

NEXT Daily – 26th May 2010

Overseas

The **Dow Jones** fell 22 pts or 0.23% to 10,043.75 (YTD -3.69%), **S&P 500** rose 0.04% to 1,074.03 (YTD -3.68%) and the **NASDAQ** fell 2 pts or 0.12% to 2,210.95 (YTD -2.56%)
The **FTSE** fell 128 pts or 2.54% to 4,940.68 (YTD -8.72%), **Nikkei** fell 298 pts or 3.06% to 9,459.89 (YTD -10.30%) and the **Hang Seng** fell 682 pts or 3.47% to 18,985.50 (YTD -13.20%)

Oil fell \$1.52 to \$68.69 a barrel.

Gold rose \$7.30 to \$1,198.95 an ounce.

Base metals were weaker with Copper down 2.66% to \$304.00, Zinc fell 4.01% to \$82.78 whilst Aluminium was down 3.20% to \$90.12 and Nickel fell 4.55% to \$957.90.

BHP ADR's trading at \$37.28 vs the Aussie close of \$36.28.

SPI 200 Futures closed up 65 pts at 4,339.

Ideas

Australian equities tumbled in yesterday's trade amidst a selloff in Asian markets, led by a slump on Wall St, as concern for the European Debt crisis continued to dominate sentiment. Escalating tensions between North and South Korea added to the market jitters. The MSCI Asia Pacific Index traded at 10-month lows amid reports that Kim Jong-il ordered his military to be ready for combat. Materials led the fall, as - BHP (-4.0%), FMG (-7.5%), RIO (-3.8%) - hit 6-month lows. The Commercial Banks - ANZ (-2.6%), CBA (-3.7%), NAB (-3.3%), WBC (-3.9%) also slumped. Defensives also traded to the downside, although marginally outperforming the cyclical plays. The US market was set to follow Asian and European markets down however staged an impressive rally from its lows of the pre-open. The Dow was losing 292 points inside the opening ten minutes but managed to close down just 23 points at 10,044, holding the psychologically important 10,000 mark. Initial weakness was again driven by continued concern in Europe from the Spain bank failure on the weekend. JP Morgan (JPM) said that feedback from their sales traders in the US was that investors were macro driven with a bigger focus on broad index activity vs. individual stock performance. JPM highlighted 2 reasons for the market turn around:

- 1) Italy's cabinet approved a multi-billion euro austerity package aimed to cut the deficit to sub 3% of GDP by FY12.
- 2) The Conference Board's measure of consumer confidence increased over 5 points in May to 63.3, beating expectations and reaching the highest level since March 2008.

This morning Foster's (FGL) chief executive Ian Johnston said the company was "increasingly seeing the benefits of operationally separating its beer and wine business". "While the beer and wine businesses are market leaders, they operate in separate market segments with different strategic and operating characteristics", Mr Johnston said in a statement. "We will proceed as quickly as possible, but priority will be given to ensuring that all relevant matters are carefully and rigorously examined with the intention of continuing to grow our businesses and minimising disruption to our customers, employees, suppliers and other stakeholders." Foster's said no decision had been made on the structure of timing of the demerger, which would depend upon "among other things, prevailing economic and capital market conditions". But the brewer said it was unlikely to be implemented until the first half of calendar 2011 at the earliest. Foster's said potential benefits of the demerger included increased transparency, allowing investors to more appropriately value each business over time. It also would provide greater investment choice

and flexibility for separate boards and management of Beer and Wine to develop their own corporate strategies and implement capital structures and financial policies appropriate to their businesses. Potential issues associated with the demerger may include financing costs, corporate and other costs and one-off implementation costs, the brewer said. In a remarkably well timed note, Merrill Lynch analysts this morning called for the breakup of Foster's (FGL) to see value realized. "We see A\$1.50/share available to Foster's shareholders if the company is split into two separate companies," Merrill Lynch said, before FGL announced its plans to demerge its beer and wine businesses into two separately listed groups.

JPM has looked at RIO given the recent falls, stating that they believe RIO has been excessively oversold by the market on the back of concerns about the impact of the so called "Resources Super Profit Tax", potential negative implications for commodity prices from government induced slowdown of growth in China, and negative implications for the global economy due to funding difficulties in European economies. JPM re-iterate their Overweight stating:

We regard the RSPT as being a punitive impost on mining companies and estimate that if implemented in its proposed form it would reduce our NPV of RIO's Pilbara iron ore operations by ~18% and our company NPV by ~10%. To address concerns of a China slowdown and consequent falls in commodity prices, we have examined the impact of more bearish commodity price assumptions on our RIO valuation using our long-term price forecasts to yield a bear-case NPV. Under this scenario, the bear-case NPV for RIO is A\$75.53/sh (ex-RSPT) and A\$69.13/sh (incl. RSPT), which represents >20% and >10% above the current share price respectively. We also note that on a forward PE basis, 12.9x and 11.7x for CY10 & CY11 earnings under this bear-case scenario (which assumes an FOB iron-ore price of ~US\$50/t!) is not overly demanding. We believe at current prices, there is significant valuation support for RIO. Interestingly, the BHP bear case NPV inclusive of RSPT is ~A\$31/sh, suggesting that if the market treated BHP with the same concerns that it has for RIO, there is potentially still some downside to BHP shares. Other key reasons supporting an Overweight RIO position include the fact that aluminium - which accounts for ~50% of RIO's net asset base but contributes ~7% to EBIT - provides tremendous earnings leverage when aluminium pricing eventually recovers. We also note the offshore investment capacity as being an attractive feature of RIO shares. In the event the RSPT passes into legislation in its current form, RIO has a number of attractive large-scale, long life-mining investment opportunities elsewhere in more attractive fiscal regimes. These include Simandou (iron ore, Africa), Resolution (copper, USA), La Granges (copper, Peru), Kennecott Utah underground (copper, USA) and Oyu Tolgai (copper, Mongolia), to name a few.

Research

Ivanhoe Australia Limited (\$3.35) – Following IVA signing an agreement to acquire the Osborne Copper Gold operation from Barrick Australia, UBS has **upgraded** to a BUY with a price target of \$4.00.

Atlas Iron Limited (\$1.77) – Following their recent share price movement, Credit Suisse has **upgraded** to a BUY with a price target of \$3.15.

Wattyl Limited (\$0.83) – With WYL receiving an indicative, non-binding and confidential acquisition proposal at \$1.30 per share, Macquarie and Credit Suisse have both **upgraded** to a BUY. Macquarie has a price target of \$1.32.

Nufarm Limited (\$5.75) – Following NUF's recent share price underperformance, JP Morgan has **upgraded** to a HOLD with a price target of \$6.13.