

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:

- Orica Limited
- Transurban Group

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

Orica Limited

Last traded: \$25.98

Sector: Materials

Market cap: \$9,407m

Buy

Price target: \$27.90

Summary of previous report dated 06/10/10

Currency update

We have adjusted our forecasts on the back of recent changes to CBA's currency forecasts. Currency movements impact ORI EBIT by around \$4m for every AUD/USD 0.01 movement, with the majority of the impact a function of translating Mining Services earnings from USD to AUD and some timing effects associated with imported ammonia in the Australian business. Overall the impact will be mitigated by hedging with around 68% of the AUD/USD hedged sufficiently to protect earnings. Chemicals and Minova are impacted to a lesser degree although import parity price will pressure explosives and chemical businesses with a sustained higher AUD. Although our earnings revisions are negative they purely reflect CBA's revised currency forecasts and no other operational changes have been made.

ORI remains one of our preferred Basic Materials stocks

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. Consequently, we retain our Buy recommendation at this stage.



Issue 181 14 October 2010 (4.30pm)

Market Wrap

There is no doubt that there is only one game in town – one 'hot button' issue, if you like – and that's quantitative easing. In essence the term refers to the printing of more money; but as you would expect economists 'pooh-pooh' that kind of simplification saying that it is more complicated than that. But it refers to the buying of securities like government bonds in exchange for cash.

How did the US Federal Reserve get to this situation? Well it's largely because it has fired all their traditional bullets. That is, interest rates are near zero – the range for the federal funds rate is between zero and 0.25%.

So what are the risks? One risk is that it doesn't work, undermining confidence. But there is another risk – it works too well – that is, all that extra money in the system creates inflation. With inflation near 1% currently, that is not a risk. Of course all those extra US dollars in the system reduce the value of the currency and that means other currencies like the Australian dollar go up. It seems to be only a matter of time before the Aussie dollar hits parity with the greenback, and a key reason is QE.

Stephen Karpin
Managing Director

Transurban Group¹

Last traded: \$5.17

Sector: Industrials

Market cap: \$7,451m

Buy

Price target: \$5.80

Summary of previous report dated 13/10/10

Traffic exceeded expectations across the board

TCL has reported September quarterly traffic and revenue figures above CBA expectations. We have therefore reviewed our earnings forecasts. TCL owns interests in high quality infrastructure assets in particular the Australian toll roads in Melbourne and Sydney. Every road across the TCL portfolio exceeded CBA's Average Daily Traffic for the quarter. Citylink ADT grew by 10.1% versus the equivalent prior period, with Citylink 1Q11 revenue 4.2% above the CBA forecast.

Further growth is expected over FY11 given benefits from third lane entry into Burnley tunnel and the recent opening of the fourth inbound lane of the Southern link. A final catalyst for further Citylink traffic growth expected later this financial year is the opening of the fifth lane on the Westgate Bridge, a key feeder of traffic to Citylink. However, no specific date was provided in the announcement.

Buy recommendation maintained

We have revised our traffic and revenue forecasts for TCL following the September traffic results and increased our distribution forecasts to be in line with our revised free cash flow per security forecasts. TCL remains our preference in the infrastructure sector. Next data points are the completion of the M2 at the end of CY10 and the M5 widening negotiations early CY11. Further clarity on Capital Beltway is forthcoming early-mid CY11. These catalysts should continue to firm up the compelling growth proposition that TCL represents.

Stocks at a glance

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

Stocks by sector

Consumer staples

GNC ² 14/10/10	GrainCorp Limited			
Summary of report dated 11/10/10	Last Traded: \$7.48 Buy	Market Cap: \$1,483m Sector: Consumer staples Price target: \$8.40		
	Murder in the fields			
Widespread locust control measures are starting to ramp up on Australia's east coast. There are several areas such as the Darling, Central West and Western areas of NSW and Northwest Victoria where locust hopper bands have developed after hatching. Farmers are now initiating aerial spray controls that will largely eradicate the pending threat of locust damage. Locusts have not made a material impact (i.e. >1%) on east coast crop volumes since the introduction of aerial spraying and CBA forecasts a record FY11 east coast wheat crop 50% above average, possibly too large to export completely within the year, which could boost GNC's FY12 exports. The FY12 planting season is forecast to benefit from continuing La Nina conditions until mid-2011 and increased planted area reducing risk of a drought affected FY12 crop.				
Record east coast harvest underway				
We expect a record east coast winter crop to not only deliver 76% profit growth in FY11, but also boost GNC's FY12 port earnings. GNC is currently trading on 9.5x FY11f EPS. We maintain our Buy recommendation on GNC.				

Locusts have not made a material impact on east coast crop volumes since the introduction of aerial spraying and CBA forecasts a record FY11 east coast wheat crop 50% above average...

Materials

OST ^{1,2} 14/10/10	OneSteel	
Summary of report dated 07/10/10	Last Traded: \$2.85 Buy	Market Cap: \$3,795m Sector: Materials Price target: \$3.65
Downstream steel environment challenged		
We have recently taken a closer look at the Australian downstream steel sector and reviewed our forecast earnings for some industry participants. Downstream steel is a difficult industry currently under pressure with short term domestic steel demand downbeat and competitive pressures fierce. Pricing pressures and limited scope for further cost control given extensive initiatives implemented during the GFC further reduce scope for dealing with the challenging environment. In the short term however, OST will fare better than its peers as it benefits from the nation building infrastructure program pipeline. Our earnings changes for OST primarily reflect slower than expected recovery in margins within OST's Australian Distribution business, although going forward this should be assisted by restructuring strategies.		
Short term OST's margins may fair well relative to peers		
Our Buy recommendation reflects OST's exposure to iron ore markets (which hold significantly better industry fundamentals when compared to steel) and its lower risk exposure to steel markets given its integrated business structure which should help protect it somewhat from steel margin pressures. Our price target of \$3.65 includes a 5% discount to reflect potential resource tax impacts.		

Downstream steel is a difficult industry currently under pressure with short term domestic steel demand downbeat and competitive pressures fierce.

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 OST

² Members of the Commonwealth Group have received fees within the previous 2 years from TCL, GNC, OST

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.commsec.com.au

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End of Report