Research Insight

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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:

- **Nexus Energy Limited**
- **AWE Limited**

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

Nexus Energy Limited

Last traded: $0.45	Sector: Energy	Market cap: $454m
Buy		Price target: $0.65

Summary of previous report dated 09/12/10

Principal activity: NSW invests in energy related projects, particularly in the exploration and development of oil & gas. The company has stakes in a number of JVs in the exploration and development phase.

Crux – the Nexus big thing

We initiate coverage on Nexus (NXS) with a Buy recommendation and price target of AUD 0.65ps. The progress of the Crux Liquids project is the key to NXS' performance with 22-46% upside to its valuation as the company resolves issues at the development. The government requires Nexus to develop the field by February 2014. Nexus previously estimated a build time of 30-36 mths. Based on FID in 2H11 an early 2014 start-up is a stretch. This represents a major risk for the development and Nexus may look to negotiate an extension to the development timetable. Shell's Prelude FLNG requires Crux gas post-2025. Crux development risk and government requirements continue to present uncertainties for Shell regarding Crux tail gas when moving to FID on Prelude. Shell are therefore likely to be reviewing potential options; a hostile takeover can't be ruled out however this is unlikely to help the stretched timetable.

Investment view

We believe Nexus offers material upside potential from the development of the Crux Liquids project which has been significantly derisked as a result of the extension of the permit transfer date. Further progress at the development will likely result in a re-rating of the stock.

Market Wrap

The old joke is that economists were invented to make weather forecasters look good but clearly economists would love to have some of the predictive models weather forecasters use. One such example is the La Niña weather event currently underway. La Niña is associated with wet weather in eastern Australia and dry conditions in New Zealand and western areas of northern and southern America.

The latest La Niña event began in late winter/early spring and by October it was clear this would be a major event – according to the World Meteorological Organisation "a moderate to strong event". Our economists highlighted this in a report on 12 October, noting the potential effects on rural and regional areas, as well as mining, insurance and retail sectors. The La Niña event did develop as expected with the Australian Bureau of Meteorology claiming this is the most severe La Niña "since the 1970s at least." And indeed it has had significant consequences for a raft of companies.

All this shows that sometimes non-traditional indicators come along that clearly bear watching. On this note it is worth noting that the La Niña event is expected to run to at least March/April 2011.

Stephen Karpin
Managing Director

Feature Article

AWE Limited

Last traded: $1.83 Sector: Energy Market cap: $952m

Buy Price target: $2.15

Summary of previous report dated 09/12/10

Principal activity: AWE (formerly Australian Worldwide Exploration Ltd) is engaged in exploration, development and production of oil, gas and condensate in Australia, Argentina and New Zealand.

Discovered and unconventional resource commercialisation offers long-term growth

We initiate coverage of AWE with a $2.15 price target and Buy recommendation. AWE has a portfolio of producing assets in Australia and New Zealand. Assets include the long-term cash flow generating gas developments at BassGas and Casino, supported by declining oil and gas assets at Tui and the Perth Basin. Key development studies on the Trefoil gas and condensate field (nearby the Yolla field) and the Lengo gas field in Indonesia offer considerable upside to existing reserves. As well through the recent acquisition of Adelphi, AWE gained a 10% interest in the Sugarloaf shale gas AMI. Sugarloaf benefits from having high condensate levels and a high calorific content of the gas. Meanwhile the Perth Basin shale gas offers long-term upside, although the economics are yet to be confirmed. Key risks for NXS include reliance on one production well, potential commercialisation failures and unproductive exploration. Additionally there are limited M&A opportunities in the space. On the upside key catalysts include:

- exploration results in Yemen by year-end,
- development of contingent gas resource at Trefoil;
- establishing the resource potential at Sugarloaf through ongoing drilling;
- proving the commerciality of Perth Basin shale gas throughout 2011, and
- appraisal of the Lengo gas resource (Indonesia) in 2H11

Investment view

AWE's portfolio of assets offer material growth potential from nearfield expansion and unconventional shale gas developments with the core producing asset base providing a platform for the business to grow. These assets make up over 75% of our core operational valuation and generate operating cash flow of AUD210m per annum on average over the next five years.

Stocks at a glance

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

Stocks by sector

Healthcare

CSL
09/12/10

Summary of report dated 07/12/10

CSL Limited

Last Traded: $36.98	Market Cap: $20,264m	Sector: Healthcare
Buy		Price target: $37.18

R&D promising but slow...turn to M&A?

CSL held its annual R&D briefing, discussing its achievements over the last 12 months and highlighting key projects in its R&D pipeline. CSL invested $343m on R&D activities in FY10, slightly up on FY09 with several projects commercialised during the period. CSL highlighted its successes in seeking new indications and geographic markets for its immunoglobulin and specialty products. We are confident that this momentum will continue in FY11. There was detail but limited new information on CSL's medium/longer-term projects, including albumin fused rFIX and rFVIIa, rHDL as well as CSL 362 for acute myeloid leukaemia and CSL 364 for acute/chronic inflammation. On the vaccine front, support for CSL's ISCOMATRIX technology remains strong with partners such as Merck entering into additional licences. CSL's research agreement with Sanofi Pasteur for a periodontal disease vaccine is working well, with the option of an exclusive worldwide licence.

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Investment view

We maintain Buy on CSL on the grounds that the plasma market is tightening and CSL is well positioned to take advantage of this trend with a strong reputation and an attractive immunoglobulin portfolio. It also has a strong balance sheet, enabling it to pursue M&A opportunities or R&D projects. While CSL's FY11 earnings will face an FX headwind, for longer-term investors.

Industrials

QAN [1,2]
09/12/10

Summary of report dated 01/12/10

Qantas Airways Limited

Last Traded: $2.70	Market Cap:$6,116m	Sector: Transport
Buy		Price target: $3.25

October stats and buying opportunity

Qantas has released its operating statistics for October 2010. QAN's international yield was up 16% on pcp in October (up 17% in Sept. and 13% in Aug.) This data is too early to have been affected by the grounding of the A380 fleet. Domestic yield was down 1.4% on pcp in October (up 1.3% in Sept. and 4.1% in Aug.) This data is consistent with expectations for the month. The grounding of the A380 fleet has removed 17% of Qantas' mainline international capacity. Due to rescheduling of aircraft in order to cope with the capacity shortage, we now expect both domestic and international yields to benefit from fewer discount fares on offer. Since the QF32 engine failure incident, QAN has lost 12% of market cap from its peak. We view this as an excessive share price reaction to an incident that was essentially one-off in nature and we understand a large portion of the costs to be recoverable.

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Retain a Buy recommendation

We continue to like Qantas for its cyclical exposure to a recovering economy. Qantas' corporate market makes it less exposed to the discount leisure sector which is currently experiencing excess capacity. The strong AUD is currently providing for lower fuel costs and increased demand for international travel. The recent share price weakness has presented attractive valuation support.

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 QAN

[2] Members of the Commonwealth Group have received fees within the previous 2 years from QAN

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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End of Report