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Goodman Fielder Limited GFF| Goodman Fielder Rejects Takeover Offer, but Fundamentals Remain Weak

Morningstar Recommendation: Reduce

Peter Rae, Morningstar Analyst

Goodman Fielder has received a conditional takeover proposal from 10.1% shareholder Wilmar International, or Wilmar, and **Hong Kong** listed investment management **firm** First Pacific **Company**. Wilmar is a Singapore-based agribusiness with interests that include edible oils, sugar and grain processing. The offer values Goodman Fielder at AUD 0.65 per share, compared with its pre-offer trading price of AUD 0.55. The Goodman Fielder**board** has rejected the offer saying it materially undervalues the **company**.

We make no changes to our earnings forecasts which were recently downgraded following Goodman Fielder's announcement of difficult trading conditions. Our fair value estimate is unchanged at AUD 0.50. On a stand-alone fundamental basis we view the shares, which are now trading at the offer price, as overpriced at a 30% premium to our fair value estimate. However, we acknowledge that Goodman Fielder could be more valuable to Wilmar if the **company** wishes to increase its foothold in Australia as part of a long-term regional growth strategy. It is possible the bidders could increase their offer to satisfy the Goodman Fielder**board**, but at the current offer price our upside scenario for the **company** is largely priced-in leaving mostly downside risk to the shares if a higher offer does not emerge and a takeover does not proceed.

Goodman Fielder owns some well-known brands, but operates in a difficult industry with strong competition across its core categories and its major supermarket customers hold significant bargaining power. It is also heavily exposed to external factors such as unseasonal weather and raw material costs. Soft commodity prices can be highly volatile and while customers may allow some pass-through for increases in input costs, the powerful supermarkets won't allow full pass-through for extreme adverse movements. We do not see this changing, even under new ownership, and in our view this is likely to limit any potential upside to offer prices for the **company**.

Echo Entertainment **Group** Limited EGP| Echo's Positive Third-Quarter Update Highlights Volatility and Cyclical Exposure of Casino Earnings

Morningstar Recommendation: Reduce

Scott Carroll, Morningstar Analyst - 02 9276 4423

No-moat Echo Entertainment has released a trading update for third-quarter fiscal 2014, with normalised gaming revenue up 5.7% from the prior corresponding period. This compares with a 6.1% decline in normalised gaming revenue in the first half of fiscal 2014. The positive March-quarter trend at Echo's Sydney and Queensland casinos is consistent with a pick-up in domestic retail sales data to February. Given weakness in the first-half result, we are reluctant to extrapolate short-term swings in performance into our long-term forecasts. In our opinion, the update highlights the cyclical exposure of Echo's casino assets. We have made small upward revisions to our fiscal 2014 and 2015 forecasts.

Long-term competitive risks from potential new entrants in Sydney and Queensland remain a key swing factor in our Echo valuation. Despite significant investment in The Star we believe the **property** will continue to operate at a competitive disadvantage in the VIP segment given its location in Pyrmont, outside the central business district, or CBD. This situation will be exacerbated by the entry of Crown from 2019 with a new VIP-only facility at Barangaroo, in our opinion a superior location on the edge of the CBD. VIP provides only a small and declining proportion of Queensland revenue. Turning around VIP performance in Queensland is a key target for Echo but will require significant capital expenditure. VIP performance at The Star has disappointed following recent investment and we believe a risk premium should be applied to the AUD 345 **million** expansion of Jupiter's **Gold** Coast **property**.

We retain our AUD 2.40 fair value estimate and view Echo as overvalued, albeit recognising high uncertainty around long-term earnings and returns given necessary investment and impending competitive change in all markets. Casino earnings can be volatile with leverage to win rates and front money in the VIP segments, while floor gaming revenues are exposed to macroeconomic conditions.

Charter Hall Retail REIT CQR| Charter Hall Turns the Leverage Dial to Acquire in Queensland

Morningstar Recommendation: Hold

Tony Sherlock, Morningstar Analyst - 02 9276 4584

Charter Hall Retail REIT has entered an option to acquire the Coomera neighbourhood shopping centre, 20 kilometres north of the **Gold** Coast, for AUD 59.2 **million** on a one year yield of 7.4%. Settlement is expected to occur in July, with the **purchase** to be entirely debt funded. Risk increases slightly with the **acquisition**, with gearing on the Australian portfolio to increase by around 2% on the 31.6% at December 2013. Gearing is slightly higher than many other Australian REITs but, with around 53% of base rents sourced from the major supermarkets, we don't have concerns about interest serviceability. Assuming borrowing costs consistent with the 4.6% weighted average cost of the **firm**'s Australian debt, the **transaction** should be around 1% accretive to earnings for fiscal 2015. Our forecasts adjust for the **transaction**, but our fair value remains unchanged at AUD 3.80. The stock looks roughly fairly valued, currently trading around AUD 3.70

The Coomera asset offers a reasonably defensive income stream with 48% of rental income coming from anchor tenant Woolworths and Dan Murphy's liquor. The **firm** advised Coomera is positioned in a growth corridor of South East Queensland, with a 5 year population growth forecast of 4.5% annually. This growth and the high proportion of rent received from good quality anchor tenants is reflected in the pricing. The asset will exchange on a 7.4% yield, well below the 8.0% weighted average capitalisation rate for the 42 neighbourhood centres owned by Charter Hall as at December 2013.

We make no revision to our no-moat rating for Charter Hall Retail. We do not consider the **firm** to benefit from an economic moat, as the portfolio is skewed to smaller properties where entry barriers for potential competitors are relatively low.

Genesis **Energy** Limited GNE-NZ| Initiating Coverage on Genesis **Energy**

Morningstar Recommendation: Reduce

Nachiket Moghe, CFA, Morningstar Analyst - 64 9 915 6776

Genesis **Energy** is a vertically integrated electricity generator and retailer, accounting for 17% of New Zealand's total electricity output. It enjoys a strong competitive position and we rate the **firm** as having a narrow economic moat on the basis of efficient scale and the oligopolistic market structure which creates significant barriers for potential entrants. Accordingly, we expect Genesis and other incumbent **energy** providers to generate returns above the cost of capital in the long term. That said, the opposition Labour party, with support from the Green party, is proposing to regulate the sector in a bid to lower retail prices. We believe this will be detrimental to the returns of all the electricity providers and lower our fair value estimate for Genesis if implemented. However, the fact that recent polls giving the ruling National party government the upper hand does provide some hope for the status quo being maintained. Also, we believe that it would be difficult, if not impossible, for Labour to regulate the sector during its first term given the complexities involved in calculating the regulatory asset values of a myriad of power plants. Consequently, we think the likelihood of regulation is not imminent.

We have a high uncertainty rating on Genesis, reflecting the regulatory uncertainty and the possibility of a significant deterioration in demand should the all-important Tiwai Point aluminium smelter shut down after 2017. Furthermore, the contribution from the Kupe oil and gas field (representing 25% to 30% of EBITDA) is expected to taper off from fiscal 2023/24 (commensurate with the declining gas reserves from the field) and could cease to exist beyond 2028. Our fair value estimate for Genesis is NZD 1.60 per share, based on a discounted cash flow analysis, incorporating a 9% cost of equity and 7.5% weighted average cost of capital. Our fair value estimate implies a fiscal 2015 enterprise value/EBITDA of 6.8 times and price/earnings of 15.7 times.

Brambles Limited BXB| Third-Quarter Trading Update Indicates Brambles Remains on Track for Fiscal 2014 Guidance

Morningstar Recommendation: Reduce

Peter Rae, Morningstar Analyst - 0414300107

Brambles reported 7% constant currency, (CC) sales growth for the nine months to 31 March 2014. While below the 8% achieved in first-half fiscal 2014, this was still a good result given subdued economic conditions across many of Brambles key regions. We have been expecting slower growth in the second half, given fewer new business wins in the Americas in prior periods. Sales growth in reuseable plastic crates, or RPCs, was strong at 9%, up marginally from 8% in the first half while Pallets grew 5% compared to 6% in the first half. Importantly, Brambles reaffirmed guidance for fiscal 2014 earnings before interest and tax, or EBIT, in the range of USD 930 million to USD 965 million based on June 2013 exchange rates.

Our fiscal 2014 forecasts are unchanged, with EBIT still at the upper end of guidance. Our medium-term forecasts are also unchanged, and our fair value estimate remains at AUD 8.50. We view the shares as slightly overvalued, at a 10% premium to our fair value estimate. We retain our favorable view of Brambles's medium-term outlook, and expect that improvements in the core economies where it operates, combined with continued expansion in emerging regions, will drive strong growth over the next five years. The market seems to be taking an even more optimistic view. Our narrow economic moat rating is intact, with the moat sourced from the network effect of its core pallet and RPC pooling operations, and global scale that provides cost advantages.

With the release of the first half result, Brambles said it was seeing modest improvements in economic conditions in its key markets. This seems to be borne out by the good sales figures, and full-year CC sales growth of 7% is expected. The first half also saw cost pressures across some of the businesses, but better conditions are allowing Brambles to achieve some price increases, and to be more selective in acquiring new business. Reaffirmation of guidance indicates costs have not deteriorated further.

BT Investment Management Limited BTT| Successful Global Expansion Drives BT Investment Management's Strong First-Half Result

Morningstar Recommendation: Hold

Nathan Zaia, Morningstar Analyst - 02 9276 4491

BT Investment Management's strong first-half performance confirmed our positive view on this narrow moat-rated wealth manager. Leveraging a sticky customer base, brand, and investment performance, BT Investment Management continues to grow funds under management, or FUM, hence increasing the constant stream of profitable fee income it receives. Higher markets, increased funds under management, performance fees, and net inflows all working in unison to drive a 143% increase in cash net profit after tax, or NPAT, to AUD 83.1 million in first half fiscal 2014. As guided in the December quarter FUM update, strong investment performance saw a substantial increase in performance fees to AUD 115 million, from only AUD 34 million in first half 2013. Performance fees sourced from the firm's UK subsidiary are paid annually and will not repeat in the second half. Base management fees beat our expectations, with a 40% increase, to AUD 138 million due to a favourable shift in the asset mix to higher margin retail funds and decline in lower-margin cash and fixed-income products.

Our fair value estimate increases to AUD 6.50 from AUD 6.00 on our more optimistic view of base management fee margins. At current prices, the stock is fairly valued. We previously assumed slight margin pressure over the explicit five-year forecast period, particularly in the crowded core equity space in Australia. We now believe a combination of lower asset allocation to cash and fixed income, and an increase in funds sourced from higher-margin retail investors, can largely offset these pressures. Base management fees for the group increased to 45 basis points in the first half of fiscal 2014 from 40 basis points a year earlier, supporting an increase in our fiscal 2014 cash NPAT forecast to AUD 119 million from AUD 107 million.

Western Areas Limited WSA| Western Areas' Third Quarter as Expected, Fair Value Estimate Unchanged

Morningstar Recommendation: Hold

Mathew Hodge, Morningstar Analyst - 02 9276 4459

Western Areas produced another solid quarter with nickel-in-concentrate output of 6,300 tonnes, in line with the previous quarter. Cash costs were steady at AUD 2.52 per pound of nickel-in-concentrate with the operations remaining soundly within the lowest half of the cost curve. High ore grades are key to the cost advantage and underpin returns in excess of the cost of capital while they're mined. However, reserves of this quality are sufficient for only seven years' production, insufficient to justify a moat. Some extensions to partly offset depletion are likely, but generating excess returns beyond 10 years is an order too tall to credit.

No change to our AUD 3.40 per share fair value estimate, with the quarter largely as expected. Key long-term assumptions remain USD 9 per pound nickel (2013 dollars, inflated at 2.5% per annum) and an Australian dollar/U.S. dollar exchange rate of 0.90. With the share price up about 80% in the year to date, appreciating from an undervalued position, we now believe the shares are modestly overvalued. Market analysts anticipated a recovery in the nickel price and returns for Western Areas from what were unsustainably low levels and this is factored into our valuation. The share price reaction reflects the market's disbelief in those higher forecasts being replaced by optimism they could now be exceeded.

The remarkably fast recovery in the nickel price, despite very large exchange stockpiles, has fueled enthusiasm for Western Areas, perhaps a bit ahead of reality. The Indonesian nickel ore export ban is the key driver and the fickle political landscape there justifies some caution. We maintain our very high fair value uncertainty rating as Western Areas is a single-commodity producer. Much hinges on the continued discipline of the Indonesians in withholding ore exports and future exploration success which brings a wide range of possible outcomes.

Woolworths Limited WOW| Market Share Gains as Both Woolworths and Coles Flex Scale to Improve Value for Customers

Morningstar Recommendation: Hold

Tim Montague-Jones, Morningstar Analyst - 02 9276 4469

Woolworths reported another healthy increase in quarterly sales, which were up 5.3% for third-quarter fiscal 2014 to AUD 15.1 billion. Australian food and liquor, which represents 82% of group earnings, increased comparable sales, after adjusting for the timing of Easter, by 3.5%. This is the same rate reported by Coles. Both companies reported strong customer numbers and growth through market share gains. Both companies are reinvesting capital back into lower prices to further differentiate their value in a time when consumers remain increasingly cost conscious. Both supermarket groups are expanding their store footprints, with Woolworths adding 32 stores this year, on an increase of 21 last year and plans to add an additional 36 next year. Retail scale enables both groups to fractionalise operating costs across a large revenue base and negotiate favourable terms with suppliers. We view these competitive advantages as offering both Woolworths and Wesfarmers wide economic moat-like qualities, derived from cost advantages. We make no material change to our fair value estimate of AUD 36 and view the company as fairly valued.

Data is becoming increasingly important to retain a competitive edge in the retail sector. Retail is becoming more of a science and less of an art as financial resources are allocated to collecting large amounts of data to analyse buying habits and trends. Data is being used to direct promotional campaigns, increase customer loyalty and ensure stores cater for local demands. Woolworths is in the process of sharing the results from its analyses to its key suppliers so they can take advantage of purchasing habits to improve their ability to meet emerging customer demand. In our view, better understanding and predicting customer demand will further reinforce the competitive advantage both Woolworths and Coles have in taking share from smaller independent retailers.

Stockland SGP| Surging Residential Drives Stockland's Earnings Upgrade

Morningstar Recommendation: Hold

Tony Sherlock, Morningstar Analyst - 02 9276 4584

Aided by continued strength in the Australian residential sector, Stockland now expects growth in fiscal 2014 earnings will be about 6%, at the top of the previously advised 5% to 6% guidance range. The firm is seeing a continued strengthening in the residential development market, and has positioned its portfolio to respond to a further acceleration in demand. Our earnings forecasts are unchanged, being already consistent with this minor earnings revision and a strong outlook for residential in fiscal 2015. We also leave our narrow moat rating and AUD 3.60 fair value estimate unchanged. Stockland's economic moat mostly reflects its portfolio of larger shopping centres that, because of their size and strong network, create entry barriers for prospective competitors.

The firm continues to hold the line that it will walk away from its indicative and conditional offer to acquire the remaining 80.1% of Australand if it is not given the right to undertake due diligence. We view the current all-scrip offer of as full and an increase without due diligence increases the risk of value destruction. Trading conditions for Australian residential developers appear near-perfect, making it increasingly likely a prospective acquirer is paying top-of-the-market prices.

Specialty retail sales for the quarter to March 2014 were up 2.5% compared with the prior year, but these figures are not conclusive as they incorporate contributions for recently completed developments in Townsville in Queensland and Merrylands in Sydney. Despite strong conditions for residential developers, we don't foresee retailers will benefit from a material improvement in trading conditions because of a series of structural headwinds. These retail headwinds include growth in the proportion of sales conducted online, rising household leverage and the future spending power dilution when mortgage rates eventually rise.

Sandfire Resources NL SFR | Record Third-Quarter Copper Production and Resource Growth for Sandfire, Fair Value Lifts 10%

Morningstar Recommendation: Hold

Mark Taylor, Morningstar Analyst - 02 9276 4478

Record quarterly copper production of 18,100 tonnes improves 17% on the December quarter, in line with expectations. Higher output drove cash costs down to USD 1.08 per pound from USD 1.29 per pound. DeGrussa mill throughput is on target for an annualised rate of 1.5 million tonnes per annum and several optimisation programs are underway to further recoveries and reduce cash costs.

We increase our fair value estimate by 10% to AUD 5.00 per share. This in part reflects the time value of money, but more so recognition of exploration potential at DeGrussa and environs. Our fair value now credits AUD 110 million, or AUD 0.70 per share, for this, almost 15% of fair value overall. In the latest quarter, Sandfire increased contained copper mineral resources by 30,000 tonnes, or 5%, to almost 590,000 tonnes and more is likely. Successful extensions to ore lenses will see more diamond drilling targeting deeper extensions. The DeGrussa package comprises more than 400 square kilometres of contiguous tenements, much of which has not been subject to modern exploration.

Sandfire shares have softened nearly 20% from September 2013 AUD 7.00 highs, though remain at a 15% premium to our upgraded fair value. The market appears enamoured with the growing production track record and improving operating costs. Net debt of AUD 153 million at end December had gearing (net debt to equity) at more than 60%. But DeGrussa's high copper grades could see net debt expunged by as soon as fiscal 2016, even assuming dividends start in fiscal 2015. Exploration success also excites the market, but brings risk and expense which tends to be ignored while dice roll favourably.

No change to our no-moat rating or high fair value uncertainty. Sandfire is a relatively low-cost producer but mine life less than 10 years precludes a moat. Single-mine and commodity risk drive the high fair value uncertainty. Risk lessens as DeGrussa beds down and net debt reduces, but not sufficiently to impact the rating.

AWE Limited AWE | Stronger-Than-Anticipated Third Quarter to Drive Higher Fiscal 2014 Earnings for No-Moat AWE

Morningstar Recommendation: Accumulate

Mark Taylor, Morningstar Analyst - 02 9276 4478

Third-quarter fiscal 2014 production fell 9% to 1.3 million barrels of oil equivalent, or mmboe, not as sharply as expected. As a result, AWE says production is tracking towards the upper end of previous 5.0 to 5.5 mmboe full-year guidance. We increase our fiscal 2014 earnings forecast by 50% to AUD 0.08 per share, large in percentage terms but from a relatively low base. At a current price of AUD 1.60, the prospective fiscal 2014 price/earnings, or P/E, is still a hefty 20 times. We project low single-digit prospective P/Es from fiscal 2017 with commissioning of the AAL oil project in Indonesia and rising domestic gas prices propelling earnings about five times higher.

Our fair value estimate is unchanged at AUD 2.60 per share. This may seem low in the context of prospective PEs but weighted average field life of less than 10 years is not in the class of majors such as Woodside Petroleum and Santos. It also plays into our no-moat and high fair value uncertainty ratings. To account for the challenge of short life, fair value equates to a fiscal 2018 enterprise value/EBITDA multiple of just 3.5 times versus 5.5 times for Woodside and Santos. We also model exploration expenditure neither adding nor destroying value. AWE has some life extending options with contingent resources of 96 mmboe at end June 2013, almost as large as reserves. Most of these are near existing **operations** making development more likely. In addition, blue-sky upside could come from unconventional sources in the Perth Basin with prospective resources independently estimated at 11 trillion cubic feet of gas and 31 **million** barrels of natural gas liquids. This equates to more than 2 **billion** barrels of **oil** equivalent.

After a long period in the sin-bin for expensive exploration failings in New Zealand, the market is again warming to AWE. The shares have risen nearly 50% from AUD 1.10 lows in early 2013. There remains plenty on the table though with the price still at a 40% discount to our fair value.

Ends

CO fdgl : Goodman Fielder Ltd

IN i6560011 : Shopping Malls/Superstores | i64 : Retail/Wholesale | i656 : Mixed Retailing | iretail : Retail | i41 : Food/Beverages/Tobacco | icnp : Consumer Goods

RE austr : Australia | sydney : Sydney | apacz : Asia Pacific | ausnz : Australia/Oceania | nswals : New South Wales

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