

Austock Group Newsletter

Issue 66 – Monday 14 June 2011



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Austock
Group

The Week in Review

Michael Heffeman, Austock Securities

In the absence of major corporate news, the market drifted further last week, as international markets wilted in the face of US data showing some hesitation in its economic activity.

But dominating the local economy and market was the decision by our Reserve Bank to leave rates unchanged at 4.75% – a level which was last set at their meeting in November last year.

Happily however, and reading between the lines of the associated media release, it seems more likely than not that interest rates in Australia will remain on hold until well into the third or fourth quarter of this year.

Significantly there was no mention in the media release of the expression that interest rates will need to increase “at some point” in the future (a phrase the Bank used in the minutes of their May meeting). This latter expression was interpreted by some commentators who appear to be out of touch with the real world, that this meant that interest rates would be raised at last week’s meeting.

An interesting counterpoint to our Reserve’s Banks’ recent decision, was that the New Zealand central bank decided last week to leave their official interest rates unchanged at 2.5%. This decision is particularly significant given the fact that their economy is growing at about the same pace as ours; their inflation is much higher than ours at 4.5% per annum compared with ours at 3.2% per annum - although their unemployment is a little higher at 6.6% compared with ours at 4.9%. But our official interest rates are almost twice as high as those in New Zealand.

A comparison like this surely should at least give our Reserve Bank pause for thought, even if NZ is not identical economically to us.

Also on the economic front, we saw the ANZ job advertisements series released last week, which showed a decided softening in the market.

This data was followed on Thursday by the official Australian Bureau of Statistics release which showed that while the unemployment rate was steady at 4.9%, of greater concern is the number of full-time employees actually fell by 22,000. Moreover as the labour market is a lagging indicator of economic activity, a further weakening in the employment/unemployment situation is more likely than not in the future.

Also information on the construction industry provided by the Australian Industry Group showed that the weakness which has been evident in this industry for some time continued in May, although the rate of reduction was less marked than in April. Nevertheless the level

Last week movements

	10/06/2011	% Change
AU\$ versus US\$	1.060	-1.0%
ASX 200 Index	4562	-0.2%
90 Day Bank Bill Rate	4.99	-0.8%
Aust 10 year bond	5.16	-1.1%
US 30 year bond	4.20	-0.5%
Dow Jones Index	11953	-1.6%
FT 100 Index	5773	-1.4%
Nikkei Dow Index	9448	-0.5%
Hang Seng Index	22508	-1.9%

Last week top winners

Top ASX 50	% Change
EGP Echo Entertainment	+30.1%
MAP Map Group	+4.9%
IPL Incitec Pivot	+3.8%
OSH Oil Search Ltd	+2.7%
WBC Westpac Banking Corp	+2.3%

Mid-cap (50-100)	% Change
ILU Iluka Resources	+10.3%
BLY Boart Longyear	+3.9%
MTS Metcash Limited	+3.3%
AQP Aquarius Platinum.	+2.4%
MYR Myer Holdings Ltd	+2.2%

Small ORDS (100-300)	% Change
SIP Sigma Pharmaceutical	+19.2%
MSB Mesoblast Limited	+15.0%
BKY Berkeley Resources	+12.8%
IFN Infigen Energy	+11.9%
MDL Mineral Deposits	+10.8%

of the index was 39.6 in May and a reading below the 50 point level, separates expansion from contraction – The index has now been below 50 for each of the last twelve months.

Housing finance figures, which also came out during the week, while showing a rebound in the month of April from the very weak levels of previous months, the value of financial commitments for housing is still substantially below the level for the equivalent period last year.

The clear message from the above litany of data is that our economy is struggling, subdued and moving in a very sluggish forward fashion. It is for these reasons that I have been of the view for almost a year now that interest rates should not be increased until the economy consolidates and moves ahead in an unequivocal way. As I have noted previously, current inflation increasing at 3% per annum is nirvana compared with the 10-15% plus per annum inflation rates of the 1970's and 1980's.

On the corporate front Metcash released its full year results which were a pleasant surprise to the market. These showed that Metcash's profit increased by 6.1% over the year in an environment which can clearly be described as challenging. However as Metcash, is the third major player in the supermarket environment it faces strong competition not only from the two major incumbents in Woolworths and Coles but also from newcomers such as Aldi and to a lesser extent Costco.

As far as the future is concerned Metcash expects that conditions will remain "challenging" for the remainder of 2011 – hardly a surprising comment.

On an initially more disappointing note was smaller iron ore explorer and potential producer Pluton, that released details on Monday of its Pre Feasibility study, which initially was not taken well by the market. The market largely concentrated on its capital costs of \$700 million being significantly higher than previously estimated. However comments by the Managing Director of Pluton on Wednesday served to place the Pre Feasibility study in a more appropriate context, which helped relieve the worst of market fears, with the result that the share price of Pluton recovered strongly on that day.

Finally on the corporate front Iluka Resources, which has had a meteoric rise in share price in recent times, advised that it has concluded discussions with its major high grade titanium dioxide customers. In particular it advised that it has reached agreement on prices and volumes for products to be delivered in the second half of 2011. And in the "almost too good to be true category", is the fact that the negotiated price for rutile for example represents an increase of between 70-75% compared to the previously forecast price.

Looking ahead on the economic front, we will see the National Bank's Business Confidence and Business Conditions Survey to be released on Tuesday; on Wednesday Westpac's leading Indicator Series and figures on dwelling starts, while on Thursday motor vehicle sales figures are scheduled.

In contrast in the United States there is a wide range of data scheduled for release with inflation figures dominating the early part of the week. The Producer Price Index out on Tuesday and the Consumer Price Index on Wednesday.

Indications of the state of consumer spending will be available on Tuesday with figures on retail sales, while data on the manufacturing sector will be out on Wednesday, with the New York Empire manufacturing index, together with broader geographical data on industrial production and capacity utilization also out on the same day. Towards the end of the week we will have the much respected University of Michigan Consumer Confidence Survey and leading indicators figures.

In conclusion many investors will be understandably disappointed with the continuing retrenchment in share market prices over recent times. However, and as has been mentioned in this column previously, 2011 is not 2008.- Many very profitable and robust companies' share prices are now much lower than they were three years and prevailing economic conditions are substantially better than they were three years ago. Accordingly all this translates to very good value opportunities, currently prevailing in our market place.

Michael Heffernan, Austock Securities

Austock Managed Accounts

Austock is now able to offer clients Separately Managed Accounts (SMA's) combining the benefits of your own fully administered portfolio with professional investment management.

Austock Managed Accounts is a direct share portfolio investment product. You delegate the daily investment decision making and administration to a professional investment team. By selecting one or more Model Portfolios you determine how your portfolio will be managed. Alternatively, you can retain some or all of the investment decision making and delegate only the portfolio administration.

Investment Menu

Austock Managed Accounts offers you a range of Model Portfolios managed by boutique investment managers. Each Model Portfolio operates according to a defined investment strategy, risk profile, objective and investment universe across:

- Australian equities
- International equities
- Options
- Fixed income securities
- Cash investments

You can also build and operate your own Client Choice portfolio of investments outside of the Model Portfolios where you or your adviser retain the portfolio decision making.

Benefits

- Combine the benefit of your choice of a range of professional investment managers of your own individual portfolio with your own Client Choice portfolio on a single account.
- Avoid the time consuming paperwork typically involved with direct share investment – we take care of all the administration for you.
- You can transfer in or out your existing share investments to and from Austock Managed Accounts without crystallising unwanted capital gains tax.
- Full, transparent, online access to your portfolio makes it easy to monitor your investments and produce reports all in the one, secure location.

Fees

Full details of the fees applicable to investments are outlined in the Product Disclosure Statement (PDS) for Austock Managed Accounts. To obtain a copy please contact your Austock adviser.

Minimum Investment

The amount you need to initially invest depends on your choice of Model Portfolio, but is typically a minimum of \$25,000 which can include the value of any existing share investments you may already own.

Contact

To find out more please call

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Ben has an 18 year career in funds management and institutional stockbroking. Ben co-founded specialist investment manager Austock Capital Management in 2009 following his role as a portfolio manager for a leading global fund manager. He previously co-founded Australian absolute return fund manager Affinity Capital Partners in 2000, which generated a track record of outperformance of the Australian equity market over its seven year life. Prior to funds management, Ben's career in institutional stockbroking included roles as Head of Growth Companies for BNP Paribas Equities (Australia) and as Associate Director of Research for ANZ Investment Bank.

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John's career spans 34 years in global and Australian funds management and stockbroking. In the seventies in the UK he managed pension fund portfolios for BBC, Ford Europe and Blue Circle. In Australia he advised on corporate takeovers and then as an institutional stockbroker, including as Head of Derivatives at a major firm. In 1992, John pioneered Separately Managed Accounts as a more tax efficient form of managed fund in Australia, launching ShareInvest in 1994. Following the sale of control of his original business in 2007, John co-founded Austock Capital Management in 2009.

Austock Global Dealing Desk

Austock is able to provide clients cost effective execution only dealing in international securities from the worlds major markets including London, New York, Toronto, Hong Kong and Johannesburg.

The Australian stock market represents only approximately two percent of global securities traded. Furthermore, a few large stocks such as BHP Billiton, Rio, Telstra and the four major banks represent about 40% of the value of the stock market; and a number of exciting industries such as technology and pharmaceutical companies are not well represented in Australia.

There are approximately twenty times as many listed securities on global stock markets as on the Australian stock market and global stock markets are approximately sixty times larger by market capitalisation.

Custody

Austock does not charge separate custody fees for its counterparty custodian service, providing corporate action and dividend administration and therefore, can provide this part of the overseas transaction for free.

Markets

Asia Pacific

Kuala Lumpur Stock Exchange
New Zealand Exchange
Singapore Exchange
Stock Exchange of Hong Kong
Tokyo Stock Exchange

United Kingdom

London Stock Exchange
AIM
OFEX

Canada

Toronto Exchange

Settlement

Austock provides settlement in Australian Dollars for all overseas transactions.

Charges

Overseas equity transactions 1%, subject to a minimum of \$95 negotiable

Summary

- Efficient and cost effective dealing in overseas securities
- Safe custody of all holdings
- Administration of Corporate Actions and Dividends
- Settlement in Australian Dollars
- Personal contact with your portfolio manager
- Exposure to growth economies and industries not available in Australia

Europe

Deutsche Borse
Euronext Amsterdam
Euronext Paris
Italian Exchange
Swiss Exchange

USA

American Exchange
NASDAQ
New York Stock Exchange

South Africa

Johannesburg Stock Exchange

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Nicholas has held senior positions within the Australian and UK financial services industry, bringing to Austock Securities over 20 years experience in funds management, institutional equity sales and research, 14 years of which were in London working as an Analyst at Morgan Stanley, Investment Manager with NatWest Stockbrokers and Branch Manager for Killik Stockbrokers.

Having relocated to Australia in 2002, Nicholas achievements include Managing Director and Fund Manager of the top quartile performing Australian Natural Resources UCITS III Fund, Head of Global IMA at Patersons Securities and Head of Institutional Global Equity Sales & Asset Management at DJ Carmichael Stockbrokers.

Nicholas qualifications include those from the Chartered Institute for Securities & Investment, Securities & Investment Institute of Australia, Financial Planning Association, Securities & Derivatives Industry Association and Deakin University.

Nicholas is a Chartered fellow member of the Chartered Institute for Securities & Investment, a Fellow member of the Financial Services Institute of Australasia and a Master member of the Stockbrokers Association of Australia Inc SDIA.

Stock selection

Oceanagold Corp. (OCG)

Recommendation	Buy
Risk Rating	High Risk
Dividend	nil
Dividend Yield	nil
Current Share Price	\$2.32
12 Month Price Target	\$4.78
Analyst	Anna Kassianos

1Q production largely inline, full year guidance achievable

1Q'CY11 production and costs came in at 68koz and US\$688/oz respectively, largely inline with our estimates. For CY11, we continue to expect 260 to 280koz production guidance to be met, although remain slightly above upper end of US\$645 to US\$685/oz cash cost guidance range. We expect CY11 gold production of 267koz at US\$704/oz cash cost.

Upcoming Catalysts not priced in

We see the market is failing to fully factor in a number of catalysts:

- Didipio Ore Reserve upgrade and optimised mine plan with our view that Didipio will increase gold production to +330koz and reduce group cash costs below US\$300/oz for copper credits.
- Confirmed ore reserve and resource growth between 2Q'CY11 and 3Q'CY11 from Frasers underground infill drilling extending mine life beyond 4 years.
- Additional New Zealand resource upgrades from drilling of areas such as Globe Deeps, the Ounce deposit and Big River historical mine working.

OGC unnecessarily cheap

OGC has dropped 40% since 31 December 2010, from \$3.65. In our view, the market has over-reacted to quarterly production, increased costs, and speculation that Didipio will never be developed.

We are conservatively below consensus expectations, largely for our commodity price assumptions, and still see OGC as a compelling investment opportunity and #2 pick in the ASX golds and coppers under coverage.

In our view, OGC is cheap, pricing in a 35% to 56% discount vs. our ASX gold peers. We price our 12 month price target at \$4.78/share.

Mineral Resources (MIN)

Recommendation	Strong Buy
Risk Rating	High
Dividend	50.0c
Dividend Yield	4.1%
Current Share Price	\$12.00
12 Month Price Target	\$16.30
Analyst	Heath Andrews

MIN has now officially secured 4.4mtpa of port access at the Kwinana Bulk Terminal, the last piece of the puzzle for the Carina iron ore project to proceed and slightly ahead of the 4mtpa access expected.

We estimate that cash costs for Carina are A\$47/t fob and that the selling price (based on the current spot price US\$182/t) would be ~US\$145/t. The project will use Panamax vessels, we assume an additional \$15/t in shipping will be incurred.

We estimate MIN would make ~A\$70/t for iron ore shipped from Carina, at today's prices. Based on 4.4mt of production, this project could generate ~\$308m EBITDA, 120% above FY'11F EBITDA.

Our forecasts are more conservative, but the point being that the Carina project alone can more than double MIN's profitability – it is the biggest single project for MIN to date. Considering they acquired POL for ~\$140m in Jan'10, it is testament to MIN's foresight.

Christmas Creek has commenced production, having been built on budget and on time, potentially an entrée to other large crushing contracts.

We have made the following changes to our forecasts:

- Increased exchange rate assumptions;
- Lowered near term Mn pricing and volume assumptions;
- Increased iron ore pricing (including long term pricing moving to \$78/t, from \$67/t) and lowered volumes; and
- Increased Carina earnings risk weight from 80% to 90%.

The net impact is lower near term earnings forecasts, but higher longer term forecasts and hence our DCF valuation has increased.

Investment View

Our DCF based price target is \$16.30/share (from \$14.90). We see further multiple growth options and believe that MIN is likely to continue to be high growth.

Min's track record on delivering and share price

outperformance is impressive. MIN is hard not to back for the long term and remains a Conviction Buy.

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Disclaimer

Risk Rating

Austock Securities Limited has a four tier Risk Rating System consisting of: Very High, High, Medium and Low. The Risk Rating is a subjective rating based on: Management Track Record, Forecasting Risk, Industry Risk and Financial Risk including cash flow analysis.

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