NEXT Daily – 4th May 2010

Overseas

The **Dow Jones** rose 143 pts or 1.30% to 11,151.83 (YTD 6.94%), **S&P 500** rose 15 pts or 1.31% to 1,202.26 (YTD 7.82%) and the **NASDAQ** rose 37 pts or 1.53% to 2,498.74 (YTD 10.12%)
The **FTSE** and **Nikkei** were both closed and the **Hang Seng** fell 297 pts or 1.41% to 20,811.36 (YTD -4.85%)
Oil rose $0.04 to $86.19 a barrel.
Gold rose $2.70 to $1,181.90 an ounce.
London Metals Exchange was closed.
BHP ADR's trading at $38.57 vs the Aussie close of $39.53.
SPI 200 Futures closed up 20 pts at 4,815.

Ideas

Stocks staged a broad based rally overnight settling just a few points shy of the intra day highs. Such broad-based buying dragged volatility down, such that the Volatility Index fell nearly 9%. Materials stocks made up the only major sector that failed to stage a gain. Instead, they finished flat as diversified metals and mining plays fell to a 2.3% loss. Goldman Sachs JBWere (GSJBW) sais some might be quick to point to the dollar's 0.6% advance as a cause for the relative weakness of the materials sector, but the greenback's gain did nothing to derail the broader market from staging a strong advance. For virtually the entire session both the dollar and the stock market with strong gains and both finished near their session highs. Most of the greenbacks strength came against the yen and the euro. The euro's slide followed news that the European Union and International Monetary Fund agreed to provide Greece with 110 billion euros in financial aid. Though that sum exceeds the 45 billion euros that had originally been proposed, some still wonder whether it would be enough to truly stem systemic risk in the region, especially as the fiscal health of Portugal, Italy, Ireland, and Spain remain rather dubious. What's more, Germany remains hesitant to commit to the recently proposed rescue plan. In other corporate news, **Continental** (CAL 22.86, +0.51) and **United** (UAUA 22.11, +0.51) agreed to a definitive merger that will give 1.05 shares of UAUA common stock for each CAL share. The announcement stoked takeover chatter, which helped lift the Amex Airline Index 2.2%.

The Rudd Government's recommendation to adopt the Resource Super Profit Tax (RSPT) clearly had a profound impact on the Australian resource sector yesterday with most stocks in the sector closing considerably weaker. Credit Suisse in their reading of the tax echoed the confusion that abounds in the market currently, as to what the exact impact the tax will have on company valuations:

> The Australian Government announced its intention to introduce a .Resources Super Profits Tax (RSPT) on Sunday 2 May, throwing financial markets into a state of mass confusion on Monday. Despite having spent several hours mulling over the releases and having two separate consultations with tax specialists, we are unable to quantify the impact of the proposed changes. Difficult to see how it can be positive: The equity market seems to be implying valuation downside of 5 to10%, but ask ten different analysts what the impact is and you will probably have ten different answers. Many investors seem to be in a state of shock, having become used to iterative and incremental policy change from Australia. If nothing else, it would seem difficult to argue that market risk premiums should not increase as a result of the changes.

JP Morgan (JPM) said the RSPT, is of particular concern to the Australian minerals sector and they believe will be damaging to earnings and valuations for existing producers and a deterrent to future investment in the Australian mining sector. JPM said:

> **The RSPT of 40% of operating margin after allowance for a long-term bond rate return on book value of assets (10-year bond rate 5.78%) and accelerated depreciation for 5 years after implementation of the tax will be in addition to State government imposed royalties on mining revenues and corporate tax of 30%** (reducing to 28% in FY15). While the royalties will be rebated to mining companies at the **current** rate by the Federal Government once the RSPT is in place, there is nothing to stop State governments increasing royalties at their leisure. Today, for example, the South Australian state government is reported to be examining increases to royalties. **Last week (April 28) with minimal detail available**, **we previewed the potential impact on earnings forecasts for BHP and RIO of a 40% mineral resources rent tax and we estimated that the reduction in NPAT forecasts for BHP and RIO could be as much as 27% (FY12e) and 36% (CY11e), respectively:** With the detail now available and the tax slated for July 1 2012 commencement, we can more accurately assess the negative impact of this punitive new tax. Thankfully, the allowance for accelerated depreciation and long-term bond rate return on asset book values as deductions from EBITDA before applying the RSPT 40% tax, has reduced our estimates of reductions to earnings forecasts to ~5% to 8% for FY13EFY17E (BHP); and ~8% to 15% for FY13E-FY17E (RIO), while NPVs are down 7.4% for BHP and 8.8% for RIO. **There was nil consultation during the Henry Review process with the mining sector, but the Government has indicated that this will now commence:** BHP has released a statement vehemently opposing the RSPT and confirmed that if implemented it will increase BHP's total tax payment from 43% of earnings to 57% in 2013.

JPM also commented on the ongoing negotiations between the Government and Telstra (TLS) stating they expect somewhat of a binary outcome- a resolution or an impasse, from the ongoing NBN negotiations between TLS and the Government/NBNco anytime over the next three months. JPM believe a resolution on NBN through a negotiated outcome between TLS and the Government is likely to drive a re-rating of the stock anywhere between 5% and 15% (15-50c) from current levels depending on the terms of the agreement. Factors supporting a resolution include a stronger political win/lower execution risks for the Government in an election year if a deal with TLS is reached. For TLS, the incentive is to simply address a risk that has systematically increased every time Telstra failed to reach an agreement with various governments on this issue over the past five years. This time is unlikely to be any different with a failure to reach an agreement likely to trigger the default Functional separation/no spectrum scenario, which JPM believe TLS would want to avoid at any cost. However, they believe that**:**

> 1) given the inherent conflicts of interests in this negotiation, there is no guarantee today that such a resolution will be reached, and as such it is not possible to entirely rule out today the "no deal, worst-case" scenario (JPMe valuation: $2.58),
> 2) the upside in case of a resolution is likely to be 'capped' by the current operational/earnings headwinds and the uncertainty over the medium term sustainability of the 28c dividend under some NBN scenarios.

JPM recognise the possibility of a re-rating on the back of a potential NBN resolution but also note the downside valuation risk in case of a "no deal" scenario.

Research

Origin Energy Limited ($16.13) – Following the Government's response to the Henry Tax Review proposing a Resources Super Profits Tax, GSJB Were and JP Morgan have retained a BUY whilst UBS and Citigroup maintain a HOLD. GSJB Were has a price target of $19.40.

Orica Limited ($27.48) – With their 1H10 result exceeding market expectations, Deutsche has maintained a BUY whilst Credit Suisse, Macquarie and UBS have retained a HOLD. Credit Suisse has a price target of $30.65.

Boart Longyear Limited ($0.35) – Following their trading update where BLY upgraded their revenue and earnings guidance for FY10, Deutsche, GSJB Were, Macquarie and JP Morgan have retained a BUY whilst Citigroup have **upgraded** to a BUY and Credit Suisse maintain their SELL. JP Morgan has a price target of $0.46.

Virgin Blue Holdings Limited ($0.55) – With VBA's FY10 guidance update, Deutsche, RBS, Credit Suisse and JP Morgan have retained a BUY whilst GSJB Were maintain a HOLD. Deutsche has a price target of $0.85.

Elders Limited ($1.16) – Following the announcement of the outcome of ELD's Forestry Asset Review, Citigroup, Deutsche and RBS have retained a BUY whilst GSJB Were and Macquarie maintain a HOLD. GSJB Were has a price target of $3.80.

BT Investment Management Limited ($2.76) – Following their strong 1H10 result driven by improved markets, GSJB Were, Macquarie and Credit Suisse have maintained a BUY whilst Wilson HTM have retained a HOLD and RBS have **upgraded** to a HOLD. GSJB Were has a price target of $3.80.

Alesco Corporation Limited ($2.94) – With the announcement of the resignation of CEO Justin Ryan effective immediately, Citigroup has **upgraded** to a BUY whilst GSJB Were maintain a HOLD. GSJB Were has a price target of $3.84.

Fantastic Holdings Limited ($3.05) – Following their trading update with a focus on net profit for FY2010, Credit Suisse has retained a BUY and Macquarie has **downgraded** to a HOLD whilst JP Morgan and Wilson HTM maintain a HOLD. Credit Suisse has a price target of $4.90.