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 187 **25 November 2010 (4.30pm)**

Feature Article

Our feature articles this week are:

- **Riversdale Mining Limited**
- **Telstra Corporation 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

Riversdale Mining Limited

Last traded: $13.10	Sector: Energy	Market cap: $3,099m
Buy		Price target: $15.00

Summary of previous report dated 23 November 2010

Infrastructure timing is the key

We initiate coverage of RIV with a Buy recommendation and $15.00 price target. RIV is an African focused coal company that operates the ZAC (74%) mine in South Africa and is developing two large projects in neighbouring Mozambique namely Benga (65%) and Zambeze (diluting to 60%). RIV has an impressive 13 billion tonnes in coal resources in Mozambique containing significant quantities of export quality hard coking coal. We are attracted to RIV's large resource base, prospective tenement holding and leverage to hard coking coal prices. In our opinion, RIV is an attractive long term investment despite some short to medium term infrastructure hurdles in Mozambique. Key catalysts for the stock are: 1) completion of the USD800m agreement with Chinese steel maker WISCO for a 40% stake in the Zambeze project; 2) first production from Benga; and 3) infrastructure development. The key risk for the three stage Benga project is timing of rail and port infrastructure for stages 2&3 which is not unusual for large infrastructure projects in Africa and incorporated into our base case. The main drivers of valuation uncertainty for RIV are coal prices and exchange rates.

Attractive coking coal exposure

Benga is a large scale project and will be a major determinant of share price performance in the medium term. RIV also has a non-binding MoU with Chinese steel maker WISCO for the development of the 9 billion tonne Zambeze coal resource, more than two times the size of Benga. These projects represent the most significant contribution to our valuation and have the potential to make RIV a significant player in the coal industry.

Market Wrap

Will there be a 'Santa Claus' rally this year? Some analysts think there will, with some tipping very solid gains, but certainly the month of November hasn't been a good lead in.

Still, the optimistic forecasters have history on their side with the All Ordinaries only sliding on four occasions over the past 20 years and seven times in the past 30 years.

So why the good track record? Some will put it down to 'window dressing' by fund managers. Whether it is the US or Australia, fund managers rule off the books for the month, the quarter and the calendar year. And it is in the interest of fund managers to show the best possible returns in order to attract new investment inflows.

And then there is the forward-looking approach by investors to take into account. Investors are likely to end this year, much the same as the last, expecting better times ahead.

The Australian sharemarket fell in both December 2007 and December 2008, but that was understandable given the GFC. In December last year stocks lifted by 3.5%, extending the rally that began in early March.

This year there is again the sense that the healing process is underway, although tinged with a little more frustration than last year.

Stephen Karpin
Managing Director

Feature Article

Telstra Corporation Limited[1]

Last traded: $2.88 Sector: Telecommunications Market cap: $35,836m

Buy (from Hold) Price target: $3.00

Summary of previous report dated 24 November 2010

One step closer to a definitive NBN deal?

With the Telecommunications Reform Bill looking more likely to pass the Senate this week (versus our previous expectation of 2011), we have factored in 100% of the $9b revenue component of the NBN deal into our Telstra valuation (50% previously). Furthermore, we were comforted by the claim at Telstra's AGM that it intends to pay a 28¢ dividend in FY11 and FY12. The key risk that we previously saw was the NBN HoA falling over, but with increasing confidence now that this will proceed, we are comfortable with our dividend forecast at 28¢ being maintained over the next three years. Succumbing to pressure from the independents, Senator Conroy agreed to release a summary of the NBN business case in an effort to see the Separation legislation passed. Further, Senator Xenophon won a commitment that the NBN will be overseen by a cross-house parliamentary committee over the course of its build and secured a private briefing on the NBN business case with no confidentiality requirements. The summary report contains no details on rollout schedule, assumed take-up rates, ARPUs/revenues or access costs. However, despite the scant detail provided in the summary report, we believe the private briefing and parliamentary committee commitment are likely to see Nick Xenophon and Steve Fielding support the bill, either this week or early next year. With the legislation voted through, anti-competitive components of the NBN Co/Telstra deal cannot be considered as such by the ACCC. Focus will shift to Telstra structural separation undertaking, and we note that Telstra and the ACCC have been discussing this for some time.

Upgrade to Buy with price target lifted 11% to $3.00/sh.

Telstra still faces many challenges and uncertainties surrounding fixed to mobile substitution, a more aggressive competitive landscape and the ultimate impact of the NBN. However, we expect increasing confidence in the $11b NBN deal, greater certainty over the 28¢ dividend and potential for capital management to see the stock outperform.

Stocks at a glance

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

Stocks by sector

Energy

WHC
25/11/10

Summary of report dated 23/11/10

Whitehaven Coal Limited

Last Traded: $6.70	Market Cap: $3,307m	Sector: Energy
Buy		Price target: $7.75

Attractive growth profile with infrastructure upside

We initiate coverage of WHC with a Buy recommendation. WHC is a coal producer focused on the Gunnedah basin of NSW, that is entering a period of strong growth driven by the expansion of its open cut operations and the ramp-up of operations at Narrabri. WHC is an appealing investment proposition underpinned by: 1) infrastructure access; 2) strong growth profile; 3) diversified asset base (five operating mines); 4) increasing exposure to metallurgical coal: 5) experienced management team with a track record of developing assets; and 6) robust balance sheet.

M&A could unlock up to $1.20ps in infrastructure value

WHC is well positioned on infrastructure with an 11% stake in Newcastle Coal Infrastructure Group (NCIG) and access through Port Waratah Coal Services. We see significant option value in WHC's rail and port access. A third party with constrained access to infrastructure could unlock up to $1.20ps ($580m) in value by shipping semi-soft coking coal instead of WHC's thermal coal. Our DCF-based valuation of WHC is $7.75, comprising $7.37 for total operations and corporate items and $0.38 for exploration potential. Key catalysts for the stock include: corporate activity, successful development of stage two of the Narrabri project and top block caving study results.

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Information technology

CRZ
25/11/10

Summary of report dated 22/11/10

Carsales.com Limited

Last Traded: $4.60	Market Cap: $1,071m	Sector: Information technology
Buy		Price target: $5.40

Limited share price downside

Given the market's recent concern about CRZ's pricing power and volume growth prospects, we have stress-tested our estimates to identify any downside risk potential. CRZ offers dealers a platform whereby average time to sell is minimised given their significantly higher unique users and brand presence. Hence, we see no incentive for a dealer to pull inventory from CRZ given it will likely take longer to reach a potential buyer and we struggle to see how a dealer-backed portal would succeed given the significantly fragmented car market. CRZ's volume penetration in the used car dealer market is relatively mature. While there is scope for CRZ to grow inventory in the new car category (i.e. convince dealers), we think the biggest challenge will be to change the consumer's mind-set (i.e. convince users to use aggregator sites like CRZ for researching and buying a new car).

...we see no incentive for a dealer to pull inventory from CRZ given it will likely take longer to reach a potential buyer and we struggle to see how a dealer-backed portal would succeed given the significantly fragmented car market.

Retain Buy

Our conclusion is that the recent share price sell-off appears overdone given valuations of ~$5.00-5.10 are achievable even under our bear-case scenario (assuming no volume growth or no yield growth). However, we acknowledge that short-term outperformance will likely remain hindered by the possibility of a sell-down by PBL Media (which owns 49.6% of CRZ) before a potential IPO. Our FY12 EPS declines marginally given we now assume the price per lead for dealers grows every two years from FY12f. Our valuation however falls by -4% to $5.38/sh (with price target $5.40/sh).

Consumer discretionary

IVC[1,] 25/11/10	**InvoCare Limited**
Summary of report dated 19/11/10	Last Traded: $7.15 — Market Cap: $732m — Sector: Consumer discretionary Buy — Price target: $7.78

Invocare wins the Bledisloe Cup

IVC has announced a proposal to acquire Bledisloe, which is New Zealand's largest funeral service provider and a top three operator in certain Australian markets. It has 52 funeral homes and 3 cemeteries and crematoria. We have been anticipating this transaction for some time; though the deal itself didn't surprise, the composition of the proposed payment did – with IVC paying $78m cash and issuing $36m in equity to Bledisloe shareholders. We had expected an all-cash payment, with IVC funding ~50% via an equity market capital raising. The regulatory review is likely to take some months and we don't expect a conclusion until April next year. Although we are confident of the deal going ahead, there may be some concessions required such as divesting certain sites in NSW. Any such moves would likely serve to reduce IVC's debt burden.

New potential element of growth

The key changes to our earnings include the addition of $10m in FY11 and $17m in FY12 EBITDA. Which with other adjustments have led to increases in our forward NPAT and EPS. Today's announcement adds a new potential element of growth to IVC. We continue to favour the company's business model, earnings history and outlook. With the increase in our earnings forecasts, we have tuned up our price target from $7.08 to $7.68 and maintain our Buy recommendation.

The regulatory review is likely to take some months and we don't expect a conclusion until April next year. Although we are confident of the deal going ahead, there may be some concessions required such as divesting certain sites in NSW.

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 IVC

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

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

Disclosure and Disclaimer

End of Report