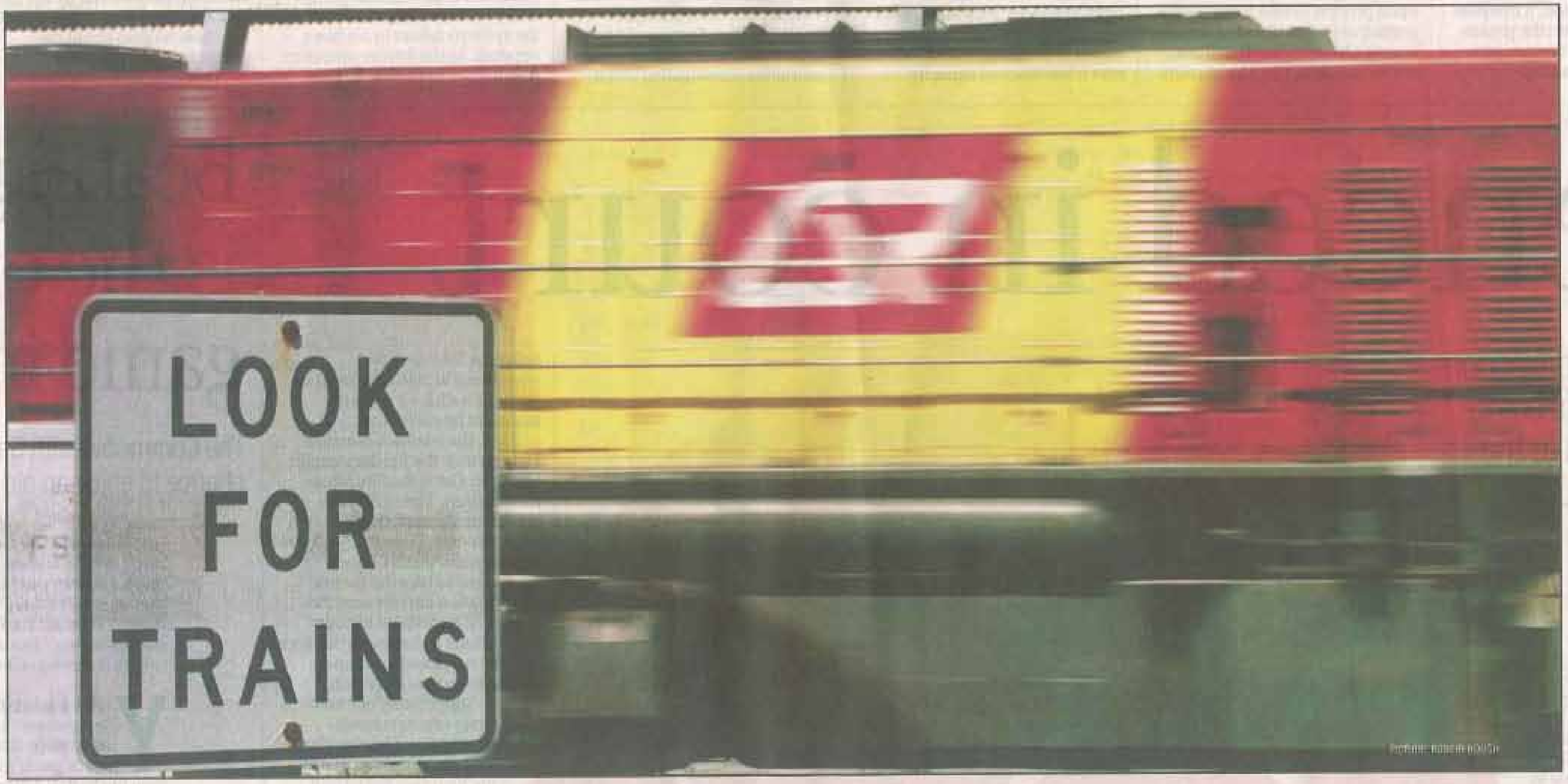
Board rail float with caution, say analysts

This float divides opinion, writes **Stephen Cauchi**.



IT'S the biggest float since the Telstra T3 offering of 2006, and next Sunday the prospectus begins hitting in-boxes and mailboxes. But the signal for mum and dad investors considering rail heavyweight QR National should remain at caution, many analysts believe.

Yes, the share offering will probably be sweetened by a discount, although the extent of that won't be known until the prospectus is out. And QR, Australia's largest rail freight operator and owner of the lucrative Queensland coal rail network, is expected to be one of the largest 50 companies on the Australian Stock Exchange after listing.

But railways are capital-intensive, the long-term future of coal in a warming world is uncertain and QR management's track record is suspect. And the sharemarket's dodgy.

Austock's Michael Heffernan, whose firm is not one of the 16 stockbrokers forming the selling syndicate, still rates QR a solid buy.

"Fundamentally, it looks a great asset. The only question is precisely how it's going to be priced. If you take a leaf out of the other privatisations, like Telstra, there's going to be quite a discount for retail investors, which will put some icing on the cake."

He points out that all government privatisations stemming back to the Commonwealth Bank sale in 1991 have done well upon listing.

"You look at Qantas, CBA, Bankwest, Telstra . . . all those did really well after they hit the decks." But down the track, he notes, "Telstra's hopeless but people have had the chance to sell it if they wanted to.

"The government doesn't want to burn off investors . . . governments have got a vested interest in making sure that they're successful."

Mr Heffernan praises Queensland's huge coal deposits as the bedrock of QR and dismisses speculation that climate change will wreck demand for coal and therefore QR's business model. "You can't just extrapolate now into the future and say coal's had it if there's an [international] emissions trading scheme . . . It's going to be years before [emissions trading] comes into force."

Intersuisse analyst Peter Russell takes a more cautious view of QR's value, certainly until the release of figures on Sunday. "You never know with a government entity whether it's making money or not until you see the whites of the eyes," he says.

Mr Russell notes QR National's ownership of the railway track is a blessing and a hinderance. "People can argue, as Asciano does, that QR has an unfair advantage, having the track and the rolling stock," he says. But track can be expensive and tricky to maintain.

He dismisses talk of climate change hurting demand for coal. China's estimates through 2050 were that it would be the "prime source of power", he says. "[China] and other countries cumulatively will be short enough of coal to need Australian coal." But he notes 30 per cent of QR's revenue is from government contracts with the BHP Billiton-Mitsubishi coal venture, which expires in 2015/16.

"That figure [30 per cent] seems to me to be extraordinarily high. Clearly, things like that need to be looked at carefully when the prospectus comes out," he says.

Independent analyst Roger Montgomery is more bearish about coal's long-term prospects. On his blog he argues world coal demand could peak before 2020, which could

> **"You never know . . . whether it's making money or not until you see the whites of the eyes."** PETER RUSSELL, analyst

"seriously weaken demand for QR shares . . . Outside of the financial markets, sentiment toward coal is not inspiring. Many investors believe coal is dirty, the cause of global warming and on the way out."

He told *The Sunday Age* QR was not a highly profitable business. "The return on equity I'm currently estimating to be in single digits, and arguably in 2012, based on the forecast, it's going to earn a rate of return on its equity of 6 or 7 per cent."

Echoing Mr Russell's concerns about owning track, he says, "a lot of the profits can't be distributed to shareholders. They need to be reinvested in the business to maintain the infrastructure . . . it's an extraordinarily capital intensive business."

He notes the QR float slogan, "Be Part of Something Big", echoes the "Big Australian" ethos of BHP. "Many of the people who managed BHP during the dark days of BHP [late 1990s] are now involved in QR National and there's some interesting similarities." This overlap is worth thinking about, he says.

Melbourne commercial and regulatory solicitor Adam Bisits calls QR management cavalier in its attitude to its workforce and says it may be similar with shareholders. He notes that in June QR was fined $660,000 for failing to tell its workers about the impending restructure and privatisation. Also, QR chairman John Prescott and chief executive Lance Hockridge are former BHP executives. "Unsophisticated mum and dad investors" would have little sway over management, Mr Bisits says.

The Sunday Age, 3 October 2010