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 196 **17 February 2011 (4.30pm)**

Feature Article

Our feature article this week is:

BHP Billiton: Please sir, can I have some more?

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: Please sir, can I have some more?

Summary of previous report dated 16/02/11

Event

- BHP reported underlying NPAT of USD10.7b for 1H FY11, up 88% on 1HFY10. The result is 5% ahead of our forecast and consensus expectations on lower tax expense.
- The final dividend of 46cps is up 10% and BHP has increased the share buyback program from USD4b to USD10b to be implemented by end-CY11. BHP has announced USD80b spend on organic growth in the next five years.

Implication

A very strong result but largely expected by the market. Cashflow was a standout and BHP now has no net debt. The capital return was at the low end of expectations but we believe is likely to be the first of many. We consider the market reaction today (down 1.6%) shows that the market is looking for more. CEO Marius Kloppers was emphatic in the post-result briefings that the focus for the group is now organic growth of its tier 1 assets.

Key points from the result include:

- The strong result was predominantly driven by commodity price strength. Price effects added USD9.3b to EBIT.
- Operating cashflow of USD12.2b is up 123%, and 14% ahead of forecast.

Market Wrap

One of the biggest issues at present is the conservatism of Aussie consumers. Australians are actively saving, rather than spending, and paying for goods with their own money – cash or EFTPOS – rather than putting them on credit.

This change in the behaviour of Australian consumers actually started back in 2003 with people gradually winding back outstanding balances on credit cards. At the second phase began just before the global financial crisis in mid 2007.

The key reason for the change? Higher interest rates. The standard variable housing rate rose three percentage points from 2003 to 2008. And while rates fell sharply as the global financial crisis took hold, it was the shock of GFC that consumers responded to rather than the attraction of lower rates.

Reserve Bank officials don't know how long this 'new conservatism' will last. In fact no one does. But the longer that consumers actively shop around for the best deals and focus more on saving, than spending, the longer the Reserve Bank can stay on the interest rate sidelines.

Asset prices will be an important part of the equation. If the sharemarket or home prices suddenly decided to take off, then the risk is that the exuberance could spill over to consumer spending.

Stephen Karpin
Managing Director

- BHP is now in a net cash position and has a very inefficient capital structure. The modest capital returns that have been announced are insufficient to address this issue.
- BHP has outlined a USD80b capital expenditure program on organic growth projects in iron ore, petroleum, copper, met coal and potash. We have not yet fully captured this growth in our forecasts or valuation.
- BHP's six tier 1 assets again contributed 2/3 of BHP's EBIT in the half. Iron ore is the standout – the Western Australian iron ore business generated 34% of BHP's EBIT in the half.
- BHP still has a number of underperforming businesses – 30% of its capital base generated just 2% of its earnings (aluminium, nickel, Olympic Dam).

Earnings and valuation revisions

We have not made changes to earnings pending further analysis of the result.

Investment view

In our view BHP is cheap – trading on 9.9x FY12f earnings - it has huge growth options and will still be able to substantially increase capital returns to shareholders.

Stocks at a glance

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

Stocks by sector

GICs sector

AWC
17/02//11

Summary of report dated 10/02/2011

Alumina Limited

Last Traded: $2.53 | Market Cap: $6.17b | Sector: Mining
BUY | Price target: $2.95

Cash flow strength; index pricing taking hold

AWC announced CY10 underlying profit of USD37m and declared a final dividend of USD4cps (fully franked, full year 6cps). Cash flow at the AWAC level increased $1.1b to USD416m, up from negative USD716m in CY09.

AWC emphasised that the structural shift to index pricing is underway, with all new contracts being set on an index basis. AWC expects alumina demand to increase 12% in CY11, double the forecast global average growth rate.

We have incorporated AWC's CY10 result, but make no changes to our forecast at this stage, pending further review.

AWC remains undervalued 20% against our $2.95 price target. The shift to index pricing will continue to unlock AWC's low-cost alumina leveraged production base. We expect AWC dividends to increase as cash flows from AWAC continue to gain strength.

FXL
17/02/2011

Summary of report dated 10/02/2011

FlexiGroup Limited

Last Traded: $1.90 | Market Cap: $523m | Sector: Emerging Companies
BUY | Price target: $2.31

FXL delivered outstanding result

FXL's 1H11 result impressed on several fronts: Adjusted NPAT growth of 29% came on the back of strong volume increases across all divisions, with the performance of Certegy being the highlight. Management upgraded FY11 NPAT guidance to $50m-$52m.

Interim dividend increased from 3cps to 5cps.

We have upgraded our earnings forecasts over FY11, FY12 and FY13. Our valuation and price target increases by 36% from $1.70 to $2.31.

We see significant value in FXL at current levels, given the strong earnings growth over the next three years. We apply a 10% discount to the FY12 small ords multiple to arrive at a price target of $2.31.

IPL
17/02/2011

Summary of report dated 10/02/2011

Incitec Pivot Limited

Last Traded: $4.50 | Market Cap: $7.3b | Sector: Chemicals
HOLD | Price target: $4.30

Corn fuels momentum

The USDA released its February 2010 World Agriculture Supply and Demand Estimates report: the highlight was corn data. US corn stocks-to-use ratio is expected to be 5.0% in August – the lowest level since 1995. The global corn stocks-to-use ratio is expected to be 14.6% in August – the lowest since 1974. Corn prices (March delivery) increased 3.6% to USD6.98/bu.

Fertilizer Week reported DAP prices to USD600-605/t this week, following concerns of tightening short-term supply conditions and production shutdowns in Tunisia in particular. This follows a period of relatively stable pricing around the USD580-600/t range over the last few months.

Short-term IPL share price momentum appears likely to continue. Investors with a high risk appetite could potentially look to put new money to work, but we see this as a short-term trade only (2-3 months). For investors with existing positions, we would be encouraging them to take advantage of the expected share price strength over the next few months. Beyond this time frame, as potential earnings upgrades slow, we expect IPL to trade closer to our $4.30 price target. Against this backdrop, we are comfortable with our Hold recommendation.

RIO
17/02/2011

Summary of report dated 10/02/11

Rio Tinto Limited

Last Traded: $87.65 | Market Cap: $38.1b | Sector: Mining
BUY | Price target: $108.00

Good value, growth options and capital returns

RIO has reported CY2010 underlying earnings of USD14.0b, up a massive 122% on 2009. It has also announced a USD5b share buyback.

In our view, RIO is outstandingly cheap at just 8.7x CY 2011 earnings. We maintain our Buy recommendation and $108 price target. RIO is now generating significant surplus cashflow, which will be used to fund additional growth. A share price rise of +50% in 2011 would not be surprising to us – and even then, RIO would be trading below its long term average PE.

SGT
17/02/2011

Summary of report dated 10/02/11

Singapore Telecommunications Ltd

Last Traded: $2.33 | Market Cap: $38b | Sector: Telecommunications
SELL | Price target: $2.32

Optus/Singapore growth offset by Associates

SGT has reported a decline in 3Q11 underlying NPAT of 2.3% (3% above our estimate). Operational EBITDA was solid, up 4%, however contributions from Associates declined (Bharti in particular), dragging down earnings.

Retain Sell and $2.32 (SGD 2.99) price target. We believe SingTel is a well-run company with an attractive, geographically diverse collection of assets. However, with already very strong competition in India and Indonesia showing few signs of abating and rising competition and uncertainty in Australia and Singapore, we think growth will be much harder to come by and margins are likely to remain under pressure.

TCL
17/02/2011

Summary of report dated 10/02/11

Transurban Group

Last Traded: $5.24 | Market Cap: $7.5b | Sector: Infrastructure
BUY | Price target: $5.65

Cruise control

TCL reported its 1H11 result which was broadly in-line with expectations.

Nothing in the result to alter our positive view. TCL is entering a strong organic growth phase that should underpin growth in free cashflow and distributions. TCL offers both capital and distribution upside.

TLS
17/02/2011

Summary of report dated 10/02/11

Telstra Corporation Limited

Last Traded: $2.98	Market Cap: $37b	Sector: Telecommunications
BUY		Price target: $3.00

Subscriber growth the highlight of 1H11 result

Telstra has reported a 0.5% decline in 1H11 sales revenue and a 12.5% decline in underlying EBITDA (in-line with guidance of low double-digit decline and CBAf at -12.5%). The key highlight was Telstra's substantial subscriber growth, with the main negative being the sharp Yellow Pages revenue losses.

Re-iterate Buy with $3.00 price target. Telstra still faces 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 continue to outperform.

DUE
17/02/2011

Summary of report dated 11/02/11

Duet Group

Last Traded: $1.67	Market Cap: $1.5b	Sector: Utilities
BUY		Price target: $2.05

Two birds with someone else's stone

DUE and the other equity owner Jemena (which is 100% owned by Singapore Power) have agreed to inject $150m into United Energy to firm up its credit metrics and fund growth capex. DUE's share is $99m, consistent with its 66% share.

No change at this stage, given DUE releases its results on 18 February 2011.

Our preferred large cap regulated utility. DUE has now taken substantial steps to simplify its corporate structure with the divestment of Duquesne, reduction of SOLA debt for Multinet Gas and the Dampier to Bunbury pipeline and now the recapitalisation of UED.

As DUE continues to simplify its structure and confidence builds that it can manage the capital requirements of its assets, the share price is expected to re-rate so as to reduce the large valuation gap that remains. Buy recommendation maintained.

HVN
17/02/2011

Summary of report dated 11/02/11

Harvey Norman Holdings Limited

Last Traded: $2.94	Market Cap: $3.1b	Sector: Retail
BUY		Price target: $3.80

Middle of the road

HVN has reported 2Q11 comparable sales growth of -5.1% and total sales growth of 1.3% to $3.31b.

We have downgraded earnings marginally in FY11-12 and reduced our growth expectations for NZ in FY13.

Valuation remains the compelling driver of our recommendation. Trading conditions continue to be difficult for HVN and the outlook is still unpredictable. However, even on conservative FY11 earnings forecasts, HVN is trading on just 11.8x FY11 EPS. After adjusting for the $1.9b in property assets on HVN's balance sheet, the stock is trading at around 8.6x FY11 and 6.4x FY12 earnings. We maintain our Buy recommendation on HVN.

NCM
17/02/2011

Summary of report dated 11/02/11

Newcrest Mining

Last Traded: $38.49 | Market Cap: $29.4b | Sector: Gold

BUY | Price target: $47.40

Solid half; CEO change no cause for panic

NCM reported a solid but subdued 1H result after production was adversely impacted by weather events at Cadia Valley and the political impasse in Cote d'Ivoire. Underlying NPAT was $523.1m with an interim dividend of 10cps (unfranked).

NCM also announced Managing Director and CEO Ian Smith would stand down from his position as from 1 July. Finance Director Greg Robinson will succeed Smith, who will remain in an advisory role until the end of CY11.

Our forecast earnings reflect a small decrease as a result of the Lihir assets depreciation and cost guidance. No change to our valuation or price target.

NCM's market leading cost of production, long-life diversified asset base, and exceptional growth prospects mean NCM will continue to benefit from ongoing strength in gold prices, supported by a substantial copper by-product contribution. We anticipate gold prices remaining well above NCM's cost of production for the long term.

SHL
17/02/2011

Summary of report dated 11/02/11

Sonic Healthcare Limited

Last Traded: $11.76 | Market Cap: $4.6b | Sector: Healthcare

HOLD | Price target: $12.30

LabCorp's 4Q10 result - sentiment improving

SHL's US major peer Laboratory Corporation of America (NYSE: LH) reported its 4Q10/FY10 result overnight. LabCorp's top line was pleasing but its earnings missed market expectations due to higher than expected costs.

While SHL's recent acquisitions have brought the stability and opportunity in SHL's offshore businesses back into attention, its share price remains highly sensitive to the performance of its domestic pathology business. Domestic volumes have shown encouraging signs recently, however we maintain our concerns about the costs associated with new collection centres and the upcoming pathology funding review. We retain our Hold recommendation.

BEN
17/02/2011

Summary of report dated 14/02/11

Bendigo and Adelaide Bank Limited

Last Traded: $9.80 | Market Cap: $3.5b | Sector: Banks

HOLD | Price target: $10.01

1H11 Result: Paddling upstream

BEN reported a 1H11 headline NPAT of $162.1m, adjusting for an ~$18m property revaluation gain, underlying 1H11 cash NPAT was broadly in line at ~$149m (CBA $152.5m). A dividend of 30cps was declared (~73% payout).

Revised FY11 and FY12 EPS by -1.5% and -2.2%, respectively.

Hold maintained. We like BEN's conservative retail banking core, attractive deposit-led model and recognise the retail appeal of a stable dividend payout ratio. At current valuation levels (~0.98x PBV and ~11.2x PER, a 5% discount to the majors), growth in higher margin lines of business as well as improved access to funding at competitive prices to support growth are required before the stock sees any meaningful re-rating.

LEI 17/02/2011	**Leighton Holdings Limited**		
Summary of report dated 14/02/11	Last Traded: $31.79	Market Cap: $9.6b	Sector: Developers & Contractors
	SELL		Price target: $27.55

Robbing Peter to pay Paul

The 1H11 operating result missed our expectations significantly, though FY11 guidance was also materially downgraded, ~26%. LEI 1H11 operating profit of $98m compared with CBA forecast of $237m. 1H11 reported NPAT of $217m compared with our forecast of $417m (which included $180m post-tax gain from the sale of the stake in the Indian JV).

We have reduced our FY11 reported NPAT forecast from $674m to $457m; which is ~5% beneath LEI's guidance of reported NPAT ~$480m. Price target: $27.55 (-4%).

LEI too expensive given short- and medium-term headwinds. Stock is trading at ~27.6x and ~15.4x FY11f and FY12f earnings, respectively.

RMD 17/02/2011	**ResMed Inc.**		
Summary of report dated 14/02/11	Last Traded: $3.25	Market Cap: $4.98b	Sector: Healthcare
	BUY		Price target: $3.89

AASM gives HST the green light

The American Academy of Sleep Medicine (AASM) has released standards for accreditation of Out of Centre Sleep Testing (also known as home sleep testing or HST).

We maintain our Buy recommendation on RMD. It is attractively priced given its strong growth profile and balance sheet strength. In addition, there is significant upside to market growth estimates related to HST not factored into the share price. Mandating by health funds will be a short-term catalyst.

WDC 17/02/2011	**Westfield Group**		
Summary of report dated 14/02/11	Last Traded: $9.86	Market Cap: $22.8b	Sector: Property
	HOLD		Price target: $10.39

FY10 result: Banking on a US recovery

WDC is due to report its full-year result on Wednesday 16 February.

No change to Hold recommendation. Long-term, we expect the move to improve ROE will widen WDC's investor base. However, this transition will take time, and at current levels we believe WDC is appropriately priced. Key near-term catalysts, in our view, will be asset sales from the US portfolio and re-ignition of the US development pipeline, of which, the latter looks unlikely in the near-term.

PMV 17/02/2011	**Premier Investments Limited**		
Summary of report dated 14/02/11	Last Traded: $6.05	Market Cap: $937m	Sector: Retail
	BUY		Price target: $7.25

Dipping into the currency honey pot

The retail apparel industry has reinvested currency benefits to drive top-line sales growth. We are downgrading PMV earnings and are now below management guidance from November's AGM.

Our earnings revisions have reduced FY11 EPS by 5.8%, and partially flowed through to FY12 (EPS -2.6%). We have downgraded our valuation to $6.85 (-2.1%) and price target to $7.25 (-3.3%, after deducting a forecast 10c special dividend).

Operating leverage a double-edged sword, but valuation and cash supportive. PMV has significant operating leverage, and unfortunately, we are more likely to see the adverse impacts of this in 1H11. However, the stock remains attractive on valuation metrics and the company's substantial cash backing will continue to fund capital management/special dividends in the absence of any acquisitions. We therefore retain our Buy recommendation on PMV.

PRY
17/02/2011

Summary of report dated 15/02/11

Primary Health Care Limited

Last Traded: $3.40	Market Cap: $1.68b	Sector: Healthcare
HOLD		Price target: $3.57

PRY rolls its sleeves up

PRY 1H11 result included a 12.9% decline in EBITDA to $152.4m. After excluding $35.7m (pre-tax) in one-offs, underlying NPAT was down 41.2% to $45m. Key drivers were lower EBITDA margins in pathology and higher-than-expected finance and corporate costs. On the outlook, PRY confirmed its FY11 EBITDA guidance range of $330m-$340m, but it noted that it was too early to assess the impact of the Queensland floods and cyclones.

We have lowered our FY11 EPS by 15% and our FY12 EPS by 6.9%. This reflects higher finance and corporate costs and extra costs associated with new collection centres, partially offset by better pathology market growth.

Despite the recent share price pull-back, PRY is trading on 13.2x FY12 earnings. In our view, this represents fair value and we upgrade to a Hold call. On balance, however, we see greater downside risks to our FY12 earnings forecasts as: (1) we have given PRY the full $18m benefit of its cost-reduction program in FY12, and (2) we have not explicitly forecast any downside risks from the upcoming pathology funding review. This remains an overhanging issue that could weigh on the stock until budget time.

TLS
17/02/2011

Summary of report dated 15/02/11

Telstra Corporation Limited

Last Traded: $2.98	Market Cap: $37b	Sector: Telecommunications
BUY		Price target: $3.00

All things LTE, spectrum and capex

Telstra has announced that it will launch commercial LTE mobile services in metro cities and some regional centres by end-2011. In this note, we: (1) look at the rationale for launching LTE on Telstra's existing 1800MHz spectrum ahead of 2.5GHz and 700MHz (digital dividend) release; (2) assess the likely capex impact and spectrum costs for Telstra and implications for cashflow/dividends, and (3) provide an update on LTE rollouts and deployment globally.

Buy recommendation with $3.00/sh price target. Telstra faces considerable operational challenges and uncertainties, including the ultimate impact of the NBN. Despite this, with confidence in the $11b NBN deal, the 28¢ dividend, and potential capital management, we expect outperformance.

WBC
17/02/2011

Summary of report dated 15/02/11

Westpac Banking Corporation

Last Traded: $24.29	Market Cap: $73b	Sector: Banks
HOLD		Price target: $25.35

1Q11 update: Back in the game

WBC reported 1Q11 cash earnings of $1.55b vs our expectation of ~$1.5b.

Revised FY11 and FY12 EPS by +2.1% and +0.5%, respectively.

Maintain Hold. WBC's 1Q11 trading update was encouraging, with clear improvement in operating momentum across the group. WBC remains at a discount despite being a large retail bank (~50% 2H10 earnings) – with the outlook for retail banking improving, sector-leading provisioning coverage and ROA >1% vs the sector at 0.94. In looking for relative value within the sector, WBC at a -2.3% discount appears overdone.

AMC
17/02/2011

Summary of report dated 16/02/11

Amcor Limited

Last Traded: $6.68	Market Cap: $8.1b	Sector: Paper & Packaging
BUY		Price target: $7.60

Global packaging showing a positive bias

The global packaging industry recently concluded its 4Q10 reporting season.

The industry is in a marginally better shape than it was three months ago.

Demand remains relatively subdued, but does have a clear upward bias.

Industry disciplines around pricing remain in place, though it could be said the plastic packaging industry is doing a better job in managing cost pressures than the paper packaging industry.

Efficiency and costs have been well managed and appear to be making a difference to earnings.

Capital management is increasing and highlights the ability of the packaging industry to deliver relatively strong cash flows, despite a less-than-perfect operating environment.

On various measures, the short-term value proposition for AMC appears to have been eroded by currency-related earnings pressures. That said, given AMC's defensive characteristics, its solid balance sheet, continuing strong financial discipline, strong earnings growth profile, and long-term value appeal, we remain comfortable in maintaining our positive bias towards AMC at this stage.

AUT
17/02/2011

Summary of report dated 16/02/11

Aurora Oil and Gas Limited

Last Traded: $3.13	Market Cap: $1.26b	Sector: Energy
BUY		Price target: $3.45

Chuck Norris eats shale for breakfast

We initiate coverage on Aurora with a Buy recommendation and price target of AUD3.45. Aurora has interests in the liquids rich Sugarkane shale gas field development. We see material reserves upside from completion improvements, enhanced estimated ultimate recovery (EUR) and tighter well spacing. Aurora also offers material production and earnings over the next decade.

BOQ
17/02/2011

Summary of report dated 16/02/11

Bank of Queensland Limited

Last Traded: $10.30	Market Cap: $2.28b	Sector: Banks
HOLD		Price target: $10.86

Playing catchup

BOQ has further downgraded FY11 earnings guidance by 17% to $175m-195m from a prior range of $210m-230m in December 2010.

EPS downgraded by –19% FY11 and -7% FY12.

Maintain Hold recommendation. While the market had been anticipating an impact from recent natural disasters in QLD largely captured by recent stock performance, two earnings downgrades in a three-month period is disappointing.

That said, BOQ's current valuation is not overly demanding with an FY11 P/BV of 0.95x and P/NTA of 1.25x. Nonetheless, until the final impact on QLD from natural disasters is clear, funding options for lower-rated banks improve and system credit growth strengthens, we see no meaningful near-term catalyst.

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

[2] Members of the Commonwealth Group have received fees within the previous 2 years from
[3] Members of the Commonwealth Group hold more than 10% of

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