NEXT Daily – 22 June 2010

Overseas

The **Dow Jones** fell 8 pts or 0.08% to 10,442.41 (YTD 0.14%), **S&P 500** fell 4 pts or 0.39% to 1,113.20 (YTD -0.17%) and the **NASDAQ** fell 21 pts or 0.90% to 2,289.09 (YTD 0.88%). The **FTSE** rose 48 pts or 0.92% to 5,299.11 (YTD -2.10%), **Nikkei** rose 243 pts or 2.43% to 10,238.01 (YTD -2.92%) and the **Hang Seng** rose 625 pts or 3.08% to 20,912.18 (YTD -4.39%)
Oil rose $0.59 to $77.77 a barrel.
Gold fell $4.60 to $1,253.70 an ounce.
Base metals were stronger with Copper up 2.62% to $298.28, Zinc rose 2.58% to $78.96 whilst Aluminium was up 0.84% to $87.54 and Nickel rose 1.32% to $897.07.
BHP ADR's trading at $39.56 vs the Aussie close of $39.91.
SPI 200 Futures closed up 7 pts at 4,567.

Ideas

The US gave up triple digit gains last night after the ramifications of an appreciating renminbi set in. A promising early rally fell apart as investors questioned how much impact the appreciation would have on the global economy. The markets fate was tied closely to the direction of currencies, which were roiled following an afternoon downgrade of BNP Paribas's credit rating by Fitch Ratings. The cut weighed on the euro and helped rekindle investors' fears about the European debt crisis. The market steadily faded through most of the session afterward, including an especially heavy bout of selling around 3pm that major indexes never quite recovered from. Retailers were torn apart amid concern a stronger Chinese currency will boost the cost of importing goods from the country. Resource stocks were large outperformers, as were commodities, however gold equities took a breather after outperforming over the past few weeks. Goldman Sachs JBWere (GSJBW) made the point that the losses in US weren't enough to erase a gain on the MSCI World Index, with the gauge of 24 developed markets rising for a 10th day, the longest streak in 11 months.

On the European debt crisis Deutsche Bank (DB) have produce a strategy piece with a view that the euro zone will survive this current crisis. DB said:

> In our view there is no way the political and financial leadership of the core euro area countries are going to sacrifice the whole single currency project over a default by Greece or Portugal. This is because the financial fabric of the bloc depends on national governments standing behind their banks. A sovereign default would cause huge losses to banks, central banks, and ultimately taxpayers. It would also set back the fragile recovery of the real economy. Such an event would represent Europe's "Lehman" moment. With the EUR 750bn rescue package and the ECB's commitment to provide required liquidity and purchase bonds of peripheral euro zone countries, we now have a comprehensive backstop to the European crisis. But market volatility could persist for the next month or two until southern European governments have demonstrated their ability to pass difficult fiscal and labour measures, Spanish cajas have been recapitalised and the ECB's commitment has been convincingly tested by the markets. Our modelling, though, suggests that Spain – the markets' current focus of concern - is in better shape than is commonly supposed and will defy the fears that its banking system is in danger of collapse. The current crisis has, though, laid bare the euro zone's fundamental weaknesses — a lack of fiscal harmonisation or control of deficits across the 16 member countries. This crisis should stimulate sufficient reform to redress some of the worst shortcomings of the union. But no amount of

new regulation will convince the markets of governments' commitment to fiscal orthodoxy. So we think constitutional rules at the national level imposing limits to fiscal deficits are needed. Finally, we expect the peripheral European countries to suffer a prolonged period of slow growth. The crisis has validated the strategy of those member states, especially Germany, that have based their growth model on exports at the expense of domestic demand. A general conversion to this "thrifty model" is likely to be a long-term consequence of the current turmoil. The world may need to get used to a Europe generating large current account surpluses without exerting significant traction over the other regions.

DB also reported on BHP and RIO's signing of a non-binding agreement with the Western Australian Government, which will increase the iron ore royalties paid by the two miners to the State government. Royalty rates will increase from 3.75% to 5.625% for Iron ore fines and from 3.25% to 5.0% for beneficiated ore. Royalty rates for lump will remain constant at 7.5%. This agreement means that all the Pilbara producers now pay the same royalty rates eliminating any previous disparity. The new agreement says DB, will allow both the companies to share infrastructure and blend ore across networks, potentially unlocking some of the synergies available to the proposed Iron Ore Joint Venture in Western Australia. The ability to combine both production units e.g. logistics and support functions e.g. IT and Procurement will unlock further synergies, but the full combination is subject to regulatory approvals. DB is cautious on the success of attaining the necessary regulatory approvals for the Iron Ore JV, however view this agreement is an important enabling step. In summary, both BHP and Rio have secured important concessions in exchange for a higher royalty, something they were always likely to have to pay. The earnings downgrade for both companies, according to DB, is modest at c.1%, but the downgrade to Rio's NPV is greater at c.4.5%. DB have trimmed their price targets (BHP to AU$ 48.00 and Rio to AU$ 92.00) to reflect this downgrade, both still based on 1.0x NPV. DB also believe that should the Resource Super Profits tax be introduced in its current form, both Rio and BHP would be eligible for a rebate at the higher royalty rates.

Goldman Sachs JBWere (GSJBW) noted last nights Four Corners programs less then glowing endorsement of WPL's proposed LNG development at James Price Point. GSJBW said the program provided some additional insight into the conditions under which the Kimberley Land Council (representing traditional landowner groups) in April 2009 signed a Heads of Agreement with Woodside (as project operator) and the WA state government to establish an LNG development site at James Price Point. Allegations were made on the program (these had already been made previously) that the meeting agenda was not appropriately communicated and that the vote on the proposal was not appropriately conducted (that an ultimatum was given the meeting and a decision had to be made in a short period of time at the end of the meeting when many key traditional landowner individuals representing the James Price Point area were not present). Mr Wayne Bergmann (of the Kimberley Land Council) indicated that the agreement with Woodside and the WA state government was the end result of a highly pressured process and that the WA state and Woodside were presenting "take it or leave it" positions (ie. compulsory acquisition regardless), and that it did not represent a true negotiation process. Former federal court judge Mr Murray Wilcox QC also made suggestions that the vote was flawed and may not have been valid. WA Premier Mr Colin Barnett has suggested in recent weeks (and reiterated on the program) that if the dispute between traditional landowners is not resolved, the government intends to move to compulsory acquisition of the site at the end of June. GSJBW makes the following comments:

1. No change to our investment view on Woodside (HOLD; accumulate at or below $42/share).
2. In our view, little is being priced in WPL shares at these levels for the Browse gas project (GSJBW stranded gas resource value $3.43/share of our $54/share

valuation). However, given that progress on Browse Basin gas commercialisation likely represents the most material source of upside to our Woodside valuation longer term (other than Carnarvon Basin exploration success which could potentially lead to a Pluto LNG project expansion, but is inherently impossible to predict), meaningful progress on the site could be viewed favourably by the market. We still believe, however, that JV partner alignment and consolidation with other gas projects in the region (eg. Inpex - to achieve sufficient scale) must be achieved before the project can proceed - even in the event that a development site is agreed.
3. If the WA state moves to compulsory acquisition of the land, the Goolarabooloo people have flagged intended resistance to the decision (as represented by Mr Joseph Roe, who appears to be fundamentally against the development at James Price Point) and while the Jabirr Jabirr people (as represented by Mr Frank Parriman) appear to be more supportive of a suitable development and the compensation package & community benefits it would bring, they also indicated they would not support compulsory acquisition of the land.

Research

Orica Limited ($26.74) – Following the announcement that ORI will be expanding its Kooragang Island project, Credit Suisse has **downgraded** from a BUY to a HOLD. Deutsche has retained a BUY rating with UBS and Macquarie reiterating a HOLD.
JB Hi-Fi Limited ($20.38) – Due to recent share price performance and downside risk to earnings estimates JP Morgan have **downgraded** from a BUY to a HOLD.
Aristocrat Leisure Limited ($3.96) – Following a downgrade to its US machine sale forecasts GSJB Were have **downgraded** from a HOLD to a SELL.
Sigma Pharmaceuticals Limited ($0.50) – After SIP held it's AGM, Macquarie have **downgraded** to a SELL with Wilson HTM, UBS and JP Morgan retaining a HOLD rating while Credit Suisse reiterated a SELL.
Telstra Corporation Limited ($3.34) – TLS announced that it has signed the Heads of Agreement with the NBNco. As a result, Credit Suisse and RBS have retained a BUY rating while GSJB Were, Macquarie and JP Morgan have reiterated a HOLD.
Bradken Limited ($7.55) - BKN has finalised the outcome of its ESCO arbitration proceedings and provided an earnings update to the market. Consequently, Deutsche, Macquarie, GSJB Were and RBS have retained a BUY rating with Credit Suisse reiterating a HOLD.