

Research Insight

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:

- BHP Billiton: 1H10 result
- Boral Limited: 1H10 result

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

BHP Billiton - 1H10 result

Last traded: \$40.35

Sector: Materials

Market cap: \$135b

Buy

Price target: \$50.00

Summary of previous report dated 10/02/10

Ramping up organic growth

BHP has reported underlying NPAT of USD5,706m for 1H10 and declared a 42cps dividend.

Following the result we made modest revisions to our forecasts, which incorporate higher bulk commodity price forecasts, offset by higher operating cost assumptions. We have increased our price target from AUD47 to AUD50 – which is mainly a currency translation effect (our USD price target is largely unchanged).

No change to our positive view

The outlook for FY11 and FY12 remains very strong – iron ore and coal prices are set for substantial increases, copper markets are tight, and BHP has substantial organic growth prospects across its portfolio.



Issue 145 11 February 2010 (4.30pm)

Market Wrap

With all the focus on debt and deficits run up by countries across the globe, it is pleasing that Australia's name hasn't been brought up. In fact if Australia has been mentioned in despatches, it has merely been to contrast the strength of our position compared with the weakness of others.

According to the OECD, Australia's general government gross debt is the lowest of any OECD nation, standing at 15.9% of GDP in 2009. It is a fair jump from there to levels near 80% of GDP for the US and the Euro area and then to 189% of GDP in Japan.

While our government did run up a budget deficit in responding to the US financial crisis, we don't need to be in a rush to restore surpluses. Just like the Reserve Bank with its rate settings, the Government has time on its hands. And no doubt both the Government and Reserve Bank currently have some reservations about the outlook for the global economy.

Feature Article

Boral Limited^{1,2}- 1H10 result

Last traded: \$5.69

Sector: Materials

Market cap: \$3,387m

Buy

Price target: \$6.30

Summary of previous report dated 10/02/10

Cost control delivers 1H10 result ahead of expectations

BLD reported a 1H10 NPAT of \$68m (\$75m pcp). The result was ahead of CBA (\$61m) and consensus expectations (\$50-55m). Operationally EBIT was around 4% ahead of our expectations.

Following the result we made some modest changes to our forecasts reflecting weaker US brick and Australian cement prices. We have also incorporated the revised CBA currency forecasts.

No change to positive view

Our positive view is supported by CBA's very positive view on the Australian housing market. CBA's Economics team is forecasting 158k housing starts in FY10 and 184k in FY11. This should be supported by generally strong pricing disciplines across the majority of the Australian building materials industry; leverage to the expected subdued US housing market recovery through CY10 and CY11; strong cost management through the downturn leading to upside margin risk in the upturn; conservative guidance; and the recently announced strategic review.

Sector wraps

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

Utilities	APA Group / Hastings Diversified			
<p>11/02/10</p> <p>Summary of report dated 8/02/10</p>	<p>APA: Last traded: \$3.25</p>	<p>Market cap: \$1,654m</p>	<p>Sector: Utilities</p>	
	<p>HDF: Last traded: \$1.07</p>	<p>Market cap: \$534m</p>	<p>Sector: Utilities</p>	
	<p>APA: Hold</p>			<p>Price target: \$3.19</p>
	<p>HDF: Buy</p>			<p>Price target: \$1.32</p>
	<p>Seizing an Epic opportunity</p>			
	<p>Following a detailed look of the economics of Epic Energy's stage 3 expansion of the South West Queensland Pipeline (SWQP) and a review of the merits of APA acquiring HDF/Epic Energy we have made revisions to forecast earnings.</p>			
<p>We reiterate our Buy recommendation on HDF</p>				
<p>For HDF, our valuation is \$1.47 (down 13cps) on a lower SE Water valuation and higher AUD/GBP assumption. Our HDF price target has however increased to \$1.32 (up 7cps) reflecting a lower (10%) discount given the stage 3 expansion financing is locked down. Changes to earnings reflect capitalisation of interest for stage 3 expansion until 2012.</p>				
<p>Significant upside remains in HDF. The stage 3 expansion project will deliver attractive equity returns. Together with valuation/yield support, a sustainable capital structure, a strong growth profile and potential corporate activity, CBA reiterates its Buy recommendation.</p>				
<p>Upgrade APA to a Hold recommendation</p>				
<p>For APA we have made no changes to earnings or valuation. Our APA price target has increased to \$3.19 per security reflecting a lesser (10%) discount for lower capital structure and refinance risks.</p>				
<p>The risks of APA needing to raise significant equity have reduced considerably despite maintaining high gearing levels and a challenging refinance task relative to its peers. Recent refinances in the sector have shown reduced debt margins and/or increased tenor. CBA upgrades APA to a Hold recommendation.</p>				

Stocks at a glance

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

Stocks by sector

Staples

AWB' 11/02/10 Summary of report dated 09/02/10	AWB Limited	Last traded: \$0.99 Market cap: \$809m Sector: Staples Hold Price target: \$1.09	AWB is trading on an undemanding multiple and we therefore retain our Hold recommendation.
Uncertainty surrounding rejected settlement AWB has unsuccessfully attempted to settle its Australian (Watson) shareholder class action. This move by AWB before the hearing (scheduled to begin Wednesday, 10 February) increases the likelihood that AWB will have to hand over some company value to the plaintiffs.			
Assume a \$100m settlement We have reduced our valuation and price target by 12cps, which implies a \$100m settlement. We will adjust earnings forecasts with the known impact of the class action (if any) when the hearing is finished. Our revised valuation is \$1.48 per share (down 12cps) and price target is \$1.09 per share (down 12cps).			
Uncertain weeks ahead Recent moves by AWB to settle its class action increase the likelihood that AWB will have to hand over some company value to the plaintiffs. We are also concerned about a number of areas of AWB's business that are in structural decline. AWB's lack of export infrastructure is likely to see it lose grain marketing share on Australia's east coast, and we expect that pool marketing will eventually die under deregulation. AWB's rural store offering, Landmark, is unlikely to deliver consistent top-line growth given the mature nature of the business. However, AWB is trading on an undemanding multiple and we therefore retain our Hold recommendation.			

Materials

IPL¹, 10/02/10 Summary of report dated 08/02/10	Incitec Pivot Limited	Last traded: \$3.46 Market cap: \$5,622m Sector: Materials Hold Price target: \$3.40	Over the next few months continued DAP pricing strength and further currency weakness are likely to result in market upgrades and potential share price appreciation
Moranbah lives another day IPL announced it will recommence construction of the Moranbah project in May 2010. We were reasonably comfortable IPL would recommence the project given the recent improvements in Qld coal exports.			
This announcement is largely reconfirming the previous metrics for this project. It is worth noting that capital costs remain unchanged at \$935m (around \$615m remaining); contracted volume increased to 90% from the previous 60%; tenor of contracts is around 8–9 years and the project is expected to be wholly debt funded.			
Recommendation remains unchanged Our new price target is \$3.40 (previously \$3.25) and our Hold recommendation remains unchanged. Over the next few months continued DAP pricing strength and further 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.			

Healthcare

<p>COH¹ 11/02/10</p> <p>Summary of report dated 9/02/10</p>	<p>Cochlear Limited</p> <p>Last traded: \$63.65 Market cap: \$3,587m Sector: Healthcare Hold Price target: \$65.37</p> <p>1H10 result slightly above market expectations</p> <p>COH delivered unit sales growth of 7% (3.6% ex donations) and sales growth of 4% (ex FX contracts and in constant currency). Reported NPAT was \$75.2m and underlying NPAT was \$70m (ex one-off items). Key result drivers were the launch of the Nucleus 5, BP100 and operating cost savings. On the outlook, COH stated that FY10 NPAT will be 'at least 15% ahead of last year'.</p> <p>We have increased our earnings and our price target by 8.2%. The key drivers were lower operating costs, the incorporation of a 'sales and lease back' program for its new facility and CBA's new FX forecasts.</p> <p>Upgraded recommendation to Hold COH is trading on a reasonable PE of 19.7x with 20% growth in FY11 and 11% in FY12. We are more confident that short- to medium-term earnings will be well supported by the roll out of the Nucleus 5 and BP100 as well as ongoing tight cost control. In turn, we have upgraded our recommendation to Hold.</p> <p>In the event that COH is involved in the acquisition of the Siemens' hearing aid unit, however, we will reconsider our position given the potential change in strategy, strain on COH's balance sheet and execution risks.</p>	<p>We are more confident that short- to medium-term earnings will be well supported by the roll out of the Nucleus 5 and BP100 as well as ongoing tight cost control</p>
<p>RMD 11/02/10</p> <p>Summary of report dated 05/02/10</p>	<p>ResMed Inc.</p> <p>Last traded: \$54.28* Market cap: \$4,079m Sector: Healthcare Buy Price target: \$60.90*</p> <p>RMD gives competitors a wake-up call</p> <p>On a half-yearly basis, RMD delivered sales growth of 18% to USD522.1m, a 60.2% gross margin and NPAT growth of 42.4% to USD88.1m. Key drivers were US market share gains, a positive product mix, tight cost control and currency movements.</p> <p>We have strengthened our top line growth to take into account the strong upside from the S9 and home sleep testing. We have also incorporated better cost control and CBA's revised FX forecasts (with a weaker AUD). In turn, we have upgraded our EPS forecasts and increased our price target by 15.2%.</p> <p>RMD remains our top pick</p> <p>RMD is trading on a forward PE of 18.2x, justifiable with EPS growth of 14.9% in FY11 and 23.6% in FY12. This growth is dependent on contributions from its new masks and the S9 series, a positive product mix shift from supportive compliance trends and ongoing growth in the obstructive sleep apnea market (especially with home sleep testing). RMD also has a net cash balance of \$307m. Risks to the stock include a strong AUD as well as the US competitive bidding program.</p> <p>*Price target, Last traded price and Market cap are in USD.</p>	<p>RMD remains our top pick but risks to the stock include a strong AUD as well as the US competitive bidding program.</p>

SHL²
11/02/10Summary of
report dated
05/02/10**Sonic Healthcare Limited**

Last Traded: \$14.76 Market Cap: \$5,733m Sector: Healthcare
Hold Price target: \$14.88

SHL sets itself up in Belgium

SHL has announced the acquisition of Medhold Group (Medhold), based in Antwerp, Belgium. The purchase price is based on an EV of €232m and represents an EBITDA multiple of ~8.4x (excluding synergies). It will be EPS accretive immediately.

Upgraded our earnings

We have upgraded our earnings and increased our price target by 3%. In acquiring a higher margin business and by using existing cash and debt, the deal is significantly EPS accretive in FY11 and FY12. CBA has also revised its FX assumptions.

SHL is trading on an undemanding forward PE of 14.3x with EPS growth of 15.7% in FY11 and 10.1% in FY12. Despite the stock 'pulling back' in recent weeks, we maintain our Hold leading into SHL's result on 23 February. We will be looking at the effectiveness of SHL's copayment strategy (and its views on the pathology funding review), further margin growth in the US and Europe from integration activity and its appetite for more acquisitions. We note that potential acquisitions are not incorporated into our forecasts.

Despite the stock 'pulling back' in recent weeks, we maintain our Hold leading into SHL's result on 23 February. We will be looking at the effectiveness of SHL's copayment strategy (and its views on the pathology funding review), further margin growth in the US and Europe from integration activity and its appetite for more acquisitions

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, COH and BLD

² Members of the Commonwealth Group have received fees within the previous 2 years from SHL and BLD

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