

Research Insight

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:

- BHP & RIO: Earnings upgraded
- AXA Asia Pacific Holdings Limited: Trying to clean up the mess
- Sonic Healthcare Limited: Attractive bolt-on at a sensible price

The comments in the articles 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 & RIO: Earnings upgraded

BHP: Last traded: \$42.47	Sector: Materials	Market cap: \$141B
BHP: ACCUMULATE / OUT PERFORM		Valuation: \$45.60
RIO: Last traded: \$73.51	Sector: Materials	Market cap: \$32,012M
RIO: ACCUMULATE / OUT PERFORM		Valuation: \$75.10

Summary of previous report dated 30/11/09

Price targets up

Following upgrades to bulk commodities (met. coal and iron ore) and base metal forecasts we have upgraded our BHP and RIO price targets. BHP's price target is now AUD47 (from AUD44) and RIO's price target is now AUD76 (from AUD 70).

Recommendations maintained

Despite these increases, we retain our respective ACCUMULATE / OUT PERFORM recommendations for both stocks.

We continue to see significant medium-to long-term upside in both stocks

In the short term, there is a significant chance of a correction in over-exuberant commodity markets that have been driven by restocking activity in China. A correction in base metal prices is likely to flow through to equities.

In the long term, however the continued economic development of China coupled with a broader global economic recovery from the GFC will see strong demand growth for commodities. BHP and RIO will both be major beneficiaries of this demand growth.



Issue 139 3 December 2009 (4.30pm)

Market Wrap

The Australian sharemarket is on track for its best yearly gain in 16 years. That may seem remarkable given how weak the market was in the early months of the year. But the sharemarket is currently up 30% over 2009, and headed for the best gain since 1993.

The old adage is "time in, not timing". That is, it is the time in the market that is most important for investors rather than trying to time purchases and sales. And this old adage rings true once again.

Who could have predicted that global sharemarkets would have turned on a dime in March, and more importantly, consistently rallied from that point?

With the likely gain of 30% this year, the average growth for the Australian sharemarket over the past six years will lift to 13.5% pa. And the sharemarket has grown on average by 10% a year over the past decade. Once you add in dividends, it is clear that sharemarket investment returns have remained very good.

Matt Comyn
General Manager

Feature Article

AXA Asia Pacific Holdings Limited: Trying to clean up the mess

Last traded: \$5.82 Sector: Financials Market cap: \$5,694M
ACCUMULATE / OUT PERFORM Valuation: \$5.84

Summary of previous report dated 01/12/09

Encouraged by strategy to improve Australian and Hong Kong business units

Following AXA's annual strategy day on Tuesday 1 December which included presentations from each of the regional managers, we are encouraged by management's actions to improve the Australian, and to a lesser degree, the Hong Kong business units.

That said, we are still not convinced on the India and China story, with the rest of SE Asia being a minimal contributor to AXA's profits for some time to come.

No comments on AMP/AXA SA bid

While the strategy briefing excluded any questions on the AMP²/AXA SA bid, the briefing confirmed our previous comments that the bid should be increased to approximately \$6.10. Our valuation of AXA remains \$5.84.

We also still believe that the increased bid should come from the Australia component of the bid (ie AMP's share). The benefits of a merged Australian business will be beneficial for both AMP and AXA.

Based on our cautious comments surrounding Asia, the offer in place for this business is adequate for the risks involved.

Feature Article

Sonic Healthcare Limited²: Attractive bolt-on at a sensible price

Last traded: \$14.44 Sector: Healthcare Market cap: \$5,494M
BUY/OUT PERFORM Valuation: \$16.27

Summary of previous report dated 01/12/09

Acquisition of East Side Clinical Laboratory

SHL announced the acquisition of East Side Clinical Laboratory (ESCL) based in Providence, Rhode Island, US. ESCL generates annual revenues of ~USD30m. CBA estimates the acquisition was done at a price/revenue multiple of ~1.6x, implying a total cost of ~USD48m.

Following this small bolt-on acquisition we have made minor changes to our forecasts. FY10 EPS is up 0.5% and FY11 EPS is up 1%. Our DCF has increased by 0.5% to AUD16.27, however our price target remains unchanged at AUD14.36.

We expect further accretive acquisitions in the near term

We retain our BUY / OUT PERFORM recommendation on the stock given the favourable asset pricing environment and expectations of further accretive acquisitions in the near term, which is not factored into the share price.

Stocks at a glance

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

Stocks by sector

Financials

PPT¹
3/12/09

Summary of
report dated
2/12/09

Perpetual Limited: Small growth options

Last Traded: \$34.55 Market Cap: \$1,380M Sector: Financials
ACCUMULATE / MARKET PERFORM Valuation: \$44.40

No change to FY10 guidance

PPT held part two of its business update (part one was in June). This session focused on Private Wealth and Corporate Trust business units with no change to guidance previously supplied for FY10.

While management outlined small growth options for the business and potential to diversify away from purely funds management, these areas are small in size.

Further recovery in equity markets key driver of profits

Over 75% of PPT's earnings are linked, to some degree, to asset movements, primarily equity markets. Further recovery in the equity markets will be the key driver of profits in the near term. We maintain our ACCUMULATE / MARKET PERFORM recommendation with a \$35.97 price target.

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WDC¹
3/12/09

Summary of
report dated
27/12/09

Westfield Group: Weakness presents opportunity

Last Traded: \$11.94 Market Cap: \$25,515M Sector: Financials
ACCUMULATE / MARKET PERFORM Valuation: \$13.12

Recommendation updated

At current levels investors are presented with an attractive entry point into a high-quality, globally diverse retail portfolio which is well positioned to take advantage of acquisition or development opportunities when conditions improve. Consequently we have upgraded our recommendation to ACCUMULATE / MARKET PERFORM.

Little downside to WDC's NTA

In our view asset values for quality retail assets have bottomed, and as such we see little downside to WDC's NTA. We believe the current security price is attributing minimal value to the present or potential development pipeline.

At current levels investors are presented with an attractive entry point into a high-quality, globally diverse retail portfolio which is well positioned to take advantage of acquisition or development opportunities when conditions improve

Industrials

AIO¹
3/12/09

Summary of
report dated
1/12/09

Asciano Group: Plenty of growth in coal

Last Traded: \$1.72 Market Cap: \$5,033M Sector: Industrials
ACCUMULATE / MARKET PERFORM Valuation: \$1.75

\$500m contract with Japanese trading company Idemitsu

AIO has announced a 12-year, \$500m contract with Japanese trading company Idemitsu to haul coal from its Boggabri mine in the Hunter Valley. Our earnings forecasts, valuation and price target are unchanged.

Trading close to fair value

AIO stands to benefit from an economic recovery through FY11 principally through its container ports business. This positive outlook is priced in, however, with AIO continuing to trade around our blended valuation of \$1.75, we would look to more aggressively pick up the stock below \$1.60.

A decision on the third stevedore at Port Botany and the 1H10 results will be the next major catalysts for AIO. Our recommendation remains ACCUMULATE / MARKET PERFORM.

With AIO continuing to trade around our blended valuation of \$1.75, we would look to more aggressively pick up the stock below \$1.60.

Regulated utilities

SKI
3/12/09Summary of
report dated
1/12/09**Spark Infrastructure: ETSA decision comforting but risks remain**

Last Traded: \$1.305

Market Cap: \$1,169M

Sector: Utilities

ACCUMULATE / MARKET PERFORM

Valuation: \$1.75

Slight adjustments to SKI forecasts

Following the Australian Energy Regulator's (AER) release of its Draft Decision for ETSA's five-year price reset commencing 1 July 2010 we have adjusted our SKI forecasts. SKI owns 49% of ETSA, CitiPower and Powercor.

Our price target has been increased to \$1.31 (+8cps) to reflect the lower regulatory and funding risks. Our valuation of \$1.75 is unchanged.

Risks remain

While SKI trades at a discount to others in the sector (FCF and distribution yield of 13.8% and 10.5% respectively), risks remain. The most significant risk for SKI remains its structure and the debt (\$425m) above the assets at the SKI level. This type of debt has proven problematic for other utilities, albeit more highly geared ones. The first tranche of this debt is due to be refinanced in December 2010.

Regulatory risks also remain given the Victorian assets (52% of EBITDA) are also subject to a reset from 1 January 2011. The draft decision for the Victorian assets will not be known until mid 2010. In our view, these considerations warrant a neutral recommendation.

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Happy investing!

Recommendation Definitions

SHORT TERM (over the next 6 months we expect the share price to):

BUY	Appreciate by >10%
ACCUMULATE	Increase between 2% and 10%
REDUCE	Increase by less than 2% or fall by up to 5%
SELL	Fall by >5%
REV	Company is under review - no recommendation available

LONG TERM (over the next 24 months we expect the total return to):

Outperform (O / P)	Exceed market return by >5%
Market Perform (M / P)	Be in line with market return, +/-5%
Under Perform (U / P)	Be less than market return by >5%
REV	Company is under review - no recommendation available

¹ Members of the Commonwealth Group hold: between 5 and 10% of AIO and WDC.

² Members of the Commonwealth Group have received fees within the previous 2 years from SHL and AMP.

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