NEXT Financial – Tuesday 18 May 2010

Overseas

The **Dow Jones** rose 5 pts or 0.05% to 10,625.83 (YTD 1.90%), **S&P 500** rose 1 pt or 0.11% to 1,136.94 (YTD 1.96%) and the **NASDAQ** rose 7 pts or 0.31% to 2,354.23 (YTD 3.75%)
The **FTSE** was flat at 5,262.54 (YTD -2.78%), **Nikkei** fell 226 pts or 2.17% to 10,235.76 (YTD -2.95%) and the **Hang Seng** fell 430 pts or 2.14% to 19,715.20 (YTD -9.86%)
Oil fell $1.55 to $70.06 a barrel.
Gold fell $12.38 to $1,220.80 an ounce.
Base metals were weaker with Copper down 6.65% to $291.91, Zinc fell 7.72% to $84.75 whilst Aluminium was down 5.48% to $89.13 and Nickel fell 3.98% to $935.62.
BHP ADR's trading at $37.40 vs the Aussie close of $36.89.
SPI 200 Futures closed up 22 pts at 4,517.

Ideas

The major US and European bourses shrugged off the ugly price action in yesterday's Asian trading, a deep selloff in the key base metals, further weakness in oil, and ongoing European-linked concerns in what was a notably resilient performance. The turnaround was directly linked to the close of European trading and a change in fortune for the euro. Having earlier tumbled to a new four year low of U$1.2235, the euro reversed course over the afternoon to be trading more than one and a half cents higher as U.S. equity markets closed. The Dow which posted a near-185 point decline at its daily low, ground higher throughout the afternoon before accelerating higher on the final forty minutes to close with a gain of 5.67 points at 10,626. On the economic front the New York Fed's "Empire State" general business conditions index fell to 19.11 (Mkt est: 30) from 31.86 in April. U.S. credit card delinquencies fell for the fourth straight month in April, but analysts cautioned that the industry will be slow to rebound from the high credit losses of the last two years. Chinese equities slumped >5% overnight (the largest single day decline since Aug) on worries the country's economic growth has peaked and will slow going forward (the recent slump in the euro is raising worries that Chinese exports to the region will be negatively impacted, something acknowledged by Chinese officials overnight). China is trading at the lowest level since May '09 and is down 19% from its mid-Feb levels.

UBS believes Australian industrial equities are trading at valuations well below historical trends levels and ask the question, are they now cheap? The Industrial-ex-financials P/E is sitting significantly below its long term median, despite the prospect of a cyclical rebound in earnings growth over the next 2 years (from depressed levels), strong structural growth prospects for the Australian economy (3 years+) and low levels of corporate gearing said UBS. UBS expect the June reporting period to be moderately improved but still somewhat patchy with subdued conditions in retail (albeit looking priced in) balanced against improving conditions in housing and media. Mining services should show some improvement, though the capex cycle is yet to move back into full swing. Within the sector, UBS are overweight industrial cyclicals – a mixture of US and Australian economy exposed. Most recently they have added exposure to US exposure and domestic discretionary retail. They also believe the investment cycle (mining and general) is still an attractive medium term theme (RSPT withstanding) and should gather steam again through FY11e and FY12e.

The AFR has suggested that Fortis is looking to compete with the ASX by establishing a rival clearing house in Australia. It is unknown what the direct impact will be on ASX, however Royal Bank of Scotland (RBS) believes the impact will be minimal. RBS said:

> **We question the financial viability of such a product, given the limited size of the Australian market, and calculate that in any event such a move would only subtract A30cents from our valuation of A$41, or less than 1%.** The AFR has suggested that Dutch-based Fortis is looking to establish a rival clearing house in Australia in conjunction with Chi-X. We see three key issues for Fortis setting up a clearing house in Australia:
>
> 1) financial viability – we calculate that Fortis would be lucky achieve a return on capital of over 10%,

2) regulation – given recent market turmoil related to increased competition in trading, we believe that ASIC is likely to be cautious in adding further complexity so soon, and
3) timing – given the consultative process and the additional legislative change, we believe competition in clearing is likely to be 2-3 years away.

If Fortis were to gain a 30% market share in clearing by FY15, this would only deduct A30c from our current valuation of A$41, or less than 1%. This can be explained through three key factors:

1) clearing was only 8% of ASX's total revenue in FY09,
2) any reduction in revenue from clearing initially impacts the large volume rebates more than ASX's net revenues, and
3) we forecast that ASX's settlement revenues remain strong and that they will account for about 60% of ASX's equities revenues in FY15F, up from about 40% in FY09.

While much of the attention is focused on the potential increase in competition, we believe it is worth observing that cash equity volumes have been extremely strong so far in May, averaging 615k/day, well ahead of the 500k/day in the first four months of 2010. We also anticipate that ASX will announce its new pricing strategy for FY11 at the beginning of June when it publishes its May figures. Volumes and values of cash trading are trending well above the levels of a year ago. Rebates are likely to hinder some of the upside in FY10F, but simple increases to rebate thresholds from FY11 could provide considerable upside potential to future earnings. In addition, we believe concerns over the potential increase in competition (although understandable) have been overstated.

Research
Myer Holdings Limited ($2.99) – With the announcement of their 3Q10 sales, Deutsche, Macquarie, Credit Suisse, UBS, GSJB Were and JP Morgan have all retained a BUY. Credit Suisse has a price target of $5.10.
Leighton Holdings Limited ($32.16) – Following their 3Q NPAT, Macquarie and JP Morgan have maintained a BUY whilst Credit Suisse, UBS and GSJB Were retain a HOLD. GSJB Were has a price target of $43.83.
Goodman Group ($0.64) – With the inception of GMG's new fund GDAF (Goodman Australia Dev Fund), Deutsche has retained a BUY, UBS has **upgraded** to a BUY whilst JP Morgan maintain their HOLD. UBS has a price target of $0.72.
Cabcharge Australia Limited ($6.00) – Following the announcement of its JV entities – ComfortDelGro (CDC) and City Fleet, Credit Suisse and Wilson HTM have maintained a HOLD whilst Macquarie and GSJB Were have retained a SELL. Credit Suisse has a price target of $6.50.
Elders Limited ($1.09) – With ELD reporting 1H10 underlying EBIT ahead of forecasts, Deutsche has maintained a BUY whilst GSJB Were, Wilson HTM and Macquarie have retained a HOLD. Deutsche has a price target of $2.00

Regards,

Zac Leman