

## NEXT DAILY – Thursday 15<sup>th</sup> April 2010

### Overseas

The **Dow Jones** rose 103 pts or 0.94% to 11,123.11 (YTD 6.67%), **S&P 500** rose 13 pts or 1.12% to 1,210.65 (YTD 8.57%) and the **NASDAQ** rose 38 pts or 1.58% to 2,504.86 (YTD 8.67%)

The **FTSE** rose 34 pts or 0.60% to 5,796.25 (YTD 7.08%), **Nikkei** rose 43 pts or 0.39% to 11,204.90 (YTD 6.24%) and the **Hang Seng** rose 17 pts or 0.08% to 22,121.43 (YTD 1.14%)

Oil rose \$1.81 to \$85.86 a barrel.

Gold rose \$5.20 to \$1,155.85 an ounce.

Base metals were stronger with Copper up 0.63% to \$359.11, Nickel rose 3.52% to \$1,194.67, Zinc was up 3.10% to \$110.10 and Aluminium rose 1.08% to \$110.19.

BHP ADR's trading at \$44.32 vs the Aussie close of \$43.99.

SPI 200 Futures closed up 31 pts at 5,036.

### Ideas

US Equities extended their winning streak to 5 consecutive sessions, with the S&P500 enjoying its largest % increase since Mar 5. This was driven by better than expected results (including JPM) and some positive economic data. March retail sales, coaxed by subdued inflation, surged higher than expected in a sign that consumers are starting to regain their confidence. A report by the Commerce Department showed that retail sales rose 1.6% in March (+1.2%), the biggest gain in four months, from an upwardly revised 0.5% gain in February (Prev: +0.3%). The CPI rose a seasonally adjusted 0.1% in March (Mkt est: +0.1%). The core consumer price index, which excludes volatile food and energy prices, remained unchanged vs mkt est: +0.1%. JP Morgan (JPM) reported a profit of 74cps (Mkt est: 64cps), up 85% YoY and flat from Q4. Revenue rose 5% YoY and 12% from Q4 to \$28bn (Mkt est: \$26.46bn). **Commentary from JPM's Dimon was very upbeat, "China's growing, India's growing, Japan is growing, home prices have stopped going down, consumer income is up, consumers are spending, service and manufacturing indexes are up, inventories are still low, I could go on and on," Dimon said. "This could be the makings of a good recovery. We don't know for sure, but if you look at those factors, it's pretty good."** Also after the Bell UPS (+0.9%) pre-announced a 37% increase in adjusted diluted earnings per share for Q1.

**Ahead of the Chinese economic data to be announced today**, Reuters, citing 'two market sources', reported that China's economy grew about 11.9% YoY in Q1 (Mkt est: +11.7%), the fastest annual pace in nearly three years. Consumer price inflation in March was roughly 2.4% YoY (Mkt est: +2.6%, Whisper No: +2.3%), a deceleration from February's 2.7% rate, one of the sources said. China is scheduled to officially publish its GDP growth rate and a suite of economic data for March at 1000h Beijing time today.

**Royal Bank of Scotland (RBS) said that as we enter the 1Q10 US reporting season with both the US and Aussie equity markets looking fairly valued, and earnings revision cycles in both countries flat they see US reporting as a significant sign post for both markets.** A key barometer for this US reporting season will be the extent to which companies deliver both top-line sales as well as earnings surprise. Of the last four US reporting seasons, only 4Q09 delivered both sales and earnings surprises. This outcome was generally seen as evidence of the US recovery accelerating and not just corporate cost-cutting said RBS. For 1Q10, Bloomberg is looking for revenue growth of 12% on 1Q09, which compares with 8% actual for December 2009. On a sector basis, the key contributors are likely to be Energy, which accounts for 36% of the expected aggregated revenue growth, and Financials at 15%. For 1Q10 the market is looking for earnings growth of 31% on 1Q09, which is a tough ask but not as much as was expected in 4Q09 where the market was looking for 81% pcp growth. Ultimately the market delivered a very strong 89% earnings growth for 4Q09 on 4Q08. On a sector basis, the key contributors are likely to be cyclical sectors such as IT, which accounts for 32% of forecast aggregated earnings growth, Financials at 19% and Consumer Discretionary at 16% said RBS.

**One of the major changes that is likely to impact the Australian market is the potential privatisation of the NSW power assets.** JPM highlighted that the Australian electricity industry is facing a challenging environment and potentially the most upheaval since the privatization of the Victorian assets in the early 1990s. JPM said the main factors affecting the operating environment are:

- **Increasing political uncertainty:** with the Rudd Government unable to pass its CPRS and the global status on climate change also unclear, the future of coal fired generation in Australia remains uncertain.
- **Increasing regulatory uncertainty:** the chairman of the AER, Steve Edwell, is due to step down in his current role at the end of May 2010. During his period as Chairman of the AER Steve handed down a historic decision on the WACC to apply to electricity distribution companies which coincided with the GFC and turmoil in the financial markets. For listed companies such as Spark and DUET, the decision was not as favourable as hoped. A change in management of the regulator may lead to a shift in regulatory outcomes more in favour of the network operators.
- **Demanding government targets to invest in renewable energy:** it is likely that the majority of the Federal Government's 20% RET will be filled by wind generation. This requirement will see substantial amounts of capex invested across the NEM. We forecast that capex associated with wind generation excluding grid upgrades will total between \$20-28bn (2010 real) over the next decade. This figure is based on average capacity factors of between 30-40% and a development cost of \$2m/MW (real).
- **Shifting electricity demand:** The roll out of smart meters in Victoria over the next 4 years may reduce demand or shift demand from peak to off-peak. However this will depend on whether the government proceeds with time-of-use pricing. With consumer backlash the Victorian government has declared a moratorium on time-of-use pricing until 2011.
- **Uncertainty over gas supply:** the advent of LNG on the East Coast of Australia has seen several proponents targeting first LNG production by 2013-14. A potential lack of customer sales contracts could result in one or several of these projects being deferred. Postponement of one or more of the LNG projects could result in domestic gas prices falling, however under a scenario where all 4 LNG projects currently in the pipeline reach FID, domestic gas prices could rise from ~\$3.50/GJ currently to in excess of \$5/GJ. In the years prior to first LNG production on the East Coast an excess of ramp up gas may put downward pressure on gas prices, although uncertainty over long term supply means developers of new gas fired generation projects may find it difficult to procure long term gas contracts.
- **Large capex requirements:** The Energy Supply Association of Australia (ESAA) forecast that up to \$85bn of new investment in generation and network upgrades and expansion will be required by 2030. ACIL Tasman have suggested new capex investment of \$33bn will be required to implement changes required by the RET and a carbon scheme. With constraints and other competing demands on government budgets, we expect the majority of new investment will come from the private sector.

With the above factors influencing investment decisions JPM believe the best placed companies will be those with integrated generation and retail operations coupled with a strong balance sheet to allow them to fund future growth opportunities. In their opinion AGL and Origin are best placed of these companies. In addition regulated utilities that offer diversification and conservative funding structures will be better placed. JPM consider DUET to be the best placed amongst its direct peers. The potential bushfire litigation associated with SP AusNet somewhat negates the attractiveness of its asset base, growth profile and lowly geared capital structure said JPM. In their opinion players such as Alinta will continue to suffer from the uncertainty posed by the CPRS, the potential level of compensation to be offered to the generators (if any compensation is to be paid at all) and level of future carbon taxes. Niche players such as Infigen may benefit from the growth options offered by its wind farm development pipeline. APA should similarly benefit from the changing generation mix that will require additional transmission infrastructure across the country, this includes likely substantial growth in gas storage capacity to provide supply on demand to new peaking generation said JPM.

#### **Research**

Wesfarmers Limited (\$32.70) – Following the conclusion of the metallurgical coal price negotiations for the majority of customers of its key Curragh mine, Deutsche and GSJB Were has retained a BUY whilst UBS, Macquarie and JP Morgan maintain a HOLD. Deutsche has a price target of \$42.92.

Coca-Cola Amatil Limited (\$11.75) – With their trading update to be released in May, USB has **downgraded** to a SELL with a price target of \$10.85.

Minara Resources Limited (\$0.96) – Following their reporting on the March quarter from Murrin Murrin, UBS has **downgraded** to a HOLD with a price target of \$1.00.

Western Areas NL (\$5.49) – With the announcement of their initial reserve for Spotted Quoll underground, UBS has **downgraded** to a HOLD with a price target of \$5.80.

OneSteel Limited (\$4.03) – Following their recent stellar performance on the back of a strong run in iron ore pricing, GSJB Were has retained a BUY whilst JP Morgan has **downgraded** to a SELL. GSJB Were has a price target of \$5.04.

Regards,

**Zac Leman**