

NEXT Daily – 27th May 2010

Overseas

The **Dow Jones** fell 69 pts or 0.69% to 9,974.45 (YTD -4.35%), **S&P 500** fell 6 pts or 0.57% to 1,067.95 (YTD -4.23%) and the **NASDAQ** fell 15 pts or 0.68% to 2,195.88 (YTD -3.23%) The **FTSE** rose 97 pts or 1.97% to 5,038.08 (YTD -6.92%), **Nikkei** rose 62 pts or 0.66% to 9,522.66 (YTD -9.71%) and the **Hang Seng** rose 210 pts or 1.11% to 19,196.45 (YTD -12.23%)

Oil rose \$2.78 to \$71.53 a barrel.

Gold rose \$15.40 to \$1,213.40 an ounce.

Base metals were mixed with Copper up 0.69% to \$306.10, Zinc rose 1.84% to \$84.30 whilst Aluminium was down 0.19% to \$89.95 and Nickel fell 0.38% to \$954.27.

BHP ADR's trading at \$37.78 vs the Aussie close of \$37.26.

SPI 200 Futures closed down 6 pts at 4,294.

Ideas

The US market was in positive territory until just before 3.30pm when reports came out that China, which boasts the world's largest foreign exchange reserves, was reviewing its holdings of eurozone debt. This then triggered stops and on light volume saw the market fall into the close. The Dow closed below 10,000 for the first time in four months. Before the news about the Chinese reviewing their euro debt, the market was upbeat about the positive US economic data. Demand for single-family homes crushed expectations, surging 14.8% MoM in April (Mkt est: +3.4%) to a seasonally adjusted annual rate of 504,000 (Mkt est: 425k) from an upwardly revised 29.9% increase (to 439k) in March (Prev: +26.9% to 411k). Durable-goods orders increased 2.9% (Mkt est: +1.3%) to a seasonally adjusted \$193.9bln from an upwardly revised 0% reading in March (Prev: minus-1.3%). The OECD raised its forecast for economic growth this year and for 2011, amid risks to recovery posed by euro-zone debt and possible economic overheating in some parts of Asia. In its twice-yearly outlook, the OECD cited strong growth in developing economies and the rapid rebound in world trade to predict that the OECD's 31 members will see their combined GDP increase 2.7% this year, and 2.8% next. In November the forecasts were +1.9% and +2.5%. This may prove to be a little too optimistic if the issues in Europe don't improve said JP Morgan (JPM).

Deutsche Bank (DB) strategy highlighted that since the start of May the S&P/ASX 200 has corrected by 11%, yet spreads in debt markets, while elevated, are nowhere near the levels seen in the GFC. This combined with their view that there won't be a default in Europe, means some good value is on offer on any sort of medium-term view. DB stated that:

The sovereign debt crisis in Europe has escalated in May. Our view is that there will not be a default, but the broad-based austerity measures will curb demand, leading to slower growth in Europe. Even HRH Queen Elizabeth II, during her speech to open UK parliament, stated deficit reduction was a priority in the UK. Europe may be sluggish, but we believe recovery is under way in the US and that growth remains robust in Asia...While the financial market contagion from Europe has been rapid, Australia's exposure to Europe in terms of the broader economy is limited. Our Economics team, in a note titled *More on the European debt crisis and the impact on Australia*, dated 21 May, addressed this issue, finding that our direct trade links with Europe are less than 4% (or about 0.5% of GDP). There is also some indirect exposure via China and its trade with Europe...We have looked for stocks that may

have overshot the market on the downside and that we believe now offer considerable upside. Specifically, we have screened for stocks on which we have Buy recommendations, whose share prices have fallen by 10%+ since 30 April and that offer a 30%+ return to their target price. Not surprisingly, the miners dominate our 10/30 list, helped by the RSPT confusion. However, much is now priced into the share prices and we think BHP, RIO and Fortescue offer good value at these levels, with a possible watereddown RSPT as a potential kicker. Other quality businesses in our 10/30 list include Origin Energy (31% upside to target price), Toll Holdings (+38%) and MAp Group (+30%).

Credit Suisse (CS) believes the current market pullback has now highlighted opportunities within the oil and gas sector, with significant layers of project risk having been removed from company capitalisations, particularly on the next phase of LNG developments and exploration. In effect, the pullback is now providing some 'free shots' at projects and upside where the returns may be somewhat ill-defined at present, but ultimately we expect the growth opportunities will be delivered said CS. Ultimately, performance in 2010 will still be dependent on delivering LNG growth, and although the headline risk may still be high CS suggest there is still a market for good projects and those with strong economics. CS said that although the event drivers most likely will occur towards the end of the year, they remain confident of deliverable upside for OSH and WPL and maintain the CSG-LNG space is still 'buy the fact' at this stage. CS see RSPT as a bit of a non-event for the sector, which already operates under the auspices of PRRT legislation. They suggest the CSG-LNG opportunities would be most affected, but at this stage not sufficiently to result in project cancellations. According to CS, at current stock prices **Woodside** offers a production, earnings and value opportunity, while **Oil Search** is tracking a 26% discount to CS derived NAV. **Santos** needs to deliver an industry re-rating event to outperform despite CSG being discounted to nil under CS modelling.

Yesterday Fosters (FGL) announced its intention to de-merge its wine and beer operations, forming two separately listed companies. It also announced that it will take a A\$1.1-1.3bn pre tax impairment charge to the carrying value of its wine operations, and that it expects to report group EBITTS of A\$1.05-1.08bn in FY10. JPM believes that this separation is necessary to preserve the competitive position of the beer business in Australia in the long term. However, the separation will also result in increased net interest costs, duplicated head office costs and higher net debt on an aggregate basis. This is likely to be under-appreciated by the market until the scheme booklet is released in March/April 2011, resulting in overstated valuations according to JPM. While the market is likely to focus on the potential for the corporate value of the beer business to be realised, JPM argue that the present value of this potential corporate value is just A\$5.41-A\$5.55 per share based on comparable transactions and is therefore already factored into the share price. Additionally, they see passive investment value on the combined Beer Co and Wine Co stock of just A\$5.16 at present. JPM would look to reduce holdings in FGL if the share price strengthens significantly from here; preferring CCL in the sector.

UBS estimate a demerged going concern value of \$5.48 being \$4.69 for Beer & \$0.79 for Wine. UBS said that while the stock is now trading at our fair value, there remains too much evidence to rule out consolidation as a medium term possibility and the proposed demerger potentially makes FGL an easier candidate, in our view. Applying LNN's takeover multiple would see FGL trade up to c\$6.70, all else being equal, a 21% premium to the current share price on UBS numbers.

Research

Foster's Group Limited (\$5.53) – With FGL announcing their intention to pursue a demerger, Credit Suisse has **upgraded** to a BUY and GSJB Were has **upgraded** to a HOLD whilst UBS and JP Morgan have retained their HOLD and Macquarie maintains a SELL. Credit Suisse has a price target of \$6.25.

Programmed Maintenance Services Limited (\$2.58) – Following their announcement of their FY2010 results, Macquarie, Credit Suisse, UBS and GSJB Were have retained a BUY whilst JP Morgan has **upgraded** to a BUY. GSJB Were has a price target of \$4.22.

Beach Energy Limited (\$0.73) – Following BPT's recent share price weakness, UBS has **upgraded** to a HOLD with a price target of \$0.79.

OneSteel Limited (\$3.01) – With OST's share price weakness in recent months, Credit Suisse has **upgraded** to a BUY with a price target of \$4.50.