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 192 **21 January 2011 (10.30am)**

Feature Article

Our feature article this week is:

- **Rio Tinto Limited: Pilbara iron ore exceeds 60Mt in Dec Qtr**

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

Rio Tinto Limited

Last traded: $84.55	Sector: Mining	Market cap: $36.9bn
Buy		Price target: $108.00

Summary of previous report dated 18/01/11

Pilbara iron ore exceeds 60Mt in Dec Qtr

RIO has reported another strong quarter of production, particularly in iron ore.

RIO is continuing to push the boundaries of its iron ore production capacity in the Pilbara with an annualised 244Mt (100% basis) produced in the December quarter – well above the 225Mt nameplate capacity.

Copper was weak as expected, due to lower grades at key operations.

Coking coal is ramping up, but is currently affected by flooding constraints. Thermal coal production has also been constrained by wet weather.

Only minor changes to forecasts – production was largely in line and we have factored in the sale of the residual 48% of Cloud Peak Energy for the first time.

In our view, RIO is outstandingly cheap at just 8.5x CY 2011 earnings. **We maintain our Buy recommendation and $108 price target.** RIO is generating significant surplus cash flow, which will fund additional growth.

Market Wrap

Last year the All Ordinaries index seemingly went nowhere, falling by 0.7 per cent over the year. By comparison the US Dow Jones index rose by 11 per cent. Given the relative weakness of the US economy and relative strength of the Australian economy, the results seem odd. But a few other factors need to be taken into consideration.

First, around 40 per cent of Australian shares are held abroad. So foreign investors have some clout. And second, the Australian dollar was the second strongest in the world last year.

Foreign investors need to take the currency into account when assessing the performance of our market as well as its relative value. So it is useful to assess performance in the same currency.

One way is to look at the MSCI indexes in US dollar terms. The MSCI Australia index actually rose 9.8 per cent. And while this was still slightly short of the 11.9 per cent gain for the MSCI United States index, the Australian market out-performed in 2009.

All this may still prove cold comfort for local Australian investors. But it does highlight the fact that times have changed – the world is a smaller place and investors across the globe are weighing up where the value lies. The level and direction of the currency is an important consideration for foreign investors, so it should be on our radar screen as well.

Stephen Karpin
Managing Director

Stocks at a glance

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

Stocks by sector

GICs sector

STO
21/01/11

Summary of report dated 13/01/11

Santos Limited

Last Traded: $13.74 | Market Cap: $11.9bn | Sector: Energy
Hold | Price target: $14.40

GLNG reaches project sanction

Santos announced formal sanction of the GLNG two-train 7.8Mtpa development on the basis of capital expenditure requirements of USD16b. This was considered a formality after the KOGAS deal and equity raising announced on 17 December 2010.

We retain our Hold recommendation and $14.40 price target. Santos has cleared all major commercial hurdles on the GLNG development over recent months. The company also now retains a more manageable interest in a technically complex development. Focus will move onto proving up sufficient reserves and managing the significant development risks.

We retain our Hold recommendation and $14.40 price target.

DLX
21/01/11

Summary of report dated 14/01/11

DuluxGroup Limited

Last Traded: $2.75 | Market Cap: $977m | Sector: Chemicals
Sell | Price target: $2.40

Rocklea plant suspension

The Queensland floods have been devastating and unfortunately have had tragic consequences for many.

DuluxGroup has announced that its primary manufacturing facility and its adjacent distribution centre and office building at Rocklea have been subject to significant flooding, and operations have been suspended.

We have not made any earnings changes at this stage.

Our medium- to longer-term concerns of market share pressures (as a result of the shakeup in the Australian paint and hardware industry), limited potential organic growth opportunities, and risk of investment in marginal offshore businesses continue to underpin our Sell recommendation.

SHL
21/01/11

Summary of report dated 17/01/11

Sonic Healthcare Limited

Last Traded: $12.26 | Market Cap: $4.7bn | Sector: Healthcare
Hold | Price target: $12.30

Beachheads set up…all about the synergies

SHL has announced three strategic laboratory acquisitions. KBL-BML-Unilabo Laboratory (KBL) based in Antwerp, Belgium and Woestyn Laboratory based in Mouscron, Belgium. In the US, SHL acquired Physicians' Automated Laboratory (PAL). The acquisition metrics look attractive at ~8x EBITDA pre-synergies or ~6x post-synergies. Industry sources indicate the combined acquisition price was ~AUD80m.

We retain our Hold on SHL. SHL continues to make strategic bolt-on acquisitions at sensible prices. Our Hold recommendation however reflects the ongoing risks to domestic pathology margins and funding risks from the upcoming pathology and radiology review.

SXE
21/01/11

Summary of report dated 17/01/11

Southern Cross Electrical Engineering Ltd

Last Traded: $1.04 | Market Cap: $129mn | Sector: Emerging Companies
Hold | Price target: $0.95

High voltage cycle

We initiate coverage on Southern Cross Electrical Engineering (SXE) with a Hold recommendation and a price target of $0.95. SXE's specialised focus on Electrical and Instrumentation (E&I), gained over 30 years servicing the Australian resources industry, positions it well for the coming surge of activity in the sector.

This earnings gap presents a dilemma for investors; namely, whether to look through short-term weakness towards the significant growth in 2H12 and beyond. Given our forecasts for revenue to double by 2015, and the strong operating leverage within the business, such a position is tempting.

However, given SXE is trading at 16.5 times FY12 earnings - a 50% premium to its peer group, we feel that short-term upside is limited.

As the market begins to focus on FY13 earnings, we would expect SXE to outperform.

We initiate coverage on Southern Cross Electrical Engineering (SXE) with a Hold recommendation and a price target of $0.95.

WRT
21/01/11

Summary of report dated 17/01/11

Westfield Retail Trust

Last Traded: $2.65 | Market Cap: $8bn | Sector: Property
Hold | Price target: $2.90

Shifting gears a year too far away

We initiate coverage with a $2.90 price target and Hold recommendation, as our 14.7% 12-month total return expectations place WRT in the middle of our coverage universe's return expectations.

While WRT has a very attractive growth profile beyond FY12, near-term growth expectations are weighed down by the inevitable interest expense headwind from the Sydney City Facility, and in our view, will limit upside potential.

However, we would expect WRT to outperform when (1) investor focus moves beyond FY12 and/or (2) investors are looking for downside protection when markets are volatile.

GFF
21/01/11

Summary of report dated 18/01/11

Goodman Fielder Limited

Last Traded: $1.32 | Market Cap: $1.8bn | Sector: Food & Beverage
Hold | Price target: $1.35

No margin

GFF has announced a number of changes to management, including the departure of long-time CEO, Peter Margin.

Better opportunities to time entry into GFF. We see value in GFF (DCF: $1.51, SOTP: $1.52), but believe input costs will pressure margins from late FY11, and see downside risk to consensus FY12 earnings forecasts. We also believe that the risk of material below-the-line FY11 charges has increased now that there will be a new CEO and new CFO at the helm in August. We see dairy in China as GFF's greatest opportunity, but this is unlikely to be reflected in the share price in the next 12 months.

Our price target of $1.35 assumes GFF will trade at its historical discount to the market (25%) based on FY12 earnings. The risk to our Hold recommendation is corporate activity, but we do not see this as a compelling reason to buy the stock.

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PMV 21/01/11	**Premier Investments Limited**

PMV
21/01/11

Summary of report dated 18/01/11

Premier Investments Limited

Last Traded: $6.17 | Market Cap: $956mn | Sector: Retail
Buy | Price target: $7.50

Putting a dampener on expectations

We are downgrading our earnings expectations for PMV following the cool and wet summer conditions, and the continuing weak sales conditions over December and early January.

A clear value proposition despite recent tough sales conditions. PMV is trading at an FY11 PE of 12.4x and 9.5x after adjusting for PMV's net cash balance. PMV has underperformed in recent months (along with the retail sector). However, the stock offers value given the leverage to improving conditions over 2H11 and downside protection through potential capital management in the absence of an acquisition.

A clear value proposition despite recent tough sales conditions.

IPL
21/01/11

Summary of report dated 19/01/11

Incitec Pivot Limited

Last Traded: $4.24 | Market Cap: $6.9bn | Sector: Chemicals
Hold | Price target: $3.70

More questions than answers

Cargill announced that it will divest its 64% shareholding in Mosaic (the leading global phosphate fertiliser producer) initially to Cargill shareholders and debt holders. An orderly sale of all shares will take place over the next few years.

IPL clearly has some positive share price momentum from continuing strong soft commodity and DAP prices and high global fertiliser industry valuations. We remain reluctant to be more positive on IPL at this stage. The highly cyclical nature of the global agriculture and fertiliser industries, the expected imminent increases to global DAP capacity, and the continuing high AUD/USD underpins our view.

PPX
21/01/11

Summary of report dated 19/01/11

PaperlinX Limited

Last Traded: $0.52 | Market Cap: $314mn | Sector: Paper & Packaging
Buy | Price target: $0.60

Value remains despite recent strength

PaperlinX (PPX) share price has increased 20% since the beginning of the year. Despite our positive view, we believe the recent price increase appears more a function of PPX's value being recognised rather than positive industry news flow.

We remain generally comfortable with our forecasts. Downside risks include our relatively aggressive US and European volume recovery in FY12 and FY13. Offsetting this is the fact that we have not included the full benefit of the reduction in costs associated with recent management changes and headcount reduction. Our pricing assumptions also remain conservative as we include no price increases in our model at all.

While short-term industry news flow may not be overly positive, we continue to believe PPX represents reasonable value relative to our $0.60 price target.

While short-term industry news flow may not be overly positive, we continue to believe PPX represents reasonable value relative to our $0.60 price target.

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