

# Research Bulletin

## Australian Equities: Portfolio Strategy Review

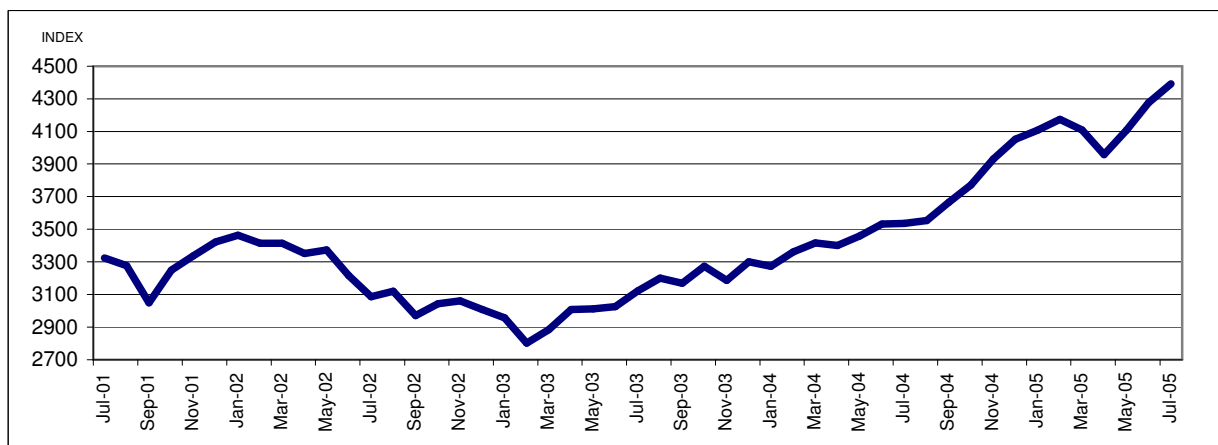
July 2005

- The Australian equity market (S&P/ASX200) continued its upward trend during July, rising **2.6% and establishing new record highs intra month**. Strong liquidity from the completion of a number of large cash takeovers, attractive yields and improving sentiment around the outlook for the economy continued to support equities as the preferred asset class.
- **Investors remained focused on cyclicals** during July, after a number of global leading indicators exceeded market expectations and China announced its long awaited currency revaluation. Information Technology, Materials (Resources & Building) and Small Caps performed strongly while Utilities, Telcos and Staples were a source of disappointment.
- **Turnover remained robust ahead** of the upcoming reporting season (August) while corporate activity continued to be feature of the market with the announced takeover bid for Baycorp Advantage.

Accumulation Index Performance			
	1 Month	6 Month	12 Month
S&P/ASX 200	2.6%	9.1%	29.4%
S&P/ASX 200 Industrials	2.0%	7.0%	26.0%
S&P/ASX 200 Resources	5.4%	19.0%	46.1%
S&P/ASX Small Ordinaries	3.8%	4.5%	25.9%
Relative Index Performance to S&P/ASX 200			
Consumer Discretionary	0.2%	-10.0%	-21.6%
Consumer Staples	-1.4%	-2.3%	-1.6%
Energy	-0.2%	25.5%	31.8%
Financials	-0.5%	-1.1%	-1.0%
Health Care	0.2%	8.7%	8.2%
Industrials	-3.0%	-5.1%	5.7%
Information Technology	5.3%	-2.4%	31.0%
Materials	3.7%	5.1%	10.5%
REITs	-0.4%	-6.2%	-11.9%
Telecommunications	-2.1%	-3.0%	-19.8%
Utilities	-2.2%	2.1%	3.0%

Source: GSJBW Research, IRESS

### Australian Equity Market Performance: S&P/ASX 200 Index (July 2001- July 2005)



Source: IRESS

*For important information relating to Goldman Sachs JBWere's interests in companies or trusts the subject of this report, please see the inside or outside back cover of this report.*

## Company Performance: Best and worst performing stocks

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

Best	% Change	Worst	% Change
PaperlinX Limited	17.3	Gunns Limited	-11.2
James Hardie Industries	16.1	Macquarie Airports	-6.4
Futuris Corporation	15.9	Newcrest Mining	-5.7
Bluescope Steel	14.5	Santos Limited	-5.5
Perpetual Trustees	11.6	Macquarie Infrastructure	-4.1
Caltex Australia	11.2	Origin Energy	-3.9
Australian Stock Exchange	11.1	Transurban Group	-3.9
Rio Tinto	9.6	Tabcorp Holdings	-2.9
Leighton Holdings	9.6	Alinta Limited	-2.7
Oxiana Limited	9.5	Lion Nathan	-2.4

Source: IRESS

## Significant Company/Economic News

### **GUD Holdings Limited (GUD)** **Analyst: George Batsakis**

- Investment View: Short Term Marketperform; Long Term Hold**
- Share Price as at 31/07/2005 \$7.90 Valuation: \$9.26**

GUD Holdings Limited announced net profit for the year ended 30 June 2005 of \$28.9 million. Stripping out the impact of restructuring expenses, earnings were down 6.2% on the previous year, largely due to the weaker performance of the Victa mowers division. Management stated they are confident that trading profit for fiscal 2006 will exceed that of 2005, given the benefit to be derived from recent acquisitions, new product initiatives and a continued focus on cost reduction. In a release earlier in the month, GUD announced the acquisition of the Oates household and commercial cleaning products business. Whilst there are no direct synergy benefits from the deal, management stated that, on their forecasts, the acquisition will be earnings per share (EPS) accretive from fiscal 2006 onwards.

### **Australand Property Group (ALZ)** **Analyst: Nick Vrondas**

- Investment View: Short Term Marketperform; Long Term Buy**
- Share Price as at 31/07/05: \$1.63 Valuation: \$1.69**

Australand delivered a sound interim result during July despite what, by the company's own admission, had been 'an unquestionably difficultly time for the residential property sector.' Management stated that they remained committed to their strategy of reducing the Group's dependence on residential development profits and increasing the level of recurrent investment income, hence the proposal to merge two of the wholesale property trusts with the listed entity. In commenting on the Group's outlook for the remainder of 2005, the company stated they were confident that the net profit for the 2005 would be at least equivalent to that of last year. They also reconfirmed the Group's full year distribution forecast of 16.5 cents per security.

### **Rinker Group Limited (RIN)** **Analyst: Matthew McNee**

- Investment View: Short Term Outperform; Long Term Buy**
- Share Price as at 31/07/2005: \$15.09 Valuation: \$13.06**

RIN reported a solid first quarter result, underpinned by a 39% increase in earnings from Rinker Materials in the US. Subsequently, management increased its fiscal 2006 earnings guidance for the US business from "up 25%" to "up 30%". Despite the impact of the current slowdown in the Australian housing sector and expectations in the market of a similar slowdown in the US, the stock reached an all-time high of \$15.26 following the result.

**Macquarie Bank (MBL)** **Analyst: James Freeman**  
 **Investment View: Short Term Outperform; Long Term Buy**  
 **Share Price as at 31/07/2005: \$63.00 Valuation: \$54.10**

Macquarie Bank registered another strong month, closing 5% higher and reaching a record stock price of \$64.64. At the company's AGM in late-July, management stated that profit for the first quarter of 2006 was considerably above that for the corresponding period last year. Guidance for the full year was for a profit at least in line with that of 2005. The company also noted that the specialist fund initiatives and asset realisations provided a strong source of potential upside. Investors appear to be already pricing in significant earnings upgrades given the large premium to the market at which the stock is currently trading. MBL also announced during July the purchase of nine retail malls in China and the establishment of an equities operation in India, indicative of their focus on expanding operations towards Asia.

**Australian Stock Exchange Limited (ASX)** **Analyst: Ryan Fisher**  
 **Investment View: Short Term Underperform; Long Term Hold**  
 **Share Price as at 31/07/2005: \$25.70 Valuation: \$20.90**

ASX has reported a strong fiscal 2005 profit result which came in ahead of market expectations, mainly due to higher than expected listing revenues and slightly lower than expected costs. A widely anticipated capital return did not eventuate with management stating that "it does not have an excess level of capital at this point in time." A source of some disappointment for investors was the announcement that no action was to be taken in the immediate future as a result of the ongoing pricing review. The market appeared to be anticipating that revenues into the new fiscal year would be significantly higher due to the implementation of new price structure.

**Economics** **Analyst: Tim Toohey**  
 **China Yuan (CHY) Revaluation**

On 20 July 2005, China announced that it would reform its foreign currency regime from a fixed peg against the US dollar to a managed float against an unspecified basket of currencies including the US dollar. This process also incorporated a revaluation of ~2.0% versus the US dollar. This revaluation has occurred as a result of both internal pricing pressures and external political pressures. Global currency markets took the move largely in their stride, with little significant moves in exchange rates following the changes – the Australian dollar finished the month marginally lower.

**Woolworths Limited (WOW)** **Analyst: Phillip Kimber**  
 **Investment View: Short Term Outperform; Long Term Buy**  
 **Share Price as at 31/07/2005: \$16.40 Valuation: \$16.05**

Woolworths reported solid sales growth across its businesses for the fourth quarter of fiscal 2005 and reconfirmed its guidance for the full year of 12-15% earnings growth. Adjusting for Easter, comparable store sales growth in Woolworth's core Food & Liquor division grew at 3.5% for the quarter, the strongest rate of growth since early fiscal 2004. The company provided positive outlook comments, indicating its belief that it is gaining market share, despite continued high levels of competition in the sector.

**Consensus Price Earnings Multiple For 2005 (as at mid-July)**

Sector	MSCI		Ratio
	World	Australia	
Consumer Discretionary	17.77	25.51	1.44
Consumer Staples	17.63	19.44	1.10
Energy	12.13	23.15	1.91
Financials	12.42	14.40	1.16
Health Care	19.00	30.37	1.60
Industrials	16.21	16.56	1.02
Materials	11.43	14.64	1.28
Telco Services	14.01	14.17	1.01
Utilities	15.03	18.46	1.23

Source: Thomson One Analytics

## Australian Equities: Key Issues for Portfolio Strategy

- The three month outlook for global markets is relatively bright. Fears of imminent economic weakness continue to be dispelled by a reality of respectable economic growth – more so in Asia and the US – and strong corporate performance. After easing over the past year, global economic momentum looks set to accelerate into 2006, an environment where the marginal investor traditionally becomes more risk tolerant. While this will ensure that the uptrend in global interest rates continues (less-so in Europe), we still believe that it will be mid-2006 before rising rates pose a material threat to corporate performance.
- As has generally been the case, the actions of the US Federal Reserve will ultimately determine the duration of the current global business cycle. Goldman Sachs Research economics team believes that the Federal Funds rate will continue to rise through 2005, ending the year around 4.00% (currently 3.25%). To date, the Fed's ability to contain rising inflation risks (and an increasingly speculative US property market) has been curtailed by the resilience of long term bond prices. The Fed will become a far more potent risk for global markets if its "measured" increases in short term rates are ever accompanied by higher long term rates. In our view, the risk is mounting that long term rates move up over the next 3-6 months.
- The domestic economy struggled in FY05. Discretionary consumer spending has been soft since late last year, residential construction activity is contracting and the business sector (less-so service industries) is confronting higher cost pressures and sluggish sales. While this slowdown is not a surprise – given the boom conditions of 2002 through 2004 – it remains an open question as to whether it will develop into a genuine cyclical downturn (i.e. rising unemployment) that persists well into 2006 or, with the help of a still supportive policy stance, prove to be short-lived. We believe that the risks are tilted in favour of the latter scenario. If so, it will imply that little has been gained in terms of resolving the structural imbalances/inflationary risks that now overhang the economy. Thus, interest rate pressures would in all likelihood quickly re-emerge. GSJBW Research forecast production (GDP) to expand by 2.0% in FY05 and 3.1% in FY06 and 3.2% in FY07.
- The policy stance in Australia remains on the generous side of neutral. Interest rates are relatively low, the terms of trade are at a 50 year high, government policy is expansionary and asset prices are basically healthy – less-so residential property. Soft house prices, and the associated implications for a household's willingness to consume the equity in their home, still stand as the major risks facing the economy as it moves into FY06. While acknowledging these risks, the combination of an accommodative policy stance and a fully-employed economy has unsettled the Reserve Bank. Accordingly, we still expect that interest rates will move higher over the next year (5.50% currently), although much will depend on whether household spending rebounds through 2H05.
- Recent strength – off an increasingly narrow base in terms of stock performance – has pushed the ASX300 back into fully valued territory. At a sector level, the majority of Australian sectors are trading at a significant valuation premium to global peers (refer table on page 3). On the basis of the prevailing outlook for profits, interest rates and liquidity, however, we continue to believe that the risk of a prolonged correction at this point is low. Significant price weakness requires material profit disappointment and, while earnings downgrades are now coming through – particularly at the small-cap level – we still believe that the risks of major market-wide downgrades remains relatively contained, particularly if the RBA adopts a more cautious approach. From a medium term perspective, however, it is important to keep in mind just how good the past three years have been. On the basis of GSJBW Research estimates, earnings per share growth for the ASX300 has expanded by 58% between FY03 and FY05 – a massive step-up in profitability. While the future is always clouded, we can confidently state that this sort of profit growth will not be replicated between FY06 and FY08. The phase of unexpectedly strong profit growth is now behind us.
- We continue to recommend an equity portfolio based around a core holding of large-cap defensive stocks. Given full valuations, however, buying opportunities in this area are limited. In our view, **Origin Energy**, **Macquarie Communications Group** and **Promina** represent the best relative value. Interest in the banking sector has been revitalised as the market seeks out relative earnings certainty. On a three-month view, this support is likely to continue. It will quickly cool, however, if the Australian economy continues to weaken or market sentiment towards the global outlook swings back to favour the optimists. **Commonwealth Bank** and **St. George** are the stocks we prefer in the sector at the moment. For investors who are looking for a global growth/cyclical bias, the stocks we favor at current prices are **News Corporation**, **AXA Asia Pacific**, **QBE Insurance** and **Computershare**. We continue to believe the medium term outlook for the resources sector is favourable. Investors with a small exposure to the sector should therefore view any periods of share price weakness as an opportunity to add to positions in **BHP Billiton** and **Rio Tinto**. Recent weakness in global steel prices, along with our expectation of a step-down in the copper price over the next six months, may well prove triggers for such periods of share price weakness.

### GSJBW Market Forecasts:

As at 31/07/05	Price Earnings Ratio (PER)			Earnings Per Share Growth (%)			Dividend Yield (%)		
	FY04	FY05E	FY06E	FY04	FY05E	FY06E	FY04	FY05E	FY06E
S&P/ASX 300	19.4	15.6	14.1	16.0	25.0	11.2	3.1	3.7	4.0
S&P/ASX 300 Industrials	18.4	16.5	15.1	10.4	11.7	9.5	3.5	4.2	4.4
S&P/ASX 300 Resources	22.8	13.5	11.7	36.9	68.9	15.2	2.1	2.4	2.9

Source: GSJBW Research estimates

**Portfolio Management: Buy Ideas**

**ConnectEast Group Limited (CEU)** **Analyst: Alison Booth**  
 **Investment View: Short Term Marketperform; Long Term Buy**  
 **Share Price as at 31/07/05: \$0.795 Valuation: \$0.90**

<b>Year End December</b>	<b>2005 Estimate</b>	<b>2006 Estimate</b>	<b>2007 Estimate</b>
DPS (¢)	2.4	6.5	6.5
Yield (%)	2.0	5.2	5.2

Source: GSJBW Research estimates

The ConnectEast Group (CEU) is a single purpose vehicle set up to own and operate the EastLink Toll Road project for a concession period of ~39 years. Eastlink will be a new multi-lane free-flowing toll road connecting the Eastern Freeway to the Frankton Freeway in Melbourne's south-east. The project will be located in a high growth area, where competing roads are constrained by both capacity and limiting features such as numerous traffic lights and level crossings.

On valuation grounds, the investment case for CEU appears compelling. The stock is currently trading at a 10% discount to our partly-paid \$0.90/security valuation (the final installment of 45cps is payable in November 2005). Furthermore, we believe the estimated yield of 5.2% (on fiscal 2006 estimates) is likely to underpin support for the stock around current levels. The entity will not generate operating cash flows until the opening of the toll road, scheduled for late 2008 and hence, in the interim, distributions will be funded from drawing down on cash reserves accumulated at the time of the original capital raising.

We acknowledge that CEU is unlikely to generate significant capital growth over the near term given the lack of obvious catalysts to drive material share price performance. Nevertheless, for investors willing to take a longer term investment view, we are comfortable buying the stock at current levels given the attractive industry structure and strong valuation case. The main risk to our long term Buy recommendation rests with the uncertainty around the performance of the road in the initial ramp up stage.

We believe that CEU offers the strongest long term investment case within the toll road sector. Accordingly, for investors reviewing their holdings within this sector, we would support a decision to switch exposures in Macquarie Infrastructure Group and Transurban into ConnectEast.

**Alesco Corporation Limited (ALS)** **Analyst: Nga Luu**  
 **Investment View: Short Term Marketperform; Long Term Hold**  
 **Stock Price as at 31/07/05: \$7.67 Valuation: \$7.25**

<b>Year End December</b>	<b>2005 Estimate</b>	<b>2006 Estimate</b>	<b>2007 Estimate</b>
Net Profit (\$m)	38.5	42.4	45.6
EPS Growth (%)	7.9	8.5	7.4
PER (x)	13.6	12.6	11.7
Yield (%)	5.9	6.0	6.3

Source: GSJBW Research estimates

Following the company's full year result, we retain our long term Hold recommendation on Alesco Corporation. We continue to like the company's diversified business model and strategy of buying good assets cheaply, with potential for improvement. While we recognise that the gains from recent purchases may now only be realised on a 2-3 year view, we believe the stock represents reasonable value at current levels, with a 6% fully franked dividend yield, with potential for further upside through the ongoing acquisition strategy.

Alesco reported a full year result that was broadly in line with expectations and, although there were some concerns over the restructuring charges, the underlying business momentum remains reasonable. The company's Scientific & Medical Equipment division reported strong earnings growth and an improving returns profile; the Construction & Mining business benefited from good demand conditions; Kitchen & Laundry Components delivered solid margins, despite soft trading conditions; and we believe that the Garage Doors & Openers business has scope for considerable operational improvements.

In the absence of any acquisitions, Alesco expects to generate single-digit earnings per share growth in fiscal 2006. While we believe that there is a significant opportunity for the company to rationalise and improve the efficiency of its Garage Doors & Openers division, following last year's B&D Doors acquisition, Alesco has confirmed that it does not expect to achieve its targeted 20% return on funds employed (that is, debt plus equity) for this business until fiscal 2008.

## Portfolio Management: Sell Ideas

Stocks that are leveraged to the financial markets have done particularly well in recent months, with some even reaching record highs, as the rising market has in turn boosted their business prospects. We have reviewed the diversified financials sector and highlight below our preferences within the sector. The following table highlights the leverage of some stocks to movements in equity markets.

Stocks	Stock Code	Share Price Performance (21 <sup>st</sup> March – 4 <sup>th</sup> May)	Share price Performance (4 <sup>th</sup> May – 29 <sup>th</sup> July)
<b>S&amp;P/ASX200</b>	<b>XJO</b>	<b>-7.5%</b>	<b>11.2%</b>
AMP Limited	AMP	-14.4%	5.4%
Australian Stock Exchange	ASX	-7.1%	30.5%
Computershare	CPU	-15.2%	24.0%
IOOF Holdings	IFL	-17.6%	13.5%
Macquarie Bank	MBL	-8.1%	38.2%
Perpetual Trustees	PPT	-14.8%	23.2%
SFE Corporation	SFE	-4.2%	20.1%

Source: IRESS

- ASX has run hard prior to the recent full year result on the market's expectation of a significant boost to earnings from the company's pricing review. Therefore, the delay in releasing this review until late this year was disappointing for those in the market who had this factored in to their numbers. **As a result we recommend investors lock in some profits, given ASX is currently trading on expensive multiples relative to its peers and to the market** (note our recent downgrade to a short-term 'Underperform'). We would be happy to revisit the stock later in the year (as we believe the pricing review will ultimately be positive for earnings), but see limited excitement / upside in the near term.
- Although we believe the investment dynamics remain positive for SFE (i.e. pricing power, strong free cash generation, high fixed cost leverage) and there is potential for further earnings upgrades, the stock has rallied hard in the past few months and the valuation has become more challenging. Similarly, PPT has risen ~14% over the last two months and its price is also now ahead of our DCF valuation. Thus, **from a valuation perspective, we are comfortable for investors with overweight positions in SFE and PPT to take advantage of recent strength to start moving towards more neutral positions.**
- We highlight that **our preferred stock within the diversified financials sector is CPU**. The macro environment continues to be very supportive for the company – equity markets have been robust, short-term interest rates are rising in CPU's key markets (US, UK, Canada) and the prospects for M&A activity in the US are improving. We see upside risk to our synergy forecasts from the Equiserve acquisition, given management's initial target of US\$55m by Year Three is predominantly driven by cost synergies, as we see scope for revenue synergies to also be achieved (as the company has demonstrated with its Georgeson acquisition).

Company	PER		EPS Growth		DCF Valuation	Price
	FY06E	FY07E	FY06E	FY07E		
Australian Stock Exchange (ASX)	21.7x	19.7x	9.8%	9.9%	\$20.90	\$25.70
SFE Corporation (SFE)*	22.9x	21.4x	13.0%	7.3%	\$9.70	\$11.07
Perpetual Trustees (PPT)	19.6x	17.7x	8.2%	11.0%	\$59.40	\$64.08
Computershare (CPU)	19.1x	16.3x	41.2%	17.7%	\$6.00	\$6.16

\* Forecasts for SFE are adjusted for June Year End

Source: GSJBW Research estimates

**Energy Sector: The PNG Pipeline Project**

Papua New Guinea (PNG) is a country with significant hydrocarbon reserves, both in oil and gas. While oil has been commercially produced since 1992, unlocking the value in the large gas reserves and associated liquids has proven more difficult. ExxonMobil and Oil Search have been working towards gas commercialisation through the development of the PNG Gas Project.

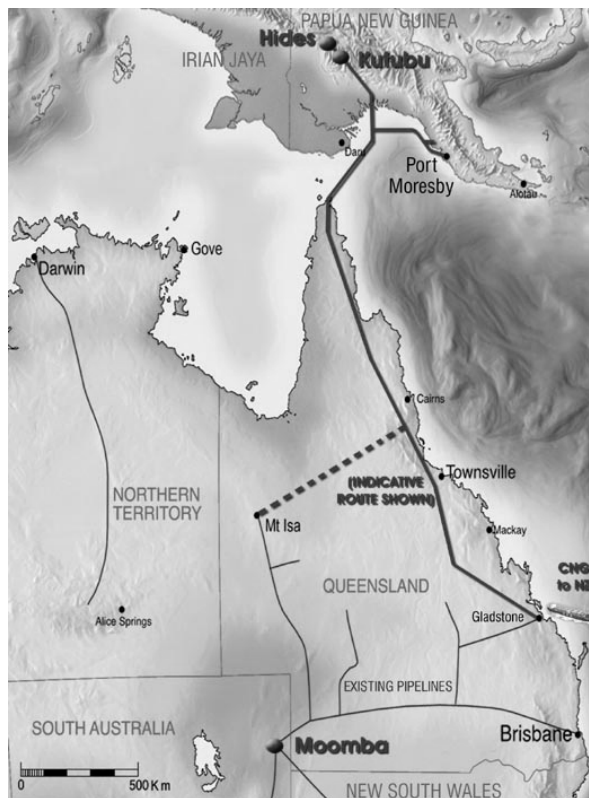
The PNG Gas Project can be broken down into three sections. Firstly, the Upstream section, which involves the extraction of “wet gas” which is basically liquids-rich gas from a number of fields in the Southern Highlands of PNG. The Midstream section is the processing/liquid extraction facilities and the gas pipeline to the PNG/Australian border. The main parties in the Up and Midstream sections are ExxonMobil, Oil Search, the PNG Government and AGL. The Downstream section is the transmission pipeline from the PNG/Australian border to the east coast gas market. This section of the project is to be built, owned and operated by APC, a 50/50 joint venture between AGL and Petronas.

In October of last year, the partners in the PNG Gas Project moved to FEED (front end engineering design) which involves detailed planning and costing of the project. This was followed by the signing of a number of large gas supply agreements, which has resulted in the Project now securing annual contracted volumes above the initial threshold that Oil Search indicated as necessary for the Project to go ahead. Consequently, the likelihood of the Project moving to construction has been greatly enhanced. Project sanction is now expected to be made early in calendar 2006.

Whilst recent news flow around the Project has been very positive, we note that there remain a number of significant hurdles to be cleared before production can commence (first production is not forecast until the start of calendar 2009). For example, as the pipeline covers such a large expanse of ground, we believe that environmental approvals on the Downstream section may prove an issue. Further, with construction costs continuing to escalate, we believe there to be a risk of increases to the forecast capital expenditure required to bring the Project online.

**Possible Pipeline Configuration**

(Actual routing will not be known until key markets are secured)



Source: Company Data

Within the GSJBW Research universe, the following companies offer exposure to the PNG Gas Project:

**Oil Search (OSH):** We anticipate that Oil Search's final equity in the Project will be ~35%. The development of the PNG Gas Project is important to ensuring long term growth in the company's production profile. We retain our positive recommendation for OSH given increased certainty on the PNG Gas Project going ahead, the potential for further customer signings and/or firming of existing conditional gas sales agreements and upside risk to the oil price, to which the company is highly leveraged.

**Australian Gas Light (AGL):** Australian Gas Light has agreed to acquire around a 10% stake in the PNG Gas Project. As part of this acquisition, the company will purchase significant quantities of gas from the Project over a 20 year timeframe commencing in calendar 2009. Whilst gaining exposure to the Project is a positive development for AGL, we remain concerned with the company's limited earnings growth profile and argue that the upside potential from the PNG development is largely reflected in the stocks current trading range.

**Santos (STO):** Santos has a 25% stake in the Hides gas field (which is likely to be the source for around half of the gas for the PNG Gas Project). This gives STO the ability to participate in the PNG Gas Project with a stake of approximately 9%. We believe that Oil Search and the remaining participants would welcome Santos' involvement due to the company's knowledge of the east coast gas market. From a broader company view, with the market pricing in the upside potential from Jeruk (a large exploration target which STO is currently drilling), we are comfortable retaining our neutral recommendation on the stock.

Assuming the pipeline proceeds, we highlight the following risks and opportunities for other energy and utility companies:

**Alinta Gas (ALN):** Alinta could benefit from the additional earnings generated from tolling revenues should the pipeline route connect with the Queensland Gas Pipeline which is an asset owned and operated by the company. However, should the PNG pipeline take an alternate path through northern Australia this could displace volumes on the Eastern Gas Pipeline. Alinta remains our preferred large cap utility stock given both the attractive yield of 5.2% (on fiscal 2006 estimates) and the strong growth prospects with the company's core operations.

**Origin Energy (ORG):** If the PNG pipeline proceeds it will create supply competition for gas drawn from the Cooper Basin. This is a risk for both ORG which owns 13% of the Cooper Basin operations and STO which holds a majority 60% stake in the venture. Further, the development of Coal Seam Methane assets in Queensland is a potentially large source of future upstream growth for ORG. While the company believes the main competition to developing its CSM reserves is other CSM assets, the PNG project still places a portion of this growth at risk. We retain our positive long term view on ORG, confident that there is scope for material earnings growth through development of Origins broad upstream business activities.

Company	Code	Valuation	EPS Growth (%)		PER (x)		Yield (%)	
			FY05	FY06	FY05	FY06	FY05	FY06
Australian Gas Light	AGL	\$12.40	6.1	-0.4	15.3	15.3	6.6	5.0
Alinta	ALN	\$8.62	-0.7	12.8	23.3	20.6	4.6	4.9
Origin Energy	ORG	\$8.08	23.7	14.6	16.7	14.6	2.0	2.3
Oil Search	OSH	\$3.36	66.3	36.2	11.2	8.2	1.6	1.5
Santos	STO	\$10.30	81.3	46.0	12.4	8.5	3.4	3.4

Source: GSJBW Research estimates

## Portfolio Management: Commodity Price Downgrades

We believe the "stronger-for-longer" theme for commodity prices remains intact. However, we remind investors that commodity markets are inherently cyclical and, in our view, we are in the early stages of a downturn. As such, we recently downgraded selectively our price forecasts for aluminum, steel, coking coal, iron ore. In April, we also downgraded our copper price forecast for the second half of 2005. Although we do not expect commodity prices to fall below our long-term average price forecasts, the spot prices of some commodities (i.e. steel, aluminium, zinc, iron ore and some metals) have already fallen and will likely continue in the short term.

Below, we summarise the rationale behind our downgrades:

- **Copper:** The first significant downgrade to our copper price forecast in nearly two years was based primarily on our concerns over weak demand growth, principally in the OECD countries. We believe the most likely outcome is a significant build in refined metal inventories as new smelting capacity comes on line during the second half of this year. In our opinion this change in the underlying demand/supply fundamentals could result in the liquidation of some long speculative positions and hence cause a price retreat.
- **Aluminium:** Given China's exports of primary aluminium exceeded our expectations in the first five months of 2005, we adjusted our supply/demand model to reflect a higher level of metal production and exports from China, resulting in a reduction in our price expectations.
- **Coking Coal:** Supply side constraints have eased significantly in the past six months with shipments from Australia and Canada. Further, coke (a key input into the steel manufacturing process) export prices have almost halved over the past year and we note that we regard the merchant coke market as a good indicator of coking coal prices.
- **Iron Ore:** Chinese imports of iron ore are expected to rise by ~50 million tonnes this year, but imports to the rest of the world are expected to fall in 2005 due to market related blast furnace cutbacks. This coincides with higher export availability and the prospect of major capacity additions in 2006. In our opinion, easier supply of iron ore at a time of weakness in the markets should exert downward pressure on iron ore contract prices.
- **Steel (Hot-Rolled Coil):** We have reduced our steel (hot-rolled coil) price forecasts in response to excessive inventories of finished steel products in most major consuming regions. Further, China has transitioned from a net importer to a small net exporter of standard grade flat rolled products and steel raw material supply constraints have eased (a major cost-push influence on prices in 2004).

	Aluminium	Copper	Nickel	Coking Coal	Iron Ore <sup>1</sup>	HRC <sup>2</sup>
	US¢/lb	US¢/lb	US¢/lb	US\$/t	US¢/dmtu	US\$/t
<b>2005F</b>	81.5	137	709	125	61.72	483
<b>2006F</b>	84.5	111.5	607.5	110	55.55	474
<b>2007F</b>	82.5	121	495	90	47.22	398

1. Iron Ore Fines - dmtu – Dry Metric Tonne Units

Source: GSJBW Research

2. Hot Rolled Coal (HRC) is quoted as a benchmark for pricing in the steel market.

Note: All forecasts are presented on a calendar year end basis aside from Coking Coal and Iron Ore which are quoted on a Japanese Fiscal Year forecast.

The table below highlights the stock recommendations within our resources investment universe (base metals ex-gold), post the recent downgrades:

STOCK	ASX CODE	PRICE (29.07.05)	DCF VALUATION	SHORT-TERM Recommendation	LONG-TERM Recommendation
Alumina	AWC	\$5.80	\$5.21	Underperform	Hold
<b>BHP Billiton</b>	<b>BHP</b>	<b>\$19.36</b>	<b>\$16.26</b>	<b>Outperform</b>	<b>Buy</b>
Bluescope Steel	BSL	\$9.42	\$8.20	Marketperform	Hold
Centennial Coal	CEY	\$4.98	\$4.35	Underperform	Hold
Excel Coal	EXL	\$7.38	\$5.33	Underperform	Hold
Iluka Resources	ILU	\$8.24	\$5.38	Marketperform	Hold
Jubilee Mines	JBM	\$8.00	\$4.16	Marketperform	Sell
Macarthur Coal	MCC	\$7.40	\$5.48	Marketperform	Hold
Minara Resources	MRE	\$1.88	\$2.36	Marketperform	Hold
Onesteel	OST	\$2.73	\$3.00	Outperform	Hold
Oxiana	OXR	\$0.98	\$0.74	Marketperform	Hold
<b>Rio Tinto</b>	<b>RIO</b>	<b>\$49.12</b>	<b>\$47.04</b>	<b>Outperform</b>	<b>Buy</b>
Sims Metal	SMS	\$16.00	\$14.06	Underperform	Hold
Smorgan Steel	SSX	\$1.26	\$1.59	Outperform	Hold
Zinifex	ZFX	\$3.21	\$2.96	Marketperform	Buy

Source: GSJBW Research

In our view, the large diversified resources companies are cushioned to some extent from a mild downturn in commodity markets. This is because approximately half of these companies' earnings come from bulk commodities, for which prices have already been fixed through to March 2006. Therefore, we reiterate that our preferences within the resources sector following the commodity price downgrades remain **BHP Billiton** (BHP) and **Rio Tinto** (RIO).

## Stock Selection Using Quantitative Techniques

Analysts' forecast earnings are an important source of information for investors in the Australian market. However, it is not just the level of predicted earnings that is informative for market participants, but also the direction of analysts' earnings revisions and the dispersion of their earnings estimates.

In previous editions of "Australian Equities: Portfolio Strategy Review", we have analysed the direction of earnings revisions as a key component of our Quant stock selection process. With the reporting season now upon us, we take a closer look at one of the most significant influences upon analysts' estimates: profit guidance as provided by the companies themselves.

Under the ASX's continuous disclosure regime, a company must inform the market when it becomes aware of information that is not generally available and where a reasonable person would expect the information to have a material share price effect. As a result of the increasing stringency of this regime in recent years, companies report that their CEOs and CFOs are increasingly involved with providing briefings and guidance to the investment community<sup>1</sup>.

The challenge for quantitative analysis then becomes to identify those companies that provide superior guidance. This is because it is less likely that the analysts' estimates for such companies will incorporate excessive expectations, thereby avoiding future disappointment.

'Superior' company guidance can come about by virtue of better forecasting ability for particular companies (e.g. being in a more stable industry, better management systems and/or skill) or due to a level of management conservatism (e.g. smoothing earnings through the use of provisions).

Our analysis has looked at changes in analysts' earnings expectations over the last 8 years, in particular the percent of all analysts' estimate changes for each stock that were positive. That is, stocks that rate highly on this measure have exhibited the least earnings disappointment over the period of analysis.

Stocks in our Research universe that rate favourably on this screen (i.e. low earnings disappointment) include: Promina, Bluescope Steel, SFE, Rinker Group and UNiTAB.

As usual, the table below provides the current top rankings in GSJBW's large industrial stock screening model, as well as changes over the last month:

Rank	Company	EVA Spread: Level	EVA Spread: Trend	Earnings Revision: Actual 3 Month	Earnings Revision: Predicted	Positive RSI	ROFE/ PEG	TOTAL	Previous Rank (30-June-05)	Move in Rank
		(out of 15)	(out of 15)	(out of 15)	(out of 15)	(out of 10)	(out of 30)	(out of 100)		
1	ALL	15	14	13	15	9	28	<b>95</b>	2	1
2	JHX	13	15	14	15	10	27	<b>94</b>	1	-1
3	ASX	15	13	12	15	6	29	<b>90</b>	15	12
4	RIO	12	14	13	15	8	25	<b>88</b>	4	0
5	RIN	11	14	15	15	5	25	<b>85</b>	3	-2
6	LEI	13	15	10	8	8	28	<b>82</b>	5	-1
7	WES	8	14	10	15	10	23	<b>80</b>	6	-1
8	BHP	14	1	11	15	9	30	<b>79</b>	9	1
9	BBG	11	13	10	8	7	24	<b>73</b>	7	-2
10	COH	9	1	12	15	10	19	<b>66</b>	18	8
11	WOW	14	0	8	15	2	27	<b>65</b>	8	-3
12	UTB	12	0	11	8	4	29	<b>64</b>	17	5

Source: GSJBW Quantitative Research

<sup>1</sup> Australian Investor Relations Association

## GSJBW Model Portfolios

### Income Portfolio

Commonwealth Bank of Australia	Rural Press
Telstra Corporation	Macquarie Communications Group
Westpac	Rio Tinto
Australian Gas Light Company	Alesco
St George Bank	Foster's
Tabcorp	Commonwealth Property Office Fund
Promina	Ten Network
Wesfarmers	Macquarie DDR Trust
Coca-Cola Amatil	Australand
Woolworths	Alinta
West Australian Newspapers	

Source: GSJBW Research

#### **Our changes to the Income Portfolio during July 2005:**

Increased: Woolworths

Removed: CFS Gandel Retail Trust

Added: Australand

#### **Income Portfolio Summary: Fiscal 2006** (\*Please note, MCG & ALN excluded from the calculation of the EPS Growth rate and PER)

Earnings per Share Growth	6.2%
Price to Earnings Ratio	13.6x
Average Yield	5.7%
Franking	79%

Source: GSJBW Research estimates

### Defensive Portfolio

BHP Billiton	Tabcorp
Commonwealth Bank of Australia	Foodland Associated
St George Bank	Macquarie Airports
Woolworths	Foster's Group
Westpac	Macquarie DDR Trust
Promina	Transurban Group
Origin Energy	Rinker
Coca-Cola Amatil	Mirrabooka
Rio Tinto	Sonic Healthcare
Macquarie Communications Group	Australian Foundation Company
Telstra	CFS Gandel Retail Trust
Australian Gas Light Company	Wesfarmers

Source: GSJBW Research

#### **Our changes to the Defensive Portfolio during July 2005:**

Reduced: Rinker, Transurban Group, CFS Gandel Retail Trust, Macquarie DDR Trust

Increased: Woolworths, Australian Foundation Company, Foster's Group, BHP Billiton

#### **Defensive Portfolio Summary: Fiscal 2006** (\*Please note, MCG & TCL excluded from the calculation of the EPS Growth rate and PER)

Earnings per Share Growth	11.2%
Price to Earnings Ratio	13.6x
Average Yield	4.7%
Franking	78%

Source: GSJBW Research estimates

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

## **Balanced Portfolio**

BHP Billiton	News Corporation
Commonwealth Bank	Sonic Healthcare
Woolworths	Macquarie DDR Trust
St George Bank	Rinker
Westpac	Computershare
Origin Energy	Australian Gas Light Company
Promina	Foodland Associated
Coca-Cola Amatil	Wesfarmers
Rio Tinto	Healthscope
Telstra	Brambles
Australian Foundation Company	Macquarie Communications Group
Billabong International	Alesco

Source: GSJBW Research

### **Our changes to the Balanced Portfolio during July 2005:**

Reduced: Rinker, Australian Foundation Company, Macquarie DDR Trust

Increased: Brambles, Healthscope, BHP Billiton

Removed: Macquarie Infrastructure Group, Just Group

Added: Macquarie Communications Group, Alesco

### **Balanced Portfolio Summary: Fiscal 2006** (Please note, MIG excluded from the calculation of the EPS Growth rate and PER)

Earnings per Share Growth	13.5%
Price to Earnings Ratio	14.0x
Average Yield	4.2%
Franking	86%

Source: GSJBW Research estimates

## **Growth Portfolio**

BHP Billiton	Rinker
Commonwealth Bank	Computershare
Woolworths	Sonic Healthcare
St George Bank	Alinta
Origin Energy	Macquarie DDR Trust
Promina	Macquarie Airports
Rio Tinto	Foodland Associated
Billabong International	Brambles
News Corporation	Alesco
Healthscope	Toll Holdings
Australian Foundation Company	Salmat
Transurban Group	Cochlear

Source: GSJBW Research

### **Our changes to the Growth Portfolio during July 2005:**

Reduced: Australian Foundation Company, Transurban Group, Macquarie DDR Trust

Increased: BHP Billiton, Brambles

Removed: Macquarie Infrastructure Group, Just Group

Added: Macquarie Airports, Alesco

### **Growth Portfolio Summary: Fiscal 2006** (\*Please note, MIG, ALN & TCL excluded from the calculation of the EPS Growth rate and PER)

Earnings per Share Growth	15.4%
Price to Earnings Ratio	14.1x
Average Yield	3.8%
Franking	82%

Source: GSJBW Research estimates

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**GSJBW Recommendation Changes Over The Past Month**

STOCK	ASX CODE	SHORT-TERM Recommendation		LONG-TERM Recommendation	
		NEW	OLD	NEW	OLD
Amcors Limited	AMC	Marketperform	Underperform	Unchanged	Hold
Australian Stock Exchange	ASX	Underperform	Marketperform	Unchanged	Hold
Alumina Limited	AWC	Underperform	Marketperform	Hold	Buy
Bradken	BKN	Outperform	Marketperform	Unchanged	Hold
Coates Hire	COA	Outperform	Marketperform	Unchanged	Hold
Envesta Limited	ENV	Underperform	Marketperform	Unchanged	Hold
Excel Coal	EXL	Underperform	Marketperform	Unchanged	Hold
GasNet Australia Group	GAS	Marketperform	Outperform	Unchanged	Hold
GWA International	GWT	Marketperform	Underperform	Unchanged	Hold
Jubilee Mines	JBM	Unchanged	Marketperform	Sell	Hold
Oil Search	OSH	Unchanged	Outperform	Buy	Hold
Portman Mining	PMM	Marketperform	Outperform	Hold	Buy
Paperlinx	PPX	Marketperform	Underperform	Unchanged	Sell
Sydney Futures Exchange	SFE	Unchanged	Marketperform	Hold	Buy
Tap Oil	TAP	Marketperform	Outperform	Hold	Buy
Wesfarmers	WES	Unchanged	Marketperform	Hold	Buy

Referred to in Document:

Stock	ASX Code	SHORT-TERM Recommendation	LONG-TERM Recommendation	Share Price (29/7/2005)
Australian Foundation	AFI	n/a	BUY	\$4.00
Australian Gas Light	AGL	Marketperform	HOLD	\$14.32
Alinta Limited	ALN	Outperform	BUY	\$9.49
Alesco Corporation	ALS	Marketperform	HOLD	\$7.67
Australand Property	ALZ	Marketperform	BUY	\$1.64
Amcor Limited	AMC	Marketperform	HOLD	\$7.01
AMP Limited	AMP	Marketperform	HOLD	\$6.78
Australian Stock Ex	ASX	Underperform	HOLD	\$25.70
Alumina Limited	AWC	Underperform	HOLD	\$5.80
Axa Asia Pacific	AXA	Marketperform	BUY	\$4.47
Billabong	BBG	Outperform	BUY	\$14.23
BHP Billiton Limited	BHP	Outperform	BUY	\$19.36
Brambles Industries	BIL	Outperform	BUY	\$8.31
Bradken Limited	BKN	Outperform	HOLD	\$2.82
Bluescope Steel Ltd	BSL	Marketperform	HOLD	\$9.42
Commonwealth Bank.	CBA	Outperform	BUY	\$39.06
Coca-Cola Amatil	CCL	Outperform	BUY	\$7.81
Connect East	CEUCA	Marketperform	BUY	\$0.80
Centennial Coal	CEY	Underperform	HOLD	\$4.98
Coates Hire	COA	Outperform	HOLD	\$4.80
Cochlear Limited	COH	Outperform	BUY	\$40.43
Commonwealth Prop	CPA	Marketperform	BUY	\$1.31
Computershare Ltd	CPU	Outperform	BUY	\$6.16
Envestra Limited	ENV	Underperform	HOLD	\$1.17
Excel Coal Limited	EXL	Underperform	HOLD	\$7.38
Foster's Group	FGL	Outperform	HOLD	\$5.46
Foodland Associated	FOA	Marketperform	HOLD	\$27.32
CFS Gandel Retail	GAN	Marketperform	BUY	\$1.72
Gasnet Australia	GAS	Marketperform	HOLD	\$2.86
G.U.D. Holdings	GUD	Marketperform	HOLD	\$7.90
GWA International	GWT	Marketperform	HOLD	\$3.06
Healthscope Limited	HSP	Outperform	BUY	\$4.98
IOOF Holdings Ltd	IFL	Marketperform	HOLD	\$6.91
Iluka Resources	ILU	Marketperform	HOLD	\$8.24
Jubilee Mines NI	JBM	Marketperform	SELL	\$8.00
Macquarie Airports	MAP	Outperform	BUY	\$3.35
Macquarie Bank Ltd	MBL	Outperform	BUY	\$63.00
Macquarie Communica.	MCG	Outperform	BUY	\$6.35
Macquarie DDR Trust	MDT	Marketperform	BUY	\$1.21
Macquarie Infrastructure	MIG	Marketperform	HOLD	\$3.99
Mirrabooka Invest.	MIR	n/a	BUY	\$1.64
Minara Resources	MRE	Marketperform	HOLD	\$1.88
News Corp	NWS	Outperform	BUY	\$22.96
Origin Energy	ORG	Marketperform	BUY	\$7.31
Oil Search Ltd	OSH	Outperform	BUY	\$3.36
Onesteel Limited	OST	Outperform	HOLD	\$2.73
Oxiana Limited	OXR	Marketperform	HOLD	\$0.98
Promina Group Ltd	PMN	Outperform	BUY	\$5.00
Perp.Trustees Aust.	PPT	Marketperform	HOLD	\$64.08
Portman Mining	PMM	Marketperform	BUY	\$4.00
QBE Insurance Group	QBE	Outperform	BUY	\$16.93
Rinker Group Limited	RIN	Outperform	BUY	\$15.09
Rio Tinto Limited	RIO	Outperform	BUY	\$49.12
Rural Press Limited	RUP	Marketperform	HOLD	\$10.78
Santos Limited	STO	Marketperform	HOLD	\$10.70
SFE Corporation	SFE	Outperform	HOLD	\$11.07
St George Bank	SGB	Outperform	HOLD	\$26.71
Sonic Healthcare	SHL	Marketperform	BUY	\$12.84
Salmat Limited	SLM	Outperform	BUY	\$4.83
Sims Group Limited	SMS	Underperform	HOLD	\$16.00
Smorgon Steel Group.	SSX	Outperform	HOLD	\$1.26

Source: IRESS, GSJBW Research

Tabcorp Holdings Ltd	TAH	Underperform	HOLD	\$15.92
Tap Oil	TAP	Marketperform	HOLD	\$2.78
Transurban Group	TCL	Marketperform	SELL	\$7.16
Ten Network Holdings	TEN	Marketperform	HOLD	\$3.76
Telstra Corporation.	TLS	Marketperform	HOLD	\$5.07
Toll Holdings Ltd	TOL	Marketperform	BUY	\$13.52
West Australian News	WAN	Marketperform	HOLD	\$8.71
Westpac Banking Corp	WBC	Marketperform	HOLD	\$19.75
Wesfarmers Limited	WES	Marketperform	HOLD	\$39.90
Woolworths Limited	WOW	Outperform	BUY	\$16.40
Zinifex Limited	ZFX	Marketperform	BUY	\$3.21

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
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### 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: <sup>1</sup>	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.

<sup>1</sup> 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 40 Index (Gross) and not the S&P/ASX 200 index.
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#### Distribution of Recommendations - As at 30th June 2005

Short Term	Overall	Corporate relationship* in last 12 months	Long Term	Overall	Corporate relationship* in last 12 months
Underperform	19%	20%	Sell	9%	8%
Marketperform	55%	51%	Hold	58%	56%
Outperform	25%	30%	Buy	32%	36%

\* 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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