

NEXT Daily – 2 July 2010

Overseas

The **Dow Jones** fell 41 pts or 0.42% to 9,732.53 (YTD -6.67%), **S&P 500** fell 3 pts or 0.32% to 1,027.37 (YTD -7.87%) and the **NASDAQ** fell 7 pts or 0.37% to 2,101.36 (YTD -7.39%). The **FTSE** rose 111 pts or 2.26% to 4,805.75 (YTD -11.22%), **Nikkei** fell 191 pts or 2.04% to 9,191.60 (YTD -12.85%) and the **Hang Seng** fell 119 pts or 0.59% to 20,128.99 (YTD -7.97%)

Oil fell \$2.69 to \$72.94 a barrel.

Gold fell \$45.50 to \$1,196.75 an ounce.

Base metals were weaker with Copper down 2.84% to \$285.74, Zinc rose 2.90% to \$77.50 whilst Aluminium was down 2.59% to \$86.22 and Nickel fell 3.78% to \$858.88.

BHP ADR's trading at \$37.00 vs the Aussie close of \$37.11.

SPI 200 Futures closed up 20 pts at 4,235.

Ideas

Stocks in the US finished Thursday with their eighth loss in nine sessions, but the scope of the slide proved far less severe than what had appeared to be in order during early action. The stock market dropped nearly 2% to a new nine-month low after market participants were hit with a flurry of disappointing reports. Leading the list of disappointing data was an initial jobless claims count of 472,000 for the week ended June 26. Something more in the order of 458,000 claims had been widely expected. Continuing jobless claims climbed to 4.62 million from 4.57 million. It was later learned that pending home sales for May plummeted 30.0% month-over-month in the worst decline in the nine years of available records. Meanwhile, ISM Manufacturing Index for June came in at 56.2, which is not only worse than the 59.0 that had been widely expected, but it is also the lowest level seen since January. Though those reports induced plenty of selling, most market participants are primarily interested in tomorrow morning's official monthly payrolls report from the federal government. Selling pressure eased into the afternoon, so that stocks still finished well above their session lows. Still, the lower finish brought the S&P 500's 50-day moving average even closer to pushing below its 200-day moving average in a move that technical traders call a Death Cross.

As reported in today's press the Prime Minister Julia Gillard flew into Canberra last night and immediately joined talks with mining bosses who had already agreed to a raft of concessions.

This morning Ms Gillard announced that she was prepared to give ground on the rate, paving the way for an agreement with the large miners BHP, RIO and Xstrata. An in-principle agreement has been reached on key sticking points, such as the headline rate of the tax, its retrospective treatment of mines and the rate of return at which the tax will apply and the name of the tax has been changed, now it will be known as the Mineral Resource Rent Tax (MRRT). The key points of the new tax are as follows:

- Iron ore and coal will be subject to a new profits-based minerals resource rent tax at a rate of 30 per cent.
- Other commodities will not be included.
- The cut-in rate for the tax will be the long-term bond rate, plus seven per cent - making it about 12 per cent.
- Small miners with resource profits below \$50 million per annum will not be subject to the tax.

- The petroleum resource rent tax regime, which currently only applies to offshore petroleum projects, will be extended to cover all oil, gas and coal seam methane projects, in onshore and offshore Australia. The tax will apply at a rate of 40 per cent.
- The new arrangements will apply to only 320 companies, down from the 2500 the resource super-profits tax would have affected.
- The new arrangements reduce planned revenue from the resource super-profits tax by \$1.5 billion.
- To offset that loss of revenue, company tax rate will be reduced only to 29 per cent, not the 28 per cent planned.
- The resource exploration rebate has been dropped.

The news wires reported that BHP Billiton chief executive officer Marius Kloppers said the company was encouraged by the government's decision. "As we have previously stated, BHP Billiton believes that tax reform that is prospective, competitive, differentiated and resource-based will ensure that the Australian mining sector continues to grow through investment in the industry which benefits all Australians," Mr Kloppers said. "We are encouraged that the MRRT design is closer to our frequently stated principles of sound tax reform, in that the proposed tax will be prospective in its treatment of profits from our iron ore and coal businesses, and not apply to the other commodities in our portfolio. He described the new regime as representing "a material improvement from the original tax proposal". However the smaller miners are reportedly not as happy with the negotiation process after the federal government's new resources tax regime was hammered out with the big three miners at the expense of others, a lobby for smaller mining companies argues. Association of Mining and Exploration Companies chief Simon Bennison said his group was left out of the negotiations. Small miners would be disadvantaged by the new arrangements announced on Friday, Mr Bennison said. "The government feels the only way it can negotiate through these sorts of situations is with three companies," he told ABC Radio, referring to BHP Billiton, Rio Tinto and Xstrata. "That's an absolute nonsense. "That's not the way to do business. It typifies the way this government responds to small businesses in this country." Small miners with resource profits below \$50 million a year won't be liable to pay the new tax. The group plans to continue campaigning against the 30 per cent tax, now limited to just 320 companies mining iron ore, coal, oil and gas.

After Gold's savage sell off last night its interesting to see Deutsche Banks (DB) analysis this morning of the gold price and their view that their analysis suggests gold has 65% upside from spot before 'extreme' levels. Db said:

With little foundation for USD strength we find cases for gold price upside. The rise in gold prices particularly in an environment where the US dollar has been strengthening has raised concerns that the market may be entering overbought territory or possibly that a price bubble is forming. We have therefore examined at what point gold prices can be considered extreme. We find that gold prices would need to exceed USD1,455/oz to surpass their all time highs in real terms as measured in PPI terms. On a CPI adjusted basis, gold prices would need to hit USD1,880/oz to reach the levels that prevailed at the beginning of the 1980s. However, relative to global GDP gold prices would need to exceed USD1,500/oz to push the share of gold relative to global GDP back to its 1980 peak. Relative to G7 per capita income gold prices would have to move towards USD2,390/oz to bring the purchasing power of an average G7 consumer back to 1980 levels. On average, gold prices would need to reach USD2,000/oz for it to be considered extreme across the eight indicators employed. Accordingly we don't see our expectation for the gold price trend to continue through to 2012 as unwarranted.

We are now in FY11 and current year PERs are well below historic levels. We have a strong gold price outlook and continue to view the sector favourably;

expecting y-o-y earnings growth even if production profiles are flat. We see NCM as having lagged the international peers and the gold price in recent months as a result of the long LGL – short NCM trades being established by the hedge funds. As the deal moves toward completion (due in August) this should unwind. We were encouraged when KCN received approval for the Chatree expansion, and were surprised by the recent share price contraction on newswire comments regarding the potential mine asset IPO as this had long been flagged. The reaction once again provides an opportunity in the equity. KCN, along with MML are our preferred mid cap exposures; Both are low cost miners with exposure to regions of considerable exploration potential. Their offshore locations had been favoured but moderation of the RSPT makes this less relevant.

Research

Metcash Limited (\$4.32) – Following MTS announcing their offer for Franklins for \$215m through existing cash resources, Macquarie has **upgraded** to a BUY whilst JP Morgan has **upgraded** to a HOLD. GSJB Were, UBS and Deutsche have retained a HOLD whilst Credit Suisse has maintained a SELL. GSJB Were has a price target of \$4.91.

AGL Energy Limited (\$14.72) – With AGK making an indicative non-binding proposal to acquire Mosaic Oil for ~\$123m, Macquarie, Deutsche, GSJB Were and RBS have retained a BUY whilst Credit Suisse has maintained a HOLD. Deutsche has a price target of \$17.05

Hunter Hall International Limited (\$5.10) – With the relative performance of HHL flagship funds slowing over recent months, Credit Suisse has **upgraded** to a HOLD with a price target of \$5.25

IOOF Holdings Limited (\$6.04) – Following IFL's recent share price weakness, Credit Suisse has **upgraded** to a BUY with a price target of \$6.85

Peet Limited (\$2.03) – With Peet aiming to grow its syndication business, Macquarie has **downgraded** to a HOLD with a price target of \$2.04.

Qantas Airways Limited (\$2.20) – Following their recent share price weakness, JP Morgan has retained a BUY whilst Deutsche has **upgraded** to a BUY. JP Morgan has a price target of \$3.00.