

NEXT Daily – Friday 16th April 2010

Overseas

The **Dow Jones** rose 21 pts or 0.19% to 11,144.57 (YTD 6.87%), **S&P 500** rose 1 pt or 0.08% to 1,211.67 (YTD 8.66%) and the **NASDAQ** rose 11 pts or 0.43% to 2,515.69 (YTD 10.86%)

The **FTSE** rose 29 pts or 0.50% to 5,825.01 (YTD 7.61%), **Nikkei** rose 69 pts or 0.61% to 11,273.79 (YTD 6.90%) and the **Hang Seng** rose 36 pts or 0.16% to 22,157.82 (YTD 1.30%)

Oil fell \$0.31 to \$85.53 a barrel.

Gold rose \$4.85 to \$1,160.20 an ounce.

Base metals were mixed with Copper up 0.04% to \$358.95, Nickel rose 3.14% to \$1,232.18, Zinc was up 2.04% to \$112.34 and Aluminium rose 0.44% to \$110.67.

BHP ADR's trading at \$43.62 vs the Aussie close of \$43.89.

SPI 200 Futures closed up 1 pts at 5,018.

Ideas

US equities lifted the Dow for the 6th straight session, while the S&P 500 benefited from its longest weekly winning streak since 2007. Ongoing optimism for quarterly earnings season continued to drive cash-to-equity rotation, notwithstanding some bearish economic news. A strong up-tick in weekly jobless claims initially weighed on stocks, but the labour department attributed the rise to 'administrative snags' rather than economic conditions. Better-than-anticipated economic growth from China and an improved Empire Manufacturing Index buoyed investor sentiment.

Deutsche Bank (DB) have studied the flow of new cash into the Australian equity market following what they identified as a two years of an elevated amount of equity raising, which in turn brought record net new cash inflows into the market. DB said that:

... more recently market inflows have slowed, and it seems probable that this more muted picture could continue through this year. The ABS *Financial Accounts* indicate foreign investors have reduced their net equity purchases substantially since late last year, while households still show little interest in buying equities directly. And while super funds continue to put new capital into the market, they are also buying up more foreign securities, and this trend could intensify. Nevertheless, this need not be a problem for the market, given companies are unlikely to require the amount of fresh capital that was accessed throughout 2008 and 2009. Foreign institutions provided a large amount of the new inflow for the market through 2008 and 2009, funding much of the equity raising, and likely attracted by the Australian economy's relative strength, and also by the rising Australian dollar. But recent months indicate very little inflow from foreign investors, a development corroborated by US Treasury data showing US investors allocating less to Australia. This has come as the AUD has stabilized at a higher level, and other markets increasingly appear to have similar growth prospects as Australia. Consequently, the appetite for Australian equities may not be as strong going forward. Super funds have continued to put new money into the market, and with a recent improvement in contributions to super by households, combined with still high cash positions of the funds themselves, this can likely continue. But a further ramping up may be less likely, as a strong AUD and relatively low foreign asset exposure could see super funds continuing their recent trend of buying foreign securities.

Finally, households still seem reluctant to increase their direct purchases of shares, perhaps still wary of the risks around equities following the recent crisis. Instead they may continue the recent trend of channelling funds into superannuation accounts and bank deposits. Overall, the propensity of major investor groups to put new money into the market seems lower than it was for much of last year. But this pattern is unlikely to be a problem, as there is far less need for companies to be raising equity now that corporate gearing has been reduced dramatically. So while the recent behaviour of the key investor groups may not be much of a positive for the market, it equally seems unlikely to be much of a negative.

Rio Tinto reported its MarQ10 production figures, with production in key profit drivers iron ore, copper, aluminium, and coal all moderately below forecasts (on 100% total production basis) JP Morgan reported. While not a great start to the year it is only the first quarter and they have not materially altered our full year production or profit forecasts JPM said. Iron ore production, which contributes ~60% of EBIT and is the guardian of RIO's earnings, was down slightly against forecasts and DecQ09. Total production (100% basis) of 56.7Mt was 4.2% below JPM forecast but 42% above MarQ09, reflecting completion of expansions. Production in the Pilbara region was up 48% on the pcq to 53Mt (56Mt DecQ09 and JPM MarQ10 f/c). JPM said:

The slight pullback in production in the MarQ10 was attributed to car dumper availability issues which have been rectified. Globally RIO have indicated they expect total production (100% basis) to be 234Mt in 2010. Copper production of 506kt was disappointing, 13.8% below our forecast of 586kt (both 100% basis), with the three major operations, Kennecott Copper, Escondida and Grasberg all below expectations. Lower grades than forecast were the main cause for the miss. Aluminium metal production was broadly in line with forecast coming in 1% below at 1324kt vs 1337kt JPM forecast. Coal performed poorly against expectations in the quarter. While hard coking production of 2.3Mt some 8% below our forecast of 2.5Mt, it was up some 36% on MarQ09 reflecting the improvement in demand from increased steel production in Asian markets; thermal and semi soft production was 15% below forecast and some 5% down on MarQ09, with RIO attributing maintenance and bad weather as the cause. **As we have allowed for catch up in areas where production missed our targets in the MarQ10, the impact of this production report on our earnings and valuation forecasts has been negligible, both trimmed by less than 1%.** We retain an Overweight recommendation with a P/T of A\$96.02. RIO is trading at a P/NPV of 0.83x, a CY10E P/E of 10.1x which is cheaper than BHP (Neutral), which is trading at a P/NPV of 1.07x and a FY11E P/E of 12.1x.

Credit Suisse (CS) reported on Oz Minerals (OZL) March Quarter numbers, citing a stronger than expected result from elevated copper and gold grades at planned mill throughput. Gold production was revised up by 30koz generating an additional \$30mn revenue at US\$1,000/oz or an additional US 13c/lb credit (15c/lb at current gold) on the 220-240Mlbs of planned copper production. Higher gold production is based on higher than modelled average gold grade in the gold only zone, reflecting conservative assumptions where drill density was below average. Clear incremental upside to CY10 mill throughput and perhaps recovery assumptions could see CY10 copper guidance exceeded. Annualised 8.8Mt mill throughput in the MarQ was despite five days lost to a power outage. The mill is running 15% above nameplate while 10% is assumed in guidance. A fourth mining

fleet is to be mobilised to accelerate mining towards sustaining steady, predictable copper production rates. Costs above the life of mine strip ratio of ~5.5:1 will be capitalized, shielding earnings. MarQ C1 cash cost of US 57.4c/lb (DecQ US 63.5c/lb and CY09 US 70.7c/lb) was well below guidance of US 85-95c/lb, driven by good cost control, elevated production and higher precious metal prices and production. Cash cost guidance revised down to US 80-90c/lb. **CS said the market appears happy to price OZL at 10x spot earnings on ramped-up production, making investment in OZL a call on the copper price and management's success in deploying the cash balance. Drilling of the Western copper zone and expansion of the gold resource in Cambodia are positive valuation catalysts. CS target price of \$1.28 is in line with their NPV of \$1.33/share.**

Research

Equinox Minerals Limited (\$4.49) – Recent share price movements have led UBS to **downgrade** from a BUY to a HOLD.

Rio Tinto Limited (\$80.05) – Following the release of RIO's MarQ production report Credit Suisse, Citigroup, UBS and JP Morgan have reiterated a BUY rating.

OZ Minerals Limited (\$1.27) – OZL has released its Mar Q production numbers. Following this announcement Credit Suisse, GSBJ Were, JP Morgan and RBS have retained a Buy rating with Deutsche, Citigroup and UBS reiterating a HOLD.

Bank of Queensland Limited (\$12.14) – After releasing its 1H10 result JP Morgan and RBS have retained a BUY rating while Deutsche, Credit Suisse, UBS and GSJB Were have reiterated a HOLD.

Regards,

Zac Leman