Goldman Sachs JBWere

Private Wealth Management

# Investment Strategy Bulletin

## Australian Equities: Portfolio Strategy Review May 2007

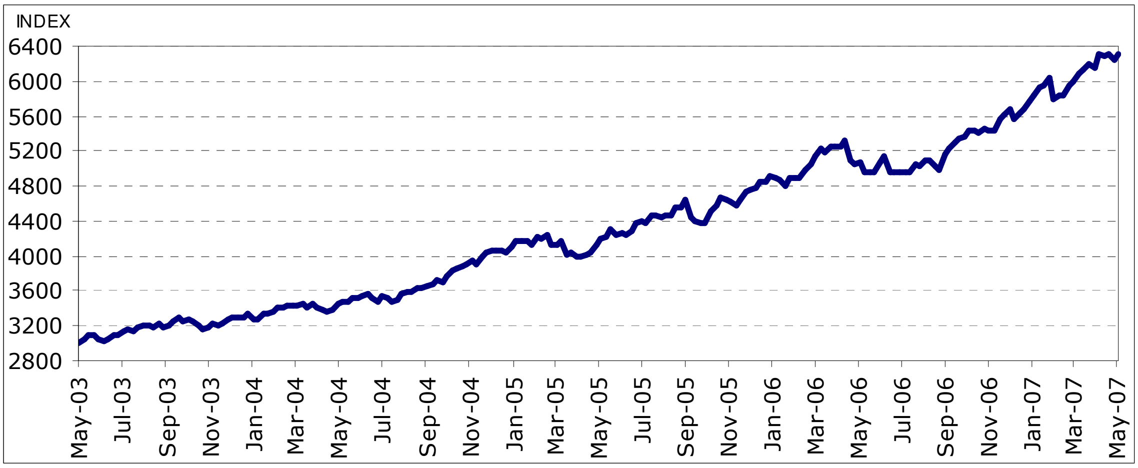
- The ASX200 continued its strong run in May, finishing the month +2.6% higher, driven by stronger global equity markets and improving sentiment around the global growth outlook.
- The increase was driven by the Resources sector, up 7.4%. The Industrials Index also moved higher, up 1.4%. Over the 12 months to April, the Industrials have delivered a gain of 34.4% while the Resources are up 22.2%.
- The Materials, Energy and IT sectors outperformed, while the Consumer Staples, Consumer Discretionary and Utility sectors lagged. The Australian Dollar ended May -0.6% lower at $US0.825.

| | Accumulation Index Performance | | |
|---|---|---|---|
| | **1 Month** | **6 Month** | **12 Month** |
| S&P/ASX 200 | 2.6% | 17.1% | 31.6% |
| S&P/ASX 200 Industrials | 1.4% | 15.8% | 34.4% |
| S&P/ASX 200 Resources | 7.4% | 21.9% | 22.2% |
| S&P/ASX Small Ordinaries | 5.4% | 23.7% | 46.0% |
| | **Relative Index Performance to S&P/ASX 200** | | |
| Consumer Discretionary | -3.0% | -5.2% | 1.9% |
| Consumer Staples | -4.5% | 2.9% | 8.4% |
| Energy | 3.8% | 4.2% | -14.4% |
| Financials | -1.3% | -3.8% | 0.8% |
| Health Care | -0.8% | 1.3% | 5.9% |
| Industrials | -0.4% | 1.9% | 7.8% |
| Information Technology | 3.5% | 6.5% | 11.9% |
| Materials | 4.3% | 3.3% | -8.9% |
| REITs | 1.5% | -4.3% | 9.2% |
| Telecommunications | 1.6% | 18.7% | 14.1% |
| Utilities | -1.9% | 2.1% | 11.7% |

Source: GSJBW Research, IRESS

**Australian Equity Market Performance: S&P/ASX 200 Index**

*(May 2003 – May 2007)*




Source: IRESS

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## Company Performance: Best and Worst Performing Large-Cap Equities

In May, the best and worst performing stocks (absolute share price returns) in the ASX 100 were as follows:

| Best | % Change | Worst | % Change |
|---|---|---|---|
| Leighton Holdings | 27.8 | West Australian News | -13.7 |
| Santos | 19.2 | Paladin Resources | -8.9 |
| Investa Property Group | 16.1 | Sigma Pharmaceutical | -8.5 |
| Commonwealth Property Office | 16.0 | Bluescope Steel | -7.8 |
| OneSteel Limited | 15.4 | Tattersall's | -7.6 |
| RIO Tinto Limited | 15.2 | Aristocrat Leisure | -7.2 |
| Billabong | 12.2 | Fairfax Media | -6.9 |
| Sims Group Limited. | 11.6 | Babcock & Brown Infra. | -6.7 |
| Challenger F.S.G. | 11.5 | ANZ Banking Group | -5.8 |
| Oil Search | 10.3 | Newcrest Mining | -5.4 |

Source: IRESS

## Significant Company/Economic News

**Consumer Staples** **Analyst: Phillip Kimber**

**Woolworths (WOW)** fell as uncertainty continues to surround its involvement in the current ownership review at **Coles Group (CGJ)**, as well as the continued delay by the NZ Commerce Commission on WOW's potential acquisition of The Warehouse. CGJ reported a poor 3Q07 sales result which continues to highlight declining momentum in the Food & Liquor and Kmart businesses. However, the major share price movement related to the news that, after completing two weeks of due diligence, 2 members of the KKR consortium (KKR and CVC) were no longer participating in the ownership review process. At this stage, the other members of the original consortium Bain, Carlyle Group, TPG and Blackstone Group will remain.

**Transport** **Analyst: Paul Ryan**

**Toll Holdings (TOL)** shareholders approved the proposed restructure of the company to create Asciano Ltd via Schemes of Arrangement during the month. Subject to court approval, Asciano will list on the ASX on 6 June with a $150m placement to be conducted the following week.

It was an eventful month for **Qantas Airways (QAN)**, with its share price surging past Airline Partners Australia’s (APA) $5.45 cash offer to an all-time-high of $5.81 following the controversial end to the takeover bid. QAN held an investor briefing later in the month, at which management committed to improve the see-through value of key non-flying assets (eg. Freight, Frequent Flyer Program) and to conduct an “extensive review” of its capital management strategy. CEO Geoff Dixon noted that while the operating environment is likely to remain favourable for the next 12-18 months, QAN continues to face headwinds in the form of higher oil/jet fuel prices and increased capacity entering the domestic and international markets.

**Telecommunications** **Analyst: Christian Guerra**

**Telstra (TLS)** rose as debate on Telstra and the G9’s proposed Fibre-to-the-Node (FTTN) roll-outs continued. It appears discussions have reached an impasse, with the ACCC publicly stating Telstra’s proposed access prices were too high. The G9 was due shortly to lodge a special access undertaking to the ACCC on its FTTN proposal. **SingTel (SGT)** strengthened after a solid but not spectacular FY07 result. The result was slightly ahead of market expectations but the quantum of capital management disappointed the market. The company provided first-time guidance for FY08 with Group Revenue expected to increase. The group continues to target double-digit underlying earnings growth over the medium term.

**Healthcare** **Analyst: Hamish Tadgell**

Domestic consolidation was again the focus for the healthcare sector with **Symbion (SYB)** announcing it had received an unsolicited, incomplete and non-binding proposal from a consortium comprising **Healthscope (HSP)**, Ironbridge Capital and Archer Capital. Under the proposal HSP will acquire all of the SYB shares on issue by way of a scheme of arrangement for cash and HSP shares.

## Gaming — Analyst: Adam Alexander

**Aristocrat Leisure (ALL)** declined this month after announcing 1H07 guidance which was below market expectations. Aristocrat announced 1H07 guidance of $120-125m. This compared to our estimate of $150m. The weakness stemmed from three areas: 1) A$ strength impacting US-denominated earnings; 2) Weakness in the Australian market as venues divert capital expenditure into developing smoking solutions (balconies, beer gardens) rather than replacing slot machines; and 3) Higher overhead costs in the US as a result of additional investment in marketing teams, legal and compliance teams to manage and monitor new jurisdictions opening up and additional personnel dedicated to multi-terminal gaming. The drivers of the earnings weakness are generally of a shorter term nature (smoking bans, soft US replacement, currency). Japan machine sales targets were in line with our estimates.

## Energy — Analyst: Anthony Bishop

**Santos (STO)** traded strongly in May, announcing a $300m buyback on 14 May. The share price has risen from $9.32 on 1 March to $13.40 at the end of May (+44%). This rise can be attributed to several factors: 1) Takeover/demerger speculation in the press (Dow Jones Newswires); 2) The SA government review of the 15% shareholder restriction; 3) Capital management activity; 4) Strong Tapis oil premium; and 5) Record WA gas prices. No further update has been provided on the Banjar Panji mudflow, and hence the financial impact of that incident still remains uncertain.

**Australian Worldwide Exploration (AWE)** had a strong month, announcing Tui oil sales contracts would be marked to Tapis (which is currently trading at strong premiums to Brent and WTI) – the project is due to commence production on schedule with first oil by 30 June. The marking to Tapis was already known due to the physical properties of the oil, however this announcement provided more certainty in relation to realising value from the Tui project.

## Building Materials — Analyst: Matthew McNee

**Rinker Group (RIN)** surged and then proceeded to hover around the $19.30 mark after Cemex announced that it would extend its offer until 7.00pm (Sydney time) on 22 June 2007. Cemex would also waive the minimum 90% acceptance condition if its aggregate interest in RIN exceeds 50% on or before 22 June. Eligible RIN shareholders will be able to retain the final dividend of 25cps. In a separate announcement Perpetual has indicated that it intends to accept the amended Cemex offer.

**James Hardie (JHX)** rallied after announcing a better than expected FY07 result. The result reflected a stronger-than-anticipated performance from the US fibre cement business. This strong result was achieved despite much weaker than expected volumes. The 4Q07 margin of 29.2% was particularly impressive when we consider the increases in raw materials (pulp, cement) prices over the last 12 months. Management provided no specific outlook guidance, but did indicate that sales volumes in 1Q08 will continue to be adversely impacted by the weaker new housing sector.

## Diversified Resources — Analyst: Neil Goodwill

May saw both **Rio Tinto (RIO)** and **BHP Billiton (BHP)** perform strongly despite a modest pull-back in base metals. Compared with 12 months ago, the base metals price correction has been modest and offset, in our view, by an improving outlook for bulk commodities. During May, we upgraded our coking coal price forecast due to strong demand from the global steel industry and infrastructure constraints on supply growth. China's demand for iron ore has run well ahead of our expectations in the first four months of 2007, prompting the May upgrade to our iron ore price forecast. The main talking point for May, however, was the possibility of corporate activity, with RIO obliged to respond to an ASX query on 9 May in which it stated: "Rio Tinto is not aware of any takeover approach from BHP Billiton Limited". Nevertheless, we believe the notion that RIO could be a target either for another mining house, or for private equity, has been a significant driver of its recent outperformance of BHP.

## Australian Equities: Key Issues for Portfolio Strategy

- The key issues facing the Australian equity market for the remainder of 2007 will be the ongoing battle between surplus liquidity and valuation risk driving asset allocation; the extent of the slowdown in the US economy following the collapse of the housing market and the resilience of the Chinese expansion in the face of increasing interest rates, an appreciating currency and slowing US economy.

- A sharp contraction in housing activity is now hitting the US economy and this drag will be at its most material through the first half of 2007. To date, the balance of the economy (i.e. consumer & business spending) has not shown any material signs of being hurt by this slump. Outside the US, the global economy appears to on track for a 'happy slowdown', with Goldman Sachs forecasting world real GDP slowing from 4.9% in 2006 to 4.4% this year. This outcome rests on the view that the world has decoupled from the US as the sole engine of global growth, with increasing domestic consumption in China and Asia expected to take over from any slow down in the US economy. The outlook for the domestic economy remains favourable, reflecting the strong employment environment and diminishing inflation risk suggesting interest rates will remain steady in the near term. We believe the Australian dollar (AUD) is close to a peak and expect increasing capital outflows to see the AUD retrace back to US78¢ by year end.

- We expect the strong liquidity environment in Australia to continue, driven by significant inflows from compulsory superannuation, supplemented near term by the ability for investors to make large one-off allocations pre 30 June 2007. This is being exacerbated by increased M&A activity driven by the re-gearing of corporate Australia's balance sheets combined with increasing activity in our market from large offshore Private Equity consortiums looking to invest funds. In addition, the Future Fund is sitting on approximately $45bn in cash, some of which we expect to be allocated to the domestic equity market during the second half of 2007.

- We remain of the view that the Industrials are fully priced both in absolute terms and relative to the level of interest rates, with the market at valuation levels that have in the past proven unsustainable. While we expect liquidity to remain a dominant force in the short-term, the equity market now appears to be priced for perfection (low risk sustained growth) and at some point this theme will likely dissipate. If, in the interim, long-term interest rates edge higher (a global risk for 2007) and profit estimates for FY08 and FY09 ease (rising cost pressures), the market would be vulnerable.

As always, appropriate portfolio construction is the best means by which to tackle this environment. Our key portfolio construction themes for Australian equities are as follows:

- Increase diversification – in an environment where portfolio outperformance is being generated by the trading of short-term momentum, we would look to maintain a broad exposure to the market, across all sectors and industries.
- Favour stocks with strong balance sheets (i.e., the potential for capital management & corporate activity), improving returns (return on capital employed) and profit drivers that are not highly dependent on strong economic conditions (i.e. organic growth).
- Utilise the current strength in the Australian dollar to increase exposure to stocks with offshore earnings and/or share price sensitivity. We prefer News Corporation (NWS), QBE Insurance (QBE), Brambles (BXB) and Singapore Telecom (SGT).
- Resources – the major diversified stocks continue to enjoy robust cash flow growth and strong balance sheets. We recommend maintaining a healthy exposure to BHP Billiton (BHP) and Rio Tinto (RIO) and would look to build positions in periods of share price weakness which take the stocks to levels around our long term valuations.

**GSJBW Market Forecasts**:

| **As at 31/05/2007** | **Price Earnings Ratio (PER)** | | | **Earnings Per Share Growth (%)** | | | **Dividend Yield (%)** | | |
|---|---|---|---|---|---|---|---|---|---|
| | **FY06** | **FY07E** | **FY08E** | **FY06** | **FY07E** | **FY08E** | **FY06** | **FY07E** | **FY08E** |
| S&P/ASX 300 | 18.2x | 16.2x | 14.9x | 23.0 | 13.4 | 8.9 | 3.2 | 3.4 | 3.8 |
| S&P/ASX 300 Industrials | 20.3x | 18.5x | 16.9x | 7.6 | 10.5 | 9.6 | 3.9 | 4.1 | 4.4 |
| S&P/ASX 300 Resources | 14.9x | 12.8x | 12.0x | 52.0 | 17.4 | 7.9 | 1.8 | 2.1 | 2.3 |

Source: GSJBW Research estimates

## REIT Sector Update: Selective Value Emerging

The property trust sector has underperformed the broader market so far in 2007, after experiencing strong performance over 2006. The Real Estate Investment Trusts (REITs) have now retraced to a level that looks more interesting. Based on GSJBW valuations the sector is 3.5% expensive (premium to valuation), the second lowest reading in the past 8 months. Previously when the REITs have fallen below ~4.5% expensive, the sector has rallied.

Below, we review three of the major stocks within the sector.

**Build Exposure**

### ❑ Westfield Group (WDC)

Westfield is a quality company with an outstanding track record, providing investors with a good balance between yield and growth. The enormous development pipeline (approximately $10 billion), experienced management, a strong operating environment, and the premiere retail portfolio held by an Australian REIT make WDC an attractive investment in our view. Underlying earnings growth remains strong, property appreciation should continue (particularly following redevelopment), acquisitions should re-emerge and WDC is also looking at further high-return-on-investment activities, such as expanding third party Funds Under Management (FUM). It appears that the exogenous factors of an appreciating Australian dollar and a declining US REIT sector have knocked down Westfield's share price, despite the underlying performance of the business being robust. As a result we believe WDC offers strong long term value, and have recently upgraded our long term recommendation to a Buy.

**Hold**

### ❑ Macquarie Goodman Group (MGQ)

We have recently reinstated research coverage of Macquarie Goodman Group with a long-term Hold recommendation. MGQ owns, manages, and develops industrial property and business space in Australasia, Asia and Europe. The company's operations encompass funds management, property services and property development. Acquisitions remain key to the growth of the business, although we note this is largely predicated on buying development businesses and land banks, rather than chasing properties in a highly competitive market. MGQ has attractive assets, a robust strategy, a global platform and amongst the strongest earnings/dividend growth in the sector. However, we believe the market has appropriately priced it for the existing businesses in place. What could be a significant catalyst for further share price performance is the successful execution of an expansion into Japan or the establishment of an initial US investment that opens the way for further developments. We would use any price corrections as an opportunity to buy the stock at levels around our valuation.

**Reduce Exposure**

### ❑ Centro Properties Group (CNP)

We believe the key to CNP's ongoing price performance is its Funds Management platform, specifically 1) the level of FUM growth, 2) external equity inflows and 3) the margin sustainability/expansion of this business. At the current share price, we estimate FUM growth and inflows significantly above our aggressive assumptions are being priced in, making the large premium to our valuation difficult to justify. Despite increasing our earnings and valuation following the New Plan transaction, and whilst acknowledging the significant momentum in CNP, we remain of the view that it is aggressively priced at current levels. We believe that opportunities for further earnings growth are limited due to the stretched nature of CNP's balance sheet and the timing and size of recent acquisitions that we believe may result in management focussing more time on the successful integration of these portfolios.

| Stock | Recommendation | | Dividend Yield | | EPS Growth | | PE Ratio | | Price/ |
|---|---|---|---|---|---|---|---|---|---|
| | Short Term | Long Term | (FY07E) | (FY08E) | (FY07E) | (FY08E) | (FY07E) | (FY08E) | Valuation |
| CNP | Underperform | SELL | 4.3% | 5.1% | 5.1% | 19.2% | 23.2x | 19.5x | 23% |
| MGQ | Marketperform | HOLD | 4.5% | 4.8% | 18.0% | 7.0% | 22.2x | 20.7x | 8% |
| WDC | Outperform | BUY | 5.1% | 5.4% | 11.7% | 5.3% | 18.5x | 17.5x | 2% |

Source: GSJBW Research estimates

## Portfolio Management: Building Positions

**Infrastructure** **Analyst: Alison Booth**

- **Macquarie Airports Group (MAP): Short Term Outperform; Long Term Buy**
  Share Price as at 31/05/07: $4.16; Valuation: $3.82

| Year End December | 2006 Actual | 2007 Estimate | 2008 Estimate |
|---|---|---|---|
| Net Profit ($m) | 600.5 | 598.3 | 637.0 |
| EPS Growth (%) | -48.4 | -3.1 | 6.3 |
| PER (x) | 11.4 | 11.7 | 11.0 |
| Yield (%) | 6.1 | 6.3 | 6.6 |

Source: Company data, GSJBW Research estimates

Macquarie Airports Group (MAP) is an international airport fund with interests in Sydney Airport (72.0%), Rome Airport (34.2%), Brussels Airport (53.9%) and Copenhagen Airport (53.4%) and Bristol Airport (32.1%). Traffic growth at all of the airports has been strong, with further upside potential in passenger growth following the introduction of the A380 in late 2008 and continued strength in demand. Furthermore, recent developments with the EU/US Open Skies Agreement (significant deregulation of trans-Atlantic traffic) are likely to encourage increased capacity at MAP's European airports. MAP's dividend remains attractive, with the stock currently trading on a yield of ~6.6%. In addition, the quality of these distributions is improving, with the company's cash flow coverage of dividends increasing (MAP has targeted 100% cash flow coverage of distributions by 2010).

The recent sale of MAP's stake in Birmingham airport at a significant premium to the company's valuation of the asset highlights potential upside to the fund's overall valuation. The value of MAP's 34% stake in Rome Airport is also depressed, in our view, given MAP's lack of control (similar to Birmingham). In addition to potentially increasing valuation, asset sales increase the prospect of capital management (buyback or special distribution). We maintain our long term Buy recommendation on the stock and believe the risk/reward equation for MAP remains positively skewed, underpinned by the attractive dividend yield, strong traffic growth outlook and potential asset sales/capital management.

**Industrials** **Analyst: Chris Savage**

- **Boart Longyear (BLY): Short Term Outperform; Long Term Buy**
  Share Price as at 31/05/07: $2.19; Valuation: $2.30

| Year End June | 2006 Actual | 2007 Estimate | 2008 Estimate |
|---|---|---|---|
| Net Profit ($m) | N/A | 199.3 | 251.3 |
| EPS Growth (%) | N/A | N/A | 23.9 |
| PER (x) | N/A | 16.0 | 12.9 |
| Yield (%) | N/A | 0.9 | 2.7 |

Source: Company data, GSJBW Research estimates

Boart Longyear (BLY) is the leading drilling services provider and drilling products manufacturer for the global minerals drilling industry, providing contract drilling services in 30 countries and distributing products in more than 100 countries. In our view the key positives for BLY include:

- *Leading Market Position*: BLY has the number one market position in both minerals drilling services and drilling products, with a 17% share of the fragmented US$2.5bn drilling services market and a 33% share of the estimated US$2.0bn exploration drilling products market.
- *Positive Market Outlook*: Commodities demand/consumption by BRIC (Brazil, Russia, India and China) economies has driven commodity prices higher and caused a significant increase in mine exploration and development activity, of which drilling is a critical element.
- *Fragmented Market*: The market for minerals drilling services is very fragmented with the top three players having only around 33% share of the global market and the remaining 67% being made up of regional and local companies with a low market share. BLY is the largest operator in the market (~17% market share) and is well positioned to lead the market's consolidation.

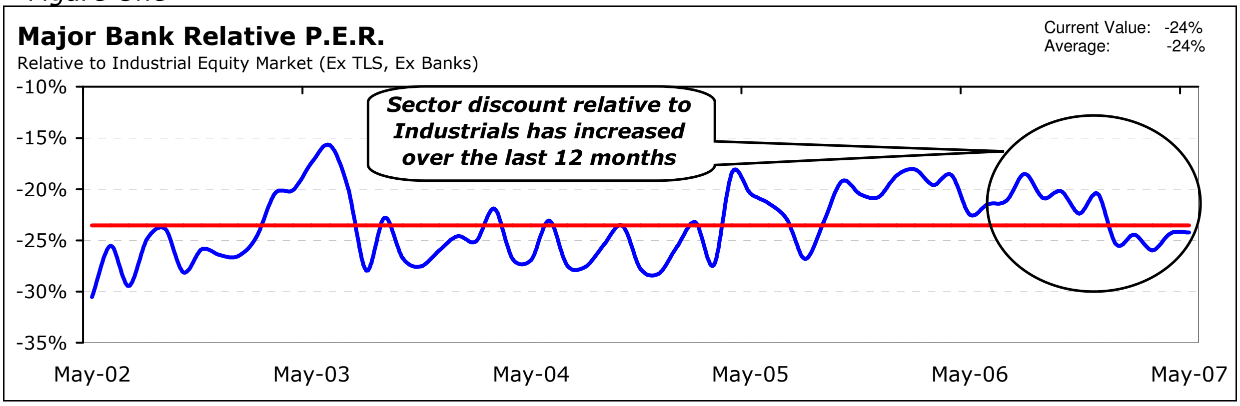
The key risk for the company remains a slowdown in the BRIC economies leading to sustained weakness in commodity prices and a potential decline in exploration activity. We have commenced coverage on BLY with a long-term Buy recommendation. We are expecting the company to produce strong Earnings per Share (EPS) growth leading into FY09 driven by expected market growth in the mid-teens percent, an increase in market share and an improvement in margins. The company is currently trading at a modest discount to our DCF valuation with a price/earnings (PE) multiple less than both its domestic and international peers.

## Banking Sector: Reporting Season Review

The overall results from the first half reporting season indicate strong momentum for the banks heading into the second half of 2007. Furthermore, the banks seem well priced compared to the more expensive broader market (particularly the Industrials). As such, we believe it is timely to review our preferred stocks within the sector.

The relative valuation risk of the banks in the current market looks attractive, reinforced by their dividend yields. On our forecasts, the average price/earnings ratio (PER) discount of the banks relative to the domestic non-bank industrials has increased over recent months (refer Figure One) and appears attractive compared to the last 5 years. The sector is currently trading on a dividend yield of ~5%.

*Figure One*




Source: GSJBW Research estimates

The recent banking sector reporting season witnessed the banks all delivering strong earnings growth of around 10-12%. Loan growth has been good, while wealth management businesses delivered strong earnings growth. Costs were generally well contained, although the more favorable revenue environment enabled some of the banks to reinvest more into the business. Overall the reporting season delivered earnings upgrades to our FY07 forecasts ranging from 0.2% to 1.1%.

A further observation from the reporting season was that bad debts have started to rise from historically low levels – suggesting a more 'normalised' credit environment is likely to return. The rise in consumer delinquencies (i.e. loans 90+ days overdue) suggests that there is limited scope for lower bad debt charges, however GSBJW does not expect any sharp deterioration given the strength of Australian economic conditions and low levels of unemployment.

We expect the strong momentum to continue into the second half, delivering Earnings per Share (EPS) growth of 10-14% for 2007. We review our preferred exposures to the sector below.

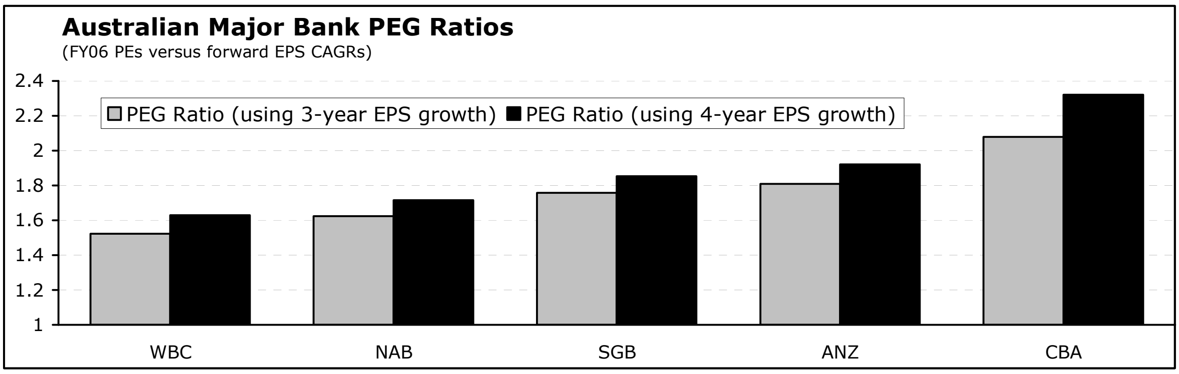
### ❑ National Australia Bank (NAB)

NAB's business continues to gain momentum, with the group delivering strong cash earnings growth and improving returns. Our positive long term view is driven by our view that NAB will increase its return on equity (ROE) to peer levels. Factors that will drive the improvement are (1) the potential for additional capital management with an additional ~$1.8bn of surplus capital even after the existing buyback and (2) further efficiency gains, particularly in the UK business. The stock also remains attractive on a price/earnings to growth (PEG) basis relative to peers (refer Figure Two). With earnings momentum strong, longer term valuation support evident and the prospects for future capital management high, we recommend longer term investors buy NAB at current prices.

### ❑ Westpac Banking Corporation (WBC)

The overall quality of WBC's earnings was good, with the bank delivering strong cash earnings momentum. New Zealand was the main source of disappointment, however this was largely expected and its contribution to group earnings continues to decline. Offsetting this, the Wealth division performed very strongly and has now overtaken New Zealand in terms of earnings contribution. There are risks around the NZ turnaround and CEO succession, however we do not expect these to impact near-term earnings and they appear more than priced. With operating momentum improving, earnings growth at top end of peers and the stock trading at a significant discount to both its peers and the market more broadly, we would recommend investors buy WBC at current prices.

*Figure Two*




Source: GSJBW Research estimates

### ❑ ANZ Banking Group (ANZ)

ANZ has been a solid performer in recent years with revenue growth and cash earnings coming in at the higher end of its peers. Whilst ANZ may look cheap with the bank trading at a slight discount to peers, we believe that this discount is justified with risk to the growth outlook rising as Personal Banking growth slows, CEO succession draws nearer and Institutional Banking continues to stumble from a growth perspective. ANZ also has the lowest exposure to the booming Wealth Management industry. As such, we see better value in WBC and NAB.

### ❑ St. George Bank (SGB)

Our analysis shows SGB to be the most expensive of the major Australian banks, trading at a premium to peers on a Price/Earnings ratio (PER) basis. We believe that there are several negatives building for SGB over the next 6-12 months, which in our view will impede SGB's ability to deliver above peer EPS growth for the next few years. These issues include: i) slowing underlying growth (adjusted for more uncertain items), ii) mortgage business is growing below peers, iii) deposit volumes are struggling, iv) NSW remains a drag and v) expensive valuation relative to peers. With these factors likely to impede earnings growth for the next few years, we believe that SGB looks expensive relative to its peers and favour stocks which offer the same if not slightly higher EPS growth over the next few years at a cheaper multiple, such as WBC and NAB.

### ❑ Commonwealth Bank of Australia (CBA)

While at face value CBA appears to have good EPS growth, the quality of earnings is lower than peers'. In our view, unsustainably low bad debts, abnormally high treasury/trading income and one-off asset sales have inflated CBA's earnings. Adjusting for these items, CBA's earnings growth would be towards the bottom end of peers, thus highlighting the weakness of CBA's core operations and underperforming Retail bank. This leaves CBA as one of our least preferred banking exposures – along with SGB. Note that CBA reports on a June year-end, compared with peers who report their full year results on a September year-end.

Within the sector, our top picks are National Australia Bank and Westpac Bank. We believe WBC provides a good buying opportunity given the bank's improving momentum and valuation discount to the sector, despite our expectations for WBC's earnings growth to be at the top of its peers coupled with an attractive dividend yield. NAB remains our preferred long term exposure, given its strong earnings momentum, longer term valuation support and the prospects for future capital management.

Your adviser can help you assess where your portfolio stands in this regard.

| Stock | Recommendation | | Dividend Yield | | EPS Growth | | | PE Ratio |
|---|---|---|---|---|---|---|---|---|
| | Short Term | Long Term | (FY07E) | (FY08E) | (FY07E) | (FY08E) | (FY07E) | (FY08E) |
| ANZ | Marketperform | HOLD | 4.8% | 5.2% | 9.9% | 8.6% | 13.9x | 12.8x |
| CBA | Underperform | HOLD | 4.7% | 5.1% | 14.7% | 6.3% | 15.9x | 15.0x |
| NAB | Marketperform | BUY | 4.3% | 4.7% | 10.4% | 12.4% | 15.9x | 14.2x |
| SGB | Underperform | HOLD | 4.6% | 5.1% | 12.0% | 10.5% | 16.9x | 15.3x |
| WBC | Outperform | HOLD | 5.0% | 5.5% | 12.4% | 11.1% | 14.0x | 12.6x |

Source: GSJBW Research estimates

## Portfolio Management: Emerging Companies

**Emerging Companies** **Analyst: Greg Ward**

- **Austbrokers Holdings (AUB): Short Term Outperform; Long Term Buy**
  Share Price as at 31/05/07: $4.82; Valuation: $5.04

| Year End June | 2006 Actual | 2007 Estimate | 2008 Estimate |
|---|---|---|---|
| Net Profit ($m) | 16.0 | 11.6 | 14.0 |
| EPS Growth (%) | 13.7 | 16.1 | 19.9 |
| PER (x) | 23.4 | 20.2 | 16.8 |
| Yield (%) | 2.8 | 3.0 | 3.9 |

Source: Company data, GSJBW Research estimates

Austbrokers Holdings (AUB) holds equity interests in a number of firms operating throughout Australia conducting its core business of general insurance broking. AUB takes an equity interest in its members (generally 50% or more) and the individual brokers/partners retain the balance of the equity as co-owners. The co-owners retain the day-to-day management and control of each member firm, whilst AUB provides strategic, IT and compliance support and services.

We believe AUB's business model is robust and likely to deliver superior growth over the medium term. The owner-driver model drives growth, ensures compliance, attracts and retains the best personnel in the industry and provides an effective vehicle to consolidate the industry. With only an estimated 12% market share, and our expectation that the SME insurance broking industry will consolidate down to two to three major players (currently six), we believe the growth options available to AUB are significant. The potential for further acquisitions, and the powerful incentives of the owner-driver model, should ensure that AUB's broker members are among the best performers in their industry. In addition, Austbrokers' members have forged strong and lasting relationships with their SME clients, which we believe can be used to successfully offer other financial products including premium funding, corporate lending, and financial planning services. With AUB continuing to trade at a discount to our valuation, we maintain our long-term buy recommendation. Our positive view is driven by management's performance to date, its attractive owner-driver business model, strengthening margins and returns and excellent positioning in a poor but rapidly consolidating industry structure.

**Emerging Companies** **Analyst: Greg Ward**

- **FlexiGroup (FXL): Short Term Outperform; Long Term Buy**
  Share Price as at 31/05/07: $3.00; Valuation: $2.92

| Year End June | 2006 Actual | 2007 Estimate | 2008 Estimate |
|---|---|---|---|
| Net Profit ($m) | 22.7 | 29.2 | 35.3 |
| EPS Growth (%) | N/A | 27.9 | 21.1 |
| PER (x) | 27.1 | 21.2 | 17.5 |
| Yield (%) | 0 | 2.0 | 4.0 |

Source: Company data, GSJBW Research estimates

FlexiGroup (FXL) is a leading provider of retail point-of-sale lease and rental finance for retail markets in Australia and New Zealand. Distribution of FXL's products is principally through its retail partners. At present, FlexiGroup's retail channel partners include Harvey Norman, Domayne, Noel Leeming, Apple and a number of other chain and independent retailers.

FXL has a leading market position in the point-of-sale finance market, primarily driven by its relationship with Harvey Norman. FXL's initial channel was IT but has now expanded into electrical and sporting as well as personal loans. FXL also has more bargaining power than a traditional supplier to the major retailers, given it has an entrenched position with its retail partners, as FXL 'owns' the customer at the end of term. It also provides sales and marketing training, thereby lifting the productivity of the retailers' salesforce. The greatest risk remains that of regulatory change; however our recent meeting with UCCC experts again leaves us comfortable there is minimal risk for at least 2 years.

FlexiGroup is a high quality, well managed business with very attractive growth opportunities both here and abroad. It has a relatively defensive business model and earnings profile which we believe are understated due to the company's conservative accounting treatment. We believe it has underperformed in recent times due to a lack of new information for the market, and more likely a lack of understanding or confidence in the business due to lower access to management and operations than other companies. We see these as short-term issues which will be reversed after the FY07 result in August 2007 as the broader market gains access to quality financials, management and operations for the first time.

# GSJBW Model Portfolios

## Income Portfolio – (Inception Date: October 2002)

| | |
|---|---|
| Westpac Banking Corporation | Woolworths |
| Commonwealth Bank of Australia | Foster's Group |
| Macquarie Communications Infrastructure Group | Telstra |
| BHP Billiton | AMP |
| National Australia Bank | Hills Industries |
| Wesfarmers | Ramsay Healthcare |
| Coca-Cola Amatil | Fairfax Media |
| Tabcorp Holdings | Crane Group |
| Suncorp-Metway | David Jones |
| AGL Energy | Insurance Australia Group |
| Australian Infrastructure Fund | Boral |

**Our changes to the Income Portfolio during May 2007:**
Removed: PBL, RUP, SGB, RIO, ALS
Added: TLS, FXJ, NAB, BHP, BLD, IAG

**Income Portfolio Summary: Fiscal 2007** (*Please note MCG is excluded from the calculation of the EPS growth rate and PER)

| | |
|---|---|
| Earnings per Share Growth | 6.9% |
| Price to Earnings Ratio | 16.5X |
| Average Yield | 4.5% |
| Franking | 89% |

Source: GSJBW Research estimates

## Balanced Portfolio – (Inception Date: October 2002)

| | |
|---|---|
| BHP Billiton | Toll Holdings |
| Macquarie Communications Infrastructure Group | AGL Energy |
| National Australia Bank | Aristocrat Leisure |
| Woolworths | Computershare |
| Westpac Banking | Woodside Petroleum |
| Rio Tinto | St. George Bank |
| Brambles | QBE Insurance Group |
| Ramsay Healthcare | AXA Asia-Pacific Holdings |
| Wesfarmers | Billabong International |
| News Corporation, Inc. | Origin Energy |
| Suncorp-Metway | Singapore Telecom |
| Publishing & Broadcasting | |

**Our changes to the Balanced Portfolio during May 2007:**
Removed: ALS, RIN, HSP, SHL
Added: QBE, TOL, WPL, RHC, SGT

**Balanced Portfolio Summary: Fiscal 2007** (Please note MCG is excluded from the calculation of the EPS growth rate and PER)

| | |
|---|---|
| Earnings per Share Growth | 12.8% |
| Price to Earnings Ratio | 16.8x |
| Average Yield | 3.2% |
| Franking | 77% |

Source: GSJBW Research estimates

## Growth Portfolio – (Inception Date: October 2002)

| | |
|---|---|
| BHP Billiton | Toll Holdings |
| National Australia Bank | Aristocrat Leisure |
| Rio Tinto | AXA Asia-Pacific Holdings |
| Brambles | Computershare |
| Woolworths | Healthscope |
| Westpac Banking | QBE Insurance Group |
| News Corporation, Inc. | Suncorp-Metway |
| Ramsay Healthcare | Billabong International |
| James Hardie | Origin Energy |
| Woodside Petroleum | Singapore Telecom |
| Publishing & Broadcasting | Sonic Healthcare |

**Our changes to the Growth Portfolio during May 2007:**
Removed: ALS, AAN, COH, RIN, SYB, MCQ, CEU, SGB
Added: QBE, SGT, RHC, WPL, JHX, PBL, WBC

**Growth Portfolio Summary: Fiscal 2007** (*Please note AAN and CEU are excluded from the calculation of the EPS growth rate and PER)

| | |
|---|---|
| Earnings per Share Growth | 13.9% |
| Price to Earnings Ratio | 16.5x |
| Average Yield | 2.7% |
| Franking | 83% |

Source: GSJBW Research estimates

*All figures or amounts stated in the table above are an estimate only and are provided by way of illustration. Actual figures or amounts may vary from those figures or amounts*

## GSJBW Recommendation Changes in May

| STOCK | ASX CODE | SHORT-TERM Recommendation | | LONG-TERM Recommendation | |
|---|---|---|---|---|---|
| | | NEW | OLD | NEW | OLD |
| Flexigroup | FXL | Outperform | Marketperform | Buy | - |
| MacArthur Coal | MCC | Outperform | Marketperform | Buy | - |
| Westfield Group | WDC | Outperform | Marketperform | Buy | Hold |
| Perilya Mining | PEM | Marketperform | Outperform | Buy | Hold |
| Qantas | QAN | Outperform | Marketperform | Buy | Hold |
| DBRreef Trust | DRT | Underperform | - | Sell | Hold |
| Seven Network | SEV | Marketperform | Outperform | Hold | - |
| Brambles | BXB | Marketperform | Outperform | Buy | - |
| Macquarie DDR Trust | MDT | Outperform | Marketperform | Buy | Hold |
| St. George Bank | SGB | Underperform | Marketperform | Hold | - |
| Austbrokers | AUB | Outperform | Marketperform | Buy | - |
| Tassal Group | TGR | Marketperform | Outperform | Buy | - |
| Envestra | ENV | Underperform | Marketperform | Hold | - |
| Centro Properties Group | CNP | Underperform | - | Sell | Hold |
| Publishing & Broadcasting | PBL | Outperform | - | Hold | Buy |
| Commander Communications | CDR | Underperform | Marketperform | Hold | Buy |
| Incitec Pivot | IPL | Marketperform | - | Hold | Sell |
| Santos | STO | Marketperform | Underperform | Hold | Sell |

Source: GSJBW Research

## GSJBW Initiation of Coverage in May

| STOCK | ASX CODE | SHORT-TERM Recommendation | | LONG-TERM Recommendation | |
|---|---|---|---|---|---|
| | | NEW | OLD | NEW | OLD |
| Macquarie Goodman Group | MGQ | Marketperform | - | Hold | - |
| Western Areas | WSA | Marketperform | - | Hold | - |
| Boart Longyear | BLY | Outperform | - | Buy | - |
| Equinox Minerals | EQN | Outperform | - | Buy | - |

Source: GSJBW Research

**Referred to in Document:**

| Company Name | Stock Code | Short Term Recommendation | Long Term Recommendation | Share Price (as at 31 May 2007) | Valuation |
|---|---|---|---|---|---|
| Austbrokers | AUB | Outperform | BUY | $4.82 | $5.04 |
| AGL Energy | AGK | Marketperform | HOLD | $15.40 | $16.24 |
| Australian Infrastructure Fund | AIX | Marketperform | HOLD | $2.98 | $2.60 |
| Aristocrat Leisure | ALL | Marketperform | BUY | $15.40 | $15.33 |
| AMP | AMP | Marketperform | HOLD | $10.11 | $9.75 |
| ANZ Bank | ANZ | Marketperform | HOLD | $28.84 | $26.69 |
| Australian Worldwide Exploration Ltd. | AWE | Outperform | BUY | $3.34 | $2.33 |
| AXA Asia Pacific | AXA | Marketperform | BUY | $7.70 | $7.30 |
| Boral | BLD | Marketperform | HOLD | $8.82 | $7.77 |
| Billabong International | BBG | Outperform | BUY | $18.51 | $16.83 |
| BHP Billiton | BHP | Outperform | BUY | $31.53 | $27.39 |
| Boart Longyear | BLY | Outperform | BUY | $2.19 | $2.30 |
| Brambles | BXB | Marketperform | BUY | $12.81 | $13.75 |
| Commonwealth Bank of Aust. | CBA | Underperform | HOLD | $55.40 | $43.90 |
| Coca-Cola Amatil | CCL | Not Rated | NR | $9.45 | $8.50 |
| Coles Group | CGJ | Marketperform | HOLD | $16.53 | $13.60 |
| Centro Properties Group | CNP | Underperform | SELL | $9.50 | $7.71 |
| Computershare | CPU | Outperform | BUY | $11.24 | $9.30 |
| Crane Group | CRG | Outperform | BUY | $17.05 | $15.90 |
| David Jones | DJS | Marketperform | HOLD | $5.19 | $4.05 |
| Fosters Group | FGL | Marketperform | BUY | $6.36 | $6.75 |
| Flexigroup | FXL | Outperform | BUY | $3.00 | $2.92 |
| Hills Industries | HIL | Marketperform | HOLD | $5.55 | $4.65 |
| Healthscope | HSP | Not Rated | NR | $5.81 | $5.82 |
| Insurance Australia Group | IAG | Underperform | HOLD | $5.97 | $5.85 |
| James Hardie | JHX | Marketperform | BUY | $9.28 | $9.94 |
| Macquarie Airports | MAP | Outperform | BUY | $4.16 | $3.82 |
| Macquarie Communications | MCG | Outperform | BUY | $6.83 | $7.45 |
| Macquarie Goodman | MGQ | Marketperform | HOLD | $7.20 | $6.69 |
| National Australia Bank | NAB | Marketperform | BUY | $42.54 | $41.57 |
| News Corporation | NWS | Outperform | BUY | $29.00 | $31.33 |
| Origin Energy | ORG | Marketperform | HOLD | $8.78 | $8.60 |
| Publishing & Broadcasting | PBL | Outperform | HOLD | $21.70 | $22.20 |
| Qantas | QAN | Outperform | BUY | $5.70 | $5.70 |
| QBE Insurance | QBE | Outperform | BUY | $31.22 | $32.80 |
| Ramsay Healthcare | RHC | Marketperform | BUY | $11.32 | $11.63 |
| Rio Tinto | RIO | Outperform | BUY | $95.46 | $80.91 |
| St.George Bank | SGB | Underperform | HOLD | $37.35 | $34.26 |
| Singapore Telecom | SGT | Marketperform | HOLD | $2.78 | $2.70 |
| Sonic Healthcare | SHL | Marketperform | HOLD | $14.56 | $14.86 |
| Santos | STO | Marketperform | HOLD | $13.40 | $9.13 |
| Suncorp-Metway | SUN | Outperform | HOLD | $21.16 | $21.20 |
| Symbion Health | SYB | Not Rated | NR | $4.37 | $3.81 |
| Tabcorp Holdings | TAH | Marketperform | HOLD | $17.75 | $16.77 |
| Telstra | TLS | Underperform | HOLD | $4.86 | $4.19 |
| Toll Holdings | TOL | Outperform | BUY | $23.10 | $19.20 |
| Westpac Bank | WBC | Outperform | HOLD | $26.06 | $26.92 |
| Westfield Group | WDC | Outperform | BUY | $21.45 | $20.30 |
| Wesfarmers | WES | Outperform | HOLD | $37.94 | $36.58 |
| Woolworths | WOW | Outperform | BUY | $27.51 | $29.30 |
| Woodside Petroleum | WPL | Marketperform | BUY | $43.00 | $33.10 |

All valuations and Prices in A$ unless otherwise stated

Source: IRESS, GSJBW Research

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# RECOMMENDATION DEFINITIONS

**Short Term**

| | |
|---|---|
| Underperform (UP) | Stock is expected to underperform the S&P/ASX 200 on a 0-6 month timeframe |
| Marketperform (MP) | Stock is expected to perform in line with the S&P/ASX 200 on a 0-6 month timeframe |
| Outperform (OP) | Stock is expected to outperform the S&P/ASX 200 on a 0-6 month timeframe |

**Long Term**

| | |
|---|---|
| Sell (S) | Stock is expected to underperform the S&P/ASX 200 for beyond 6 months |
| Hold (H) | Stock is expected to perform in line with the S&P/ASX 200 for beyond 6 months |
| Buy (B) | Stock is expected to outperform the S&P/ASX 200 for beyond 6 months |

**Other Definitions**

NR: Not rated. The investment rating has been suspended temporarily. Such suspension is in compliance with applicable regulations and/or Goldman Sachs JBWere policies in circumstances when Goldman Sachs JBWere is acting in an advisory capacity in a merger or strategic transaction involving the company and in certain other situations

**Research Criteria Definitions**

The above recommendations are primarily determined with reference to the recommendation criteria outlined below. Analysts can introduce other factors when determining their recommendation, with any material factors stated in the written research where appropriate. Each criterion is clearly defined for the research team to ensure consistent consideration of the relevant criteria in an appropriate manner.

**SHORT TERM (0-6 MONTHS)**

Relative Earnings Outlook: Forward looking assessment of risk to consensus EPS estimates relative to estimated EPS risk across the market.

Earnings Revision: The percentage change in the current consensus EPS estimate for the stock (year 1) over the consensus EPS estimate for the stock 3 months ago. Stocks are rated according to their relative rank, effectively making it a market relative measure.

News Flow: The consideration of stock specific news flow, market and/or cyclical thematics and other issues such as index changes. Addresses two issues: (1) What is the potential news flow; and (2) What is the share price reflecting?

Relative Performance: Historic rolling 3 month performance versus the broader market. Stocks are rated according to their relative ranking.

Valuation Support: Considers a range of valuation methodologies, including discounted cash flow (DCF) valuation, PER, dividend yield and any other relevant measure.

**LONG TERM (> 6 MONTHS)**

Industry Structure: Based on Goldman Sachs JBWere industry structure ranking. All industries relevant to the Australian equity market are ranked, based on a combination of Porter's Five Forces of industry structure as well as an industry's growth potential, relevant regulatory risk and probable technological risk. A company's specific ranking is based on the proportion of funds employed in particular industry segments, aggregated to determine an overall company rating, adjusted to reflect a view of the quality of a company's management team.

EVA™ Trend: [1] EVA™ trend forecast for coming two years. Designed to reflect "turnaround stories" or to highlight companies Goldman Sachs JBWere analysts believe will allocate capital poorly in the estimated timeframe. (An ROE measure is used for insurance stocks in conjunction with an assessment of the strength of an insurer's balance sheet).

Growth Option: A qualitative and quantitative assessment of a company's long term growth options that the analyst believes should be considered and possibly recognised by the market.

Price:Base Case DCF: The premium or discount to base case DCF valuation at which the stock is trading relative to the average premium or discount across the market.

[1] *EVA™ is a registered trademark of the U.S. consultancy firm Stern Stewart*

**For Insurers**

Return On Equity: Rating taking into account the expected level and trend of ROE over the next two to three years.

Balance Sheet: Analyst's assessment of the quality and strength of the insurer's balance sheet, including conservatism of provisioning, sufficiency of capital, and quality of capital.

**For REITs**

EPU Growth: Ranking of Earnings Per Unit growth relative to other listed Real Estate Investment Trusts. Used instead of EVA™ Trend.

Strategy: Used instead of industry structure as many REIT investors are intra rather than inter sector focussed.

Yield: Yield relative to the REIT sector average. Used instead of Valuation Support.

**For NZ Companies**

Relevant Index: If a research report is published by the New Zealand affiliate of Goldman Sachs JBWere, the recommendation of a company or trust is based on their performance relative to the NZSX 50 Index (Gross) and not the S&P/ASX 200 index.

**Distribution of Recommendations – As at 31 March 2007**

| Short Term | Overall | Corporate relationship* in last 12 months | Long Term | Overall | Corporate relationship* in last 12 months |
|---|---|---|---|---|---|
| Underperform | 12% | 12% | Sell | 5% | 5% |
| Marketperform | 65% | 62% | Hold | 60% | 61% |
| Outperform | 24% | 26% | Buy | 35% | 34% |

* No direct linkage with overall distribution as the latter relates to the full GSJBW stock coverage (>200 companies). The above table combines the corporate relationships and recommendations of both Goldman Sachs JBWere Pty Ltd and its affiliate in New Zealand, Goldman Sachs JBWere (NZ) Limited.

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