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.

Feature Article

Our feature articles this week are:

- **Harvey Norman Holdings Limited**
- **Origin Energy 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

Harvey Norman Holdings Limited

Last traded: $3.14	Sector: Consumer Discretionary	Market cap: $3,336m
Buy		Price target: $4.00

Summary of previous report dated 28/10/10

An Apple a day...

HVN has reported surprisingly decent comparable sales in its 1Q11 sales result given the prevailing market conditions, and the underlying profit was not as bad as feared. HVN made a significant bet on 3DTV which did not pay off, and we expect margin compression in the Australian franchise division in 1H11.1Q11 profit was down 10.3% on underlying basis, and was consistent with our forecast margin compression. With this margin compression already factored in we have not changed our FY11 Australian franchise forecast. HVN has bitten the bullet and will now begin rolling out Apple products into 40 of its Harvey Norman stores. Despite Apple product's lower gross margin, we believe this is a significantly positive development for HVN's future top-line and profit growth. We have slightly reduced our forecast FY11 earnings from Clive Peeters, but overall underlying NPAT reductions were less than 0.5% in each forecast period.

Valuation and price target unchanged

While there are significant issues in AV sales in consumer electronics, the stimulus-affected periods are now almost cycled and we expect a return to underlying growth in 2H11. Our price target of $4.00 and valuation of $3.73 per share is unchanged.

Issue 184 **04 November 2010 (4.30pm)**

Market Wrap

This year began with plenty of optimism. The hope was that the GFC had finally ended, that major economies would continue to repair and share markets would continue to drift higher.

Unfortunately this didn't quite go to plan. Debt problems in Europe upset the apple-cart earlier in the year while the continual sluggishness of the US economy have kept investors guessing about the potential for a double-dip recession.

So after a solid increase of 30.8% in 2009, 2010 has turned out as somewhat of a disappointment for investors. In the year to date, the ASX 200 is down by 2.5%. Still, a good performance over the next eight weeks could still ensure that the market finishes with respectable gains.

So far only seven of the 21 sub-sectors are higher for the year. The star performer has been Autos & components (up 54%) but it is dominated by one stock – Fleetwood Corp. Next best has been Consumer services, Utilities, Food, beverage and tobacco and Food and staples retailing. At the other end of the scale, biggest declines have been in Telecom (down 22%) and Insurance (down 18%).

Stephen Karpin
Managing Director

Feature Article

Origin Energy Limited

Last traded: $16.23	Sector: Utilities	Market cap: $14,354m
Buy		Price target: $16.61

Summary of previous report dated 28/10/10

Auditor gives us a peek at the upside

The NSW Auditor-General has tabled a report to the NSW Parliament examining the electricity sector. Our own analysis of the electricity retailers, Energy Australia, Country Energy and Integral Energy, suggests they have recorded substantial increases in earnings in FY10 from the combined benefit of price increases and cost reductions. There are underlying uncertainties in our analysis, which must be taken into account, but the underlying trend in the retail business does appear encouraging. This improved performance is not likely to result in a higher sale price, when AGK/ORG do seek to bed down an acquisition of these assets. We expect there to be little competitive price tension for the retailers and therefore AGK/ORG are likely to secure the assets at attractive multiples. In effect, any improved performance from the retailers achieved to date is likely to accrue to AGK and ORG rather than NSW taxpayers. It is the ACCC not price, that remains the largest potential obstacle to the privatisation in terms of the assets AGK/ORG can acquire. AGK and ORG stocks are not equally positioned in relation to upside risk from the privatisation with the ACCC a key risk to the AGK share price which has pulled back 5% since we downgraded the stock in early October. In contrast to AGK, the ORG share price implies little or no upside from NSW privatisation.

Retain our preference for ORG

The ORG share price does not currently reflect upside from either the NSW privatisation or ORG's 50% interest in APLNG which continues to support our Buy recommendation and $16.61 price target.

CommSec

Stocks at a glance

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

Stocks by sector

Healthcare

RMD[1,] 04/11/10	**ResMed Inc.**
	Last Traded: $3.20 (US$32.00) · Market Cap: $$4,852m (US$4,842m) · Sector: Healthcare
Summary of report dated 29/10/10	Buy · Price target: $3.90 (US$35.52)

Awake at the wheel

RMD reported sales growth of 14% to $282m, a gross margin of 61.7% and operating income growth of 26% to $66.4m. The key drivers were strong top-line growth, cost savings and efficiency improvements, and a large gain on its FX hedge. Gross margin was an impressive 61.7% on the back of market share gains, a positive product/geographic mix, manufacturing and logistics efficiencies from the S9 platform, scale purchasing benefits and an FX benefit from a rising EUR/USD. In turn, RMD guided to a gross margin range of 60%-62% for the full year. RMD appears to be taking further share in the US (16% sales growth) and ROW (13% sales growth) with ongoing momentum with the S9 platform (Autoset, Elite and Escape) and masks (Swift FX and Mirage Softgel).

Earnings and valuation revisions

We have increased our FY11 forecasts on the back of stronger-than-expected gross margins and the gain on FX hedging, which we do not forecast. Our updated price target is USD35.52/AUD3.90 per share. We retain our conviction Buy on RMD.

We have increased our FY11 forecasts on the back of stronger-than-expected gross margins and the gain on FX hedging, which we do not forecast.

Financials

ANZ[2,]
04/11/10

Summary of report dated 28/10/10

ANZ Banking Group Limited

Last Traded: $24.34 Market Cap: $62,305m Sector: Banks
Buy Price target: $26.08

FY10 result – ongoing resilience

ANZ reported FY10 underlying profit of $5,025m (CBA: $4,817m) well ahead of consensus with a surprisingly strong final dividend of 74cps (CBA: 66cps). ANZ continued to see positive revenue and PPOP momentum in 2H10, driven by a still rising group net interest margin and solid mortgage growth. This compares favourably with peers struggling to realise positive revenue growth. ANZ's 2H10 margin of 2.50% (+5bps hoh) was surprisingly strong, reflecting ongoing re-pricing benefits from institutional lending as well as NZ fixed rate mortgage re-pricing. Lower IP charges from the institutional bank combined with falling impaired assets resulted in a 2H10 BDD charge down 35% hoh to $722m (CBA: $765m). While further normalisation of markets income was expected, given the unusual peak reached in FY09, markets income remained strong at $864m in 2H10. While we expect further normalisation, ANZ appears well placed to see markets income settle at a level higher than prior to the GFC and at a reasonably moderate pace. Given minimum capital requirements for systemically important banks is yet to be finalised by the Basel Committee, it is unclear just how well capitalised the majors are from a core capital standpoint, including ANZ. Core tier 1 of 6.6% as presented by ANZ at its FY10 results presentation is low relative to recent proposals for minimum core capital at systemically important banks of 9-10%.

Given minimum capital requirements for systemically important banks is yet to be finalised by the Basel Committee, it is unclear just how well capitalised the majors are from a core capital standpoint, including ANZ.

Maintain Buy rating with a price target of $26.08

Notwithstanding a still challenging banking environment, we remain favourably disposed to ANZ given further evidence of relative operating strength, including a more resilient margin and solid asset growth. We see scope for further meaningful reductions to BDD charges, upside from any lift in demand for business credit and strong mortgage momentum. We believe markets income should remain relatively resilient with ANZ well placed to manage near-term margin pressure.

Financials

WBC[2,] 04/11/10 Summary of report dated 03/11/10	**Westpac Banking Corporation**

Last Traded: $23.35 | Market Cap: $69,801 | Sector: Banks
Hold (from Buy) | | Price target: $24.70

FY10 result – momentum stabilising, headwinds remain

WBC reported FY10 cash earnings of $5,879m (CBA: $5,833m), adjusting for an economic overlay release of $49m leaves a broadly in-line result. A final dividend of 74cps (CBA: 69cps) was larger than expected, bringing the FY10 dividend to a total of $1.39ps with a 71% payout ratio. Known headwinds including funding cost pressure, normalising markets income, fee cuts and low credit growth contributed to negative revenue and core earnings growth in 2H10 with revenue down -3% hoh and core earnings down -6% hoh. Some signs of improving momentum qoq with margins stabilising and modest asset growth. Funding cost pressure remains a headwind with an ongoing rise in average cost of wholesale funding and still intense competition for customer deposits. In FY11, underlying margins are expected to reduce, although the rate of decline should moderate. WBC's BDD charge continued to fall in 2H10 -34% hoh to $577m. While there was a release of $49m from the economic overlay, coverage remains strong with CP/CRWA of 143bps. Notwithstanding WBC's productivity program and commitment to lower headcount in FY11 and FY12, rising project expenses will need to be absorbed. While WBC is relatively well placed in terms of capital, uncertainty surrounding final Basel 3/APRA requirements as well as the definition of systemically important banks remains a potential risk.

Reduce recommendation to Hold

While encouraged by improving trends in the rate of margin decline and more stable retail/business revenue, margin pressure remains along with relatively constrained asset growth. We expect limited assistance from productivity given WBC's already low cost-to-income ratio, pre-committed investment in distribution and rising project expenses.

While encouraged by improving trends in the rate of margin decline and more stable retail/business revenue, margin pressure remains along with relatively constrained asset growth.

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.

[2] Members of the Commonwealth Group have received fees within the previous 2 years from ANZ; WBC

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

Disclosure and Disclaimer

Commonwealth Securities Limited ABN 60 067 254 399 AFSL 238814 ("CommSec"), is a wholly owned, but non-guaranteed, subsidiary of the Commonwealth Bank of Australia ABN 48 123 123 124 AFSL 234945 ("the Bank"), and both are incorporated in Australia with limited liability.

This document is published, approved and distributed by CommSec. This document is only for distribution in Australia.

CommSec Research is a unit of the Commonwealth Bank Group of Companies (The Commonwealth Bank Group).

This document has been prepared without taking account of the objectives, financial situation or needs of any particular individual. Any individual should, before acting on the information in this document, consider the appropriateness of the information, having regard to the individual's objectives, financial situation and needs and, if necessary, seek appropriate professional advice.

We believe that the information in this document is correct and any opinions, conclusions or recommendations are reasonably held or made, based on the information available at the time of its compilation, but no warranty is made as to accuracy, reliability or completeness. To the extent permitted by law, the Commonwealth Bank Group does not accept liability to any person for loss or damage arising from the use of this document. Any valuations, projections and forecasts contained in this document are based on a number of assumptions and estimates and are subject to contingencies and uncertainties. The inclusion of any such valuations, projections and forecasts in this document should not be regarded as a representation or warranty by or on behalf of the Commonwealth Bank Group or any other person that such valuations, projections and forecasts or their underlying assumptions and estimates will be met. Past performance is not a reliable indicator of future performance.

The Commonwealth Bank Group have effected or may effect transactions for their own account in any investments or related investments referred to in this document, including selling to or buying from clients on a principal basis. The Commonwealth Bank Group may engage in transactions in a manner inconsistent with this research document. In the case of certain products the Bank is or may be the only market maker. No inducement has been or will be received by the Commonwealth Bank Group or the research analyst from the subject of this document or its associates to undertake the research or make the recommendation. The research staff responsible for this document receive a salary and a bonus that is dependent on a number of factors including their performance and the overall financial performance of the Commonwealth Bank Group. The Commonwealth Bank Group provides, or seeks to provide, services to the subject of the document and its associates. Our Analysts, and their associates, hold interests in the companies named in this document.

This document is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation or which would subject the Commonwealth Bank Group to any registration or licensing requirement within such jurisdiction. All material presented in this document, unless specifically indicated otherwise, is under copyright to the Commonwealth Bank Group. None of the material, nor its content, nor any copy of it, may be altered in any way, transmitted to, copied or distributed to any other party, without the prior express written permission of the Commonwealth Bank Group.

More information on our research methodology, organisation structure, summary documenting frequency and recommendations can be obtained at **research.commsec.com.au**

Unless agreed separately, we do not charge any fee for any information provided in this presentation. You may be charged fees in relation to the financial products or other services CommSec provides, these are set out in the CommSec Financial Services Guide (FSG) and relevant Product Disclosure Statements (PDS). Our employees may be eligible for an annual bonus payment. Some representatives' bonus payments may be up to 50% of initial fees, and 10% of ongoing fees and commissions that CommSec receives from the placement of a financial product. Bonus payments are discretionary and based on objectives that include business outcomes, customer service, people engagement, special tasks and people principals. Our employees may also receive benefits such as tickets to sporting and cultural events, corporate promotional merchandise and other similar benefits. If you have a complaint, CommSec's dispute resolution process can be accessed on 13 15 19.

End of Report