

NEXT Daily – 12th May 2010

Overseas

The **Dow Jones** fell 36 pts or 0.34% to 10,748.26 (YTD 3.07%), **S&P 500** fell 3 pts or 0.34% to 1,155.79 (YTD 3.65%) and the **NASDAQ** rose 0.03% to 2,375.31 (YTD 4.68%)

The **FTSE** fell 53 pts or 0.99% to 5,334.21 (YTD -1.45%), **Nikkei** fell 119 pts or 1.14% to 10,411.10 (YTD -1.28%) and the **Hang Seng** fell 280 pts or 1.37% to 20,146.51 (YTD -7.89%)

Oil fell \$0.45 to \$76.35 a barrel.

Gold fell \$29.50 to \$1,232.60 an ounce.

Base metals were weaker with Copper down 1.00% to \$318.13, Zinc fell 3.27% to \$92.44 whilst Aluminium was down 1.95% to \$94.03 and Nickel fell 1.81% to \$1,021.49.

BHP ADR's trading at \$38.03 vs the Aussie close of \$38.13.

SPI 200 Futures closed up 23 pts at 4,580.

Ideas

The US market weakened from its highs into the close however, with no 1 catalyst. It did however coincide with the official resignation of the UK PM Gordon Brown although the GBP hardly moved and ended the day near its highs. The sell off also coincided with a press conference by Senator Dodd who said there would be a vote this week to impose tougher "Volcker Rules" on banks although this has been talked about for a while. The press were also highlighting that the ECB would not give out specifics on its bond program which raised speculation that it may not be that large. JP Morgan (JPM) said they struggle to find a catalyst for the sell off in the US with their traders noting that there was not a lot of real long only money behind the early rally so perhaps the market still lacks conviction.

There is a lot of commentary this morning on the Budget delivered last night by Treasurer Wayne Swan, with the general consensus being that it was a conservative budget with very few surprises and mostly confirming the policies that had already been released. The real kicker for the Government coming from confirmation that Australia will return to surplus in less than 3 years, 3 years ahead of previous expectations. Royal Bank of Scotland's (RBS) comments are as follows:

The forecast budget deficit of A\$40.8bn in 2010-11 is A\$16.3bn less than projected one year ago, reaffirming the strong economic backdrop and support for Australian equity market performance. A return to surplus three years ahead of schedule and ahead of developed economies The Australian government starts FY10-11 on a far healthier economic base than that envisaged just one year ago, according to Treasurer Wayne Swan. The forecast budget deficit of A\$40.8bn in 2010-11 was A\$16.3bn less than that forecast a year ago. Net debt was projected to peak at just 6.1% of GDP; half of the level projected a year ago and less than one-tenth the average across major advanced economies. The government has committed to maintain the 2% cap on real spending growth until the surplus hits 1% of GDP.

Equity market impact minimal

Banks: We believe the 50% reduction in interest income tax will assist Australian banks to maintain their term deposits as a source of funding and also facilitate the reduction of term deposit rates back below the RBA cash rate. However, it also provides for cheaper funding for smaller banks and credit unions thereby increasing competition in the financial sector, in our view. The proposed phasing down of the interest withholding tax (IWT) rate paid by banks and other financial institutions on

most interest paid on offshore borrowings will also increase competition in the sector.

Healthcare: The government had previously announced a A\$5.3bn package for health and, in the Budget, announced a further A\$2.2bn package of investments in the National Health and Hospitals Network over four years, to improve access to general practitioners (GPs) and primary healthcare, train nurses and modernise hospitals, all of which should extend the reach of healthcare to a wider audience with an overall volume uplift for the sector.

Renewables and energy efficiency

The Renewable Energy Future Fund investment of A\$652.5m over four years will form part of the Government's expanded A\$5.1bn Clean Energy Initiative. Funding is to be used to provide support for the development and deployment of renewable energy projects, including wind, solar and biomass. The fund aims to complement existing support through the Government's expanded Renewable Energy Target and bring total investment in renewable and clean energy to over A\$10bn.

Deutsche Bank (DB) equity strategists believe that despite the setback the Australian market has sustained over the past week the market can still put in a strong year. DB said:

The past week has seen the Australian equity market set back again, as it has been on a number of occasions this year. The proposed resources profits tax clearly contributed, through its perceived impact on resource company earnings, and possibly also by attaching some political uncertainty to investments in Australia. But its consequences would now seem reasonably factored in, as best can be assessed at this stage. The intensification of concerns about European sovereign debt also weighed, but these seem to have been eased, for the time being at least, by the stabilization fund and other initiatives announced in the past 48 hours. Nonetheless, even before the past week, it's the case that the Australian market has struggled for much of this year, and not shared in the further gains recorded in other developed country markets like the US. The Australian market has effectively de-rated, more than other developed markets, with the market PE multiple on one year ahead expected earnings declining to around 12x, from a "normal" level of 14-15x. And the main cause of the de-rating seems to be nervousness about policy tightening, in both China, with its risks for Australia, and in Australia itself, and in each case the tightening could well be on-going in coming months. This suggests the market is unlikely to recover its normal rating in the near term, even if it improves after the past week. But while the market has been struggling, company earnings forecasts have held up, and have actually seen continued upgrades. Since the start of the year, forecast market earnings growth for both FY10 and FY11 has been upgraded 5%, and there seems scope for this to continue, with spot commodity prices still well above forecast prices, and the Australian economy essentially back to normal. If upgrades do continue and stronger earnings growth comes through, it can still lift the market much higher, even with a lower multiple. So while nervousness has been weighing on the Australian market, the concerns seem reasonably well priced in, given the lower multiple in place. And while uneasiness about policy tightening might remain, more optimism about global prospects, particularly the broadening US recovery, should see equity markets in general re-rate after recent weakness, including Australia. This, along with the strong earnings growth envisaged, can still see the local market post another strong year, despite the poor start.

Commonwealth Bank of Australia (CBA) has provided a 3Q trading update this morning. Goldman Sachs JBWere (GSJBW) said that overall the 3Q10 update showed an earnings run-rate that is broadly in line with consensus estimates for 2H10. However, this appears to be driven by better bad debts, while pre-provision earnings look weaker. Key details include:

- **Cash NPAT broadly in line:** Cash NPAT of \$1.5bn, versus implied consensus of \$1.5bn-\$1.6bn.
- **Bad debts slightly better:** 3Q10 bad debts of \$500m, implies a 2H10 charge of \$1bn versus consensus 2H10 at \$1.05bn.
- **Pre-provision earnings slightly weaker:** 3Q10 pre-provision earnings (assuming a 27% tax rate) was \$2.56bn, implying a 2H10 run-rate of \$5.12bn versus consensus 2H10 at \$5.44bn (GSJBW \$5.54bn).
- **Tier 1 slightly better:** Tier 1 ratio at 9.2%, which appears slightly ahead of GSJBW FY10 forecast of 9.1%.
- **Outlook:** CBA has provided limited outlook commentary, noting the outlook is improving, but challenges remain in the business.

GSJBW said that overall they believe this update is likely to disappoint the market on the pre-provisioning line. RBS said 1Q10 cash NPAT of \$1.5bn and impairment charge of ~\$500m was bang in line with their estimates. Consensus was closer to \$1.6bn, so may disappoint. CBA's commentary suggests the group margin came under pressure in the quarter, RBS suggest the best outcome in 2H10 will be to hold group margin steady at 1H10 levels. Like peers, the growth rate of new impaired assets has slowed, however total impaired assets is still rising. 30 day arrears rates held steady through the quarter and ASB arrears rates appear to have stabilised. Commentary on asset quality stressed a gradual, rather than dramatic improvement.

Research

Asciano Group (\$1.64) – Following their announcement of a A\$1.1bn non-cash write-down relating mostly to goodwill to be taken in 2H10, Deutsche, Macquarie, RBS and GSJB Were have retained a BUY, UBS has maintained a HOLD whilst Credit Suisse has reiterated a SELL. RBS has a price target of \$2.30.

Transfield Services Limited (\$3.96) – With TSE announcing they would support the outcome of the Transfield Services Infrastructure (TSI) capital structure review and would participate in the announced \$110mn equity raising, UBS has maintained a BUY whilst Deutsche, GSJB Were and JP Morgan have retained a HOLD. GSJB Were has a price target of \$5.00.

Charter Hall Retail Reit (\$0.52) – With CQR to acquire a 50% interest in 2 adjacent retail centres at Lake Macquarie for \$33mn, JP Morgan has retained a HOLD whilst Credit Suisse has **upgraded** to a HOLD with a price target of \$0.59.

Henderson Group PLC (\$2.33) – With the release of their Interim Management Statement, GSJB Were, Citigroup, Deutsche, Credit Suisse and RBS have all retained a BUY. Credit Suisse has a price target of \$3.29.

OZ Minerals Limited (\$1.05) – With the development and mining of the Prominent Hill site being incorporated into the production schedule, RBS has retained a BUY whilst Credit Suisse has **upgraded** to a BUY with a price target of \$1.30.

PaperlinX Limited (\$0.78) – Following the EU bail out and improved sentiment, Credit Suisse has **upgraded** to a HOLD with a price target of \$0.90.

Sigma Pharmaceuticals Limited (\$0.39) – Following the Fed Budget 2010/11 reducing funding to the community pharmacy industry, Citigroup has **downgraded** to a SELL whilst GSJB Were has retained a SELL with a price target of \$0.50.

Wesfarmers Limited (\$28.40) – Following their recent share price performance, Citigroup has **upgraded** to a BUY with a price target of \$31.40.