

NEXT Daily – 18 June 2010

Overseas

The **Dow Jones** rose 24 pts or 0.24% to 10,434.17 (YTD 0.06%), **S&P 500** rose 1 pt or 0.13% to 1,116.04 (YTD 0.09%) and the **NASDAQ** rose 1 pt or 0.05% to 2,307.16 (YTD 1.67%).

The **FTSE** rose 15 pts or 0.30% to 5,253.89 (YTD -2.93%), **Nikkei** fell 67 pts or 0.67% to 9,999.40 (YTD -3.87%) and the **Hang Seng** rose 76 pts or 0.38% to 20,138 (YTD -8.28%) Oil fell \$0.40 to \$76.39 a barrel.

Gold rose \$18.20 to \$1,248.70 an ounce.

Base metals were weaker with Copper down 3.10% to \$292.00, Zinc fell 3.50% to \$80.00 whilst Aluminium was down 1.90% to \$89.00 and Nickel fell 1.20% to \$898.00.

BHP ADR's trading at \$38.66 vs the Aussie close of \$38.82.

SPI 200 Futures closed up 8 pts at 4,540.

Ideas

U.S. stocks crept back into the black in the final ten minutes - sparked by a House vote that softened the Collins (bank capital) amendment - to mask what had been a broadly weaker session. As has been the case for the past three days investors appeared to find a way to look through another bout of disappointing economic data - jobless claims, Philly Fed - to maintain a modest underlying bid for the major averages. Gold futures settled at a record \$1,248.70 an ounce as investors sought some refuge from the underwhelming data. The consumer price index dropped 0.2% (Mkt est: minus-0.2%). The "core" rate of inflation - which strip out volatile energy and food items - rose 0.1% in May (Mkt est: +0.1%). The Labor Department said in that initial claims for jobless benefits rose 12,000 to 472,000 in the week ended June 12 (Mkt est: 450k).

After a number of earning downgrades from companies during confession season UBS have released the following note on the risks and opportunities to earnings outlook.

Lingering Uncertainty Over Earnings

With market uncertainty over the earnings outlook still high (as reflected by a low market P/E on a high market earnings growth forecast) we run some earnings based screens to look for stocks that are potentially 1) vulnerable and alternatively 2) oversold, and also draw out some top down themes.

FY11e EPS Growth – Bolstered By The Bulks

Our bottom up aggregate market cap-weighted EPS growth of 27% (consensus is at 24%) is heavily influenced by BHP Billiton, and to a lesser extent Rio Tinto, with around half of the 27% coming from these 2 stocks alone. Growth excluding resources is a more moderate 12% (consensus is at 14%) or 13% on a median basis, well above long term trend growth of 6% but not particularly onerous following two years of sub-par earnings.

Margins - How Optimistic?

While we are not overly bearish on earnings we think margin assumptions are a source of some vulnerability. While we believe it is logical to assume margins rise in FY11 given 2 years of sub-trend earnings performance the degree of uplift might be optimistic particularly for the industrials.

LEI announced that it has secured two major contract awards and extensions totalling more than \$1.5bn. The larger of the two is a 6yr, \$1.1bn contract extension of Thiess Indonesia's contract mining role at the MSJ coal mine in Indonesia. Thiess has been on site since 2004 and will now increase coal mining operations to over 8Mtpa. The second contract is a \$405m contract from BHP to undertake remediation works as part of the Hunter River Remediation Project (HRPP). The HRPP involves the remediation of river sediments affected by industrial activities at the former Newcastle Steelworks facility in Mayfield, NSW. LEI expects to complete the remediation works in CY12. Following the announcement of these contract extensions **JP Morgan went on to make the following comments:**

In terms of the financial impact, we estimate these projects could potentially translate into \$55-80m (18-27cps) after-tax profit over the life of the contracts. In addition, these contracts will make a positive contribution to Group work-in-hand. Based on the timeframe of these contracts, we expect the net addition to Group WIH to be in the order of \$1.3bn. If nothing else, these wins raise our confidence level in Group WIH trending towards \$40bn by 30 Jun10, up from \$37.5bn as at 31 Mar10. We note that the Group still has around \$4bn of preferred bidder status work yet to be finalised so we think it's possible we may see further contract awards announced before the end of FY10E.

We believe the Group is on track to meet market expectations for FY10E. Further ahead, growing evidence of rising WIH raises our confidence level in a return to earnings growth in FY11E. We believe the current share price represents an attractive point at which to leverage these potential positive data points (i.e. rising WIH and earnings growth) Key risks to our investment view include continued operating difficulties in the Gulf (including inability to recover outstanding payments from developer clients), a deferral of investment in the Australian resources sector due to the proposed RSPT and fixed-price construction risk generally.

Morgan Stanley has updated their Asia Pacific "Best Ideas" this morning by removing Worley Parsons. The rationale for WorleyParsons' inclusion was a view that the hydrocarbon capex cycle is at an inflexion point, with proprietary analysis from our global energy team suggesting a decline in net oil supplies in the medium term. This combined with an improved macro and oil medium-term outlook should, in our view, prompt a rise in exploration and production, favourably impacting WorleyParsons' earnings. Andrew Moller, the Morgan Stanley analyst covering WorleyParsons, maintains this view and retains his Overweight rating on the stock, but acknowledges reduced near-term positive catalysts because of the overhang from the Gulf of Mexico deepwater drilling moratorium.

The only Australian holding currently in their Asia Pacific "Best Ideas" is FGL and they recent Buy recommendation this week maybe the catalyst behind the strength in FGL this week. Morgan Stanley saying:

We continue to believe that FGL is substantially undervalued. **While we don't regard M&A as an imminent catalyst, we feel the stock's strategic appeal could mean that it trades towards precedent transaction multiples over time.** FGL has been the subject of ongoing takeover speculation – most recently *Dow Jones* on June 8 reporting Tsingtao and Bright Foods were looking at FGL (FGL has said it has had no formal approaches). Before any real M&A premium however, we expect that FGL can trade at \$6.50, our twelve month price-target. Our analysis of the current state of global beer consolidation leads us to believe that the number of attractive targets has reduced dramatically. Australia has provided very healthy long-term profit pool growth, has an attractive market structure, positive demographic trends, and large current base of profits. We think this pool is highly defensible, and in fact offers more robust absolute growth than many appreciate. Given that the eight leading

brewers control at least 70% of the current profit pool, and should harvest 75%+ share of the incremental growth, the 'available' remainder is actually quite small. We project US\$8.3b in global incremental profit pool growth in the next decade (from the current US\$22.6 billion), but the majors should capture at least US\$6.3 billion of that. Foster's should generate as much as 15% of what is left, assuming only 4% Australian profit pool growth (compared to a ten year history of more like 7%). Few other single assets globally will come close to this type of contribution.

Research

Boom Logistics Limited (\$0.45) – Following BOL's recent share price strength, UBS has **downgraded** to a HOLD with a price target of \$0.50.

Infigen Energy (\$0.85) – With IFN management releasing an update on the business, Credit Suisse has **downgraded** to a SELL with a price target of \$0.90.

Mineral Deposits Limited (\$0.85) – With MDL releasing results from the Definitive Feasibility Study for the Grande Cote Mineral Sands Project, GSJB Were has **upgraded** to a BUY with a price target of \$1.35.