NEXT Daily – Thursday 22nd April 2010

Overseas

The **Dow Jones** rose 7 pts or 0.07% to 11,124.92 (YTD 6.63%), **S&P 500** fell 1 pt or 0.10% to 1,205.93 (YTD 8.07%) and the **NASDAQ** rose 4 pts or 0.17% to 2,504.61 (YTD 10.28%)
The **FTSE** fell 60 pts or 1.04% to 5,723.43 (YTD 5.77%), **Nikkei** rose 189 pts or 1.74% to 11,090.05 (YTD 5.20%) and the **Hang Seng** fell 112 pts or 0.52% to 21,510.93 (YTD -1.63%)
Oil fell $0.58 to $83.38 a barrel.
Gold rose $4.80 to $1,144.00 an ounce.
Base metals were generally weaker with Copper down 0.4% to $350.00, Nickel fell 1.1% to $1,222.00, Zinc was down 1.0% to $108.00 and Aluminium fell 1.4% to $105.00.
BHP ADR's trading at $42.35 vs the Aussie close of $42.73.
SPI 200 Futures closed down 35 pts at 4,937.

Ideas

US equities pared modest losses to end little changed, Euro bourses were weighed down by Greek concerns as 10-yr bond yields surged through 8%. The International Monetary Fund (IMF) raised 2010 world growth forecast by 0.3pps to 4.2%, and left 2011 view at 4.3%, but warns about 'debt explosion' if public finances are not reined in.

JP Morgan (JPM) has reviewed the implications of the Rudd's proposed Australian health reforms. Rudd has won the support of all States (except WA) for health reform at the COAG meeting which concluded yesterday. The deal essentially claws back one-third of State GST funding, which will then be reallocated by the Federal Government taking control of 60% of public hospital funding and 100% of primary care/aged care funding. The Federal Government will be increasing funding by $5.4b, which includes an extra 1600 longer-stay sub acute beds by 2013-14. The funding will be channelled through new State based payment authorities, rather than directly to the local hospital networks. This means the States will still remain largely in control of the management of the hospital system. JPM said:

> Hospital funding will shift from block grants to activity-based payments, which we view as a positive and think is likely to increase efficiency within the public hospital system. This arrangement still requires parliament to pass 3 pieces of legislation, however, so there is still a long way to go in the process. In the near term, the health reform is likely a positive for the private hospital operators (RHC/HSP), given extra elective surgery work in the public system would be contracted to private hospitals, at higher rates than received from PHI funds. This could increase occupancy rates in RHC/HSP hospitals (e.g., from 75-80% currently to 85-90%). However, in the longer term, this could be a negative for private system, as increased efficiency/reduced waiting times could make private health insurance redundant. It also remains to be seen how this extra spending will be funded in the 2010-11 Federal Budget (11-May). This could potentially mean extracting more out of PBS (SIP), pathology (SHL/PRY/HSP), radiology (SHL/PRY), primary care (PRY) or other sub-sectors in healthcare.

Royal Bank of Scotland (RBS) has reviewed the major banks leading into their reporting season later this month stating that they think that ANZ, NAB and WBC will post strong earnings driven by improved asset quality and healthy net interest margins. Their view of sector earnings drivers is:

1) lending growth is unlikely to surprise, as APRA figures show that growth rates declined across most segments in 1H10;
2) sequential growth in interest margins could disappoint, as we think many drivers of the recent rebound, such as repricing on housing and business loans, waned in 1H10; and,
3) the bad debt charge could beat forecasts, given softening impaired assets trend in the December 2009 quarter and firming economic growth in Australia and New Zealand.

On each of the banks RBS said:

ANZ (Buy, target price A$26.28/share) - reports 29 April
We think risks to our forecasts are skewed to the upside for ANZ. The Asian strategy progressed smoothly through 1H10 and new acquisitions will boost already strong growth in ANZ's retail partnerships and Institutional. The extent of the mix shift from business to housing lending has been subdued at ANZ compared to WBC, which should bolster margins, while we believe our decline in B&DD forecast of 13% on pcp may be conservative.

NAB (Buy, target price A$31.00/share) - reports 6 May
We believe risks to our forecasts are skewed to the upside for NAB. Like ANZ, the extent of the mix shift from business to housing lending has been more restrained at NAB compared to WBC, which should bolster interest margins. Lower impaired assets (outside of the UK) may allow a bigger-than-expected fall in B&DDs while profits at Bank of New Zealand rebounded strongly in the December 2009 quarter.

WBC (Hold, target price A$26.39/share) - reports 5 May
We believe that risks to our forecasts are skewed to the downside for WBC. Market share gains in housing and retail deposits may have come at the cost of lower interest margins. WBC's rock-bottom cost-to-income ratio leaves far less room than peers for further operating costs gains and WBC's FY10 B&DD charge might exceed our forecasts despite the low A$0.4bn bad debt charge posted in the December 2009 quarter.

On BHP's latest Quarterly production released yesterday RBS stated that it was generally lower than their forecasts. However, they believe slightly lower output for 1Q10 is not material in the bigger picture. RBS believe BHP offers a compelling investment case due to quality management, its strong growth pipeline, financial strength and with the stock at a discount to NPV. RBS said:

As was the case for RIO, BHP's quarterly production volumes generally disappointed relative to our forecasts. Output in iron ore, petroleum and base metals, which contribute about 75% of earnings, was 8-11% lower than we expected and down on the previous quarter. Weather issues contributed to shortfalls in iron ore and coal, lower grades hit copper and the other base metals, while maintenance downtime was a feature in petroleum and nickel. We would like to have seen gains qoq in BHP's major commodities, but there was nothing in the quarterly that was a major concern to us. We expect the market to largely ignore the production numbers as they do not change the investment case, in our view. No outlook statement was provided by the company. Our FY10 earnings have fallen 3.6% on the back of the 1Q10 production report after adjusting for the shortfalls relative to our estimates and downgrading Escondida copper output for 2QCY10. We forecast reported NPAT of A$12.8bn for FY10, slightly below Bloomberg consensus of A$13.4bn (we believe consensus will come down a touch following the quarterly). Our NPV has fallen less than 1% to A$54.30ps, bringing our target price, which is based on the long-term average P/NPV multiple of 1.05x, to A$57.01 from A$57.09. We continue to believe BHP is one of the best-placed miners to take advantage of the global economic recovery and the subsequent increase in commodity demand. In our view, BHP offers exposure to some of the best mining assets globally, is well diversified, has a strong management team, and a balance sheet that allows it the flexibility to fund growth and undertake capital management in the near term. We believe ongoing improvements in global economic indicators, along with a potential announcement on capital management in the medium term, will lead to a rerating of the stock.

Research

BHP Billiton Limited ($42.73) – With BHP reporting a weak 3Q production in line with expectations, UBS, Credit Suisse, RBS and Citigroup have retained a BUY whilst Deutsche and JP Morgan maintain a HOLD. RBS has a price target of $57.01.
GrainCorp Limited ($5.70) – Following their conference call ahead of the upcoming 1H10 result, Credit Suisse, JP Morgan and RBS have all retained a BUY with Credit Suisse putting forward a price target of $9.80.
OneSteel Limited ($3.91) – Following complications arising from repairing a recent incident at Whyalla blast furnace, Deutsche has retained a BUY, Credit Suisse and RBS have maintained a HOLD whilst JP Morgan have reiterated a SELL. Deutsche has a price target of $5.56.
Kingsgate Consolidated Limited ($8.99) – With KCN announcing their 3QFY10 production, GSJB Were, Macquarie and RBS have retained a BUY whilst Deutsche have **upgraded** to a BUY. GSJB Were has a price target of $14.00.
Cochlear Limited ($75.86) – Following COH's recent share price performance, Citigroup have **downgraded** to a SELL with a price target of $70.39.