

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:

- Mirvac Group
- Downer EDI 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

Mirvac Group¹

Last traded: \$1.43

Sector: Financials

Market cap: \$4272m

Buy

Price target: \$1.85

Summary of previous report dated 07/04/10

For WOT?

Mirvac announced an equity raising up to \$500m via a fully underwritten institutional placement (\$350m) and a non-underwritten SPP (capped at \$150m). MGR has also been granted exclusivity to conduct due diligence in relation to the potential acquisition of all units and instalment receipts in Westpac Office Trust (WOT).

We have changed our earnings to reflect the institutional equity raising and recent Canberra acquisition. Consequently our valuation has declined to \$1.59 (was \$1.60) and our price target has declined to \$1.85 (\$1.89).

We retain our Buy recommendation

Despite the negatives, including raising further equity at dilutive levels, deal risk and softer EPS growth as a result of increasing passive income, Mirvac remains attractive in our view given its leverage to a residential recovery which should deliver some of the highest EPS growth in the sector (10.2% three-year EPS CAGR).



Issue 152

8 April 2010 (4.30pm)

Market Wrap

Sometimes it's hard to isolate the 'hot button' reasons behind Reserve Bank interest rate decisions. But not this time – and in fact there were two of them in the latest decision to lift cash rates. The first influence was the so-called 'terms of trade'. And the second was the 'buoyancy' in home prices.

In essence both factors are outside the Reserve Bank's control. The housing market needs more supply – more homes built to accommodate the growing population. And the 'terms of trade' is rising because China is forced to pay higher prices for our coal and iron ore. While the Reserve Bank can't solve these problems, it certainly can try and slow other parts of the economy so it doesn't overheat.

But what is the mystical 'terms of trade'? It compares the prices we get for our exports to the prices we pay for our imports. And it looks as if we are on track to repeat the record 'terms of trade' result achieved in 2008 with potentially \$30 billion extra dollars being earned. No wonder the Reserve Bank is worried.

Stephen Karpin
Managing Director

Feature Article

Downer EDI Limited¹

Last traded: \$7.30

Sector: Industrials

Market cap: \$2435m

Sell

Price target: \$6.00

Summary of previous report dated 01/04/10

Reliance Rail – several risks worth thinking about

Post our initiation of coverage report on DOW, we have continued to perform due diligence on Reliance Rail and exactly what DOW's contractual obligations are. We believe there are several risks present for DOW in relation to the operational and financial performance of Reliance Rail.

DOW's balance sheet exposed to the SPV

Our primary concern relates to Reliance Rail. Despite it being set up as a non-recourse SPV, implying that the entity's financial obligations are non-recourse and ring-fenced from the balance sheets of its investors, the design and construct and maintenance phases carry joint and several operating guarantees. These performance guarantees effectively put DOW's balance sheet at risk to performance issues within Reliance Rail's business. And given there have already been serious delays in the delivery of the first train set there is a real risk that DOW must reimburse the SPV. In effect, its balance sheet is exposed to the SPV through performance contracts, albeit the business is financially ring-fenced from other equity holders.

Downgraded to Sell

All things considered, despite the recent share price weakness, we believe the risks surrounding Reliance Rail and the recourse to DOW, financially, operationally and by reputation are significant. In this context we have downgraded our recommendation to Sell.

Stocks at a glance

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

Stocks by sector

Financials

ASX 08/04/10 Summary of report dated 07/04/10	ASX Limited
	Last Traded: \$34.37 Market Cap: \$5965m Sector: Financials Hold Price target: \$38.13 Earnings and sentiment risk Following ASX's release of its monthly trading report for March 2010 we have made no changes to our earnings based on the third quarter data. However the risk now lies to the downside with trading value currently sitting below our forecast and capital raisings. In regards to sensitivity to earnings a 10% fall in trades (value) would result in a 1% decrease in EPS. The sensitivity of listing revenue is similar to trades, that is, we need a 10% lift to increase EPS by 1%; however, we expect the volatility in listings in the next 6–12 months to be high and hence this is more likely to drive changes to our earnings forecasts. As a result of potential downside to earnings and the 'in principle' approval of new entrant Chi-X, we have decreased our price target by 1.5% to \$38.13. Despite 7% fall in the share price in last month, we maintain our Hold call On valuation grounds we see upside to the current share price; however, sentiment in the near term is likely to hold the stock down. As further clarity on the timing of new entrants and ASX's fee and rebate changes are announced in coming months we will become more confident on ASX's earnings. We note that an aggressive stance on fee increases is likely to be negative for the stock, pushing trades to competitors; we are expecting minimal changes to the fee and rebate structure.

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Industrials

CSR² 08/04/10 Summary of report dated 01/04/10	CSR Limited
	Last Traded: \$1.75 Market Cap: \$2651m Sector: Industrials Hold Price target: \$1.65 Bright Food sweetens the bid CSR announced it has received a conditional offer from Bright Food (a Chinese food conglomerate) to acquire Sucrogen (CSR's sugar and renewable energy business) for \$1.75b. Conditions include regulatory approval in Australia (FIRB in particular) and China, completion of due diligence and execution of various transaction documents. CSR intends to engage in discussions; however, completion of the transaction remains uncertain at this stage. No earnings changes as yet We have not made any earnings changes at this stage, however, should we assume the sale is completed our valuation would increase to around \$1.97. That said the transaction is dilutionary with short-term earnings 10% below our current forecasts and longer-term earnings around 20% below current forecasts. ROE is also negatively impacted as returns on the surplus cash are not sufficient to replace the returns lost as a result of the Sucrogen sale. We believe our Hold recommendation remains appropriate although CSR is trading above our \$1.65 price target. We see some valuation upside should the Bright Food conditional offer ultimately close. However, given uncertainty around the success of the Bright Food conditional offer, CSR's ability to freely use potential proceeds for accretive capital management initiatives, proposed demerger uncertainty, and recent sugar price weakness we are reluctant to take a more positive view at this stage.

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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 DOW and MGR.

² Members of the Commonwealth Group have received fees within the previous 2 years from CSR.

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

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End of Report