

NEXT Daily – 30 June 2010

Overseas

The **Dow Jones** fell 268 pts or 2.65% to 9,870.30 (YTD -5.35%), **S&P 500** fell 33 pts or 3.10% to 1,014.24 (YTD -6.62%) and the **NASDAQ** fell 85 pts or 3.85% to 2,135.18 (YTD -5.90%).

The **FTSE** fell 157 pts or 3.10% to 4,914.22 (YTD -9.21%), **Nikkei** fell 123 pts or 1.27% to 9,570.67 (YTD -9.25%) and the **Hang Seng** fell 477 pts or 2.31% to 20,248.90 (YTD -7.42%)
Oil fell \$2.38 to \$75.87 a barrel.

Gold rose \$1.00 to \$1,239.95 an ounce.

Base metals were weaker with Copper down 5.52% to \$293.13, Zinc fell 7.47% to \$77.55 whilst Aluminium was down 4.19% to \$87.06 and Nickel fell 7.63% to \$862.28.

BHP ADR's trading at \$37.33 vs the Aussie close of \$38.10.

SPI 200 Futures closed down 95 pts at 4,243.

Ideas

China kicked off a terrible night on global bourses as the Shanghai exchange slumped ~4.3% (its now off 26% YTD) with worries about liquidity and economic growth (revision to Conference Board Leading Economic Indicator to 0.3 from 1.7% in April) hurting. This was China's largest single day % decline since May 17. The weakness in Asia extended into Europe, with people citing worries about the 12 month liquidity tender expiry as the cause of the selling. JP Morgan (JPM) said, on the EU bank stress test front, we continue to receive press reports that some of the most critical institutions will pass but investors are still nervous. US Consumer confidence took a nasty spill in June, falling almost 10 points to 52.9, a slide which undoes the improvement seen over the prior two months. The Bank of England's monthly monetary and financial statistics publication for May showed continued weakness in bank credit growth.

Fears of a global slow down have hit the commodity sector hard recently with base metals feeling the brunt, particularly last night, Deutsche Bank (DB) has this morning produced two pieces looking through the short term noise to how they see the resources trading in the longer term. Firstly on the bulks, iron ore and coal they state that while the destinies of both iron ore and coking coal markets are strongly tied to that of the global steel industry, they see the prospects for performance between the two materials as becoming more discordant going forward. This is a function of two key variables in their view:

- 1) a shift in growth characteristics for steel production globally, but particularly the emerging world and
- 2) the differentiated prospects for supply growth for the two markets.

In the first instance, DB are concerned about the potential for a meaningful deceleration in China's steel consumption growth over the next 12 months. DB's analysis of consumption intensity suggests that steel consumption in China is unlikely to meaningfully exceed 750mt. Other markets however, are expected to experience rapidly steel consumption growth, these include Brazil, India and South-east Asia. This migration of growth is expected to have significant repercussions for both iron ore and coking coal. Given both Brazil and India have significant domestic reserves and production of iron ore, it is unlikely that they will ever be large importers of iron ore; whereas both have little to no domestic coking coal resources, meaning that they will be increasingly reliant on the seaborne market. In the second instance DB see stronger supply growth prospects for iron ore vis-à-vis coking coal. There is significant capital being invested in new iron ore capacity in various regions and we expect

that this will result in a much more balanced market in 2-3 years time. The coking coal market on the other hand faces significant challenges in exploiting new resources, particularly in building the infrastructure which is necessary to exploit the giant reserves in new mining regions such as Mongolia or Mozambique. Under the new quarterly pricing system for both iron ore and coking coal DB expect prices to be under some pressure into Q4 this year with weakness potentially extending into 2011. This implies that we see the contract settlements for Q3 10 as a near-term peak. **Longer-term however they expect that coking coal prices are likely to move higher still, into mid-2011 and then 2012, reaching USD250/t, whereas they expect that iron ore pricing could remain somewhat moribund at the USD130/t level.**

Looking more broadly at the resource sector DB believes value is emerging with seasonal weakness stating that the commodities complex has been susceptible to an escalation in European sovereign concerns, fears of a double dip recession, and Chinese seasonal demand weakness. As mentioned above they expect price weakness to continue into 3Q, particularly for base metals, although they see 3Q as the near-term peak for iron ore due to temporary weakness in Chinese steel demand. Overcapacity in crude and stainless steel, aluminium smelting, and industrial metals refining is a concern in light of a weak 2H demand backdrop according to DB. In addition, both steel and LME stocks remain at high levels they said. Saying that, physical raw commodity supply remains tight especially for thermal and metallurgical coal, iron ore, copper, and platinum due to; infrastructure constraints (port and rail), labour and equipment shortages, and lengthy project development schedules. Hence with their ~4% global GDP growth forecast in 2011, they see tight commodity markets throughout 2011&12. DB are most bullish iron ore (US\$125/135/t 2011/12 – CIF Australia to China), thermal coal (US\$110/120/t 2011/12), coking coal (US\$238/250/t), copper (US\$3.50/4.00/lb), nickel (US\$11.50/12.00/lb), platinum (US\$1,750/1,850/oz), and gold (US\$1,450/1,600/oz). Further DB said:

With the expectation of further seasonal demand weakness in 3Q driven by slowing Chinese FAI and imports, compelling value appears to have emerged in the mining sector at 0.88xNPV. Overcapacity in steel, and base metals refining, remains a concern, but tight bulk commodity and concentrate supply should result in higher prices in 2011&12 as OECD demand rebounds. Our top commodity picks remain iron ore, coal, copper, platinum (all supply constrained), and gold. Our top stock picks are; BHP, RIO, NCM, AVO, AQP, MCC, PNA, OZL, IGO, MBN. At the large end of town, our preference is now clearly BHP (0.8xNPV) over RIO due to greater diversification and more compelling medium to long term growth. IGO (0.8xNPV) and MBN (0.7xNPV) remain our top nickel picks, PNA our top copper pick (0.8xNPV), AVO and NCM for gold and AQP for platinum. For our contrarian aluminium call, BUY AWC (0.7x NPV). We upgrade WSA, PAN, MCC, and EXT to BUY, and MCR and MRE to HOLD, all on valuation. **Earnings – big upgrades in 2011&12, sector looks attractive on 9x 2011 EPS**

On the back of our strong 2011&12 commodity price upgrades, our sector earnings forecasts have been upgraded by 9% and 30% respectively and the sector is trading on 9x and 6x EPS. Along with the commodity price upgrades, we have increased our capex and opex (fixed and variable) cost assumptions significantly. Sub sector stand-outs include – the diversifieds (8x/7x), copper (7x/5x) & nickel (7x/4x).

Research

MAp Group (\$2.66) – With the announcement that Sydney Airport has completed a \$175mn, 5 year debt raising to buyback around \$120mn of existing November 2011 medium term notes, Macquarie and JP Morgan have retained a BUY whilst UBS has maintained a HOLD. Macquarie has a price target of \$3.45.

Campbell Brothers Limited (\$30.15) – Following CPB's acquisition of a 5% interest in Ammtec (AEC), Deutsche, Credit Suisse and UBS have all maintained a BUY. Credit Suisse has a price target of \$37.20.

APA Group (\$3.54) – Following APA's site tour of its Southern Expansion in NSW and its Young compressor station, Wilson HTM has **upgraded** to a BUY with a price target of \$4.03.