# Research Bulletin

## Australian Equities: Portfolio Strategy Review 31 August 2005

- The Australian equity market has once again recorded a month of gains, with the benchmark **S&P/ASX200 rising 1.3% over August**. Newsflow was dominated by company results for the period ended 30 June 2005, with the majority of results being released during the last two weeks of the month.

- **Reporting season saw relatively benign changes to the market's forecasts,** with most companies announcing results in line with expectations and issuing subdued outlook comments. The key trends from the reporting season continue to be increasing costs (higher raw material/input costs, energy and transport); slowing demand for housing, retail (discretionary) and advertising.

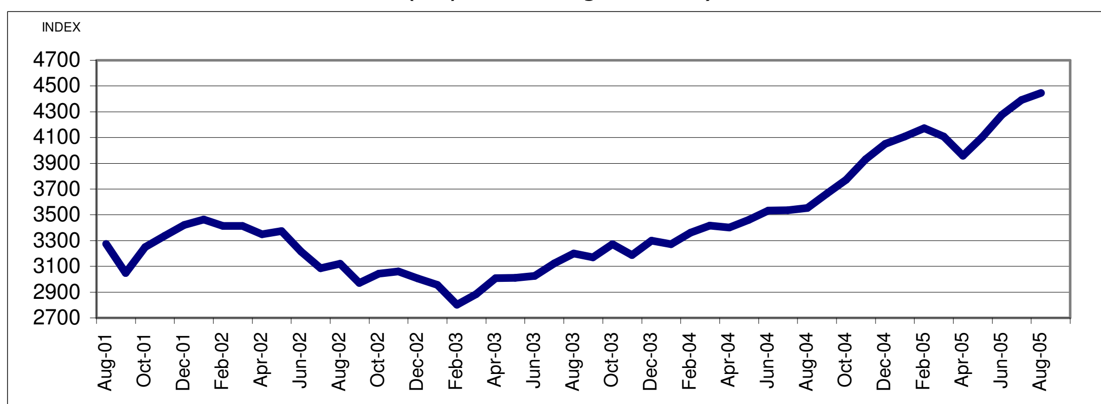
- **The energy sector was once again a standout performer** last month, driven in principal by further strength in the oil price as Cyclone Katrina threatened supply from the Gulf of Mexico late in the month. The Healthcare and Utilities sectors also performed strongly while investors reduced their exposure to Telecoms, Financials, and Property Trusts. Corporate activity was also once again on the agenda, with Toll Holdings launching a takeover offer for Patrick Corporation and Sigma Company for Arrow Pharmaceuticals.

| | **Accumulation Index Performance** | | |
|---|---|---|---|
| | **1 Month** | **6 Month** | **12 Month** |
| S&P/ASX 200 | 2.0% | 8.9% | 30.5% |
| S&P/ASX 200 Industrials | 1.2% | 8.0% | 25.8% |
| S&P/ASX 200 Resources | 5.5% | 12.7% | 53.9% |
| S&P/ASX Small Ordinaries | 4.4% | 10.2% | 29.1% |
| | **Relative Index Performance to S&P/ASX 200** | | |
| Consumer Discretionary | -0.8% | -5.3% | -17.9% |
| Consumer Staples | 0.9% | -1.1% | -3.6% |
| Energy | 4.9% | 27.2% | 44.7% |
| Financials | -0.7% | 0.1% | -2.5% |
| Health Care | 3.7% | 12.6% | 12.5% |
| Industrials | 1.3% | -0.8% | 2.1% |
| Information Technology | 1.7% | 5.2% | 20.3% |
| Materials | 1.0% | -1.1% | 11.9% |
| REITs | -0.3% | -1.5% | -12.9% |
| Telecommunications | -8.1% | -15.2% | -24.9% |
| Utilities | 1.5% | 5.0% | -1.9% |

Source: GSJBW Research, IRESS

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

*(July 2001- August 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 August, the best and worst performing stocks (absolute returns) in the ASX 100 were as follows:

| Best | % Change | Worst | % Change |
|---|---|---|---|
| Zinifex Limited | 21.5 | Gunns Limited | -20.7 |
| Patrick Corporation | 21.2 | Insurance Australia Group | -11.5 |
| Sonic Healthcare | 19.2 | Billabong | -9.0 |
| Leighton Holdings | 18.2 | Paperlinx | -7.9 |
| Sigma Company | 17.9 | Telstra Corporation | -7.7 |
| Onesteel Limited | 17.2 | Unitab Limited | -6.1 |
| Pacific Brands | 16.0 | Amcor Limited | -5.9 |
| Alinta Limited | 15.9 | Futuris Corporation | -5.2 |
| Oxiana Limited | 13.9 | Macquarie Airports | -4.8 |
| Henderson Group | 10.8 | Rinker Group Limited | -4.8 |

Source: IRESS

## Significant Company/Economic News

**Toll Holdings Limited (TOL)** **Analyst: Paul Ryan**
- **Investment View: Short Term Marketperform; Long Term Hold**
- **Share Price as at 31/08/2005 $14.08 Valuation: $12.35**

**Patrick Corporation Limited (PRK)**
- **Investment View: Short Term Marketperform; Long Term Hold**
- **Share Price as at 31/08/2005 $7.04 Valuation: $5.55**

**Virgin Blue Holdings Limited (VBA)**
- **Investment View: Short Term Not Rated; Long Term Not Rated**
- **Share Price as at 31/08/2005 $1.555 Valuation: $1.35**

In late August, Toll Holdings announced that it would make a hostile cash/scrip takeover bid for all of the outstanding shares of Patrick Corporation, citing the potential for an enhanced integrated logistics offer (eg. to major importers) and additional capacity to fund IT and infrastructure expenditure. The offer includes a sell-down of Patrick's 62% stake in Virgin Blue to ~12% by a distribution of that holding to Patrick shareholders (20%) and a public offer or sale to the Virgin Group of the remainder. The board of directors of Patrick Corporation rejected the offer, indicating its belief that shareholders would be better served by the company retaining its independence, while the Virgin Group indicated its support for the bid.

**Sonic Healthcare Limited (SHL)** **Analyst: Jack Mordes**
- **Investment View: Short Term Outperform; Long Term Buy**
- **Share Price as at 31/08/05: $15.30 Valuation: $13.54**

**Sigma Company Limited (SIG)**
- **Investment View: Short Term Marketperform; Long Term Hold**
- **Share Price as at 31/08/2005 $11.02 Valuation: $8.15**

The healthcare sector was also witness to corporate activity over the month. Sonic Healthcare announced the acquisition of 80-85% of Clinical Pathology Laboratories, the third largest comprehensive pathology provider in the US independent laboratory sector. The deal provides Sonic with an entry into the strongly growing, but highly fragmented US independent laboratory industry. The company's underlying fiscal 2005 result, also announced during August, was encouraging. The domestic business recorded solid growth, the Schottdorf acquisition in Germany appears to be tracking well and management was upbeat in its assessment of potential for future offshore expansion opportunities, particularly throughout the UK, US and Germany. Elsewhere in the sector, Sigma announced a proposed merger with Arrow Pharmaceuticals, an Australian drug marketing and distribution business, with 36% market share in the domestic generic pharmaceuticals market. Sigma commented that "the primary reason for the merger is growth, not operational integration" and accordingly, cost synergies were described as "small". In the event that the merger is completed, it will provided Sigma with direct exposure to the fast-growing generics market and dilute its dependence on the regulated pharmacy distribution industry.

**Zinifex Limited (ZFX)** **Analyst: Ian Preston**

- **Investment View: Short Term Marketperform; Long Term Buy**
- **Share Price as at 31/08/2005: $3.90 Valuation: $3.42**

ZFX traded to fresh record highs in August (up 21.5% for the month), as sentiment remained positive following the continuing rally of the zinc price on the London Metals Exchange. The zinc market remains tight, with zinc stockpiles having declined more than 10% this year on the back of surging demand from China. This tightness has been exacerbated by the 6-week strike at Teck Cominco's operations in Canada. At the recent full year result, ZFX management indicated that it expects the solid zinc market to continue through to fiscal 2007 on the back of continuing declines in zinc stocks.

**Alinta Limited (ALN)** **Analyst: Anthony Bishop**

- **Investment View: Short Term Outperform; Long Term Buy**
- **Share Price as at 31/08/2005: $11.00 Valuation: $10.90**

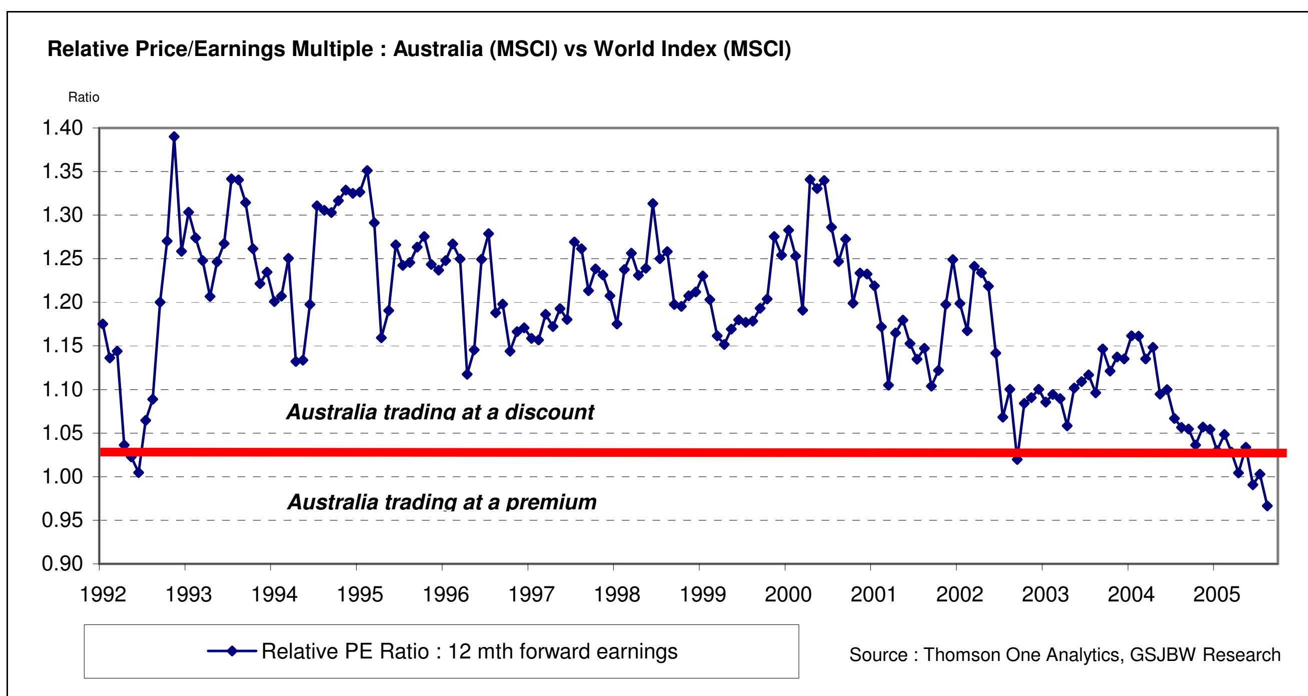
Although Alinta's full year result for fiscal 2005 was largely in line with both the market's and our expectations, a more significant driver for the stock was the announcement that the company will spin out the gas transmission assets that it acquired from Duke Energy into a separate trust, thereby freeing up the company's capital base and providing Alinta with management and performance fees for operating and growing the trust in future. Although the prospectus with the precise details of the asset deconsolidation was released late in the month, the market appeared comfortable to very quickly capitalise the prospects of an improved returns profile to the parent company.

**Leighton Holdings Limited (LEI)** **Analyst: Matthew McNee**

- **Investment View: Short Term Marketperform; Long Term Hold**
- **Share Price as at 31/08/2005: $14.89 Valuation: $11.69**

Leighton reported a full year net profit 87% higher than the previous corresponding period and well ahead of management's earlier guidance, driven by a substantial turnaround in the Australian operations relative to fiscal 2004. Asian earnings were weak due to the higher Australian dollar and a loss on a project in the Philippines. Leighton's forward order book remains at a record $15.5bn and outlook comments were also encouraging. Management stated that near term performance will be "driven by a record level of work, an extended construction and resources upswing in Australia and the company's strong balance sheet position."

**Relative Value: Australian Equity Market versus Global Equities (as at 31/08/2005)**



## Australian Equities: Key Issues for Portfolio Strategy

- The three month outlook for global markets is still relatively bright. Fears of imminent economic weakness continue to be dispelled by a reality of solid 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. While this environment 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 been the case over the past two years, the rising oil price will continue, from time to time, to unsettle markets and economies. At levels in excess of US$60 per barrel, the risk of a material drag on consumer spending is obviously increasing. If this risk were to materialise more forcibly over coming months, we believe it would be accompanied by lower long term interest rates and, ultimately, weaker demand for oil/refined products. We therefore suspect that any oil-related correction in global markets would be relatively short-lived.
- The US Federal Reserve will ultimately determine the duration of the current global business cycle. Goldman Sachs Research believes that the Federal Funds rate will continue to rise into 2006, peaking around the 5.00% level (currently 3.50%). 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 6 months (oil price permitting).
- The domestic economy struggled in fiscal 2005. Discretionary consumer spending has been soft since late last year, residential construction activity has stagnated 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 2002/04 – it remains an open question as to whether it will develop into a genuine cyclical downturn (ie. 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 reemerge. GSJBW Research forecasts 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 healthy. While the Reserve Bank has recently expressed contentment with the prevailing trends in domestic spending, inflation, house prices and consumer borrowing, we are not convinced that this will continue into 2006. 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 the second half of calendar 2005.
- 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, all the major Australian industry groups are trading at a significant valuation premium to their global peers. 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. Material price weakness requires material profit disappointment and, while fiscal 2006 and fiscal 2007 earnings estimates have been tempered through the recent reporting season, we still believe that the risks of major market-wide downgrades remains relatively contained – particularly while the RBA sticks to its 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 60% between fiscal 2003 and fiscal 2005 – a massive step-up in profitability. While the future is always clouded, we can confidently state that this sort of profit growth is highly unlikely to be replicated between fiscal 2006 and fiscal 2008.
- 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**, **Woolworths**, **Coca Cola Amatil** and **Promina** represent the best relative value. Interest in the banking sector has waned again over recent months as investors seek opportunities in the more cyclically leveraged sectors and fret about heightened competition and its potential impact on margins. **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** and **Billabong**. 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 31/08/2005** | **Price Earnings Ratio (PER)** | | | **Earnings Per Share Growth (%)** | | | **Dividend Yield (%)** | | |
|---|---|---|---|---|---|---|---|---|---|
| | **FY04** | **FY05E** | **FY06E** | **FY04** | **FY05E** | **FY06E** | **FY04** | **FY05E** | **FY06E** |
| S&P/ASX 300 | 15.8 | 14.3 | 13.8 | 27.3 | 10.6 | 4.1 | 3.8 | 4.1 | 4.3 |
| S&P/ASX 300 Industrials | 16.7 | 15.3 | 14.1 | 12.2 | 9.4 | 8.5 | 4.3 | 4.6 | 4.8 |
| S&P/ASX 300 Resources | 13.8 | 12.2 | 12.9 | 77.0 | 13.2 | -5.3 | 2.3 | 2.6 | 2.9 |

Source: GSJBW Research estimates

## Portfolio Management: Buy Ideas

**News Corporation, Inc. (NWS)** **Analyst: David Roberts**

- **Investment View: Short Term Outperform; Long Term Buy**
- **Share Price as at 31/08/05: $22.53 Valuation: $26.20**

| Year End June | 2006 Estimate | 2007 Estimate | 2008 Estimate |
|---|---|---|---|
| Net Profit ($m) | $3614.6m | $4061.6m | $4971.6m |
| EPS Growth (%) | 28.3% | 15.4% | 21.8% |
| PER (x) | 21.5x | 18.7x | 15.3x |
| Yield (%) | 0.6% | 0.6% | 0.6% |

Source: GSJBW Research estimates

With the stock having effectively traded sideways for several months, we thought it timely to reiterate the reasoning behind our positive view on News Corporation, Inc. (News Corp).

The company's result in early August was an important one: it demonstrated the strong cash flow generating ability of News Corp's existing operations, as well as the material earnings potential of the satellite businesses. While the company is now trading largely in line with its US media peers, its pay TV portfolio enables News Corp to deliver superior profit growth over the next few years, regardless of the outlook for the US advertising market.

With concerns relating to Liberty Media's ownership of News Corp stock now effectively taking a back seat, and index down-weighting issues in the domestic market having nearly finished running their course, we believe that the market will once again begin to focus on the strong fundamentals of this company. We remain comfortable with our long term Buy recommendation on the stock.

Investors should note, however, that a significant influence (both positive and negative) on News Corp's share price performance remains currency movements – for example, over the last 3 years, News Corp's US dollar share price has increased >75%, but the local share price has only risen ~20%, with the Australian dollar >35% stronger over the same period.

**Healthscope Limited (HSP)** **Analyst: Jack Mordes**

- **Investment View: Short Term Outperform; Long Term Buy**
- **Stock Price as at 31/08/05: $5.62 Valuation: $4.98**

| Year End June | 2006 Estimate | 2007 Estimate | 2008 Estimate |
|---|---|---|---|
| Net Profit ($m) | $56.3m | $69.4m | $79.5m |
| EPS Growth (%) | 80.4% | 22.1% | 13.1% |
| PER (x) | 18.0x | 14.8x | 13.0x |
| Yield (%) | 2.9% | 3.5% | 3.9% |

Source: GSJBW Research estimates

Healthscope is a leading provider of private hospital and health related services to the public and private sectors. Over the past 12 months the company has significantly broadened the scope of its operations with the acquisition of The Gribbles Group, an Australian healthcare company specialising in human pathology testing.

Whilst execution risk around the Gribbles acquisitions remains an issue, encouragingly, Healthscope's recent full year result indicated that it is on track to meet its integration targets. Cost synergies from the Gribbles acquisition have exceeded the forecasts outlined in the prospectus issued at the time of the capital raising and the capture of revenue synergies is well advanced and "will be fully realised in fiscal 2006." We believe that the vertical integration of a pathology services operator with Healthscope's hospital portfolio could prove a very attractive business model.

In our view, the investment case for Healthscope remains one of the most compelling within the healthcare sector. The company is well positioned to record strong earnings growth in future periods driven by earnings leverage within its existing business and the delivery of synergies from the pathology integration. Demographic trends are also very supportive: we believe that the demand for hospital and pathology services will only increase with the ageing of the Australian population. Finally, in our view, the business is well positioned to continue to expand its asset base through organic growth and further consolidation opportunities. We reiterate our Buy recommendation.

## Portfolio Management: Buy Ideas

**AXA Asia-Pacific Holdings Limited (AXA)** **Analyst: Ryan Fisher**

- **Investment View: Short Term Marketperform; Long Term Buy**
- **Share Price as at 31/08/05: $4.93 Valuation: $4.70**

| Year End December | 2006 Estimate | 2007 Estimate | 2008 Estimate |
| --- | --- | --- | --- |
| Net Profit ($m) | $489.8m | $536.1m | $592.0m |
| EPS Growth (%) | 4.1% | 9.3% | 10.5% |
| PER (x) | 17.7x | 16.2x | 14.6x |
| Yield (%) | 3.0% | 3.3% | 3.7% |

Source: GSJBW Research estimates

At current levels, we believe the long term risk/reward proposition for AXA Asia-Pacific Holdings (AXA) remains attractive and therefore reiterate our long-term Buy recommendation on the stock.

AXA's recent first half result was good quality and came in well above the market's expectations. Consequently, we upgraded our operating profit estimates by 12% for fiscal 2005 and by 8-10% for future years. From a valuation perspective, AXA's share price is not significantly ahead of our valuation of $4.70 per share, which we forecast will grow in the order of 13-15% per annum if AXA achieves its targeted growth objectives. We also believe that AXA now carries somewhat better valuation support than its locally-focused wealth management peers.

We believe that the company is well placed to take advantage of continued superannuation driven growth in the Australian wealth management market, as well as continued growth in the Hong Kong life insurance and retirement savings market. While management has not ruled out the possibility of capital management initiatives down the track, the company is currently more focused upon pursuing opportunities to invest its growth options in Asia. We believe AXA's attractive growth prospects in markets such as China, Indonesia, Philippines and India differentiate the company from its local peers and could result in further re-rating of the stock if management is successful in achieving its well-publicised targets.

While life insurance/wealth management stocks will always have above-average sensitivity to the performance of the broader equity market (a 'double hit' from the impact of sentiment towards these stocks, as well as the actual market impact on their investments), we note that AXA is more exposed to global equities (through its large Hong Kong business) than to the local market. Hence, any slowdown in the domestic market (relative to offshore markets) should see it face less downside risk than its peers. Further, the parent company's clear interest in eventually owning 100% of the business should help place a floor under the share price if markets weaken.

**Woolworths Limited (WOW)** **Analyst: Phillip Kimber**

- **Investment View: Short Term Outperform; Long Term Buy**
- **Stock Price as at 31/08/05: $16.25 Valuation: $17.50**

| Year End December | 2006 Estimate | 2007 Estimate | 2008 Estimate |
| --- | --- | --- | --- |
| Net Profit ($m) | $976.1m | $1130.0m | $1286.2m |
| EPS Growth (%) | 13.4% | 14.4% | 16.3% |
| PER (x) | 18.1x | 15.8x | 13.6x |
| Yield (%) | 3.4% | 3.8% | 4.2% |

Source: GSJBW Research estimates

Woolworths remains our preferred exposure within the large-cap retail defensive sector and we remain comfortable with our long term Buy recommendation on the stock.

Our positive investment case for Woolworths is based upon its defensive earnings profile given its relatively low exposure to the cyclical non-food retail sector (~15%, compared to ~35% of Coles Myer sales). Woolworths is also ahead of its key competitor in achieving supply chain efficiency gains. These cost savings enable the company to drive a healthy balance between sales growth (investing some of these benefits with customers through lower prices) and margin expansion (allowing some of the cost savings to flow through to profit for shareholders).

We continue to see opportunities for further upside earnings potential. Woolworths' Food & Liquor division has delivered profit growth of ~15% per annum over the last 5 years and we forecast average annual earnings growth of 12% over the next 4 years. We believe that this forecast may prove conservative, given the current momentum in the business and with significant supply chain benefits yet to flow through.

In addition, a successful acquisition of Foodland's New Zealand assets should help underpin Woolworths' cost reduction-led market share growth strategy in the medium term.

## Portfolio Management: Reduce/Switch Exposure

**Telstra Corporation Limited (TLS)** **Analyst: Christian Guerra**

- **Investment View: Short Term Marketperform; Long Term Hold**
- **Stock Price as at 31/08/05: $4.68 Valuation: $5.35**

| Year End June | 2006 Estimate | 2007 Estimate | 2008 Estimate |
|---|---|---|---|
| Net Profit ($m) | $4163.7m | $3968.0m | $3904.1m |
| EPS Growth (%) | -6.7% | -4.2% | -0.1% |
| PER (x) | 14.0x | 14.6x | 14.7x |
| Yield (%) | 9.0% | 6.8% | 7.3% |

Source: GSJBW Research estimates

The recent fiscal 2005 result provided a clear insight into the operational challenges facing Telstra. Revenues from the fixed line business are in decline and this trend is likely to accelerate as consumers increase their substitution from fixed line to mobile phone usage. While the company is looking to expand its mobile, data and internet operations in order to offset the challenging outlook for its fixed copper network, strong earnings growth within these businesses will likely prove challenging given the highly competitive nature of the telecommunications industry.

A further threat to the company's earnings growth outlook is higher depreciation and amortisation resulting from Telstra's rising capital expenditure (capex) bill. Telstra is being forced to reinvest large amounts of capital back into the business in order to improve the efficiency and flexibility of its network infrastructure. At its recent fiscal 2005 result, management indicated that fiscal 2006 domestic capex would be approximately $4.0bn, over 20% higher than previous company guidance. Further, we expect that the company will announce a large business transformation program at the upcoming CEO Strategy update in October/November, which could add a further $500m to this capex charge.

In addition, we believe that Telstra's capacity to complete the third tranche of its 3-year capital management program is also under increasing risk. The company recently stated that it was confident that the program was secure given "normal operating conditions". However, in our view, the potential $1.1-1.2bn spend on a business transformation program – and likely expenditure associated with the Federal Government's sale of its share in TLS – could create doubt regarding Telstra's capital management potential in the minds of some investors, creating a further headwind for share price performance. While the strong upcoming distribution profile (~41 cents per share in dividends in a little over 6 months) will likely be supportive in the short term, for investors with large positions in the stock, we believe that this may be a timely juncture at which to review their exposure, given the risk of negative news flow at the time of the upcoming strategy update.

**Real Estate Investment Trusts (REITs) Sector** **Analyst: Ben Dalling**

- **Commonwealth Property Office Fund: Short Term Underperform; Long Term Hold**
- **Macquarie DDR Trust: Short Term Marketperform; Long Term Hold**
- **Centro Properties Group: Short Term Outperform; Long Term Buy**
- **Stockland: Short Term Marketperform; Long Term Buy**

**Commonwealth Property Office Fund (CPA)** – Commonwealth Property Office Fund's recent full year result came in below consensus and our expectations, driven by a weaker operational performance. While we believe most of the disappointment was due to cyclical factors, the time required for it to recover remains unknown. Further, the trust's lease expiration profile continues to deteriorate and, given the group is behind the required run rate to lease out vacated properties, we are comfortable for income-seeking investors to switch into Macquarie DDR, and for those looking for more growth-oriented exposure within the sector into Centro and Stockland.

**Macquarie DDR Trust (MDT)** – Macquarie DDR Trust's underlying portfolio is well positioned, given US retail thematics remain supportive of big box retailing and landlords in this asset class. With significant under-renting in the portfolio and the trust's lease expiry increasing beyond fiscal 2007, we believe growth should move to the upper end of its peers while its yield remains appealing.

**Centro Properties Group (CNP)** – We remain comfortable with our positive recommendation on the stock. We believe Centro's Services business is entering a solid growth phase (with the recent listing of a retail trust) which, when combined with the positive outlook for rentals within the property portfolio, will likely improve the group's distribution profile.

**Stockland (SGP)** – In our view, the outlook for Stockland's core operations remains sound in the near term and we believe the stock remains a key long-term investment. Stockland is trading marginally below our valuation and on an attractive distribution yield.

## Portfolio Management: Insurance Sector Review

The recent reporting season delivered a mixed performance from the insurance sector. In the lead up to the results, share prices were driven higher by investors' expectations for very strong results across all of the insurers. As a consequence, even though all the companies delivered strong numbers in absolute terms, those that disappointed against consensus expectations were dealt a harsh blow. Hence, we believe it timely to reflect upon the recent performance of the insurers and flesh out the rationale underpinning our preferences across the sector.

**QBE Insurance (QBE) –** QBE remains our preferred exposure in the general insurers and we retain our Buy recommendation on the stock. The company delivered a very strong full year result, following which we materially increased both our future earnings forecasts and our valuation. Outlook comments were also encouraging, with management implying that there is less threat of margin attrition in coming periods than the market had previously suspected. Given where we are in the global insurance cycle, we believe that we are unlikely to see much organic growth in the next few years. However, the company has a proven track record of making value-accretive acquisitions and has indicated that there are a number of potential deals in the pipeline. Meanwhile, an increase in the payout ratio has returned the stock to a yield in the mid-4% range. While there is potential for negative news flow in the near term relating to the US hurricane season, the risks are already well known to the market and have been accounted for in the company's guidance. We would therefore see any hurricane-related pullbacks as presenting a good opportunity to build positions in the stock.

**Promina Group (PMN) –** The result was sound, but the market sold off the stock after the release, with the main issue troubling investors being the general insurance margin, which came in at the lower end of expectations. While this was more than offset at the bottom line by revenue strength, we believe that the market's focus was firmly fixed upon profitability. Notwithstanding this, we believe the stock remains attractive on valuation grounds. Promina is trading at a large discount to our $5.25 valuation and around 11x our forecast of fiscal 2006 earnings, on a dividend yield of over 5%. In addition, the company will carry out a $100m on-market buyback some time between now and the end of the calendar year, with plenty of room for further capital management next year. We therefore retain our long-term Buy recommendation on the stock.

**Insurance Australia Group (IAG)** – IAG reported a disappointing result for fiscal 2005, with its revenue coming in weaker than expectations and its margin at the lower end of the expected range. Since investors had been factoring in a somewhat more stellar performance, this outcome came as a particular surprise. Following the recent weakness in the share price, the valuation equation is looking more reasonable than it has for some time, but we still find it difficult to get excited about the stock, particularly when compared with QBE (superior growth) and Promina (less demanding valuation). We see the logic of the group's Asian expansion plans, but note that this may raise its risk profile (and will likely come at the expense of near term capital management initiatives).

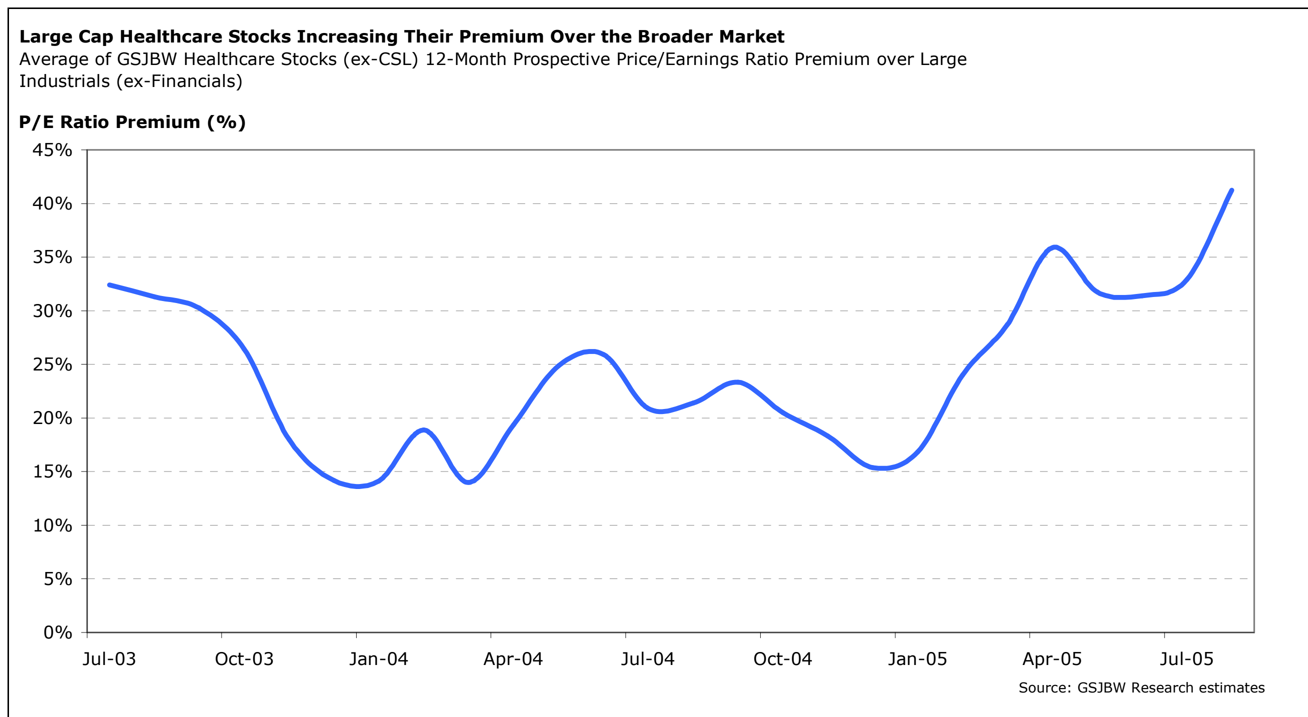
**AMP (AMP)** – A combination of strong growth in funds under management (FUM) and impressive cost control drove a good first half result from AMP. We believe the near term outlook for the business remains very encouraging, with the strong equity market performance year to date having virtually guaranteed an increase in average FUM over the second half of calendar 2005. In addition, dynamics within the broader industry continue to be supportive – and AMP is clearly, in our view, the leading franchise in a solidly growing industry. However, we feel these positive dynamics are already priced into the stock. Therefore, with the stock trading significantly above our $6.30 valuation and at a large premium to the market on a price/earnings basis (fiscal 2006 forecasts), we are comfortable retaining our Hold recommendation on AMP.

**AXA Asia Pacific (AXA)** – As we have noted elsewhere in this bulletin, AXA recorded a very strong first half result, with all three of the group's main operating divisions (Australia/New Zealand Insurance, Australia/New Zealand Wealth Management and Hong Kong) recording operating profit numbers well ahead of our forecasts. Our valuation increased to $4.70 on the back of the result and we highlight that our approach to valuing the business is based on what we believe to be relatively conservative parameters. While the stock rallied post the release, our confidence in the long term outlook for the business sees us retain our Buy recommendation. We believe there is scope for further upside from the local operations, with the Asian franchise remaining an attractive long dated growth option.

## Portfolio Management: Healthcare Sector Review

Since the beginning of the year, the healthcare sector as a group has substantially outperformed the broader market, on the back of significant corporate activity and the market's recognition of the earnings growth potential for many of these companies. While this has meant that valuations for some of the companies within this sector have become somewhat stretched, we remain comfortable investing in high-quality names, with strong balance sheet positions and clear long term growth prospects – to this end, we highlight our preferences in the sector below.

The chart below maps the rolling 12-month prospective price/earnings ratio of the healthcare stocks within GSJBW Research stock coverage (excluding CSL, as this company makes up almost 50% of the sector by market capitalisation):




Clearly, the healthcare sector has enjoyed a recent period of price/earnings ratio expansion relative to the broader market – that is, the market has been prepared to 'pay up' now for the promise of growth, without a corresponding increase in next year's earnings estimates. In our view, this positive re-rating has seen absolute valuations become challenging for some companies and we continue to believe that Resmed (RMD) and CSL Limited (CSL) look expensive at current levels.

Our long term preferences within the sector are outlined as follows:

- **Healthscope (HSP)** – Healthscope remains one of our preferred exposures within the domestic Healthcare sector and we re-iterate our long-term Buy recommendation on the stock. As we have noted elsewhere, our positive investment case is based on our view that Healthscope is well positioned to achieve solid earnings growth driven by the positive outlook for the hospital sector, earnings leverage within its current business and delivering significant synergies from the integration of pathology services.
- **Sonic Healthcare (SHL)** – Our confidence in Sonic's investment case has increased following its recent acquisition of CPL, a US pathology operator. The deal provides Sonic with a US platform for significant organic growth-driven potential combined with bolt-on acquisition opportunities in order to generate attractive incremental returns. In addition, we remain positive on the outlook for the domestic pathology industry and see further consolidation opportunities in the fragmented German market, as well as longer-dated growth prospects in the UK through the NHS outsourcing process.
- **Cochlear (COH)** – Whilst Cochlear lacks valuation support at current levels, we retain a positive view on the stock. We believe the company's short term earnings momentum will likely remain solid, given the combined benefits of sales momentum in Nucleus Freedom and its competitor's continuing regulatory issues. From a longer term perspective, further margin expansion and product development expectations contribute to Cochlear's appealing growth profile – we estimate EPS will grow by 27.5% in fiscal 2006 and 32.7% in fiscal 2007.

## Stock Selection Using Quantitative Techniques

With the August reporting season drawing to a close, it is timely to review the status of our main GSJBW multi-factor Quant stock selection model, given that earnings revisions and share price movements over the last month may well have had an impact on rankings within the model. The current top rankings in GSJBW's large industrial stock screening model are shown on the table below, as well as changes in rankings over the last month.

It is also a useful exercise to review the longer term performance of each of these factors individually, as well as their overall performance when combined into our broader model. Investors should note that 'applying' each of these screens involves ranking our universe of stocks (we look at the top 100 ex-property trusts) on each factor and investing in the top quartile of these stocks (usually ~10-15 equities), rebalancing the portfolio each month. Listed below are brief outlines for each factor, followed by their individual, per annum returns over the last 9 years, after accounting for transactions costs (**bold**). For reference, the benchmark ASX100 ex-Property Trusts returned 12.3% per annum over this period.

- **EVA™ (Economic Value Added) Spread:** degree to which a company has created value in excess of its required returns (larger spread ranks higher on this factor) – **20.3% per annum**;
- **EVA™ Trend:** degree to which a company's EVA™ is changing over time (an improving trend ranks higher versus a deteriorating trend) – **16.6% per annum**;
- **Historical Earnings Revision (3 Months):** recent changes in the market's consensus earnings forecasts are a key signal of longer term share price performance (higher positive revisions rate higher on this factor and vice versa) – **22.8% per annum**;
- **Relative Strength Index (RSI):** This is a measure of share price momentum – is a share price strongly appreciating (rates higher) or depreciating (rates lower) – **20.3% per annum**;
- **ROFE/PEG:** a valuation factor, combining a measure of returns generation (ROFE) and the market's assessment of earnings growth (the PEG ratio measures the market's pricing of forecast earnings per share growth) – stocks that have higher ROFE and lower PEG ratios score more highly on this factor than comparable companies will low ROFE and high PEG ratios – **17.0% per annum**.

Our main stock screening model combines these screens (in addition to a Predicted Earnings Revision screen), to provide diversification across market themes and thus to deliver stable 'through-the-cycle' returns, acknowledging that some screens will perform better than others in different market environments. Using the methodology outlined above, GSJBW's large industrial stock screening model has returned **21.3% per annum** over the last 9 years, after transaction costs. Investors should note, however, that the average portfolio turnover is 23%, that is, around a quarter of the portfolio is bought/sold in any month – hence this tool is most useful for timing investment decisions and as an aid to portfolio construction.

| Rank | Company | EVA Spread: Level | Trend | Earnings Revision: Actual 3 Month | Predicted | Positive RSI | ROFE/ PEG | TOTAL | Previous Rank (31-July-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 | JHX | 13 | 14 | 14 | 15 | 10 | 29 | **95** | 2 | 1 |
| 2 | ALL | 15 | 15 | 10 | 15 | 5 | 29 | **89** | 1 | -1 |
| 3 | RIN | 12 | 14 | 14 | 15 | 1 | 27 | **83** | 5 | 2 |
| 4 | RIO | 11 | 13 | 12 | 15 | 4 | 27 | **82** | 4 | 0 |
| 5 | PPT | 14 | 15 | 6 | 8 | 3 | 28 | **75** | n/a | n/a |
| 6 | CPU | 8 | 5 | 13 | 15 | 8 | 25 | **75** | 15 | 9 |
| 7 | SHL | 5 | 11 | 15 | 15 | 10 | 18 | **74** | 17 | 10 |
| 8 | LEI | 13 | 14 | 10 | 8 | 7 | 19 | **71** | 6 | -2 |
| 9 | ASX | 15 | 1 | 12 | 8 | 5 | 30 | **71** | 3 | -6 |
| 10 | COH | 10 | 2 | 12 | 15 | 8 | 23 | **70** | 10 | 0 |
| 11 | BHP | 13 | 1 | 13 | 15 | 4 | 22 | **68** | 8 | -3 |
| 12 | WOW | 14 | 0 | 8 | 15 | 2 | 28 | **67** | 11 | -1 |

Source: GSJBW Quantitative Research

## GSJBW Model Portfolios

### Income Portfolio

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

Source: GSJBW Research

**Our changes to the Income Portfolio during August 2005:**
Reduced: Telstra Corporation
Increased: Australand Holdings, Macquarie Communications Infrastructure Group

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

| | |
|---|---|
| Earnings per Share Growth | 6.4% |
| Price to Earnings Ratio | 14.0x |
| Average Yield | 5.6% |
| Franking | 78% |

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 Banking Corporation | Macquarie DDR Trust |
| Promina | Transurban Group |
| Origin Energy | Mirrabooka |
| Coca-Cola Amatil | Sonic Healthcare |
| Macquarie Communications Infrastructure Group | Australian Foundation Investment Company |
| Rio Tinto | Rinker |
| Telstra Corporation | CFS Gandel Retail Trust |
| Australian Gas Light Company | Wesfarmers |

Source: GSJBW Research

**Our changes to the Defensive Portfolio during August 2005:**
Reduced: Rinker, Telstra Corporation
Increased: Woolworths, Macquarie Communications Infrastructure Group

**Defensive Portfolio Summary: Fiscal 2006** (*Please note, MCG and 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, Inc. |
| Commonwealth Bank of Australia | Sonic Healthcare |
| Woolworths | Macquarie Communications Infrastructure Group |
| St George Bank | Macquarie DDR Trust |
| Westpac Banking Corporation | Computershare |
| Origin Energy | Australian Gas Light Company |
| Promina | Foodland Associated |
| Coca-Cola Amatil | Healthscope |
| Rio Tinto | Brambles |
| Telstra Corporation | Wesfarmers |
| Australian Foundation Investment Company | Rinker |
| Billabong International | Alesco |

Source: GSJBW Research

**Our changes to the Balanced Portfolio during August 2005:**
Reduced: Rinker, Telstra Corporation, Wesfarmers
Increased: Woolworths, Macquarie Communications Infrastructure Group

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

| | |
|---|---|
| Earnings per Share Growth | 11.9% |
| Price to Earnings Ratio | 14.5x |
| Average Yield | 4.1% |
| Franking | 85% |

Source: GSJBW Research estimates

## Growth Portfolio

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

Source: GSJBW Research

**Our changes to the Growth Portfolio during August 2005:**
No changes

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

| | |
|---|---|
| Earnings per Share Growth | 13.5% |
| Price to Earnings Ratio | 14.8x |
| Average Yield | 3.7% |
| Franking | 81% |

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*

## GSJBW Recommendation Changes Over The Past Month

| STOCK | ASX CODE | SHORT-TERM Recommendation | | LONG-TERM Recommendation | |
|---|---|---|---|---|---|
| | | NEW | OLD | NEW | OLD |
| Aristocrat | ALL | Outperform | Marketperform | - | Buy |
| Bendigo Mining | BDG | Marketperform | Underperform | - | Hold |
| Cabcharge Australia | CAB | Outperform | Marketperform | Buy | Hold |
| Commonwealth Bank | CBA | Marketperform | Outperform | Hold | Buy |
| Coates Hire | COA | Marketperform | Outperform | - | Hold |
| Commonwealth Property Office | CPA | Underperform | Marketperform | Hold | Buy |
| Computershare | CPU | Marketperform | Outperform | - | Buy |
| Crane Group | CRG | Outperform | Marketperform | - | Hold |
| David Jones | DJS | Marketperform | Underperform | Hold | Sell |
| Energy Developments | ENE | - | Marketperform | Hold | Buy |
| Flight Centre | FLT | - | Underperform | Hold | Sell |
| Hills Industries | HIL | Outperform | Marketperform | - | Hold |
| James Hardie | JHX | Marketperform | Outperform | Hold | Buy |
| Leighton | LEI | Marketperform | Underperform | - | Hold |
| Macquarie Communications | MCG | Marketperform | Outperform | - | Buy |
| Macquarie DDR Trust | MDT | - | Marketperform | Hold | Buy |
| Mirvac | MGR | Marketperform | Underperform | - | Hold |
| Pacifica | PBB | Marketperform | Underperform | Hold | Sell |
| Pacific Brands | PBG | Marketperform | Underperform | Hold | Sell |
| Promina | PMN | Marketperform | Outperform | - | Buy |
| Patrick Corporation | PRK | Marketperform | Underperform | - | Hold |
| Stockland | SGP | - | Marketperform | Buy | Hold |
| Sonic Healthcare | SHL | Outperform | Marketperform | - | Buy |
| Salmat | SLM | Marketperform | Outperform | - | Buy |
| Sims Group | SMS | Marketperform | Underperform | - | Hold |
| Suncorp-Metway | SUN | - | Marketperform | Sell | Hold |
| Toll Holdings | TOL | - | Marketperform | Hold | Buy |
| Tap Oil | TAP | Outperform | Marketperform | Buy | Hold |

Source: IRESS, GSJBW Research

**Referred to in Document:**

| Company Name | Stock Code | Share Price (as at 31 August 2005) | Valuation | Short Term Recommendation | Long Term Recommendation |
|---|---|---|---|---|---|
| Australian Foundation Investment Company | AFI | $3.98 | $4.25 | N/a | Buy |
| Australian Gas Light Company | AGL | $14.19 | $12.70 | Marketperform | Hold |
| Aristocrat Leisure | ALL | $12.53 | $13.10 | Outperform | Buy |
| Alinta | ALN | $11.00 | $10.90 | Outperform | Buy |
| Alesco Corporation | ALS | $7.91 | $7.50 | Marketperform | Hold |
| Australand Holdings | ALZ | $1.84 | $1.73 | Marketperform | Buy |
| AMP | AMP | $7.37 | $6.30 | Marketperform | Hold |
| AXA Asia-Pacific Holdings | AXA | $4.93 | $4.70 | Marketperform | Buy |
| Billabong International | BBG | $12.95 | $13.15 | Outperform | Buy |
| Bendigo Mining | BDG | $1.02 | $1.21 | Marketperform | Hold |
| BHP Billiton | BHP | $20.46 | $11.83 | Outperform | Buy |
| Brambles Industries | BIL | $8.88 | $10.10 | Outperform | Buy |
| Cabcharge | CAB | $5.75 | $5.53 | Outperform | Buy |
| Commonwealth Bank of Australia | CBA | $37.40 | $38.50 | Marketperform | Hold |
| Coca-Cola Amatil | CCL | $8.64 | $9.00 | Outperform | Buy |
| Centro Properties Group | CNP | $5.95 | $5.75 | Outperform | Buy |
| Coates Hire | COA | $4.72 | $3.60 | Marketperform | Hold |
| Cochlear | COH | $42.00 | $41.50 | Outperform | Buy |
| Commonwealth Property Office Fund | CPA | $1.27 | $1.24 | Underperform | Hold |
| Computershare | CPU | $6.68 | $6.25 | Marketperform | Buy |
| Crane Group | CRG | $10.75 | $10.35 | Outperform | Hold |
| CSL | CSL | $34.27 | $27.00 | Underperform | Hold |
| David Jones | DJS | $2.33 | $2.30 | Marketperform | Hold |
| Energy Developments | ENE | $4.52 | $4.06 | Marketperform | Hold |
| Foster's Group | FGL | $5.75 | $5.85 | Outperform | Hold |
| Flight Centre | FLT | $15.25 | $15.65 | Underperform | Hold |
| Foodland Associated | FOA | $26.81 | $19.15 | Marketperform | Hold |
| CFS Gandel Retail Trust | GAN | $1.77 | $1.66 | Marketperform | Buy |
| Hills Industries | HIL | $4.95 | $4.30 | Outperform | Hold |
| Healthscope | HSP | $5.62 | $4.98 | Outperform | Buy |
| Insurance Australia Group | IAG | $5.41 | $5.60 | Marketperform | Hold |
| James Hardie Industries | JHX | $8.62 | $8.86 | Marketperform | Hold |
| Leighton Holdings | LEI | $14.89 | $11.69 | Marketperform | Hold |
| Macquarie Airports | MAP | $3.19 | $3.63 | Outperform | Buy |
| Macquarie Comm. Infra. Group | MCG | $6.29 | $6.32 | Marketperform | Buy |
| Macquarie DDR Trust | MDT | $1.16 | $1.18 | Marketperform | Hold |
| Mirvac | MGR | $3.82 | $4.10 | Marketperform | Hold |
| Mirrabooka Investments | MIR | $1.65 | $1.73 | N/a | Buy |
| News Corporation, Inc. | NWS | $22.53 | $26.20 | Outperform | Buy |
| Origin Energy | ORG | $7.25 | $7.70 | Marketperform | Buy |
| Pacifica Group | PBB | $2.36 | $2.86 | Marketperform | Hold |
| Pacific Brands | PBG | $2.76 | $2.90 | Marketperform | Hold |
| Promina Group | PMN | $4.77 | $5.25 | Marketperform | Buy |
| Patrick Corporation | PRK | $7.04 | $5.55 | Marketperform | Hold |
| QBE Insurance | QBE | $17.10 | $17.70 | Outperform | Buy |
| Rinker Group | RIN | $14.37 | $13.07 | Outperform | Buy |
| Rio Tinto | RIO | $50.31 | $34.15 | Outperform | Buy |
| Resmed | RMD | $9.60 | $7.60 | Underperform | Hold |
| Rural Press | RUP | $11.49 | $9.00 | Marketperform | Hold |
| St George Bank | SGB | $27.03 | $26.79 | Outperform | Hold |
| Stockland Group | SGP | $5.90 | $6.19 | Marketperform | Buy |
| Sonic Healthcare | SHL | $15.30 | $13.54 | Outperform | Buy |
| Sigma Company | SIG | $11.02 | $8.15 | Marketperform | Hold |
| Salmat | SLM | $4.68 | $5.70 | Marketperform | Buy |
| Sims Group | SMS | $17.49 | $14.53 | Marketperform | Hold |
| Suncorp-Metway | SUN | $19.70 | $18.30 | Marketperform | Sell |
| Tabcorp | TAH | $16.50 | $17.85 | Underperform | Hold |
| Tap Oil | TAP | $2.97 | $2.17 | Marketperform | Hold |
| Transurban Group | TCL | $7.15 | $5.65 | Marketperform | Sell |
| Ten Network Holdings | TEN | $3.69 | $3.50 | Marketperform | Hold |
| Telstra Corporation | TLS | $4.68 | $5.35 | Marketperform | Hold |
| Toll Holdings | TOL | $14.08 | $12.35 | Marketperform | Hold |
| Virgin Blue Holdings | VBA | $1.56 | $1.35 | Not Rated | Not Rated |
| West Australian Newspapers | WAN | $8.30 | $7.45 | Marketperform | Hold |
| Westpac Banking Corporation | WBC | $19.74 | $20.19 | Marketperform | Hold |
| Westfield Group | WDC | $17.42 | $16.45 | Marketperform | Hold |
| Wesfarmers | WES | $39.40 | $35.91 | Marketperform | Hold |
| Woolworths | WOW | $16.25 | $17.50 | Outperform | Buy |
| Zinifex | ZFX | $3.90 | $3.42 | Marketperform | Buy |

Source: IRESS, GSJBW Research

**Disclosure of Interests:**

The following disclosure applies to each of the following: NWS
Notice to clients based in the United States only: Customers of The Goldman Sachs Group, Inc. in the United States can receive independent, third-party research on the company or companies covered in this report, at no cost to them, where such research is available. Customers can access this independent research at http://www.independentresearch.gs.com or can call 1-866-727-7000 to request a copy of this research.

The following disclosure applies to each of the following: NWS, RMD
Goldman Sachs JBWere does and seeks to do business with companies covered in its research reports. As a result, investors should be aware that Goldman Sachs JBWere may have a conflict of interest that could affect the objectivity of this report. Investors should consider this report as only a single factor in making their investment decision.

Goldman Sachs JBWere and/or its affiliates expect to receive or intend to seek compensation for financial and advisory services in the next 3 months from the following companies, its parent, or its wholly owned or majority owned subsidiaries: ALN, AMP, ALL, ALZ, AGL, AXA, BHP, BBG, BIL, CCL, COH, CBA, CPU, CSL, FGL, HSP, IAG, JHX, LEI, MAP, MCG, MIR, NWS, ORG, PRK, PMN, QBE, RMD, RIN, RIO, SIG, SHL, SGB, SUN, TAH, TLS, TEN, TOL, TCL, VBA, WES, WAN, WBC, WOW

Goldman Sachs JBWere and/or its affiliates have received during the past 12 months compensation for financial and advisory services from the following companies, its parent, or its wholly owned or majority owned subsidiaries: ALZ, AFI, AGL, BHP, BBG, GAN, CCL, COH, CBA, FGL, HSP, NWS, PMN, RIO, SGB, WDC

Goldman Sachs JBWere and/or its affiliates have managed or co-managed a public offering of securities of the following companies or its affiliates in the past 5 years: ALZ, CBA, CPU, FGL, HSP, IAG, MCG, PBG, PRK, PMN, SGB, TOL, VBA, WBC

Goldman Sachs JBWere and/or its affiliates have managed or co-managed a public offering of securities of the following companies or its affiliates in the past 12 months: CBA, FGL, HSP, IAG

Goldman Sachs JBWere and/or its affiliates make a market in the securities of the following companies: AMP, BHP, BIL, CBA, JHX, NWS, RMD, RIO, TLS, VBA, WBC, WOW

Goldman Sachs JBWere and its affiliates beneficially owned 1% or more of a class of equity securities of the following companies or trusts as of the end of the week immediately preceding the publication date of this report: CPU, DJS, IAG

A director or employee of Goldman Sachs JBWere or its affiliates is a director of the following companies: AFI, HSP, IAG, MIR, SIG, SGB, TOL

Goldman Sachs JBWere and its affiliates are a substantial shareholder in the following companies or trusts: ENE

The following disclosure applies to each of the following: MIR, NWS
The company has announced that it will undertake a buy-back of part of its issued share capital. Goldman Sachs JBWere has been appointed to act on the company's behalf in relation to the buy-back.

The following disclosure applies to each of the following: NWS, RIO
Goldman Sachs and Goldman Sachs JBWere each have research coverage of the company the subject of this report. Any views, investment opinions or recommendations relating to the subject company published by Goldman Sachs JBWere are independently developed and may differ from those published by Goldman Sachs.

The Goldman Sachs Group, Inc. is a specialist in the securities (including derivative securities) of the following companies: JHX, NWS, RMD

The following disclosure applies to each of the following: ALZ Goldman Sachs JBWere and/or its affiliates have been appointed to act as co-manager of an offering of Australand Subordinated Step-up Exchangeable Trust Securities (ASSETS) by Australand Property Limited. A product disclosure statement for the ASSETS is available and can be obtained from the issuer, Australand Property Limited. A potential investor in the ASSETS should consider the product disclosure statement in deciding whether to acquire, or continue to hold, the ASSETS. Goldman Sachs JBWere has been allocated, and will procure investors to subscribe for, Broker Firm stock and will receive a fee of 1.25% of the proceeds of its broker firm allocation.

The following disclosure applies to each of the following: VBA
Goldman Sachs JBWere and/or its affiliates have been appointed as financial advisor to Virgin Group in relation to Virgin Group's potential acquisition of ordinary shares in Virgin Blue Holdings Limited. Goldman Sachs JBWere and/or its affiliates will receive fees for acting in this capacity.

**Important Notice:**

This document should not be construed as an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. This document contains general advice only. In preparing this document, Goldman Sachs JBWere Pty Ltd ("Goldman Sachs JBWere") did not take into account the investment objectives, financial situation and particular needs ('financial circumstances') of any particular person. Accordingly, before acting on any advice contained in this document, you should assess whether the advice is appropriate in light of your own financial circumstances or contact your Goldman Sachs JBWere adviser. If you were referred to Goldman Sachs JBWere by an investment adviser, that adviser may receive a financial benefit from Goldman Sachs JBWere for dealing in securities on your behalf. Your Goldman Sachs JBWere adviser will give you precise details of any benefit payable to the investment adviser who referred you to Goldman Sachs JBWere. For purposes of calculating whether The Goldman Sachs Group, Inc. or Goldman Sachs JBWere beneficially owns or controls, including having the right to vote for directors, 1% or more of a class of the common equity security of the subject issuer of a research report, The Goldman Sachs Group, Inc. and Goldman Sachs JBWere includes all derivatives that, by their terms, give a right to acquire the common equity security within 60 days through the conversion or exercise of a warrant, option, or other right but does not aggregate accounts managed by Goldman Sachs Asset Management, Goldman Sachs JBWere Asset Management or Goldman Sachs JBWere Portfolio Management. For the purposes of determining whether Goldman Sachs JBWere and its affiliates have a substantial holding in a company or trust, Goldman Sachs JBWere calculates that holding as prescribed by the Corporations Act 2001 (Aust) which for the avoidance of doubt includes accounts managed by Goldman Sachs Asset Management, Goldman Sachs JBWere Asset Management and Goldman Sachs JBWere Portfolio Management. Goldman Sachs JBWere generally prohibits its analysts and persons reporting to analysts from maintaining a financial interest in the securities or derivatives of any companies or trusts that the analyst cover. This document is distributed in the United States by Goldman, Sachs & Co., in Hong Kong by Goldman Sachs (Asia) L.L.C., in Korea by Goldman Sachs (Asia) L.L.C., Seoul Branch, in Japan by Goldman Sachs (Japan) Ltd., in New Zealand by Goldman Sachs JBWere (NZ) Limited and in Singapore by Goldman Sachs (Singapore) Pte (Company Number: 198602165W). This material has been issued by Goldman Sachs JBWere Pty Ltd and has been approved for the purposes of section 21 of the Financial Services and Markets Act 2000 by Goldman Sachs International, which is regulated by the Financial Services Authority, in connection with its distribution in the United Kingdom, and by Goldman Sachs Canada, in connection with its distribution in Canada. Goldman Sachs International and its non-US affiliates may, to the extent permitted under applicable law, have acted on or used this research, to the extent that it relates to non-US issuers, prior to or immediately following its publication. Further information on any of the securities mentioned in this material may be obtained on request, and for this purpose, persons in Italy should contact Goldman Sachs S.I.M. S.p.A. in Milan or its London branch office at 133 Fleet Street; and persons in Hong Kong should contact Goldman Sachs (Asia) L.L.C. at 2 Queen's Road Central. Persons who would be categorized as private customers in the United Kingdom, as such term is defined in the rules of the Financial Services Authority, should read this material in conjunction with the last published reports on the companies mentioned herein and should refer to the risk warnings that have been sent to them by Goldman Sachs International. A copy of these risk warnings is available from the offices of Goldman Sachs International on request. Unless governing law permits otherwise, you must contact a Goldman Sachs entity in your home jurisdiction if you want to use Goldman Sachs JBWere's or The Goldman Sachs Group, Inc's services in effecting a transaction in the securities mentioned in this material. Goldman Sachs JBWere Pty Ltd (which trades as Goldman Sachs JBWere) and its related entities distributing this document and each of their respective directors, officers and agents ("Goldman Sachs JBWere Group") believe that the information contained in this document is correct and that any estimates, opinions, conclusions or recommendations contained in this document are reasonably held or made as at the time of compilation. However, no warranty is made as to the accuracy or reliability of any estimates, opinions, conclusions, recommendations (which may change without notice) or other information contained in this document and, to the maximum extent permitted by law, Goldman Sachs JBWere Group disclaims all liability and responsibility for any direct or indirect loss or damage which may be suffered by any recipient through relying on anything contained in or omitted from this document. In producing research reports, members of Goldman Sachs JBWere Investment Research may attend site visits and other meetings hosted by the issuers the subject of its research reports. In some instances the costs of such site visits or meetings may be met in part or in whole by the issuers concerned if Goldman Sachs JBWere considers it is appropriate and reasonable in the specific circumstances relating to the site visit or meeting. This document is for the intended recipient only and is provided on the condition that you keep it confidential and do not copy or circulate it in whole or in part. No part of this document may be reproduced without the permission of Goldman Sachs JBWere Group. Copyright in this document is owned by Goldman Sachs JBWere Pty Ltd.

© 2005 Goldman Sachs JBWere Pty Ltd ABN 21 006 797 897 All rights reserved.

**Research Analyst Certification:**

I, Michael Hawkins, hereby certify that all of the views expressed in this report accurately reflect my personal views about the Subject Company or companies and its or their securities. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

## 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 40 Index (Gross) and not the S&P/ASX 200 index.

**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.

© 2005 Goldman Sachs JBWere Pty Ltd ABN 21 006 797 897 All rights reserved.

## Goldman Sachs JBWere Offices

**Melbourne**
Telephone (03) 9679 1111
Facsimile (03) 9679 1493

**Sydney**
Telephone (02) 9321 8777
Facsimile (02) 9321 8621

**Brisbane**
Telephone (07) 3258 1111
Facsimile (07) 3258 1112

**Gold Coast**
Telephone (07) 5582 2444
Facsimile (07) 5582 2400

**Adelaide**
Telephone (08) 8407 1111
Facsimile (08) 8407 1112

**Perth**
Telephone (08) 9422 3333
Facsimile (08) 9422 3399

**Canberra**
Telephone (02) 6218 2000
Facsimile (02) 6218 2001

**Overseas Offices**

New York
London
Auckland
Christchurch
Wellington