NEXT Daily – 4 June 2010

Overseas

The **Dow Jones** rose 5 pts or 0.06% to 10,255.28 (YTD -1.66%), **S&P 500** rose 4 pts or 0.41% to 1,102.83 (YTD -1.10%) and the **NASDAQ** rose 21 pts or 0.96% to 2,303.03 (YTD 1.49%).
The **FTSE** rose 59 pts or 1.16% to 5,211.18 (YTD -3.73%), **Nikkei** rose 310 pts or 3.24% to 9,914.19 (YTD -5.99%) and the **Hang Seng** rose 314 pts or 1.62% to 19,786.71 (YTD - 9.54%)
Oil rose $1.75 to $74.61 a barrel.
Gold fell $18.03 to $1,205.43 an ounce.
Base metals were weaker with Copper down 2.15% to $294.61, Zinc fell 3.19% to $77.71 whilst Aluminium was down 1.43% to $87.25 and Nickel fell 4.98% to $843.68.
BHP ADR's trading at $37.73 vs the Aussie close of $38.74.
SPI 200 Futures closed up 79 pts at 4,466.

Ideas

Continuing positive economic data out of the US enable markets to push slightly higher despite a number of macroeconomic factors weighing on the market. China worries hit materials stocks while financials were sluggish on worries of tougher "Volcker Rules" The European concerns have spread to a country outside the PIGS ... Hungary. The Hungarian currency, the forint, is getting hit after one of its leaders said the country was at risk of a "Greece-like" crisis. Meanwhile, North Korea is again threatening that war could break out at any moment. All eyes were on the May economic data as it was the first full month to encapsulate the European sovereign crisis. Generally, most growth indications remained on track. The ISM/PMI surveys, while coming in a bit light of expectations in certain instances, are signaling continued expansion. The US consumer remains healthy judging by the retail sales this morning or yesterday's auto releases (importantly, a bunch of big retailers commented that the month of May ended stronger than it started, signaling momentum into June). The ISM's non-manufacturing purchasing managers' index held at 55.4 in May (Mkt est: 55.6), the same reading as in April and March. Nonetheless the services sector, although expanding, continues to lag the gains made by U.S. manufacturers.

Higher European sovereign risks have shaken global credit markets leading RBS to argue that the Australian banks will face rising whole sale funding pressures. They estimate that Australian banks on average need to raise A$140bn pa over FY11-14. While this is manageable, RBS believe that the increased cost of debt will be a margin headwind for the sector over this period making the comments.

> **Term debt borrowing costs look set to rise**
> The rise in European sovereign risk since April 2010 has shaken global credit markets. Borrowing costs have risen even for the safest commercial borrowers. We understand that risk spreads above benchmarks for the AA-rated Australian banks have spiked by 40-50 basis points for five-year debt and by 30 basis points for three-year paper. Given Australia's big four banks rely on term debt for about 20% of their total funding, with most of this raised in offshore credit markets, the potential spike in offshore borrowing costs will place additional pressure on margins.
> **Funding requirements seem manageable**
> We estimate that that the major banks' total term debt issuance will be close to A$160bn in FY11F and on average A$140bn pa in the four years FY11-14. Over this four-year period, we estimate that WBC needs to raise about A$43bn, CBA A$41bn,

NAB A$29bn and ANZ A$28bn. The major variables in this analysis remain the level of loan versus deposit growth and any further regulatory driven switching from S/T to L/T wholesale debt.

But represents a margin headwind

Consistent with our credit strategist, we remain of the view that the term debt requirement of the major Australian banks is manageable over the next four years. That said, the banks will be competing in a significantly more crowded market in 2011-14 than over the last two years and therefore pricing pressures are likely on the increase. To this end, our analysis suggests that if the cost of new term debt increases by +50bp from current levels, then our FY14 margin assumptions would need to be reduced by 6bp (ceteris paribus). Furthermore, if the banks do look to further rotate their wholesale funding from short-term to long-term, this would represent an additional margin headwind, particularly for CBA and WBC.

Refinancing burden appears to favour ANZ and NAB over the next four years

With an average term debt burden approximately A$10bn pa lower than both CBA and WBC over the next four years, ANZ and NAB appear better placed to face the challenges posed by uncertainty in wholesale debt markets and any surprises the regulatory environment might hold for the sector with regards to stable funding.

AGK announced to the market yesterday that they have upgraded its FY10 NPAT guidance to $420-430mn up from the previous guidance was $390-420mn, issued at the AGM in late October 2009. Credit Suisse (CS) had been expecting this upgrade, post the strong 1H10. Credit Suisse FY10 NPAT forecast was $433mn, unchanged since October 2009, and they see no reason to change, going on to make the following comments:

- **Weather is the driver:** While no reason was given in the release, we understand that after 11 months of trading, AGK could be more confident to upgrade following the strong 1H10 result (NPAT $239mn). The overall contributor to the result was weather. It was not from extra wind development fees (guided at around $55mn, similar to FY09). AGK expects the 1H/2H split for FY10 is more like a normal 55/45 split, compared to the prior year when a very hot January-March led to a stronger 2H result (51/49 split). FY10 was characterised by hot weather in 1H, causing the more asymmetric split.

- **Wind farms, NSW privatisation and Moranbah selldown are catalysts:** The main catalysts now for AGK are its participation in any NSW energy privatisation (data room is scheduled to open on 1 July), and any further wind farm developments/selldowns. A sale of its 50% stake in the Moranbah coal seam gas reserves could deliver upside of $860mn net ($1.92cps). We include $540mn risk weighted in our valuation for the Moranbah stake.

Research

AGL Energy Limited ($14.33) - With AGK upgrading their FY10 guidance, GSJB Were, JP Morgan and UBS have retained a BUY whilst Credit Suisse maintains a HOLD. GSJB Were has a price target of $17.05.

ASX Limited ($30.70) – With ASX aggressively lowering its fee structure to compete with likely new entrants, RBS and UBS have maintained a BUY whilst Credit Suisse and GSJB Were have retained a HOLD. Macquarie have reiterated a SELL. UBS has a price target of $40.50.

Equinox Minerals Limited ($4.44) – Following EQN's increased production of copper in concentrate in April/May, UBS has **upgraded** to a BUY with a price target of $4.90.