

NEXT Daily – 31st May 2010

Overseas

The **Dow Jones** fell 122 pts or 1.19% to 10,136.63 (YTD -2.80%), **S&P 500** fell 14 pts or 1.24% to 1,089.41 (YTD -2.30%) and the **NASDAQ** fell 21 pts or 0.91% to 2,257.04 (YTD -0.53%)

The **FTSE** fell 7 pts or 0.13% to 5,188.43 (YTD -4.15%), **Nikkei** rose 123 pts or 1.28% to 9,762.98 (YTD -7.43%) and the **Hang Seng** rose 335 pts or 1.73% to 19,766.71 (YTD -9.63%)

Oil fell \$0.58 to \$73.97 a barrel.

Gold rose \$1.72 to \$1,214.38 an ounce.

Base metals were broadly weaker with Copper down 0.63% to \$313.49, Zinc fell 0.22% to \$86.39, Aluminium was down 1.07% to \$91.30 and Nickel fell 2.07% to \$965.11.

BHP ADR's trading at \$38.26 vs the Aussie close of \$38.97.

SPI 200 Futures closed down 42 pts at 4,424.

Ideas

The US closed down on Friday to see the end of the worst May in nearly 50 years. Partly to blame for the fall was news that Fitch Ratings removed Spain's AAA credit rating, dropping it by a notch, on expectations that the moves to cut the nation's debt will slow its economic growth. The downgrade to AA+, still the second-highest possible rating, moves Fitch closer in line with S&P which cut Spain's ratings to AA last month. The move also came on the same day that the Spanish government lowered its forecasts for GDP growth in 2012 to 2.5% from 2.9% previously, and for growth in 2013 to 2.7% from 3.1%. In the US, consumer spending was flat vs expectations of a +0.3% rise despite an increase in incomes.

Despite falling from recent highs RBS believes iron ore prices remain very healthy.

They believe Australian-listed iron ore exposures have been oversold on global growth fears and uncertainties around the RSPT. At current levels iron ore prices still provide very healthy margins said RBS:

Spot iron ore FOB has fallen 27% from US\$165/t to US\$120/t over the past month. However, Chinese iron ore imports remain strong, with 53Mt in April, down 6% MoM but well above the levels seen in January and February. Chinese iron ore imports are running at about the same annualised rate as last year (631Mtpa), whereas steel production is running at an annualised rate of 640Mtpa or 14% higher than in 2009. With the easing in spot iron ore prices, we believe Chinese buyers could begin to show an increased appetite for higher-quality imports over domestic production, which should support prices around current levels. These prices still provide some of the best margins in the mining industry. Our forecast cash costs are as follows: BHP/RIO, about US\$20/t; FMG, about US\$30/t; and MGX/AGO, US\$45-55/t... The overseas marginal price setter/buyer of iron ore miners has lost about 10% on the AUD/USD going the wrong way over the past month. Add to this uncertainty around EU and China, combined with the potential RSPT impact, and many overseas fund managers have thrown in the towel and put Australian miners in the too-hard basket, driving a significant sell off. Iron ore plays have been some of the hardest hit, with many declining more than 30% from recent highs. BHP, RIO, FMG and MGX are all trading at more than a 20% discount to NPV (with RSPT factored in). With the AUD holding at 82-83c, commodity prices stabilising (albeit at lower levels) and stocks trading well below their RSPT-impacted valuations, we may begin to see confidence return and buyers on the hunt for bargains driving positive share price movements.

JP Morgan (JPM) has revised their healthcare sector earnings forecasts and share price targets for changes to their currency forecasts. The main earnings impacts are in FY11E: FY11E EPS **COH** (+9%), **CSL** (+6%), **RMD** (+7%), **SHL** (+4%). JPM said:

RMD's USD reported earnings benefit from 50% of COGS and 75% of R&D, while only ~4% of revenues in AUD, particularly at the gross margin line. Our Dec-10 Share Price Target for the ASX-listed stock also benefits from translation of NYSE stock to ASX-CDIs. Meanwhile, an appreciation of the USD vs. AUD benefits AUD reported earnings for US revenues for COH, CSL and SHL. We reiterate our Overweight rating on CSL, which we think on a 12 month forward PE of 16x does not capture upside risk from clinical trial optionality and the potential for plasma industry conditions better than expected, through strong growth rates in the subcutaneous IG space. Although we believe medical device companies COH and RMD both have reasonable prospects for EPS growth through new product launches, we think both are fully priced. We prefer RMD to COH given COH is trading on a 12-month forward P/E of ~25x and RMD is on ~20x vs. forecast 3 year EPS CAGR of 15% and ~17% respectively. The risk for both SHL and PRY is whether the Pathology funding cuts can be recovered through co-payment increases and whether there is a structural decline in pathology volumes. We prefer SHL to PRY given both are trading on 12-month forward P/Es of ~12x, while SHL has higher forecast EPS growth (SHL 3 year EPS CAGR of ~8% vs. PRY ~0%). We think there is EPS upside risk for SHL from highly synergistic acquisitions in the US/Europe while PRY faces the risk for further market share losses from SYB merger disruptions. We are Neutral HSP and SIP. We now await Board decisions on whether to recommend or reject the current approaches as the next catalysts for the stocks. Although we think HSP's bid price of A\$5.75 is attractive (vs. our DCF valuation A\$5.57) and we think SIP's A\$0.60 offer by Aspen is opportunistic (vs. our DCF valuation A\$0.75), in our view both bids appear more attractive vs. the stocks on a stand-alone basis.

Research

Virgin Blue Holdings Limited (\$0.31) – After VBA announced a profit downgrade UBS have **downgraded** from a BUY to a HOLD. Credit Suisse, Macquarie and JP Morgan have retained a BUY rating while GSJB Were maintained its HOLD.

Transpacific Industries Group Ltd (\$1.21) – UBS have reviewed their short term estimates for TPI and have **upgraded** from a SELL to a HOLD.

Nufarm Limited (\$6.00) – Following the structural decline in the glyphosate markets JP Morgan and UBS have retained a HOLD rating while Credit Suisse has reiterated a SELL.