

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:

- Insurance Australia Group
- BHP Billiton

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

Insurance Australia Group¹

Last traded: \$3.98

Sector: Insurance

Market cap: \$8,348M

Hold

Price target: \$4.10

Summary of previous report dated 12/03/10

Weathering the storm

IAG announced that it expects the claims cost from the recent Victorian storms to reach its maximum event retention (MER) of \$135m. As a result of this event IAG now expects to exceed its 2H10 weather allowance of \$184m by \$105m.

This has led to a downgrade in guidance for the FY10 insurance margin from 11.5–13% to 10.5–12% and consequently we have reduced our FY10 insurance margin by 0.9ppt to 11.1% and EPS down 3.6%. our price target is down by 1.5% to \$4.10 and maintain our Hold recommendation.

IAG business in good shape but risks emerging beyond FY10

The fact that IAG increased its weather allowance but did not have to pass this fully to the insurance margin supports our view that IAG's business is currently in great shape with continued expansion in the underlying insurance margin.

However, we see risks emerging beyond FY10. The threat of new players is our key concern, not only from a market share perspective but more importantly for the premium rate outlook. In addition to this we are not convinced that the turnaround in CGU can offset some of this downside.



Issue149

18 March 2010 (4.30pm)

Market Wrap

Is the sharemarket cheap or expensive? Actually it depends on what measure you use. And, importantly, this apparent contradiction isn't just limited to Australia.

When you compare current share prices with the latest corporate earnings, global sharemarkets appear somewhat pricey. That is understandable. The North American financial crisis depressed global economic growth, and in turn, corporate earnings. Of the 72 countries and regions tracked by FactSet, 38 currently have PE ratios above decade averages.

But when earnings projections for the next financial year are used, the picture changes – only 27 of the 72 markets have ratios higher than decade averages.

On the forward PE measure, Australia would appear to be well priced. Australia's forward PE currently stands at 15.90, in line with decade averages. This probably accounts for the flat performance of the sharemarket over 2010 and the sideways trend over the past month. The good news for investors is that analysts are increasingly getting more positive about the earnings outlook.

Stephen Karpin
Managing Director

Feature article

BHP Billiton

Last traded: \$43.16

Sector: Materials

Market cap: \$145B

Buy

Price target: \$50

Summary of previous report dated 17/03/10

Coking coal to China – is BHP ready?

In 2009 China became a net importer of coking coal for the first time. This marks a significant turning point in coking coal markets and Chinese coking coal imports are expected to exceed 50Mt by 2015. India and Brazil will also increase imports. We forecast exports of coking coal from Australia to increase 51% from 133Mt in FY09 to 201Mt in FY15.

We maintain our Buy recommendation and AUD50 price target

BHP will enjoy strong earnings growth in the next two to three years as the result of rising commodity prices (particularly bulk commodities) and a strong pipeline of organic growth options.

Sector wraps

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

Bank	Bank sector report		
18/03/10 Summary of report dated 15/03/10	ANZ: Last Traded: \$24.88	Market Cap: \$62,193M	Sector: Financials
	NAB: Last Traded: \$26.75	Market Cap: \$56,741M	Sector: Financials
	WBC: Last Traded: \$27.30	Market Cap: \$81,161M	Sector: Financials
	BEN: Last Traded: \$10.00	Market Cap: \$3,460M	Sector: Financials
	BOQ: Last Traded: \$11.48	Market Cap: \$2,403M	Sector: Financials
	ANZ: Buy		Price target: \$26.29
	NAB: Hold		Price target: \$28.00
	WBC: Buy		Price target: \$28.69
	BEN: Hold		Price target: \$10.08
	BOQ: Hold		Price target: \$12.21
	Bank sector strategy: Looking beyond the peak		
	We initiate coverage of the Australian bank sector with a generally positive outlook for 2010. While there is no doubt the sector still faces meaningful risks that cannot be ignored, we believe the Australian banks are well placed to manage the challenges facing the industry. The key driver of our essentially positive view is the benefits to flow from impairment recovery of which we have only seen the early signs of this from recent bank updates, supported by an improving domestic economy and more stable albeit still fragile global conditions.		
	12 month major bank sector rating		
	1) WBC - \$28.69 price target. Healthy balance sheet, attractive and undervalued.		
	2) ANZ - \$26.29 price target. Risks abating, earnings momentum improving.		
3) NAB - \$28.00 price target. Caution remains, acquisition and UK uncertainty.			
12 month regional bank sector ranking			
1) BOQ - \$12.21 price target. Conditions trying for a small bank seeking growth.			
2) BEN - \$10.08 price target. Playing it safe, limits momentum.			

Stocks at a glance

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

Stocks by sector

Staples

AWB ¹ 18/03/10	AWB Limited		
Summary of report dated 17/03/10	Last Traded: \$0.955	Market Cap: \$733M	Sector: Staples
	Hold	Price target: \$1.08	
	Growth options limited		
AWB has downgraded its FY10 earnings guidance to \$85–110m PBT (from \$115–140m PBT) based largely on lower earnings out of its grain marketing operations.			
We have made significant earnings forecast revisions to FY10 but have only materially changed our Financial Services earnings forecasts in outer years. Our price target is now \$1.08 per share (down 10.7%).			
Still prefer GNC over AWB			
AWB is trading on an undemanding normalised multiple and has low gearing. However, we maintain the Hold recommendation due to our concerns around AWB's long-term growth options.			
GNC (Buy, PT \$7.40) has medium-term growth options in the form of increased malt capacity and increasing penetration of the export wheat market.			

AWB is trading on an undemanding normalised multiple and has low gearing. However, we maintain the Hold recommendation on the company due to our concerns around AWB's long-term growth options.

Materials

JHX ¹ 18/03/10	James Hardie Industries N.V.		
Summary of report dated 15/03/10	Last Traded: \$7.86	Market Cap: \$3,321M	Sector: Materials
	Hold	Price target: \$8.75	
	Queensland tour – strategic evolution continues		
JHX hosted management presentations for its Asia Pacific fibre cement division and a tour of its Queensland manufacturing operations. Generally we can't help but be impressed by the improvements achieved in the business over the last few years.			
Investment view			
Our current price target is \$8.75. Our Hold recommendation is a function of the following factors: a subdued recovery for the US housing market given continuing high unemployment, rising delinquencies and foreclosures; continued house price pressure and rising inventories; continuing solid FY10 margins despite rising cost pressures; increasing certainty on non-operational concerns, specifically taxation litigation and asbestos funding and currency related valuation risk.			
In short, the strength of the JHX business model is unquestionable. Despite some value emerging we still see downside risks to our US housing forecasts.			

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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 JHX and IAG.

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

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