:

1. Increasing risks around the USD and inflation expectations.
2. Increasing geopolitical instability and inflation policy mistakes.
3. Increasing scale and volatility of investor flows.
4. Demand recovery dominated by emerging markets.
5. Growing dependence on new OPEC supply.
6. Unconventional gas and liquids development.

Weak USD => higher USD prices => inflation => ?

US Federal Reserve bond purchases and US government stimulus packages are dramatically increasing the quantity of USD in circulation. Prices of USD-denominated commodities have risen as the USD has fallen, with some prices now at or near record highs, including food and copper. Oil is high by historical standards.

Market Wrap

The big issue across the globe at present is inflation. At the start of the year, sharply rising food prices prompted riots in Algeria, with dissatisfaction quickly spreading to Tunisia and Egypt. The unrest in Egypt also served to unsettle other regimes across the Middle East as evidenced in anti-government riots in Jordan, culminating in the dismissal of the government.

And it's not just food prices that have been soaring, textile prices have risen sharply over the past five months with cotton doubling in price to record highs and wool hitting the highest levels in 23 years.

Higher prices for agricultural commodities is positive for producers in emerging and developing nations as well as farmers in Australia, but poorer workers, especially in manufacturing and tertiary sectors, are faced with higher living costs.

But many advanced nations must wonder what all the fuss is about. In the US, inflation stands at just 1.5 per cent while in Australia underlying inflation is at decade lows.

But as economies in the US and Europe continue to recover, inflation will become a more pressing concern. China has lifted interest rates three times since October last year and we can expect a progression of other central banks to tighten policy over coming months.

Stephen Karpin
Managing Director

…higher risk of geopolitical instability and policy mistakes

Higher food and energy prices spur inflation, lowering living standards, that in turn could trigger civil unrest – often in significant oil-producing regions. More broadly, commodity price inflation threatens the global economic recovery, especially if central banks respond to shifting inflation expectations too aggressively.

Investors chase yield, not oil…

Investor flows have risen as low interest rates spur diversification to alternate asset classes in the chase for yield. But this could reverse very quickly if the outlook for non-commodity asset returns improves.

World growth recovery broadens, with EM's driving…

Oil demand will rise further through 2011 as world economic recovery continues and broadens. Emerging markets will drive growth.

…while supply remains beholden to OPEC spare capacity

With limited non-OPEC new supply coming on stream over the coming years, global crude oil markets will become more dependent on OPEC spare capacity and projects – that are often in riskier jurisdictions.

Unconventional gas and liquids will reshape energy markets

Newly commercialised unconventional shale gas and liquids in the US has changed the energy market irreversibly, and these changes are set to affect global energy markets over the medium to long term.

Stocks at a glance

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

Stocks by sector

GICs sector

NWS
10/02/11

Summary of report dated 03/02/11

News Corporation

Last Traded: $17.83	Market Cap: $14.4b	Sector: Media
BUY		Price target: $19.80

TV and Cable drive strong 2Q result

NWS has delivered a solid result, with revenue growth of 1% dropping through to 7% EBIT growth (13% above CBAf). Underlying EPS was 28.8¢/sh, up 17% yoy (and 12% above CBAf). TV and Cable earnings grew strongly, offsetting soft performances from Film and Sky Italia. Overall, there was nothing in this result to change our positive view on the stock.

Revenue is lifted by 2% across FY11 and FY12, EBIT by 2-3% and EPS by 1-3%. Our blended valuation lifts by 1.5% to $22.00/sh (in line with our USD valuation, given we assume parity in our valuation translation). Applying a 10% discount (due to M&A risk and complexities in valuing the minorities) results in our AUD price target reducing to $19.80/sh.

Reiterate Buy with $19.80 price target. We retain a Buy given continued strong revenue growth and margin expansion for NWS' Cable assets, improvements in its broadcast TV assets from re-transmission, exposure to the global cyclical recovery and the potential for the BSkyB deal to allay M&A fears and boost NWS' cash flows.

ORI
10/02/11

Summary of report dated 03/02/11

Orica Limited

Last Traded: $26.19	Market Cap: $9.5b	Sector: Chemicals
BUY		Price target: $28.35

WARNING: Explosives and water don't mix

ORI has announced that the Queensland floods would cost $20m-30m through the four-month period to the end of January. This impact is expected to be across both the Explosives business and the Chemicals business. We would not expect this announcement to surprise many.

ORI has also reiterated its guidance that it anticipates to deliver profit growth in FY11. Continuing NPAT (i.e. ex DuluxGroup) was $618.8m in FY10.

ORI remains one of the preferred stocks in our Basic Materials coverage universe. Over and above the usual highlight (namely, its market leading position in the attractive global explosives industry), we remain attracted by its relative earnings certainty, strong balance sheet, and significant pipeline of growth opportunities. While the upside implied by our price target is limited, we suspect greater scrutiny of growth potential could result in earnings upgrades.

QAN 10/02/11 Summary of report dated 03/02/11	

Qantas Airways Limited

Last Traded: $2.42 | Market Cap: $5.5b | Sector: Transport
BUY | Price target: $3.20

Surcharge a lot

Qantas will increase fares by raising international fuel surcharges.

The new fuel surcharges on a one-way flight are $145 to the UK and Europe ($95 previously), $115 to the Americas, South Africa and India ($85 previously), and $75 to Asia, Pacific and Hawaii ($55 previously).

Surcharges on domestic and trans-Tasman air fares are under review (note, these levies were removed in January 2009).

Jetstar will not re-introduce fuel surcharges, but will explore other options for withstanding the rising cost of fuel, including ancillary revenue.

No changes to earnings, DCF valuation ($2.91/share) or 12-month price target ($3.20/share).

Buy recommendation maintained. The recent weakness in QAN share price has presented a buying opportunity with strong valuation upside. While second half conditions are likely to be tough, we believe Qantas' favourable mix of customers means it is better than its competitors at withstanding the headwinds of rising fuel prices and modest economic growth.

AGK
10/02/11

Summary of report dated 07/02/11

AGL Energy Limited

Last Traded: $14.78 | Market Cap: $6.8b | Sector: Utilities
HOLD | Price target: $16.10

When it rains, it poors

AGK has downgraded FY11 earnings guidance to $415m-440m (from $450m to $480m). The earnings downgrade is due to recent extreme weather events in QLD, NSW, VIC and SA.

Maintain Hold at this stage. Some longer-term value has emerged given the recent weakness since AGK failed to acquire any of the NSW assets. On normalised earnings, AGK is trading consistent with its three-year PE; yet there are reasons why AGK should trade at a premium.

To be more confident that the value will be realised, however, we need to see greater clarity on AGK's growth profile, balance sheet and NSW retail strategy.

JBH
10/02/11

Summary of report dated 07/02/11

JB Hi-Fi Limited

Last Traded: $19.27 | Market Cap: $2.1b | Sector: Retail
HOLD | Price target: $19.70

Give a little bit…

JBH has reported a soft 1H11 result, in line with expectations; a 48cps dividend was declared.

We have marginally (less than 1%) trimmed our FY11-13 forecasts.

We believe JBH will undertake capital management initiatives in the coming months, that could add ~2.7% to our valuation (assuming 10% of shares repurchased). We have therefore added 2.7% to our price target, which is now $19.70 per share (up 6.8%).

Headwinds will remain, but Sell no longer justified. JBH will continue to face tough trading conditions, with category-specific weakness and deflation unlikely to relent. However, the anticipated capital management initiatives will likely underpin the stock in the short term. Since we moved to a Sell recommendation in October 2010, JBH has underperformed the S&P/ASX200 Industrials on a total return basis (-7.0%) and has experienced a material relative PE de-rating. At these levels, we believe a Sell recommendation on JBH is no longer justified, and therefore upgrade our recommendation to Hold.

MYR
10/02/11

Summary of report dated 07/02/11

Myer Holdings Limited

Last Traded: $3.23 | Market Cap: $1.8b | Sector: Retail

BUY | Price target: $4.10

Biding time or buying time?

MYR has provided sales figures up to January 2011, and subsequently downgraded FY11 earnings guidance. MYR also announced its acquisition of sass & bide.

We have downgraded FY11 NPAT and EPS by 12.1% to $161.4m and 27.8 cents, respectively. Increased caution in the future outlook has resulted in earnings downgrades of a similar order over FY12 and FY13.

Valuation upside remains, but a recovery in consumer spending needed. We are maintaining our Buy recommendation on MYR based on valuation support ($3.86 per share). This valuation upside is driven by the prospect of further department store expansion, increased representation of Myer exclusive brands and the efficiency improvements from IT upgrades. However, our rolled-forward price target ($4.10 per share) is unlikely to be realised until consumer spending activity begins to demonstrate some positive momentum.

SHL
10/02/11

Summary of report dated 07/02/11

Sonic Healthcare Limited

Last Traded: $11.72 | Market Cap: $4.6b | Sector: Healthcare

HOLD | Price target: $12.30

California here we come

SHL has announced the acquisition of Central Coast Pathology Consultants (CCPC), a full service laboratory based in California in the US. The acquisition metrics look attractive at ~6x EBITDA post-synergies. Industry sources suggest the acquisition price was ~USD30m.

CCPC completes anatomical and clinical testing for the Santa Barbara and San Luis Obispo counties in California (between Los Angeles and San Francisco). It operates one laboratory, manages 7 patient service centres, services 6 hospitals and has annual revenues of ~USD20m.

The acquisition will be funded from SHL's existing debt facilities. We do not expect the acquisition to be a material contributor to earnings in the near term and estimate the EPS impact in the order of <0.5% in FY11 and 1% in FY12. Post acquisition, SHL is expected to have ~USD150m of headroom in its USD denominated borrowing facilities.

We retain our Hold on SHL. The CCPC is another example of SHL making a strategic bolt-on acquisition at a reasonable price. Our Hold recommendation is based on concerns about collection centre costs, specialist work competition as well as funding scrutiny in the domestic pathology market.

WBC
10/02/11

Summary of report dated 07/02/11

Westpac Banking Corporation

Last Traded: $24.24 | Market Cap: $72.9b | Sector: Banks

HOLD | Price target: $24.70

Treading water...awaiting a credit wave

WBC provided an update on its Institutional banking division (~26% FY10 NPAT). A broader 1Q11 trading update is scheduled for 15 February.

Maintain Neutral sector stance. The majors continue to face broad pressures resulting in soft top line growth including subdued asset growth, higher funding costs and increased regulation. However, with these issues increasingly appreciated by the market, we believe the relative stability of bank earnings coupled with a solid dividend yield of ~6% should provide relative comfort.

While we see potential value at WBC currently at a 2% discount to sector despite a predominantly retail banking business similar to CBA (currently at a 9% premium to the sector) – near term catalysts are difficult to identify.

WBC's 1Q11 trading update on 15 February will provide a broader perspective on overall group performance, with improving certainty/stability of earnings potentially the basis of greater appeal.

AWC
10/02/11

Summary of report dated 08/02/11

Alumina Limited

Last Traded: $2.46 | Market Cap: $6.1b | Sector: Mining
BUY | Price target: $2.95

Don't be foiled, there's upside to come

AWC is due to report its CY10 result on Thursday 10 February. The result is known to have been impacted by commissioning issues and foreign currency translation impacts. Nevertheless our forecast NPAT of USD65.4m is up markedly on last year's subdued result in a turnaround year for aluminium.

AWC remains undervalued 17% against our $2.95 price target. The shift to index pricing will continue to unlock AWC's low cost alumina leveraged production base. We expect the market to reflect this as the structural change gathers momentum.

BKN
10/02/11

Summary of report dated 08/02/11

Bradken Limited

Last Traded: $8.43 | Market Cap: $1.2b | Sector: Emerging Companies
SELL | Price target: $8.39

1H result mixed - question marks over growth

BKN reported 1H11 adjusted NPAT of $38.2m, after adjusting for impairment charges of $12.2m, up 49% on pcp, compared to CBA expectations of $40.9m.

We have revised our numbers marginally, and remain at the bottom end of management's guidance range for FY11, which was re-iterated at the result. Given the solid order books in the non-rail businesses, we expect BKN to deliver on guidance, although there is little room for error.

Focus should turn to FY12 earnings, given the continuing pricing pressure in rail and the roll-off of the ESCO licence. We see these two issues combined with the significant increase in overheads culminating in an FY12 EPS decline of 7.7%.

The higher capex outlook also raises the prospects of further underwritten DRPs as well as increasing the risk profile of the business as it adds capacity through the cyclical upswing.

COH
10/02/11

Summary of report dated 08/02/11

Cochlear

Last Traded: $77.21 | Market Cap: $4.4b | Sector: Healthcare
HOLD | Price target: $78.80

Solid result, AB and upgrades the swing factors

COH's 1H11 result was in line with expectations. It delivered constant currency sales growth of 17% (ex FX contracts) and adjusted NPAT was $82.9m (ex the $4.3m gain on the Macquarie University facility). The key result drivers were strong N5 unit sales and a $21.9m hedging gain, partially offset by unfavourable currency movements.

We have lowered our FY11 EPS forecast by 1.4% and increased our FY12 EPS forecast by 1%. More conservative market share gains from the AB recall were partially offset by slightly lower administration and selling costs.

We retain our Hold recommendation on COH. At current prices, we see limited upside for the stock on a 6-12 month view as it cycles strong comparable unit sales growth. Upgrade sales remain a swing factor for our forecasts however we already have them ramping up, so they would need to pick up significantly in FY12 to have a material impact on our earnings forecasts.

CSR
10/02/11

Summary of report dated 08/02/11

CSR Limited

Last Traded: $1.21 Market Cap: $1.8b Sector: Building Materials
BUY Price target: $1.80

Capital management approved

CSR has obtained approval, by way of an ordinary resolution, for the capital return of $0.4357/share totalling $661.4m and a 3-for-1 consolidation of CSR's existing share capital.

Our current forecasts have appropriately recognised the respective cash flows relating to the capital return. We have not adjusted our valuation at this stage for the capital return and consolidation, but it is worth noting that our price target is likely to adjust to around $4.20 once CSR goes ex-entitlement to the capital return and the 3-for-1 consolidation is complete.

CSR remains our most preferred stock. Despite limited earnings growth, we believe CSR offers considerable value. While the implied FY12 P/E of 11.4x is modestly below its historic average P/E of 12.0x, we believe a premium is justified given the Sucrogen divestment earnings are currently cyclically low, balance sheet strength, new management and an attractive fully-franked 7% dividend yield (subsequent to the capital return). Given our average valuation and $1.80 price target implies 17.1% upside, we are very comfortable with our Buy recommendation.

DLX
10/02/11

Summary of report dated 08/02/11

DuluxGroup Limited

Last Traded: $2.77 Market Cap: $1b Sector: Chemicals
SELL Price target: $2.40

AGM: Guidance headroom washed away

DLX released its AGM commentary and an update of 1H11 trading conditions.

We have not made any revisions to our forecasts. We would anticipate a challenging 1H11, reflecting impacts of the recent wet weather and flooding, the timing of the Easter holiday period for 2H11, and recognition and receipt of insurance recoveries.

Our medium- to long-term concerns of market share pressures (as a result of the shakeup in the Australian paint and hardware industry), limited potential organic growth opportunities, and risk of investment in marginal offshore businesses continue to underpin our Sell recommendation.

NAB
10/02/11

Summary of report dated 08/02/11

National Australia Bank Limited

Last Traded: $25.94 Market Cap: $56.4b Sector: Banks
HOLD Price target: $27.26

1Q11: Gaining ground, transition continues

NAB released its unaudited 1Q11 cash earnings of $1.3b, or $1.283b after adjusting for a $49m mark-to-market gain on SCDO and a $25m QLD overlay, which was modestly ahead of consensus at ~$1.25b.

NAB's 1Q11 update with cash earnings modestly ahead of consensus is a fairly solid performance given general conditions in the broader banking environment and ongoing delay in a pick-up in system business credit. NAB has further strengthened its position in business banking and has continued to build traction in its retail turnaround with strong mortgage growth.

With NAB at a PE discount of ~9% and a dividend yield of 6.4%, we see scope for some reduction in its discount. However, to meaningfully close its valuation gap, NAB requires stronger evidence of a lift in demand for credit by businesses, greater clarity on the timing of a UK recovery and acquisition risk.

AEO
10/02/11

Summary of report dated 09/02/11

Austereo Group Limited

Last Traded: $2.09 Market Cap: $720m Sector: Media
HOLD Price target: $1.93

1H result shows impressive revenue share gains

Despite 1H11 revenue growth of 12% coming in 3% above CBAf, higher opex resulted in EPS of 8.7cps (+11%), missing our forecast by -3%. The key positive was that AEO lifted revenue share in 1H, a trend we expect will continue in 2H, helped primarily by MMM but also by the Today Network.

Retain Hold. We believe AEO has a solid track record on yield management and cost control, and is well positioned to benefit as MMM continues to improve and gain revenue share. However, with AEO trading modestly above our fundamental $1.93/sh valuation, we maintain a Hold recommendation.

BLD
10/02/11

Summary of report dated 09/02/11

Boral Limited

Last Traded: $5.25 Market Cap: $3.7b Sector: Building Materials
HOLD Price target: $5.40

Soggy guidance mitigates strong result

Boral reported 1H11 NPAT of $92m ($68m pcp). This was above our expectations of $82m and above market expectations of around $77m. A dividend of 7.5cps was declared (7.0cps pcp), which was also above our expectations of 6.5cps.

While Boral's implied total return is becoming increasingly attractive, it is supported by a view that it should benefit from the recent flooding across Eastern Australia through FY12 and continued extraction of benefits associated with the recent strategic review. As we are not entirely comfortable with the quantum of these potential benefits given uncertainty around the size of the potential flood rebuild required and continued commentary that BLD has not dramatically changed its approach to market, we don't believe this is sufficient to support a more positive view at this stage.

OZL
10/02/11

Summary of report dated 09/02/11

OZ Minerals Limited

Last Traded: $1.75 Market Cap: $5.8b Sector: Mining
HOLD Price target: $1.78

OZL payday – cashflow to keep on growing

OZL released a strong CY10 result, underlying NPAT of $398m, NPAT from continuing operations of $539m, and a second half dividend of 4cps (unfranked) bringing full year dividend to 7cps.

We continue to see potential upside in OZL through organic growth and M&A/buyback potential with little downside risk. Strength in copper to at least 2015, protection against FX downside through accelerated gold production and near mine resource extension should provide a low-risk secure earnings base.

QRN
10/02/11

Summary of report dated 09/02/11

QR National Limited

Last Traded: $2.93 Market Cap: $7.3b Sector: Transport
BUY Price target: $3.30

The gravy train stops here

QR National will offer voluntary redundancy (VR) packages to 3,500 of its workforce of 9,390.

QR National benefits from growing Asian demand for coking coal, as well as an attractive market structure. We are confident that QR National can significantly improve its financial performance to earn above WACC returns on new projects and boost returns on existing operations.

RIC 10/02/11 Summary of report dated 09/02/11	**Ridley Corporation Limited**		
	Last Traded: $1.27	Market Cap: $386m	Sector: Agribusiness
	BUY		Price target: $1.40

Short-term weather pain before gains

RIC has reported a 1H11 result that is below expectations at the operating level but saved by a negligible tax expense; a 3.75cps dividend was declared.

We have downgraded our FY11 forecasts substantially following the extent of the weather impact on RIC. The 2.5% EBITDA downgrades over FY12-20 were offset by capex reductions in our valuation ($1.34 per share).

Remains the preferred pick in the sector. RIC delivered an underwhelming result that was impacted by the recent extreme weather, and there remains weather risk in 2H11. However, the strong drivers of herd rebuilding and operational cost reductions in the salt division are likely to be reflected in strong FY12-13 earnings growth. We view RIC as an attractive medium-term takeover target based on the long-term drivers of domestic feed demand and note RIC has unrecognised value from land holdings on its balance sheet. We maintain our Buy recommendation on RIC.

The next potential catalysts for RIC appear to be FY11 earnings guidance (likely to be provided in April) or the next land holding announced for development into residential property (possibly at the FY11 result).

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

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

[3] Members of the Commonwealth Group hold more than 10% of

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