

Daily Bulletin 30/10/03



Macquarie Research Equities

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Overnight market action

Stocks rose slightly in mid-afternoon US trading overnight. Better-than-expected results from Boeing Co underpinned the Dow Jones industrial average.

Shares of long-distance phone company AT&T Corp however, kept a lid on the Dow's gains. AT&T's stock fell sharply after industry sources said merger talks with BellSouth fell through. Johnson & Johnson also weighed on the Dow after US regulators warned of side effects with its newest heart device.

The Dow Jones industrial average was up 26.22 points (0.27%), at 9775. The broader Standard & Poor's 500 Index was up 1.32 points (0.13%) at 1048. The technology-laced Nasdaq Composite Index was up 4.30 points (0.22%) at 1937.

Base metals prices picked up strongly on Wednesday, with copper climbing back and nickel pushing back towards \$11,500/t. The catalyst for the move in copper appears to have been Chinese buying. Gold prices slipped to \$380/oz on Wednesday, before rebounding to \$386.

	29-Oct	+/-	% chg
Indices			
S&P/ASX 200	3,263.4	19.9	0.61
S&P/ASX 200 Industrials	5,407.9	42.6	0.79
S&P/ASX 200 Resources	1,822.9	-5.8	-0.31
Dow Jones	9,774.5	26.2	0.27
S&P 500	1,048.1	1.3	0.13
NASDAQ	1,936.6	4.3	0.22
FTSE 100	4,265.7	-7.2	-0.17
Hang Seng	12,130.5	38.6	0.32
Nikkei	10,739.2	178.2	1.69
Commodity Prices			
Aluminium (US\$/tn)	1,503.5	19.0	1.3
Copper (US\$/tn)	2,010.0	31.5	1.6
Lead (US\$/tn)	625.0	22.0	3.6
Nickel (US\$/tn)	11,430.0	190.0	1.7
Tin (US\$/tn)	5,285.0	50.0	1.0
Zinc (US\$/tn)	939.0	21.0	2.3
Gold (US\$/oz)	385.4	1.0	0.3
Silver (US\$/oz)	5.1	-0.1	-1.2
Oil WTI (US\$/bbl)	28.9	-0.7	-2.3
Currencies			
AUD/USD	0.7035	-0.003	-0.37
AUD/STG	0.4143	-0.001	-0.26
AUD/EURO	0.603	-0.002	-0.25
AUD/NZD	1.1497	-0.002	-0.18

Smorgon Steel (SSX)

\$1.17

Short term Market perform, long term Outperform, volatility index High

We have lowered our recommendation and valuation for Smorgon Steel following its AGM. At the AGM, the Managing Director indicated that first half results would be "materially below" last year. Further, "the outlook for the full year's result remains challenging."

Our previous forecasts had assumed a 20% lift in underlying earnings in 2004. So why the difference? We had expected some reduction in scrap and hot rolled coil steel prices. This hasn't occurred and in fact looks like staying high for longer.

The reasons given for the likely poor first half are higher input costs (scrap and hot rolled coil) and stronger, A\$ induced, import competition.

If Smorgon Steel collects and sells more steel scrap than it uses in steel making, how can it be negatively impacted overall by higher scrap prices? Crudely, the costs of collection erode some of the increase benefits for recycling operations while the steel making operations pay parity pricing for scrap.

The net outcome is that Smorgon Steel is not yet at a stage where a full natural hedge would be in place. It exports some 350,000 tonnes per annum of scrap and recent hikes in freight costs will also have contributed to lowered expectations.

The higher A\$ has also resulted in some increased import pressure, especially in pipe products. Given that Hot Rolled Coil is a feedstock for this, then import price pressure on margins would be compounded by higher costs.

Smorgon's comments imply a negative, albeit less significant, impact on our OneSteel expectations. That company's AGM is scheduled for 17 November. We will be reviewing our numbers ahead of this.

We have sharply reduced profit expectations for SSX. We have cut 2004 reported profit by 27%. Our adjusted profit forecasts for 2005 and 2006 have been cut by 15% and 14% respectively. We have assumed dividends of 8¢ will be maintained in 2004, a 1¢ reduction from our prior forecast.

Action and recommendation

Our fair value price target has fallen by 15¢ to \$1.36. While this is 17% above the current share price, we aren't convinced that the market will overcome its nervousness with Smorgon Steel anytime soon. We have reduced our short term recommendation to Market perform.

Today's revisions

Recommendation changes

↓ *Smorgon Steel Group – s/t Market perform*

Stock analysis

ASX Code:

RMD

Share Price:

\$6.25

Short term:

Outperform

Long term:

Outperform

Volatility index:

High

ResMed

ResMed reported first quarter sales of US\$72.9m, up 24.4% on the same period in the previous year. Net profit after tax of US\$12.2m was an increase of 28.0%.

ResMed's first quarter was the preparation for the current quarter's full scale launch of a number of new products that include AutoSet Respond, VPAPIII, new masks and channel management software. Given distributors would be running down inventory of the old products, 24% revenue growth this period was impressive. We expect the current quarter to benefit from the full scale release and lead to strong numbers.

Research & Development spend has continued to increase (somewhat a function of the AUD:USD appreciation). However, ResMed's new range of products is proof that the dollars are being targeted at strategic initiatives.

For example, software that aims to increase patient compliance results in higher mask and accessory sales. This means ResMed not only generates greater repeat business from existing customers but it comes in the highest margin segment.

The development of the AutoSet Respond is designed to address the lack of reimbursement for auto-setting devices in the US, potentially giving ResMed a significant advantage over competitors that do not possess this technology.

Action and recommendation

We retain our outperform recommendation. The launch of a raft of new products is expected to deliver a strong December quarter as distributors stock up. These products demonstrate how ResMed is utilising its technology leadership to maintain sales growth above 20%, combat competitive forces and maintain prices and gross profit margins.

ASX Code:

BHP

Share Price:

\$11.12

Short term:

Outperform

Long term:

Outperform

Volatility index:

Low

BHP Billiton

BHP reported a first quarter result of US\$518m, lower than expected and 9% lower than the same period last year. The interim dividend was announced in line with expectations as up US1 cent to US8 cents per share.

The headline number of US\$518m once again masks a strong underlying operational result as it includes a negative impact of US\$88m from net monetary liabilities caused by an appreciating South African rand and Australian dollar. Removing the non-cash net monetary liabilities, operating earnings were US\$606m for the quarter, a 36% increase over the same period last year.

The total negative impact from currency changes of US\$190m on the same period last year, was more than offset by the positive impact from higher commodity prices, which added US\$370m.

Divisionally, the drivers behind the strong operational result were the Base Metal and Stainless groups, contributing EBIT growth of US\$79m and US\$38m over the same period last year, largely as a result of higher copper (up 13% over the same period last year) and nickel prices (+34%). The main downward revisions have been made to the South African assets, where manganese earnings halved despite a US\$20m boost from higher prices and Richards Bay mineral sands, which is not reported but where we estimate earnings have more than halved to just US\$10m for the quarter.

Commentary from the Chief Financial Officer, Chris Lynch was consistent with our view that the global economy is heading for a strong recovery early in 2004, with Chinese demand still extremely strong and leading the way. Last year, sales to China accounted for US\$1.2bn or 6% of BHP's total revenue, whilst revenue from China this quarter was US\$440m representing a 50% increase on last year. (cont.)

BHP Billiton (continued)

We have revised our earnings estimates down by 1.5% in 2004 and by 1.1% in 2005.

Whilst the headline profit for the quarter was marginally weaker than forecast, the underlying operating earnings remain robust and we expect the company to report a 34% increase in earnings this year. Our full year profit estimate of US\$2.6bn translates to an increase in return on shareholder equity from 16% last year to 20% in FY04. We maintain our short and long term outperform recommendation for BHP on the expectation shares will continue to advance towards our peak cycle target price of A\$13.40.

ASX Code:

SUN

Share Price:

\$12.84

Short term:

Market perform

Long term:

Outperform

Volatility index:

Low

Suncorp-Metway

Chief Executive Officer, Mr John Mulcahy, provided an update on operating conditions since 30 June at Suncorp's Annual General Meeting. We retain our short term Market perform recommendation.

The business is tracking in line with previously provided guidance. Total underlying profit is expected grow 15% in the 2004 financial year reflecting a continued recovery in insurance profitability coupled with high single digit earnings growth from the banking and wealth management businesses.

Management's positive outlook statement with respect to the general insurance division is consistent with the finalisation of the GIO integration and favourable structural changes in the local general insurance market that support an improved profit outlook.

Notwithstanding an estimated \$25–30m loss from recent hail storms in Qld (majority) and NSW, John Mulcahy reaffirmed the Group's 10–13% insurance margin target.

Reference to the recently introduced Qld Civil Liabilities Act 2003 (which enhances discipline around personal injury award processes) highlights the importance of a stable Compulsory Third Party (CTP) scheme to Suncorp's general insurance performance. The legislation (which is retrospectively dated to 1/1/03) should reduce claims cost inflation and small claims frequency (issues that have hampered Qld CTP profitability/predictability in recent periods).

Action and recommendation

Delivering on stated earnings targets will enhance market confidence in Suncorp's management. Guidance provided at the Annual General Meeting suggests this process is on track.

Notwithstanding our positive view of the outlook for the general insurers, our relatively subdued Suncorp recommendation reflects our underweight short term banking sector recommendation.

Longer term, Suncorp faces strategic issues such as the dilution of the Group's material Qld CTP exposure and the attainment (likely by way of acquisition) of additional scale and geographic diversification in banking and/or general insurance.

Qantas

ASX Code:

QAN

Share Price:

\$3.64

Short term:

Outperform

Long term:

Market perform

Volatility index:

Medium

Qantas released its August traffic data, which confirmed that the business has stabilised but is yet to provide evidence of a significant recovery.

International volume was down 6.5%, which was a little weaker than expected and was below the growth recently released by Sydney Airport (+0.3% for August). This probably reflects a more rapid recovery in some of the markets such as Korea, Taiwan and China in which Qantas does not have a high market share.

Despite the fall in August, we are convinced that the international recovery is starting. Volume was down 18.8% in June, 7.5% in July and only 6.5% in August. Based on Sydney Airport's traffic numbers for September which have already been released, we are expecting Qantas volume growth in September to be close to zero, with October showing growth of 3–5%.

As evidence of this emerges confidence will grow in earnings expectations resulting which will justify higher multiples for the stock. We maintain our Strong Outperform recommendation in the short term and have a target price of \$4.00–4.10.

ASX Code:	MIG
Share Price:	\$3.23
Short term:	Outperform
Long term:	Outperform
Volatility index:	Medium

Macquarie Infrastructure Group

Macquarie Infrastructure Group released the third quarter profit numbers for Highway 407 (Canada), at the same time hosting its Annual General Meeting.

The third quarter result again demonstrates the attractiveness of the 407's pricing flexibility. It has obtained a 13% price rise with a 1% lift in volume. Importantly this was in an environment of a weak economy caused by the effects of SARS and the Iraq War. In a stronger economy the revenue growth potential is significant.

Costs have been problematic for the 407 over the last 12 months. This quarter was the first to show some improvement. Whilst costs per trip were up 7% on the third quarter of last year, they were down by 11% on the June quarter. We believe there is potential to lower costs by a further 10~20% as more IT upgrades and number plate denial are implemented, and the internet payments system gains traction with customers.

The dividend was flat at \$16m despite the profit improvement. At this stage it has little impact on Macquarie Infrastructure Group shareholders, as the major portion of the dividend is retained within subsidiary Cintra.

Macquarie Infrastructure Group remains our preferred road stock. The opening of the M6 Toll in the UK, continuing improvement in Highway 407 and the Australian roads all contribute to an attractive outlook for the stock. We have a short term target price of \$3.50~4.00, and maintain our short and long term outperform recommendations.

ASX Code:	STO
Share Price:	\$6.17
Short term:	Outperform
Long term:	Outperform
Volatility index:	Low/Medium

Santos

Santos has released its third quarter production report, and updated its forward exploration program.

Production for the quarter was 14.4 million barrels, 5% down on the previous corresponding quarter but in line with our expectations. Decreases were largely accounted for by declines in Cooper Basin gas production as a result of drops in end user demand and oil field declines.

Revenue for the quarter was also down 5% which was slightly ahead of our forecast. The major contributor to the declining revenues was a 12% fall in the A\$ value of oil from \$48.60 to \$42.78 per barrel.

Santos has also updated its forward exploration program. This has seen the timing of a few prospects being delayed into 2004. These delays have been largely offset by the inclusion of new targets. Overall, Santos has identified eleven wells to be drilled by the end of the year with another four due in the first quarter of next year.

We have increased our earnings forecasts for 2003 slightly, but have made no change to our valuation of \$6.50, and have maintained our short and long term Outperform recommendations. The key price driver for this stock will be exploration and gas commercialisation success.

ASX Code:	IPG
Share Price:	\$1.94
Short term:	Market perform
Long term:	Market perform
Volatility index:	Low

Investa Property Group

Investa Property Group (IPG) has announced the launch of its eighth syndicate comprising of three office assets and a 25% interest in Martin Place Wholesale Fund (MPWF). Total asset value equates to around \$91.6m comprising of \$47.6m in equity with the remainder debt .

IPG will sell down 100% of 241 Adelaide St, Brisbane, 115 Grenfell St, Adelaide and 32 Phillip St, Parramatta. In addition to the three assets it will include c.\$23m worth of units in MPWF. It has had some difficulty in selling MPWF to wholesale investors due to the fact that it is a single asset fund and general softness in office markets.

The portfolio offers a geared yield of 9% year one with the key risk being 115 Grenfell St, Adelaide where Centrelink will probably give back half of its current space by June 2004. (cont.)

Investa Property Group (continued)

Action

We are currently undertaking a review of IPG following its recent Principal Office Fund (POF) takeover. In the next 18 months IPG has 109,450 sqm of key lease expiries. The POF acquisition shortened its weighted average lease to expiry to 4.3 years.

Also of interest is its residential business, the recent engine room of growth. Our initial thoughts at this point suggest that the next two years (at least) look relatively strong. The third key area of interest is the Wholesale Funds Management business. With office markets having (probably) bottomed and IPG having operated in the wholesale market now for around two years there may be a feeling amongst consultants and potential clients that IPG may have "done its time" in looking to establish its wholesale business. We are watching closely for further success in this area.

Short points, quick returns

QBE Insurance (QBE)

\$10.26

Short term Outperform, long term Outperform, volatility index Low/Medium

- QBE has acquired a further \$250m capacity at Lloyds, comprising \$150m to acquire an additional interest in s386 (taking its ownership to 55%) and \$100m to increase capacity across QBE's 100% owned syndicates. This is a relatively low risk way of expanding the premium business.
- To fund the purchase (and refinance \$500m in letters of credit currently providing solvency support to QBE's Lloyd's operations), QBE has issued USD550m of 5 year debt (held off balance sheet).
- We maintain our recommendations at short and long term Outperform.

United Group (UGL)

\$4.07

Short term Outperform, long term Outperform, volatility index High

- United Group hosted its AGM where management stated that markets look strong for the next three to four years.
- United Group stated that given these conditions, 10-15% annual earnings growth is achievable over this period. This compares to our 16.5% forecast growth in earnings per share for 2004.
- UGL remains one of our preferred stocks to benefit from a pick up in resources related construction activity. We maintain our Outperform recommendation.

Macarthur Coal (MCC)

\$1.19

Short term Market Perform, long term Market Perform, volatility index High

- Macarthur Coal released its September quarter production report.
- We have recently increased our valuation to \$1.35 as a result of increased coal price forecasts.
- Macarthur Coal is the most leveraged coal stock to the price rise, however it is also very sensitive to exchange rate fluctuations.

Short term Market perform, long term Outperform, volatility index High

- Following the annual general meeting which reported good trading conditions for the first quarter, the independent advisers released their report on Sky. Based on the report, Sky's independent directors believe INL's offer for Sky is too low and recommend minority shareholders do not sell. The report arrives at a valuation of between \$NZ5.03 and \$NZ5.62 for Sky, with a mid point of \$NZ5.32.
- Our valuation remains at \$NZ5.00. We maintain our recommendations at short term Market perform and long term Outperform

What's happening today?

Corporate

Result figures are Reported Profit/MRE Adjusted Profit

WBC: FY Result \$2175.7m/\$2254.6m

BCA: AGM

FLT: AGM

GWT: AGM

KCN: AGM

PBL: AGM

TAH: AGM

THG: AGM

TOL: AGM

TSE: AGM

Economics

AUS

Trade Balance, Sep

NZ

Building Consents, Sep

USA

FOMC Minutes, Sep

GDP (Advanced), Sep Qtr

Recommendation Definition

'Outperform' - return > 5% in excess of benchmark return

'Market perform' - return within 5% of benchmark return

'Underperform' - return > 5% below benchmark return

short term 3-12 months

long term 12 months - 2 years

Volatility Index Definition

This factor has been calculated from the volatility of historic price movements.

Very High - Highest Risk-- Stock should be expected to move up or down 60 - 100% in a year - Investors should be aware this stock is highly speculative .

High - Stock should be expected to move up or down at least 40 -- 60% in a year - Investors should be aware this stock could be speculative.

Medium - Stock should be expected to move up or down at least 30 - 40% in a year.

Low/Medium - Stock should be expected to move up or down at least 25 - 30% in a year.

Low - Stock should be expected to move up or down at least 15 - 25% in a year.

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The Macquarie Group is acting as financial adviser to QAN in relation to its strategic alliance with and equity investment in AIZ announced 25.11.02 and acted as joint lead manager to and joint underwriter of a portion of a non-renounceable entitlement offer of shares in QAN, announced 21.08.02. The Macquarie Group acted as joint lead manager to the issue of preference shares by STO and as financial adviser to the buy-back of the Company's ordinary shares, both announced 17.10.01. The Macquarie Group acted as Co-Manager to the offer of convertible notes by RMD announced 12.06.01. The analyst and/or associated parties own or have other interests in securities issued by RMD. The Macquarie Group is a substantial securities holder in IPG. The Macquarie Group acted as joint lead manager to the issue of SUN reset preference shares, announced 04.07.01. The Macquarie Group advised SSX in relation to their takeover offer to acquire all of the fully paid ordinary shares in Email Limited announced 28.09.00. The Macquarie Group acted as Co-Manager in connection with the BHP Steel de-merger and associated public offering, announced 13.05.02. The Macquarie Group advised UGL in relation to its purchase of business process outsourcing company, KFPW, announced 27.08.02 and also acted as manager to the placement of securities of UGL announced 15.03.02. The Macquarie Group acted as joint lead manager of an issue of ordinary shares in QBE announced 16.10.01.