

NEXT Daily – 28th May 2010

Overseas

The **Dow Jones** rose 284 pts or 2.85% to 10,258.99 (YTD -1.62%), **S&P 500** rose 35 pts or 3.29% to 1,103.06 (YTD -1.08%) and the **NASDAQ** rose 81 pts or 3.73% to 2,277.68 (YTD 0.38%)

The **FTSE** rose 157 pts or 3.12% to 5,195.17 (YTD -4.02%), **Nikkei** rose 117 pts or 1.23% to 9,639.72 (YTD -8.60%) and the **Hang Seng** rose 234 pts or 1.22% to 19,431.37 (YTD -11.16%)

Oil rose \$3.02 to \$74.53 a barrel.

Gold fell \$0.30 to \$1,211.50 an ounce.

Base metals were stronger with Copper up 3.06% to \$315.47, Zinc rose 2.70% to \$86.58 whilst Aluminium was up 2.60% to \$92.28 and Nickel rose 3.27% to \$985.47.

BHP ADR's trading at \$39.32 vs the Aussie close of \$38.85.

SPI 200 Futures closed up 67 pts at 4,449.

Ideas

Australian Equities advanced in yesterday's trade, despite a late sell-off on Wall St. The S&PASX 200 lifted at the open, but was met with profit taking before rebounding again at lunch and surging into the close, in-line with US futures. The Australian Dollar also rallied, in a near identical trend to the equity index. News that Kim Jong Il is reportedly looking for an exit strategy from the showdown caused by sinking a South Korean Warship, gave a rise to sentiment, along with news a Chinese Government Official rejected claims it was reviewing its Eurozone Government bond holdings. Finally materials led the upward push, after a news article reported the Government may increase the hurdle rate for the Resource Super Profits Tax. In the US the Market managed to open higher and advanced throughout the session. JP Morgan highlighted what they saw as the drivers of the market move last night. 1) China and Kuwait have denied that they are considering adjusting their Eurobond holdings; 2) Positive Earnings; 3) Comments from tech companies that they are not seeing slowing in Europe; 4) Weaker euro aiding European exports; 5) China backing off tightening measures (PBOC set to make its first net injection of funds into the banking system this week since February); 6) Korean tensions easing; 7) news BP has successfully plugged the leading well; 8) Spain's parliament approving austerity measures; 9) Indications Greek deposits stabilizing and actually rising again after outflows for last months; 10) Moody's saying it wouldn't downgrade Portugal out of the AA2 to A1 range; 11) relief after the Obama press conf failed to mention anything that weighed on equities (aside from one question on Afghanistan, the press conf focused entirely on the Gulf; there was no mention of fin reg reform).

As mentioned above the market reacted positively to reports that the Rudd Government may consider an increase to the RSPT allowance rates. UBS said that:

According to The Australian newspaper this morning, the Rudd government is moving towards a change in its proposed RSPT. The newspaper states that the government is proposing to lift the uplift factor from 6% to 12% and the removal of the 40% compensation offered for mining projects that fail. We estimate the impact on valuation is minimal: We have run a sensitivity analysis on different allowance rates on our mining stocks under coverage. On average, a change in allowance rate from 6% to 12% only lifts NPVs by 4-5% (ignoring companies with no impact) and this is skewed by large gains to smaller companies. For most, the impact of the change in allowance rate is relatively modest. The stocks with the largest upside to a

change in allowance rate are IVA, CEY and GBG with 22%, 14% and 11% respectively. This is because they are relatively lower margin businesses and are spending capital now or in the future (ie. assets have not been depreciated). A higher allowance rate would not change our view of the RSPT: While a royalty on profits rather than revenues makes sense in our view, we believe the overall increase in tax is too large particularly compared to other regions. We believe a change to increase the uplift factor also makes sense because we see little value for the miners in the 40% loss compensation. However, given the change in uplift factor would not materially impact valuation, we would retain our view of the tax being too onerous for the Australian mining industry.

Wesfarmers (WES) held their 2010 investor day with the key points as highlighted by JPM being:

- 1) **Coles turnaround remains on track**, with the division now entering Phase 2 of the turnaround, “delivering consistently well.”
- 2) **Target’s “New Way of Working”**, where it will design more product in-house, **is a defensive strategy against international entrants and an offensive move to distance itself away from domestic peers** (including Kmart). While this new strategy is the driver of sustained LFL sales growth in the face of rising competition in the future, we believe the risk profile of the business will increase, and we continue to see CY2009 EBIT margin levels as an aberration.
- 3) **Kmart turnaround continues**, although the cost of price reductions in 2H10 will result in softer than- forecast EBIT margins.
- 4) **Bunnings is aggressively positioned in the face of rising competition** from the WOW/LOW US home improvement JV, **with significant store investment planned as well an adjustment of ranges to introduce new products**. The Officeworks turnaround is well positioned.
- 5) **Resources is experiencing strong metallurgical coal demand, with rising cost pressures and the RSPT negatives**.
- 6) Insurance is negatively impacted from increased claims experience (Melbourne and Perth storms) and the delay in premium rate hardening.
- 7) Chemicals, Energy & Fertilisers is benefiting from strong chemicals demand while Energy is disappointing.
- 8) Industrial & Safety has growth opportunities, especially Coregas.
- 9) WES remains well capitalised and is planning to extend the duration and diversify the source of its borrowings.

As a result JPM have adjusted their EPS forecasts -1.4%, +1.4% and -1.3% for FY10, FY11 and FY12, respectively, with their DCF increasing to A\$31.99 per share. While lower food inflation (Coles) and cycling fiscal stimulus is a challenge (for all retail divisions), JPM suggest the retail turnarounds are on track, Bunnings and Target are set to address rising competitive threats, Resources enjoys strong demand although there are headwinds (costs and RSPT), with Insurance the only division performing poorly. **Overall, JPM suggest the risk/reward remains compelling for an investor, given the broadly positive outlook and attractive valuation.**

Research

Wesfarmers Limited (\$27.71) – Following WES’s Investor Briefing, GSJB Were and JP Morgan have retained a BUY, Macquarie has **upgraded** to a BUY whilst UBS has maintained a HOLD and Credit Suisse reiterates a SELL. JP Morgan has a price target of \$33.39.

James Hardie Industries Se (\$7.11) – Following their FY10 results, UBS and Macquarie have maintained a BUY and Credit Suisse has **upgraded** to a BUY whilst GSJB Were retained a HOLD and JP Morgan reiterated a SELL. Credit Suisse has a price target of \$8.80.

Ausenco Limited (\$2.58) – With Ausenco providing a second earnings guidance in a month, JP Morgan has retained a BUY, UBS has **upgraded** to a BUY and GSJB Were has **downgraded** to a HOLD whilst Macquarie retains its HOLD. JP Morgan has a price target of \$3.91.

ING Office Fund (\$0.54) – Following recent share price performance, Credit Suisse has **upgraded** to a BUY with a price target of \$0.64.

Map Group (\$2.79) – With MAP holding its AGM, GSJB Were has **upgraded** to a BUY with a price target of \$3.50.