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Portfolio Watch Weekly

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In This Issue

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BHP Billiton Ltd (BHP) – Recommendation upgrade. Prefer BHP to RIO

Price: $41.50	Recommendation: Accumulate (previously Hold)
PER: 19.1x ('10 est); 13.6x ('11 est)	Div. Yield: 2.3% (100% franked) ('10 est)

- Our recommendation on BHP has been upgraded from Hold to Accumulate (refer HOLST report, 2 February 2010, $39.20) following the fall in BHP's share price, continuing supportive economic releases (eg China data, US ISM manufacturing index) and our previous advice that we prefer BHP to Rio Tinto (refer HOLST report on RIO, 21 January 2010, $78.04, Hold).
- The change in preference for BHP relative to RIO was based on: the respective iron ore sales mix advised by both companies in their quarterly reports: (BHP has 46% of iron ore sales based on shorter term reference pricing); RIO's outperformance relative to BHP over the past six months; and, in the event that there are substantial curbs to credit growth in China, BHP has less downside risk relative to its peer group (due to its unrivalled balance sheet strength, operating cash flow).
- In its iron ore business, BHP (on 29 January 2010) has pre-approved US$1.93 billion of early capital expenditure for the company's Rapid Growth Project 6 (RGP6) in the Pilbara.
- BHP's December Quarter Production Report (released 20 January 2010) was mixed, but had some key positive features (primarily iron ore sales pricing basis; also iron ore production, copper concentrate provisional pricing).
- For the half year ended December 2009, 46% of BHP's WA Iron Ore shipments were based on shorter term reference pricing (quarterly, spot or index pricing basis), which was higher than we would have expected. We upgraded our current year earnings estimate for BHP by 5% to US$10.9 billion, largely due to the change in iron ore sales mix.
- BHP reports its 2010 interim financial results on 10 February 2010 (estimated interim earnings: US$5.0 billion; 2009 interim: US$6.1 billion).
- Overall, we remain somewhat cautious on the outlook for the resources sector given: base metals prices have been – and still are – above levels that could be justified from fundamentals; and recent cautious comments from both BHP and RIO. Any further strengthening in the US$ relative to the Euro (on concern over sovereign debt issues) is likely to constrain base metals prices.

Rob Craigie and/or associated parties own or have an interest in the securities of BHP Billiton Ltd and Rio Tinto Ltd.

Myer (MYR) – Sales slightly below, EBIT growth higher, than forecast

Price: $3.25	Recommendation: Buy
PER: 11.7x ('10 est); 10.9x ('11 est)	Div. Yield: 6.1% (100% franked) ('10 est)

Sales rose 2% in 1H10 (comparative growth rate 1.2%). First quarter sales growth was strong at 5.2%, with second quarter sales flat. Comparative sales were strong in November and in particular January. However December comparative sales were negative, reflecting the anniversary of the Government stimulus package and delayed purchases by consumers in anticipation of post Christmas sales. The impact of the government stimulus packages has been difficult for retailers to measure and they are now cycling higher than normal comparative growth rates in many cases. It appears that many retailers have under-estimated that impact of the government stimulus packages. Operationally MYR is performing well with all new stores and refurbishments providing a strong boost to sales. There are still a number of new stores to come on stream including the new Melbourne store which should drive sales growth over the next few years.

In addition to the sales announcement, MYR expects 1H10 EBIT growth to exceed 10% (prospectus guidance 5.6%). This is pleasing and reflects gains at the gross margin level and on-going cost reductions/efficiency gains. MYR, through investment in systems and supply chain is now able to manage the gross margin up or down to balance returns to shareholders and customers without damaging the EBIT line.

MYR has confirmed guidance for FY10 and with the significant buffer generated in 1H10 plans to invest in order to maximise sales and achieve the 3% sales growth forecast contained in the prospectus. Depending on the amount of investment undertaken to drive sales will determine whether MYR exceeds EBIT guidance of $261m or not. At this stage they are about $7-$9m ahead of forecasts.

The discretionary retail market is facing a number of challenges including the cycling of stimulus packages and rising interest rates offset to some degree by relatively strong employment growth. We believe the discretionary market will be patchy and consumers will continue to be very value driven. Therefore retail pricing will be very keen and promotion activity is likely to intensify. Margin management and working capital will be critical elements.

MYR is currently selling on a **FY10 PER of 11.7x and a dividend yield of 6.1% fully franked** and we believe the stock continues to represent value around current prices for longer-term investors.

OM Holdings Ltd (OMH) - A buying opportunity at current prices

Price: $1.725	Recommendation: Accumulate
PER: 12.0x ('10 est); 9.1x ('11 est)	Div. Yield: 2.3% (100% franked) ('10 est)

- **Manganese ore production from Bootu Creek, in the NT, is targeted to increase 54% in 2010 to 1mtpa (shipments: +34% if shipments match production). The target comprises 750kt of 38% Mn grade product and SPP production of 250kt of 35% Mn grade product.**
- **As a result of the increased SPP plant capacity at Bootu Creek (250ktpa; original plan: 150ktpa) and OMH's 2010 production target of 1mtpa (we assume 950kt shipped), our 2010 earnings estimate has been increased 6% to $70.4m (estimated 2009 underlying earnings: $3.2m).**
- **Our estimated 2010 and 2011 P/E ratios of 12.0x and 9.1x (at $1.725 per share) naturally exclude any benefits from OMH's A$64m investment in the Tshipi Project (likely first production: 2013) and the A$41m equity investment in Northern Iron Ltd (NFE, No Rating).**
- **At $1.725 per share, we retain an Accumulate recommendation underpinned by: higher production in 2010 (Bootu Creek target:+54%, Qinzhou smelter: +22%); lower unit cash costs; and rising manganese ore and alloy prices. The 15% fall in the OMH share price since 18 January 2010 (S&P/ASX200 index: -6%) provides a buying opportunity in OMH.**
- **Excluding global equity market risks, key OMH share price risks include: a weaker than expected Chinese and global steel outlook; unexpected production disruptions at Bootu Creek; and delayed/limited rail and port access for product from the planned Tshipi Manganese Project in South Africa (upon transaction completion, OMH's effective interest: 13%).**

OMH reported (on 28 January 2010) December quarter production of 184,242 tonnes grading 38.7% manganese (its second highest quarterly tonnage on record) from its Bootu Creek operation in the NT. Record December half production of 389,614 tonnes was up 51% increase from the June half and a 20% increase from the 2008 December half.

December quarter unit cash costs Bootu Creek of A$4.29/dmtu were impacted by production disruptions during November (and fully expensed accelerated mine development and pre-stripping costs). **OMH is targeting A$3.50/dmtu unit cash costs in 2010** as production volumes and yields benefit from the newly commissioned Secondary Processing Plant (SPP.)

The Bootu Creek Secondary Processing Plant (capital cost: A$15m) was commissioned on schedule in December 2009 and is operating above the targeted 150ktpa rate. The decision was taken during the December quarter to increase the capacity of the SPP to 250ktpa (at a minor additional capital cost: A$2m). The SPP is now budgeted to produce 250kt of sinter feed product during 2010.

Manganese ore production from Bootu Creek, in the NT, is targeted to increase 54% in 2010 to 1mtpa (and shipments: +34% if shipments match production). The target comprises 750kt of 38% Mn grade and SPP production of 250kt of 35% Mn grade products.

At the Qinzhou Smelter (OMH: 100% interest, Guangxi, China), OMH expects the sinter ore plant will be fully commissioned during February 2010.

Market Outlook

China crude steel production is expected to reach 620mtpa in 2010 (2009: 570mt). As a result, OMH expects demand for manganese ore will continue to strengthen.

Global steel production forecast to grow by 9.2% to 1.2 billion tonnes during 2010, recovering to 2008 levels. China is expected to continue to represent close to 50% of global steel output.

The January/February 2010 manganese product market price is currently US$6.50-7.00/dmtu CIF China and is expected to increase to US$7.50/dmtu for March/April 2010 shipments supporting the view of strong demand and tight supply.

Rob Craigie and/or associated parties own or have an interest in the securities of OM Holdings Ltd.

Ramsay Health Care (RHC) – Upgrade to guidance

Price: $12.05	Recommendation: Hold
PER: 14.5x ('10 est); 13.2x ('11 est)	Div. Yield: 3.8% (100% franked) ('10 est)

Ramsay expects its 1H10 net profit after tax (NPAT) to be 32-34% higher than the previous corresponding period. This strong NPAT growth resulted from better-than-expected performances in both its UK and Australian businesses. The UK operations benefitted from internal cost restructuring in 2H09 and the realisation of cost efficiencies in 1H10. Meanwhile, the Australian operating performance has been slightly ahead of expectations. Ramsay also enjoyed lower-than-expected interest costs due to its interest rate management initiatives.

Ramsay now expects its FY10 NPAT to grow 18-20%, higher than its earlier guidance of 12-14%. This translates into a core EPS growth expectation of 10-12%. Due to the strong rise in Ramsay's share price, we have a **Hold** recommendation, pending further details on the composition of the 1H10 results to be released on 25 February 2010.

Calendar of Events

	Mon 8 February	Tue 9 February	Wed 10 February	Thu 11 February	Fri 12 February
Reporting Date:	JBH	AWC, BKN, COH	BHP, BLD, CBA, CPU, SGP	RIO, TLS	LEI, NCM
AGM:					
Ex-Date:	ALS, NVT			ARG, MLT	
Div Payable:	ALZ				MIG

Market Summary

4.10pm	3-Feb-10	28-Jan-10	% change		3-Feb-10	28-Jan-10	% change
All Ordinaries (500)	4673.2	4637.5	0.8%	Dow Jones	10296.9	10236.2	0.6%
ASX 200	4647.9	4673.3	-0.5%	S&P500	1103.3	1097.5	0.5%
SFE Futures 200	4607.0	4647.0	-0.9%	NASDAQ	2190.1	2221.4	-1.4%
$A/US	0.8825	0.8944	-1.3%	FTSE 100	5283.3	5217.5	1.3%
90 day bank bills	4.13%	4.33%	-4.6%	Nikkei	10404.3	10414.3	-0.1%
10 Yr Bond Yield	5.52%	5.51%	0.1%	US 30 Yr Bond Yield	4.56%	4.57%	-0.2%

Company Information

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