

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 article this week is:

- QBE Insurance Group: Discipline versus the dollar

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

QBE Insurance Group: Discipline versus the dollar

Last traded: \$21.50

Sector: Financials

Market cap: \$22,023m

ACCUMULATE / MARKET PERFORM

Valuation: \$28.48

Summary of previous report dated 02/11/09

A medium to long term investment

Following QBE's first strategy day which included presentations from regional managers on their business units along with FY10 guidance numbers, our view that a turnaround will come in late 2H10 appears to be supported.

Following minor revisions to QBE earnings forecasts, our valuation is up less than 1% to \$28.48 and our price target is up 0.5% to \$23.59 with the increase in FY10 earnings almost offset by the decreases in FY09.

As a medium- to long-term investment we see value in QBE as evidenced by our valuation, however in the short term, our high AUD assumptions prevent us from being too bullish on the stock. We have an EPS decrease of 10% in FY10, held back by the increase in the AUD, despite profitable growth in most business units.

We maintain our ACCUMULATE / MARKET PERFORM recommendation and we will be looking for a change in the AUD or the premium cycle to alter this view based on QBE's current share price.



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Market Wrap

It's hard to think of anything in the finance world that excites the passions as much as the gold price. Either you track the precious metal's every movement or you don't – there doesn't appear too much middle ground.

So there certainly has been a degree of excitement in the past week with gold pushing to fresh record highs following news that India's central bank has bought 200 tonnes of the metal to boost its foreign exchange reserves.

The interesting point is that while the gold price has lifted 23% this year, copper and lead have more than doubled, oil is up 75% and even wool is up 46% in USD terms.

Gold is in favour largely because the USD is out of favour, not because investors fear a break-out of inflation. So gold bugs, as well as central banks, will be spending much of their time assessing prospects for the greenback in coming months.

Matt Comyn
General Manager

Sector wraps

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

A-REITs	Residential recovery still on track despite rate rises		
05/11/09 Summary of report dated 03/11/09	MGR ¹ : Last Traded: \$1.38	Market Cap: \$3,885m	Sector: Financials
	SGP ¹ : Last Traded: \$3.66	Market Cap: \$8,721m	Sector: Financials
	MGR: ACCUMULATE / OUT PERFORM		Valuation: \$1.73
	SGP: ACCUMULATE / MARKET PERFORM		Valuation: \$3.95
	What's new?		
<p>Following this week's 25bp interest rate increase, the second in consecutive months, we have examined the impact of rising interest rates and rising house prices on housing affordability.</p> <p>We estimate that <i>despite rising interest rates and increasing house prices</i> that housing <i>will remain affordable</i> throughout our forecast period (2012) and should therefore remain supportive of a residential recovery. However by June 2012 we do expect affordability will decline to close to record lows.</p>			
What does this mean for REITs with residential exposure?			
<p>We tracked the relationship between the EBIT from Stockland and Mirvac's residential divisions and affordability and found that an inverse relationship existed through the last residential cycle, whereby residential EBIT increased despite falling affordability. While this relationship is yet to be proven, and is likely to be impacted by other factors (i.e. acquisitions), it does highlight that declining affordability does not appear to be a lead indicator of residential earnings.</p> <p>We reiterate our ACCUMULATE / OUTPERFORM call for MGR (\$1.85 price target) and our ACCUMULATE / MARKET PERFORM recommendation for SGP (\$4.19 price target).</p>			

Insurance	General insurance sector		
05/11/09 Summary of report dated 30/10/09	IAG ¹ : Last Traded: \$3.72	Market Cap: \$7,733m	Sector: Financials
	QBE: Last Traded: \$21.50	Market Cap: \$22,023m	Sector: Financials
	SUN ² : Last Traded: \$8.37	Market Cap: \$10,637m	Sector: Financials
	IAG: ACCUMULATE / MARKET PERFORM		Valuation: \$4.13
	QBE: ACCUMULATE / MARKET PERFORM		Valuation: \$28.48*
	SUN: SELL / MARKET PERFORM		Valuation: \$8.72
NSW CTP – AAMI still shedding business			
<p>The MAA (Motor Accidents Authority) released its quarterly premium report as at 30 September 2009. The data showed further encouraging signs for QBE as it continues its organic growth strategy in the attractive Australian personal lines market. Conversely the data represented more bad news for SUN's AAMI with it losing 1.3% market share on pcp.</p> <p>We previously assumed that AAMI's loss of market share would stop and QBE's growth would slow however this clearly has not happened. And while we appreciate that SUN's GIO brand is picking up some of the lost business, it is at a premium of more than 6% below AAMI and in this light we question the margins coming out of this supposedly niche player.</p>			
Stock preferences			
<ul style="list-style-type: none"> ■ <i>Our preferred insurance stock remains IAG with its high exposure to the Australian personal lines market.</i> Profit margins are expected to remain healthy in CTP (and personal lines in general), so long as adequate premium increases are being pushed through. ■ <i>Our least preferred stock remains SUN.</i> We see numerous hurdles facing SUN, not only its banking operations but also its general and life insurance arms. 			

*QBE valuation was \$28.34 when published but was upgraded to \$28.48 on 2/11/09 in *QBE Insurance Group: Discipline versus the dollar report*

Stocks at a glance

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

Stocks by sector

Financials

IAG¹ 05/11/09 Summary of report dated 30/10/09	Insurance Australia Group: Cautious comments continue			We consider IAG to be the best-positioned insurer to turn around earnings in the short term
	Last Traded: \$3.72	Market Cap: \$7,773m	Sector: Financials	
	ACCUMULATE / MARKET PERFORM		Valuation: \$4.13	
	IAG remains our preferred stock in the sector			
	Following IAG's annual strategy day which included an outline of the current strategy and priorities for the Group, we noted that while the business is certainly on track to recover from previous poor performance years, we did note a very cautious tone in management comments.			
We consider IAG to be the best-positioned insurer to turn around earnings in the short term. This view was supported by the earnings guidance update and points highlighted at the strategy briefing. We are disappointed by the lack of further expense savings that will come out of the business; however this was not factored into our forecasts and was only highlighted as potential upside.				
We maintain our ACCUMULATE / MARKET PERFORM recommendation with a \$4.13 valuation and \$3.78 price target.				

Healthcare

PRY 05/11/09 Summary of report dated 30/10/09	Primary Health Care Limited: Could, would, should PRY buy HSP?			We believe the strategic rationale in PRY acquiring HSP is weak
	Last Traded: \$6.11	Market Cap: \$2,939m	Sector: Healthcare	
	ACCUMULATE / MARKET PERFORM		Valuation: \$6.69	
	Mounting media speculation			
	Once again, media speculation is mounting that HSP is on the 'sales block'. With limited private equity activity, press reports have named PRY as the obvious trade buyer. PRY CEO Dr Bateman has also allegedly spoken about adding hospitals to PRY's existing medical, pathology and radiology interests.			
We believe the strategic rationale in PRY acquiring HSP is weak, and attach a low likelihood of it going ahead. We have not changed our PRY or HSP forecasts or recommendations.				
PRY could buy HSP but the opportunity cost of the deal is high. We see more value in PRY bedding down the SYB assets, focusing on operational issues across its businesses and ramping up its medical centre roll out strategy. After all, its mature, large medical centres achieve a margin of ~60% and also support its pathology and radiology services. In turn, there is no change to our price target or recommendation.				

Industrials

QAN¹
05/11/09Summary of
report dated
02/11/09**Qantas Airways Limited: Domestic yields show signs of life**

Last Traded: \$2.62

Market Cap: \$5,934m

Sector: Industrial

BUY / MARKET PERFORM

Valuation: \$3.27

Passenger statistics

QAN's September 2009 passenger statistics showed some underlying passenger growth and excellent utilisation, but yields remain significantly down on FY09.

Our view is unchanged: Improved passenger growth and capacity utilisation is what will drive a recovery in yields, which remain the key to improving profitability. While yields remain weak, we think the worst has passed and QAN is highly leveraged to an economic recovery. We expect to see yields show some recovery in 2H10.

In the meantime a surge in the AUD/USD is reducing the USD net cost base. QAN has full participation in a rising AUD/USD and CBA forecasts the AUD/USD to rise to 0.98 by June 2010.

In light of QAN trading at a ~18% discount to our valuation and our view that QAN is inexpensive on a P/E basis at current levels, we retain our BUY / MARKET PERFORM recommendation.

QAN is trading at a ~18% discount to our valuation and is, in our view, inexpensive at current levels

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 QAN, IAG, SGP, and MGR

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

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