

## NEXT Daily – 29 June 2010

### Overseas

The **Dow Jones** fell 5 pts or 0.05% to 10,138.52 (YTD -2.78%), **S&P 500** fell 2 pts or 0.20% to 1,074.57 (YTD -3.63%) and the **NASDAQ** fell 2 pts or 0.13% to 2,220.65 (YTD -2.14%). The **FTSE** rose 25 pts or 0.50% to 5,071.68 (YTD -6.30%), **Nikkei** fell 43 pts or 0.45% to 9,693.94 (YTD -8.08%) and the **Hang Seng** rose 35 pts or 0.17% to 20,726.68 (YTD -5.24%)

Oil fell \$0.65 to \$78.21 a barrel.

Gold fell \$16.90 to \$1,238.70 an ounce.

Base metals were stronger with Copper up 1.44% to \$310.26, Zinc rose 0.34% to \$83.81 whilst Aluminium was up 1.67% to \$90.87 and Nickel rose 4.58% to \$933.54.

BHP ADR's trading at \$38.22 vs the Aussie close of \$38.49.

SPI 200 Futures closed down 21 pts at 4,356.

### Ideas

US stocks stayed within a pretty narrow range and hovered around unchanged for most of the session (the S&P500 never being up or down much more than 5 or 6 points) on light volumes, providing a prelude to how many think the next two weeks will play out as we head into a news vacuum ahead of the Jul 4 holiday (this weekend) and the Q2 earnings season (starting week of Jul 12) said JP Morgan (JPM). Aside from a couple of earnings and eco numbers, the coming fortnight will be barren of major market catalysts. JPM believes that while many continue to make the valuation argument it seems like people won't step into the market in a meaningful way until we get:

- 1) earnings - starting week of Jul 12
- 2) European bank stress tests - expected mid July.

**Goldman Sachs JBWere (GSJBW) issued a cautionary note on bulk commodity prices citing that after trading a narrow range either side of US\$144/t CFR China for most of June, seaborne spot iron ore prices (basis 62% Fe) have fallen sharply in the past few days.** The Platts index for Friday was US\$135.50/t, Monday's quote from TSI was US\$139.70/t and in the OTC SWAP market 3Q-10 dropped by US\$7.44/t on Monday to \$128.56/t. GSJBW spot price forecast for 3Q-10 is US\$145/t CFR China, 62% Fe (note, 2Q-10 looks set to come in at US\$160/t). GSJBW said the fact that spot prices have fallen sharply at a time of reduced export availability from India's west coast ports (due to the monsoon) suggests that demand for spot cargoes has fallen sharply as sentiment towards the Chinese steel sector continues to weaken. Feedback from industry participants suggests that seaborne spot iron ore prices will continue falling in the short term. Freight rates have also collapsed in the past few weeks, albeit largely due to oversupply of vessels rather than reduced demand for cargoes: capesize rates from Australia to China have fallen by 38% since the start of June (now \$8.70/wmt) and from Brazil to China rates are down 37% to \$21.50/wmt.

**Post the NBN Heads of Agreement (HoA), JPM believe the valuation conundrum on Telstra has moved from a deal/ no deal binary dimension to the analysis of a range of potential scenarios,** under what looks like a reasonably likely negotiated outcome now. JPM said:

We see 4 key building blocks in the value of Telstra's fixed line business today:

- 1- the NPV of the FCF from FY11-13 reflecting a minimal impact from the NBN,
- 2- the NPV of the FCF from FY14-30 (when migration to NBN is expected to be completed) factoring in the impact of the migration to NBN,
- 3- a terminal value for the Fixed line business at that point,
- 4- The \$11bn NPV from the NBN HoA which remains impossible to test given the lack of details at this stage.

Amongst many other variables, we believe modelling the NBN impact on Telstra's fixed business involves making 3 key long term assumptions,

- 1- Telstra's sustainable fixed retail market share,
- 2- the level of fixed retail margins,
- 3- Telstra's Fixed capex spend under the NBN.

We stress that forecasting these key parameters in the long term is inherently hazardous given the high level of unpredictability of potential competitive developments, regulatory decisions, consumer behavior, etc. Based on different value estimates of Telstra's Fixed business under a Base, Best and Worst case scenario, we derive a valuation range for the stock comprised between \$3.20 and \$3.61 per share. Our Dec-10 price target of \$3.42 underpins our Neutral recommendation. Whilst the release of more details closer to the shareholder vote (c. 1Q11) might shed some light as to how Telstra sees its future in an NBN world, we believe only time and further detail on the NBN roll-out will provide the answers to these long term questions. **In the meantime, and in the absence of any global precedent, we believe the market will continue to struggle to canvass the implications of this transformational transaction on Telstra's future earnings and FCF generation.**

## Research

Wesfarmers Limited (\$29.19) – Following the announcement from WES that it has negotiated quarterly contract hard coking coal prices, Deutsche and JP Morgan have retained a BUY whilst UBS maintain a HOLD and Credit Suisse reiterates a SELL. Deutsche has a price target of \$42.39.

Energy Resources of Australia Limited (\$13.60) – With ERA attempting to extend the mine lease beyond 2021, Deutsche has **upgraded** to a BUY whilst RBS has retained a HOLD. Deutsche has a price target of \$17.30.

Nufarm Limited (\$5.20) – Following recent share price underperformance, Credit Suisse has **upgraded** to a HOLD with a price target of \$5.80.

Wattyl Limited (\$1.61) – Following WYL's first announcement since receiving an indicative, non-binding and confidential offer of A\$1.30per share on 25 May, Macquarie and Credit Suisse have retained a HOLD whilst RBS has **downgraded** to a HOLD with a price target of \$1.67.