Research Insight

CommSec

Issue 180 07 October 2010 (4.30pm)

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:

- **Qantas Airways Limited**
- **Wesfarmers 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

Qantas Airways Limited

Last traded: $2.88	Sector: Transport	Market cap: $6,524m
Buy		Price target: $3.25

Summary of previous report dated 30/09/10

Airfares rising and fuel costs falling

Qantas has released its operating statistics for August 2010. Yield performance in August was strong, particularly given the group-wide capacity growth. While the yield rise is occurring as expected, it is the currency-driven fuel cost reductions that has caused us to upgrade earnings. The increase in both international and domestic yields appears to be accelerating with the increase in international yields taking place despite a significant mix shift towards lower yielding Jetstar services. The AUD crude price has fallen 14% since 3 August with part of the fall offset by a higher refining margin. Qantas' low levels of effective fuel and currency hedging means it has significant exposure to falling AUD fuel costs with the strong AUD also likely to increase demand for international travel, possibly at the expense of domestic travel. This is usually a net positive for Qantas.

Qantas is leveraged to rising airfares

We continue to like Qantas for its leverage to rising airfares, especially corporate fares and international fares. At the moment, Qantas is enjoying rising fares, falling AUD fuel costs and increased demand for international travel and is less exposed to the excess leisure market capacity faced by low-cost competitors. We retain our Buy recommendation and increased our 12 month price target to $3.25 per share ($3.15 previously).

Market Wrap

With another interest rate decision out of the way, it's a good time to assess the state of play with investment returns. Of course while we can track current returns, investors always have to be forward looking and that requires a more detailed assessment of markets and judgment about where they are headed.

In terms of cash-based investments, while the official cash rate stands at 4.50%, 3-month term deposit rates are more attractive, with yields as high as 6%.

On the share market, unfortunately the major indices have eased around 3% since the start of the year. But dividend yields for stocks are around longer-term averages at 4.4%, with yields even higher after grossing up returns.

Then there is residential property. Home prices have eased in recent months with national annual growth easing from 14% to 8%. But with rental yields on units near 5%, total returns are still healthy.

Overall it's pretty clear that Australians are spoilt for choice, with investment assets still recording healthy growth rates – especially compared with what's on offer in other parts of the globe.

Stephen Karpin
Managing Director

Wesfarmers Limited[1]

Last traded: $33.73 | Sector: Retail | Market cap: $39,084m

Buy | Price target:$34.70

Summary of previous report dated 04/10/10

Coles maintaining the rage

We have upgraded our Coles forecasts after recent positive industry feedback and downgraded Resource division earnings due to weather-induced production delays and currency revisions. We now anticipate the momentum from Coles we saw in 2H10 is being maintained into FY11, based on industry feedback. However, deflation continues to be an issue for the industry and value growth is limited. Most participants believe Coles continues to take market share on the back of its renewal program and aggressive pricing strategy. Coles Food & Liquor EBIT margins expanded 55bps in 2H10 and we believe strong margin expansion is likely to continue into FY11. We now forecast further FY11 Coles EBIT margin expansion. Our Coles upgrade is offset by the impact of weather and currency changes on the Resources (Coal) division. Rain interruptions have impacted FY11 production volumes at the Curragh coal mine, resulting in a reduction to forecast metallurgical sales volumes, which in combination with our exchange rate revisions, leads to a material reduction in our FY11f Resources EBIT to $651m.

Maintain Buy recommendation

We believe Coles continues to take market share in the Australian supermarket sector and that the momentum in margin expansion is likely to be sustained at levels seen in 2H10. As a key driver of share price sentiment, we anticipate the 1Q11 sales announcement to be a positive catalyst. Against this is the fact that WES' share price outperformance over the past year means the strong growth outlook is more adequately priced. We maintain our Buy recommendation on WES.

Sector wraps

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

Banks — Monthly banking statistics – August 2010

07/10/10

ANZ: Last Traded: $24.14	Market Cap: $61,790m	Sector: Banks
CBA: Last Traded: $51.50	Market Cap: $79,767m	Sector: Banks
NAB: Last Traded: $25.84	Market Cap: $55,126m	Sector: Banks
WBC[2]: Last Traded:$23.30	Market Cap: $69,648m	Sector: Banks
BEN: Last Traded: $9.19	Market Cap: $3,286m	Sector: Banks
BOQ[2]: Last Traded $11.11	Market Cap: $2,396m	Sector: Banks

Summary of report dated 30/09/10

ANZ	Buy	Price target: $24.98
NAB	Hold	Price target: $26.68
WBC[2]	Buy	Price target: $24.99
BEN	Hold	Price target: $9.13
BOQ[2]	Hold	Price target: $11.38

RBA: Growth in financial aggregates remains subdued

Credit growth remained slow in August, with system credit growth of just +0.1% mom, below July's +0.3%, and the lowest level of monthly growth in 10 months.

- *Credit growth* for August was +3.1% yoy, consistent with growth levels over the past three months.
- *Business credit* growth still showed no sign of recovery, with August lending growth of -0.6% mom and -4.0% yoy, slightly weaker than July levels – with a recovery in business lending likely delayed until 2011.
- *Housing credit* also slowed modestly with growth of +0.6% mom and +8.1% yoy in August, representing a third consecutive month of yoy slowdown in growth.

Owner-occupied lending continues to slow, although remains positive at +0.5% mom, while investor credit growth maintained its stronger trend of +0.8% mom.

APRA: Deposit growth exceeding loan growth

Deposit growth outstripped lending growth for the second month in a row, with annualised deposit growth in August of 13% above lending growth of 7%. The last time deposit growth was consistently above loan growth was July to December 2008. As long as deposit growth remains stronger than loan growth, this will assist in easing the funding burden of the banks. Housing market share among the majors remains consistent on the prior month with ANZ and NAB continuing to grow strongly while CBA and WBC grew at around system. On an annualised basis, ANZ grew housing credit by 2.1x system, and NAB the strongest by 2.4x. Regional banks performed strongly in August, with BEN in particular growing at 2.0x system following a weak July. SUN mortgage lending increased to 1.3x system, being at the upper end of its target range of 1.0-1.3x system by December. BOQ grew in line with system, slowing from above-system growth, likely reflecting a slowdown towards its financial year-end.

Household deposits growth strong at NAB and WBC

System retail deposits grew by 0.8% mom, in line with July growth levels, and above the average growth rate experienced over the past 12 months of 0.7%. MoM growth varied across the major banks, with strong growth of +1.4% and +1.0% respectively for NAB and WBC, while ANZ and CBA lagged with growth of only ~0.3-0.4% for the month. Finally, the regionals – SUN saw strong retail deposit growth in August, +2.3% on the preceding month, as did BOQ at +1.4%. On the other hand, BEN retail deposits were down nearly 1% compared to July levels.

Stocks at a glance

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

Stocks by sector

Energy

WPL
07/10/10

Summary of report dated 04/10/10

Woodside Petroleum Limited[2]

Last Traded: $44.64	Market Cap: $34,971m	Sector: Energy
Buy		Price target:$52.00

Pluto expansion: equity versus third-party gas

The biggest near-term driver of Woodside's shareholder value is expansion of the Pluto facilities beyond the initial one-train Pluto Foundation project. Pluto may ultimately be expanded to five trains, with Woodside aiming for three trains processing its own equity gas and two trains treating other resource owner (ORO) gas. Our modelling shows that adding an additional train of own gas adds about $11ps to Woodside's valuation, whereas an additional train treating ORO gas adds around $1.50ps. Woodside needs an additional 1.5tcf of gas in the Inner/Central Hubs to meet targeted gas requirements for Pluto 2. The company is confident that the centrally-focused drilling program in 2H10 will deliver enough gas by early 2011. Pluto 3 may be fed from gas from the Outer hubs and early success at Alaric is encouraging with follow-up drilling expected in mid-2011. With respect to the third-party gas solution, commercial discussion on third-party trains may be resolved in the next six months with news on Scarborough likely pre-year end and Hess early 2011**.**

Pluto may ultimately be expanded to five trains, with Woodside aiming for three trains processing its own equity gas and two trains treating other resource owner (ORO) gas.

Buy recommendation and $52 price target retained

The biggest near-term driver of Woodside shareholder value will be expansion of the Pluto facilitie. Achievinig this via the company's equity gas will be the greatest way to add value to the Pluto development. Woodside is currently undertaking a 20+ well, 18-month exploration program that is predominantly aimed at finding enough gas for two additional LNG expansion trains. Success will drive continued re-rating of the stock.

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 QAN, WES

[2] Members of the Commonwealth Group have received fees within the previous 2 years from QAN, WBC, BOQ, WPL

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