



Monthly Commentary – April 2010

World Cup

We have written very little about the imminent (not necessarily eminent, as stated by a confused SABC newsreader) World Cup, except to mention, back in 2008, that the share price of Murray and Roberts seemed to require that South Africa hosted a World Cup almost every four years. M&R did go on to underperform the market by 67%. Well, we certainly don't want to be chronic malcontents and we sincerely hope that South Africa hosts a terrific tournament. Even after the event though, it will be very difficult to decide whether it was a commercial success, given the farrago of factors to be considered. Let's all just hope it's not remembered the way the 1976 Montreal Olympics has been remembered: more for the financial flop than the Fosbury Flop in the high jump:

"[Montreal] Mayor Jean Drapeau had confidently predicted in 1970 that "the Olympics can no more have a deficit than a man can have a baby", but the debt racked up to a billion dollars that the Quebec government mandated the city pay in full. This would prompt cartoonist Aislin to draw a pregnant Drapeau on the telephone saying, "Allo, Morgentaler?" in reference to a famous Montreal abortion provider. Montreal's economy declined after the games, and the increasing poverty and decreasing income within Montreal as of today are a sign of the financial disaster for the city from the 1976 Games".

Source: Wikipedia.

So, it seems that Aislin (pregnant male mayors) was ahead of Zapiro (presidents with showerheads popping out of their heads).

Australia

Australians have been busy reviewing their tax system. Below we discuss this in relation to BHP Billiton. For now, we'll stick to the World Cup theme and note that they appear to have scored an own goal. When has it ever been wise to deter investors? In a radio interview, Prime Minister Kevin Rudd inadvertently revealed a remarkable lack of understanding of elementary accounting. Further, he seemed to define "super profits" as profits in excess of returns on government bonds! Later in the week, he outdid himself by saying: "... it's necessary for the good people of Western Australia, because there's a big call here for greater investment in the state's infrastructure." Doesn't that make you feel a bit better about our own bamboozling politicians? Ours dropped their harebrained scheme for mining royalties when a few of the obvious implications sunk in. Perhaps they should now seize the opportunity to *lower* mining related taxes, and once again South Africa, which has the world's richest mineral reserves (ahead of Russia and Australia), might become the world's preferred location for mining companies. Maybe PM Rudd should consider what two counterparts had to say on tax:

"I contend that for a nation to try to tax itself into prosperity is like a man standing in a bucket and trying to lift himself up by the handle." - Winston Churchill.

"Government's view of the economy could be summed up in a few short phrases: If it moves, tax it. If it keeps moving, regulate it. And if it stops moving, subsidize it." - Ronald Reagan

Rating agencies

Readers of these commentaries will know that we regard rating agencies as utterly useless to investors. So we are pleased to read (Wall Street Journal, 5th May 2010) that CALPERS, the largest state pension fund in the USA, has won a court decision letting it go forward with a lawsuit against the big three ratings agencies for "negligent representation". In addition, Attorneys General in both Connecticut and Ohio have sued rating agencies. We wish them every success.



Some company news during April:

BHP Billiton (held) Starting in 2008, what has become known as the Henry Tax Review in Australia was tasked with a comprehensive review of the Australian tax system. The treasury secretary, Ken Henry, delivered this study to the government in December of last year. Based on this review, the government recently announced their revised tax proposals, among which are a widely expected “Resource Super Profits Tax” (RSPT).

In a nutshell, the proposed RSPT will mimic the current 40% tax on profits levied by the federal government on the profits of offshore petroleum operations. This seems onerous in the light of the additional burden of ordinary income tax, although the latter will be reduced piecemeal from the current 30% to 28%. However, there are numerous items that may be offset against the RSTP, such as the current royalties that mining firms pay to the Australian states that they operate in, accelerated write-downs for existing assets and some relief for future capex. The proposed commencement date for the RSPT is July 2012, after much consultation with the affected parties.

We note the following:

- While the brief of the Henry Review was to simplify the Australian tax system, the RSTP proposal appears highly complex.
- A national election is scheduled before July 2012, making the new tax proposals contingent on a return to power for Kevin Rudd’s government.
- State governments in Australia’s major mining states (Western Australia, Queensland) are fiercely opposed to the RSPT, given that it is a federal tax.
- Implementation will make Australia perhaps the most heavily taxed mining region in the world, with obvious implications for future resource development and competitiveness.
- We doubt that the proposed RSPT will survive in its present form.
- Given its complex nature, analysts’ views of the effect on BIL’s NPV range from -5% to -20%, if the RSPT remains unchanged. When the (mostly iron ore) dust settles in 2012, we would be surprised if it turns out to be even as much as the projected lower limit.

With the exception of the past two weeks, BIL has performed roughly in line with the market over the past 12 months. We ascribe recent weakness (-14% since mid-April) not only to overblown fears about this tax issue, but also to an expected pullback in recent rampant iron ore and coal prices. The company now trades at a 10% PE discount to the market, close to 1 standard deviation cheaper than its recent history (average PE relative since 1998 = 1.16). BIL remains a core holding in all our clients’ portfolios.

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