

Research Bulletin

Australian Equities: Portfolio Strategy Review

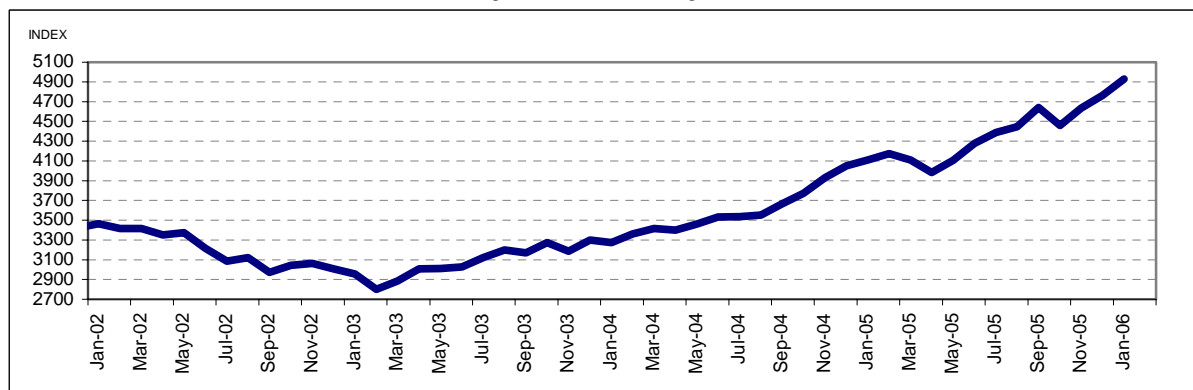
31 Jan 2006

- The Australian equity market (S&P/ASX200) posted a strong start to the year, rising 3.5% in January and establishing new record highs. The resources sector was once again the standout performer for the month, driven mainly by a small number of large cap mining companies which achieved double digit returns.
- Economic news was somewhat mixed in January, with building approvals (ex NSW) and housing finance sending some bullish signals whilst retail sales and employment continued to disappoint. The Australian dollar ended the month higher at US\$0.751 while the 10-year bond yield retreated by 15 basis points to 5.35%.
- Investors remained focused on increasing leverage to their portfolios, with the Resources (Energy and Materials) sector outperforming whilst the more defensive sectors such as Property Trusts (REITs), Consumer Discretionary, Healthcare and Telecommunications lagged. Profit warnings from Healthscope, Pacific Brands and Colorado Group highlighted the downside risk associated with stocks that disappoint consensus expectations.

Accumulation Index Performance			
	1 Month	6 Month	12 Month
S&P/ASX 200	3.5%	14.9%	25.4%
S&P/ASX 200 Industrials	1.5%	10.3%	18.0%
S&P/ASX 200 Resources	10.9%	34.5%	60.1%
S&P/ASX Small Ordinaries	3.8%	13.6%	18.7%
Relative Index Performance to S&P/ASX 200			
Consumer Discretionary	-5.0%	-16.6%	-27.9%
Consumer Staples	-3.6%	-8.7%	-12.0%
Energy	6.7%	12.5%	46.1%
Financials	-0.8%	-0.6%	-2.0%
Health Care	-5.1%	1.3%	11.5%
Industrials	-3.8%	-7.5%	-13.6%
Information Technology	-0.4%	-4.8%	-8.0%
Materials	5.6%	16.2%	24.4%
REITs	-4.7%	-7.6%	-14.9%
Telecommunications	-4.0%	-30.5%	-35.9%
Utilities	-1.4%	4.4%	7.4%

Source: GSJBW Research, IRESS

Australian Equity Market Performance: S&P/ASX 200 Index (January 2002 – January 2006)



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

Best	% Change	Worst	% Change
CSR	21.8%	Toll holdings	-24.0%
Oxiana	16.1%	AWB	-17.9%
Woodside Petroleum	15.4%	Pacific Brands	-17.3%
Zinifex	14.1%	PaperlinX	-10.7%
BHP Billiton	13.4%	Sigma Pharmaceutical	-10.6%
Leighton Holdings	13.3%	DCA Group	-9.6%
Bluescope Steel	12.3%	Sims Group	-8.9%
Onesteel	12.2%	Telecom Corporation	-8.4%
Harvey Norman	12.0%	Amcor	-8.3%
Lihir Gold	11.0%	Patrick Corporation	-8.1%

Source: IRESS

Significant Company/Economic News

Woolworths Limited (WOW) **Analyst: Phillip Kimber**
 Investment View: Short Term Outperform; Long Term Buy
 Share Price as at 31/01/06: \$17.25 **Valuation: \$17.85**

WOW's second quarter sales result was solid and above market expectations. This was driven by the continuing improvement in the Food & Liquor business, which suggests that WOW continues to win market share. Sales growth for Big W also exceeded consensus expectations and was generally perceived as a good result, given the difficult trading conditions. Further, management remains confident in the medium term growth potential for Progressive NZ, which will be driven by cost savings and market share gains. The company will provide updated full year earnings guidance at its upcoming first half profit result on February 27.

Healthscope (HSP) **Assistant Analyst: Rob Gilderdale**
 Investment View: Short Term Marketperform; Long Term Hold
 Share Price as at 31/01/06: \$4.27 **Valuation: \$4.46**

Healthscope recently announced that, on management's estimates, net profit for the full year will be ~18% below consensus expectations. The downgrade was mainly driven by a shortfall in revenues from the GP-based pathology markets as well as a slower than expected capture of pathology synergies from HSP's hospitals. Although the company clarified its remaining businesses (including the recently-acquired 14 Affinity Hospitals) are performing to or exceeding expectations, the share price was punished by the market. Healthscope was the worst performer for the month in the S&P/ASX200, down 24%. The company is in a "blackout" period until its interim result (scheduled for February 22).

Transport Sector **Analyst: Paul Ryan**
 Toll Holdings (TOL): Short Term Underperform; Long Term Hold
Share Price as at 31/01/06: \$11.33 **Valuation: \$13.00**
 Patrick Corporation (PRK): Short Term Marketperform; Long Term Buy
Share Price as at 31/01/06: \$6.80 **Valuation: \$6.50**

January was another very eventful month in the ongoing battle between TOL and PRK. The ACCC announced that it strongly opposed TOL's acquisition of PRK given that, in the opinion of the regulator, it would substantially lessen competition in several transport markets. The ACCC stated that TOL's proposed undertaking's were "not... nearly sufficient" to address its concerns regarding specific markets, especially Pacific National on the East-West rail corridor. PRK welcomed the ACCC's decision and indicated that they intend to pursue the landside logistics strategy which management have outlined in recent months, starting with the acquisition of FCL Interstate Transport. Meanwhile, TOL is taking the ACCC's ruling to Court, in an attempt to contest the ACCC's conclusions that the bid would break federal trade practices law. The company also updated its profit expectations for Pacific National, which reflected a 13% downgrade on previous guidance.

Commodities & Resources

Analyst: Malcolm Southwood

Commodity markets have started the new calendar year on a very strong note. Spot prices across the base metals have continued to run hard with copper, aluminium and zinc all hitting new record highs in the context of the current cycle. The gold price has forged ahead, breaking through the US\$550 per ounce threshold early in the month and has continued to move higher as investors and speculators look to hedge against mounting inflationary concerns and gain leverage to the precious metal's strong demand/supply fundamentals. With respect to the bulk commodities, the big news for the month was BHP Billiton Mitsubishi Alliance's settlement on coking coal contract prices for Japanese fiscal year 2006/07 with the major Japanese blast furnace steel producers agreeing to a price of \$115/tonne for premium grade hard coking coal. This represents an 8% reduction on the previous contracted settlement. Finally, the oil price is once again testing the US\$70 per barrel level, reflecting growing concerns around Iran's defiant stance against the UN regarding the development of its nuclear capabilities and political unrest in Nigeria (which has forced some capacity offline).

Emerging Companies

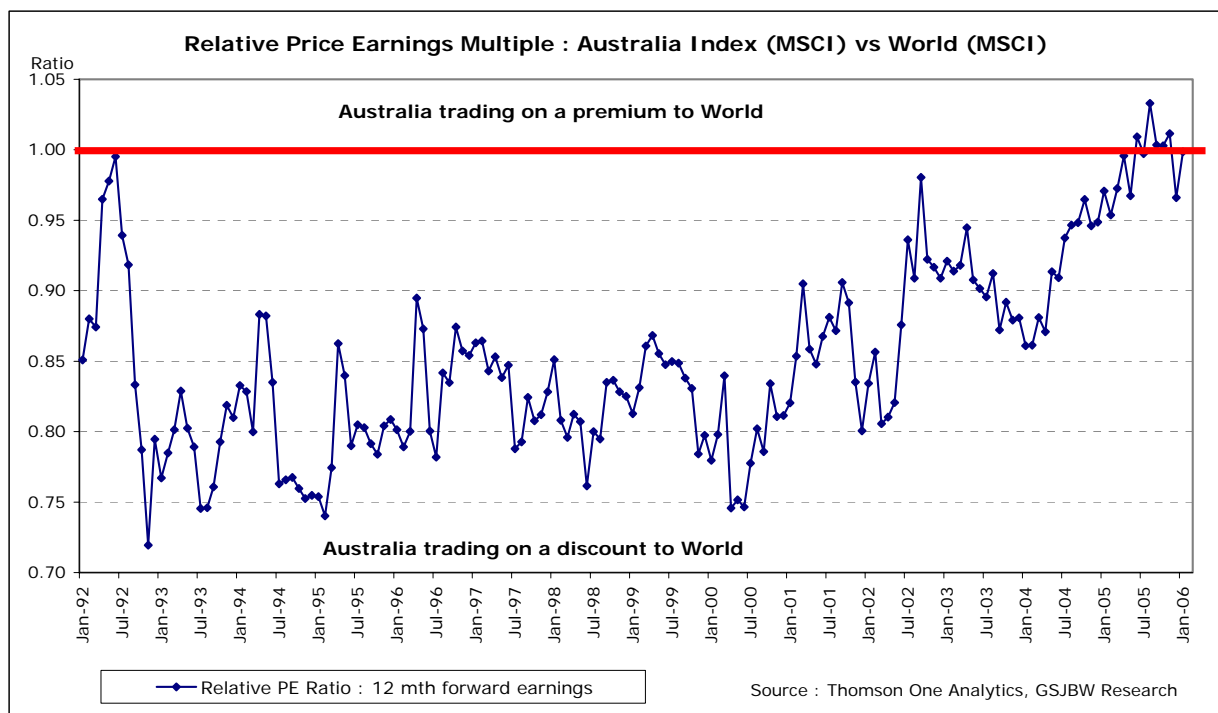
Analysts: George Batsakis, Nga Luu

- **G.U.D. Holdings (GUD): Short Term Marketperform; Long Term Hold**
Share Price as at 31/01/06: \$7.90 Valuation: \$9.00
- **Alesco Corporation (ALS): Short Term Marketperform; Long Term Buy**
Share Price as at 31/01/06: \$9.33 Valuation: \$8.40

GUD's first half result sent the stock above \$8 for the first time in five months, as the company increased its dividend payout ratio to ~80% in this half and forecasts a 15% to 20% rise in the full year dividend per share. GUD left its profit guidance unchanged and expects full year trading profit to exceed last year's result. Meanwhile, Alesco's interim result came in above consensus expectations and left its full year guidance comments unchanged at "single digit" EPS growth. Similarly to GUD, Alesco increased its payout ratio from 75% to 80%, resulting in a 6% rise in the share price on the day of the result. The increased payout ratio from GUD and Alesco was well received by the market, as it reflects that management remains reasonably comfortable with the outlook.

Relative Value: Australian Equity Market versus Global Equities (as at 31/01/2006)

Australia's equity market has performed strongly relative to the world over the last month and is currently trading at parity with the global market.



Australian Equities: Key Issues for Portfolio Strategy

- After showing some long-awaited strength through the second half of 2005, the outlook for global markets into early 2006 is still relatively bright. The consensus has now shifted firmly to the view that the global economy will do well in 2006. We have little reason to challenge the consensus on this point. If anything, we feel that the risks are tilted in favour of activity exceeding expectations over the coming quarters. The more critical medium term issue for global markets will be whether this economic strength can be delivered without any material negative implications for global interest rates – the current consensus view. On this issue we are more circumspect. We continue to believe that global policy normalization has further to run and that the general level of global interest rates is still low relative to the strong nominal economic environment we are now in. We therefore believe that the uptrend in global rates will continue through 2006, possibly in a more stop/start fashion than was the case in 2005. Goldman Sachs Research believes that the US Federal Funds Rate will peak around the 5.00% level (currently 4.50%).
- The marginal global investor is currently hungry for ‘high beta’ exposure. This reflects a still very generous liquidity environment for financial assets; equity performance now clearly outpacing bonds; expectations that US interest rates are peaking (and thus providing scope for PE multiples to expand), accelerating global industrial activity; accelerating merger and acquisition activity and firmly established market trends (e.g. base metals, Asian equities). In the near term, it is difficult to see any macro catalysts that could undermine this optimal environment for the risk tolerant investor. Nonetheless, we need to be wary that under these conditions a pick-up in market volatility is inevitable – as momentum investing becomes more widespread - and absolute/relative valuations are prone to distortion.
- Looking at the Australian economy, discretionary consumer spending has been soft since late 2004, the expected rebound in residential construction remains elusive and the export sector is struggling to generate meaningful volume growth. Business spending remains the one bright spot. While the softer macro environment of the past year is not a surprise – given the boom conditions of 2002/04 – we believe that with the help of a still supportive policy stance, and the financial strength of the corporate sector, household sector activity will strengthen through 2006. If this occurs, it will imply that little has been gained in terms of resolving the structural imbalances/inflationary risks that overhang the economy. Thus, interest rate pressures would quickly reemerge. After growth of 3.1% in FY05, GSJBW Research expects production (GDP) to expand by 3.2% in FY06 and 3.6% 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, the Australian Dollar has retreated, further income tax cuts (possibly significant) are likely at the next Budget and asset prices are healthy. This assessment is acknowledged by the Reserve Bank who is of the view that rates are more likely to rise than fall. 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 over the next 3-6 months.
- Coming in the December half reporting season, valuations across the Australian equity market are looking full-to-expensive. We believe it is very unlikely that the reporting season will do much to improve the valuation picture. 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 industrial FY06 and FY07 earnings estimates have been tempered over recent months, we still believe that the risks of major market-wide downgrades remains relatively contained – particularly while the RBA sticks to its more cautious approach. While all this is a source of comfort, valuation risk will become a far more material issue if the market makes further solid gains over the next 3-6 months.
- Consistent with our view that the market is fully valued, we are finding it difficult to identify stocks that offer compelling absolute value. Within the large-cap defensive universe **Macquarie Communications Group, Coca Cola Amatil, Promina** and **Publishing & Broadcasting** represent the best relative value. The major banks have performed strongly over recent months and the sector is now fully valued. Into any meaningful share price weakness we prefer **National Australia Bank** and **St. George**. Globally exposed stocks we recommend accumulating during periods of market weakness – **Brambles, Computershare, Fosters** and **Rinker**. We continue to believe the medium term outlook for the resources sector is favourable. While the sector is still enjoying positive earning revision, the recent strong gains have tightened valuations – particularly if calendar 2006 proves to be the peak in commodity prices and earnings (as we suspect). Being, a ‘high beta’ exposure, we also believe the sector (and base metal markets) are currently benefiting from speculative inflows. We are therefore cautious near term. Medium term, we continue to view periods of share price weakness as an opportunity to add to positions in **BHP Billiton, Rio Tinto** and **Australian Worldwide Exploration**.

GSJBW Market Forecasts:

As at 31/01/2006	Price Earnings Ratio (PER)			Earnings Per Share Growth (%)			Dividend Yield (%)		
	FY05	FY06E	FY07E	FY05	FY06E	FY07E	FY05	FY06E	FY07E
S&P/ASX 300	17.4x	14.9x	15.0x	29.6	17.2	-0.6	3.5	3.8	4.0
S&P/ASX 300 Industrials	17.3x	16.1x	14.7x	12.4	8.1	9.0	4.4	4.6	4.9
S&P/ASX 300 Resources	17.6x	13.1x	15.6x	83.6	35.5	-16.4	1.7	2.2	2.3

Source: GSJBW Research estimates

Portfolio Management: Switch Idea

Banks **Analyst: James Freeman**
 National Australia Bank (NAB): Short Term Marketperform; Long Term Hold
Share Price as at 31/01/06: \$33.88 Valuation: \$31.39
 Commonwealth Bank of Australia (CBA): Short Term Marketperform; Long Term Hold
Share Price as at 31/01/06: \$44.65 Valuation: \$40.70

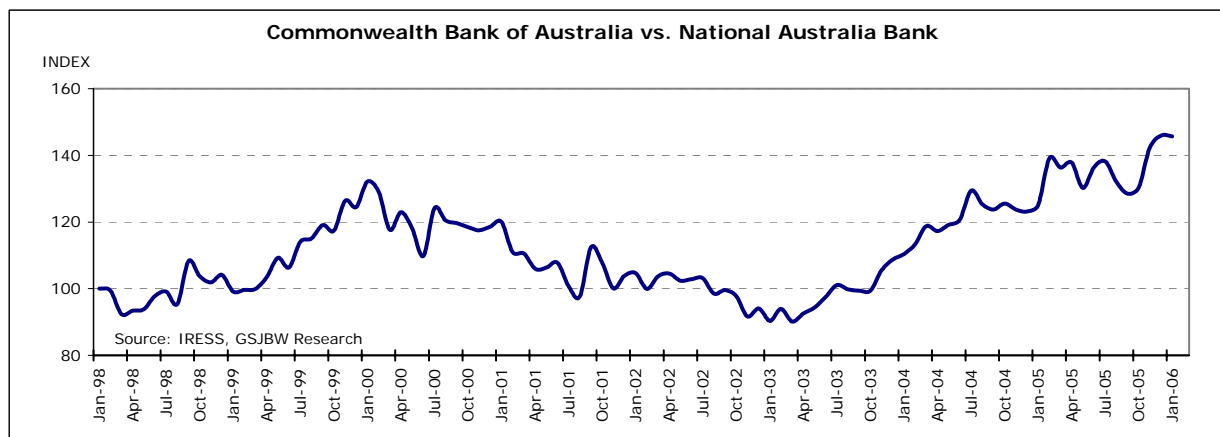
September Year End	FY06 Estimate			FY07 Estimate			FY08 Estimate		
	NAB	CBA*	Peer average (ex-CBA)	NAB	CBA*	Peer average (ex-CBA)	NAB	CBA*	Peer average (ex-CBA)
Cash Profit (\$m)	3,616	3,958		4,158	4,273		4,648	4,552	
EPS Growth (%)	9.3%	11.4%		13.5%	7.0%		10.7%	5.0%	
PER (x)	15.1	14.5	14.6	13.3	13.6	13.3	12.0	12.9	12.2
Yield (%)	4.9%	5.1%	4.8%	5.1%	5.4%	5.1%	5.5%	5.7%	5.5%

* Adjusted for September year end
 Source: GSJBW Research estimates

The Australian banking sector underperformed the S&P/ASX200 in January (2.8% vs. 3.8%). Nonetheless, the overall sector remains fully valued at current levels. We believe the earnings uncertainty of the non-bank industrials (particularly prior to the half year reporting season) will likely continue to provide some support for the banks. Within the sector, we are of the view that an attractive switching opportunity has presented itself for investors with a 2-3 year view.

CBA has had a solid share price run over the last 5 months (+19%) and at current levels, the stock is trading on expensive multiples relative to peers (refer table). Potential catalysts for earnings upside are likely to include improved margin performance, higher than expected benefits from the 'Which New Bank' restructuring program or reduced bad and doubtful debt charges. However, we believe this upside earnings potential is already captured into our forecasts. Given the limited prospects for significant earnings upgrades to our estimates and the challenging valuation multiples, **we recommend investors reduce their exposure to Commonwealth Bank of Australia leading into the first half earnings result (February 18) and switch into National Australia Bank.**

From a longer term perspective, we believe **NAB offers a relatively appealing long term risk/return proposition** at current share price. As per the chart below, NAB has underperformed relative to CBA in the last 6-12 months. Management has indicated it would reinvest many of the nearer term cost benefits from the restructuring program back into the core franchise in order to improve the future growth prospects. Ultimately, this strategy should place NAB in a stronger position for sustainable longer term growth. Further, the freeing-up of risk weighted assets from its Institutional Markets and Services (IMS) business has already exceeded \$11bn in fiscal 2005 and, management expects this to continue throughout fiscal 2006. This release of capital increases the potential for longer term capital management initiatives as well as the prospects for earnings upgrades. Also, NAB's initiative to rebuild its franchise is well underway and the bank is half way through a 3-year turnaround, suggesting a declining risk profile. **We stress that whilst we believe the business is turning around, the benefits from the current restructuring and investment program are unlikely to flow through before fiscal 2007/2008.**



* Commonwealth Bank (CBA) forecasts have been adjusted for a September year end.

Portfolio Management: MIG

Macquarie Infrastructure Group (MIG) **Analyst: Alison Booth**
 Investment View: Short Term Marketperform; Long Term Hold
 Share Price as at 31/12/05: \$3.53 **Valuation: \$4.05**

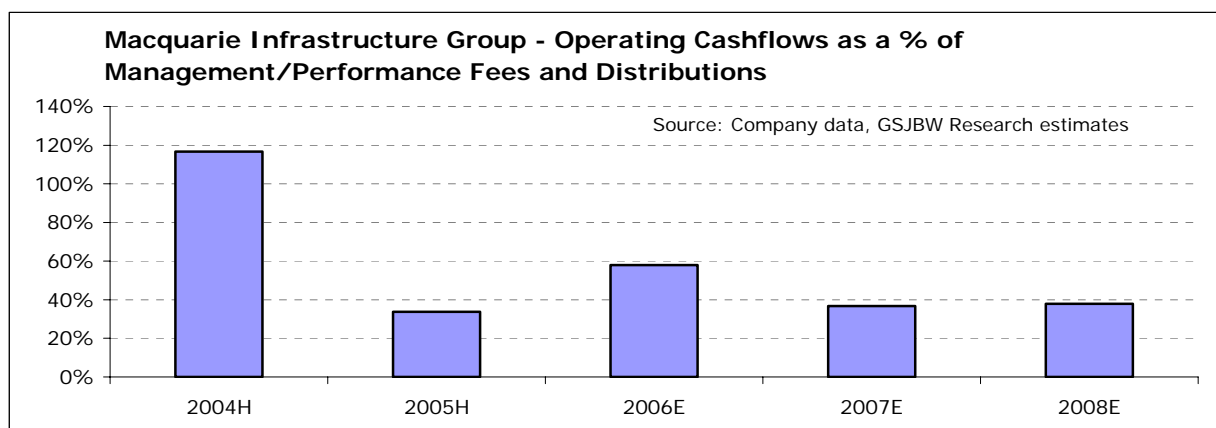
Although readers of our research over the last year or so could be forgiven for thinking otherwise, we are, in fact, supportive of the underlying risk/return profile and diversification benefits available to investors through an exposure to the monopolistic infrastructure asset class. Further, the vast majority of the underlying assets owned listed Australian infrastructure companies are of high quality, providing low risk, long term income for investors as well as plentiful growth opportunities.

Macquarie Infrastructure Group (MIG), however, provides a good demonstration of an increasingly widespread business model in this sector, whereby a 'group' structure incorporating debt financing to 'bring forward' infrastructure asset cashflows and significant management/performance fees can dilute an investor's exposure to the underlying risk/return characteristics of this asset class (we have discussed this topic in further detail elsewhere – refer GSJBW Research Bulletin, *"Financially engineered investment performance: private investors beware!"*, 7 September 2005).

In particular, we are concerned by some of MIG's recent acquisitions (e.g. Dulles Greenway, Indiana Toll Road) which, unlike earlier additions to its portfolio, have not been materially value-accretive on our estimates. This reflects their relative maturity (and thus less opportunity for traffic – and therefore cashflow – growth) and the higher prices being paid for these toll roads, in the face of increasing competition for assets in the sector. As such, we retain our view that the US expansion story is not a reason to be buying the stock.

We retain a favourable long term view in relation to MIG's two core assets, the M6 Toll in the UK (~38% of our DCF valuation) and H407 in Canada (~26%). However, ongoing transactions such as those outlined above have the effect of reducing an investor's overall exposure to these high quality assets that have been central to the investment case in MIG (e.g. Dulles Greenway ~10% of our valuation, Indiana Toll Road ~5%).

Further, we do not believe that investors are likely to gain meaningful exposure to the underlying risk/reward profile of MIG's assets at least in the medium term. The chart below highlights the proportion of MIG's cash dividends and management/performance fees that are covered by actual operating cashflows from its assets – clearly, funding of its distributions to external managers and shareholders has to come from somewhere (being debt and or equity capital raisings) – potentially raising the group's risk profile.



On balance, at current prices, we do not see MIG's investment case as being compelling – although we retain our neutral view on the stock given valuation support at these levels. We continue to prefer 'cleaner' infrastructure exposures, with higher cashflow coverage of their distributions, including **Macquarie Communications Infrastructure Group (MCG)** and **the Australian Infrastructure Fund (AIX)**.

Portfolio Construction: Resources... Don't be Greedy!

Coming into 2006, the resources sector has continued to perform very strongly. Consistent with the past three years, the major positive driver has been positive earnings revision. Most commodity prices have continued to outpace analyst forecasts – particularly the base metals. The sector has also benefited from the consensus view that 2006 will be a good year for the global economy. The marginal global investor's appetite for risk has picked up over recent months – a shift which is always supportive for high beta assets such as commodities/resource stocks.

While we maintain a positive medium term outlook for the major resource companies, investors with a large exposure to the sector need to remain vigilant. The 'cycle' is still with us and now that the world is fully aboard the commodity/resources trade, the risk of a significant correction (30%+) is increasing. Potential triggers for such a cyclical reassessment include:

- **Base metal prices have surged higher over recent months.** While the supply/demand balances remain tight, we believe that there is a speculative component to the recent strength. A new source of demand also seems to be emerging from long-only commodity investment funds seeking to capture the diversification benefits which history suggests commodities provide to a balanced portfolio. We are sceptical about the wisdom of this move. To the extent that it is a real source of new demand it will impact the equilibrium price for many commodities and thus breakdown the historical relationships (i.e. asset class correlations, etc) which the commodity fund investor is trying to capture.
- **Who is paying?** Material shifts in relative prices lead to material shifts in economic behaviour. In light of the huge gains in commodity prices over recent years (relative to the average which has prevailed over the past 20 years), major changes in behaviour must follow – less demand, more substitution, more supply, a hit to profit margins and/or a pick-up in core inflation. These second and third round effects are yet to be fully revealed. They will be significant.
- **Resource companies are facing soaring operating and capital costs.** At the moment, soaring commodity prices are protecting profits and margins. If this was to fade – as we expect it will in FY07 – the long period of positive earnings revision would reverse.
- **The US economy still looks to be in good shape.** Further interest rate increases, however, may expose the vulnerability of the US consumer to faltering house prices/housing activity. We doubt whether the marginal global investor will be prepared to maintain a big exposure to resources if the US economy was under pressure.

Over recent years, resource stocks have provided magnificent returns to private investors. As a result, the exposure of many portfolios to resources would now be significant (i.e. 25%+). You must look to lock in a portion of these gains. The 'cycle' still exists. The following table outlines our earnings forecasts and recommendations for the major stocks. Please contact your GSJBW Adviser to discuss profit taking options which may be applicable for your portfolio.

Stock	CY06 (e)			CY07 (e)			DCF Valuation	Long Term Recommendation
	EPS Growth %	PER	Yield %	EPS Growth %	PER	Yield %		
BHP Billiton	17.7	13.4	2.1	-11.6	15.1	2.2	\$17.51	Buy
Rio Tinto	20.1	12.8	2.0	-22.6	16.5	2.4	\$70.25	Buy
Alumina	86.2	13.9	2.7	-33.5	20.9	2.7	\$6.16	Hold
Woodside Petroleum	56.6	19.2	2.9	-6.6	20.5	2.7	\$26.20	Hold
Oil Search	24.5	12.6	1.4	-32.7	18.8	0.7	\$2.95	Buy
Santos	9.0	10.3	2.7	-41.1	17.5	2.7	\$10.21	Hold
Newcrest Mining	29.6	37.9	0.2	22.4	30.8	0.9	\$9.32	Buy
ASX300 Industrials	8.5	16.0	4.7	8.9	14.6	5.0		

Source: GSJBW Research estimates

Emerging Companies: Monthly Update

Tassal Group (TGR)

Analyst: Craig Temby

 Investment View: Short Term Marketperform; Long Term Buy

 Share Price as at 31/01/06: \$1.20 Valuation: \$1.23

Year End December	2006 Estimate	2007 Estimate	2008 Estimate
Net Profit (\$m)	11.4	15.2	19.0
EPS Growth (%)	59.4%	34.3%	24.8%
PER (x)	11.8x	8.8x	6.9x
Yield (%)	4.3%	5.7%	7.1%

Source: GSJBW Research estimates

Tassal Group (TGR) is Australia's largest producer of Atlantic salmon with annual production of around 75% of domestic consumption. TGR remains one of our preferred exposures within the small cap sector, a view driven in part by the stock's attractive valuation metrics and the supportive market conditions for producers within the salmon farming industry. **At current levels, we believe TGR represents an attractive opportunity for long term investors and reiterate our Buy recommendation.**

On our forecasts, TGR's earnings base will expand by an average of 40% per annum from fiscal 2005 through 2008. This impressive EPS profile is driven mainly by continued growth in volumes (demand for salmon in Australia has risen by around 9% per annum over the last five years) and an improvement in margins, as the business realises further cost savings opportunities following the recent acquisition of a major competitor in 2005. The investment case for TGR is further strengthened by the stock's attractive valuation fundamentals. TGR is trading approximately 10% below our \$1.29 valuation and on a price to earnings ratio of 11.2x forecast 2006 earnings, representing a significant discount to the small cap peer group average.

We highlight that, as with any primary producer within the agricultural sector, the TGR business is not without agricultural risk. Levels of salmon production remain exposed to threats such as disease and changing environmental conditions (e.g. Atlantic salmon are sensitive to any significant change in water temperature). The company is actively working on preventative measures to mitigate these risks.

Healthscope Limited (HSP)

Assistant Analyst: Rob Gilderdale

 Investment View: Short Term Marketperform; Long Term Hold

 Share Price as at 31/01/06: \$4.27 Valuation: \$4.49

Year End December	2006 Estimate	2007 Estimate	2008 Estimate
Net Profit (\$m)	50.0	73.6	87.7
EPS Growth (%)	35.9%	38.5%	17.8%
PER (x)	18.5x	13.3x	11.4x
Yield (%)	3.5%	4.7%	5.6%

Source: GSJBW Research estimates

We have revised down our recommendation on Healthscope (HSP) to a long term Hold. This move was driven by the increased level of uncertainty around the outlook for company earnings, following the recent profit downgrade (refer page 2). The company has confirmed that the profit warning was solely attributable to the underperformance of the Australian human pathology business (acquired through the Gribbles Pathology acquisition in 2005). Management has outlined a number of initiatives implemented to address the revenue shortfall in pathology and remains confident in achieving its previously stated Gribbles synergy targets, albeit over a longer time frame.

HSP has aggressively pursued growth through acquisition over the past twelve months and the profit warning has now brought into question management's ability to seamlessly execute on their strategic expansion plans. We believe that it will take some time for the market's confidence in the business to be restored. The profit warning has also raised questions about increased competition in the pathology industry.

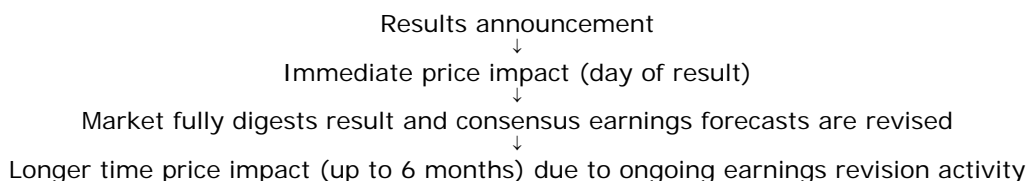
Despite the lack of clarity on the near term outlook for the stock, we remain comfortable holders of HSP on a long term view. We see significant appeal in the structure of the pathology industry, given its high incremental margins and regulated 5% revenue growth. We also continue to view very favourably the outlook for the hospital industry given supportive demographics underpinning strong organic growth and high barriers to entry. **We reiterate our Hold recommendation on HSP.**

Stock Selection Using Quantitative Techniques

The flood of new information into the market during the reporting season can be somewhat overwhelming, given especially the short length of the interim results period. In the face of this confusion, quantitative analysis, as always, is designed to give investors an objective and broad-reaching view of market activity and investor sentiment, even during times of rapid share price movements and changes in investor opinion.

It is, of course, difficult to predict what will happen when a company releases its results and so the price reaction for any given stock on the day of its report is quite hard to capture from a portfolio construction perspective – unless an investor takes a position in the stock prior to it announcing its results. However, the impact of results announcements can be felt long after the actual release date, stemming from the time it takes the market to fully analyse the result, revise forward earnings expectations and for investors to act on the advice of analysts – not to mention the fact that the market often continues to incrementally revise its estimates in the same direction over the subsequent few months. We observe this as ‘serial correlation’ in consensus earnings forecasts – the move in forecasts in any period is likely to be in the same direction as the move in a prior period and so the first revision can be a good indicator of future revisions.

Thus, broadly summarising the typical price response pattern from a reported earnings surprise:



Confirming this dynamic, over several past reporting seasons we have observed that it is not the direction of actual headline profit surprise that is a predictor of longer term share price performance (can be impacted by accounting, compositional or other factors), but the direction of initial consensus earnings revisions. This is a clearer signal, because it is an expression of how the market feels about the earnings outlook after taking all these various factors into account.

Throughout the reporting season our Quantitative Research team progressively update a ‘surprise versus revisions’ matrix, which plots stocks according to how they rank on the earnings revision reaction (+ve, neutral, -ve) and headline earnings surprise (+ve, neutral, -ve). Clearly, we prefer to use earnings revision as the first factor to look at (top row), with headline surprise as a secondary factor (right hand column).

GSJBW Earnings Per Share Revision Post-Result		Headline EPS Surprise		
		-ve	neutral	+ve
+ve				
Neutral				
-ve				

We have also updated the results from our broader Quant stock selection model (Table below), which aims to provide diversification across market themes (i.e. more than just earnings revision activity!) and thus to deliver stable ‘through-the-cycle’ returns. This is achieved by combining several individual stock selection screens which attempt to capture returns, momentum and value factors. The Table shows the current top rankings in GSJBW’s large industrial stock screening model, as well as changes in rankings over the last month and the ongoing performance of our model since February 2005 (refer GSBW Research Bulletin, ‘Australian Equities: Portfolio Strategy Review’, 4 January 2006).

Company	EVA Spread:		Earnings Revision:		Positive RSI	ROFE/PEG	TOTAL	Previous Rank	Move in Rank
	Level	Trend	Actual	Predicted				(30-Nov-05)	
	(out of 15)	(out of 15)	(out of 15)	(out of 15)	(out of 10)	(out of 30)	(out of 100)		
ASX	15	14	11	8	9	30	88	2	1
PPT	15	15	12	8	10	28	86	5	3
JHX	14	14	12	15	2	29	86	4	1
COH	11	13	14	15	7	25	85	3	-1
RIN	13	15	8	15	3	28	83	1	-4
SYB	6	13	15	15	8	26	82	N/A	N/A
BBG	13	12	11	8	6	21	70	8	1
RIO	12	2	9	15	5	27	70	9	1
ALL	14	5	12	8	1	29	69	6	-3
TOL	13	14	2	8	2	27	66	7	-3
CPU	10	12	8	8	2	25	65	10	-1
BHP	6	0	13	15	7	23	63	15	3

Quant portfolio performance for January was soft, with gains in the resources and financials stocks (ASX, PPT and RIO) more than offset by the fall in TOL’s share price following ACCC rejection of its proposed merger with PRK. Removals: UTB, WOW. Additions: SYB, BHP.

GSJBW Model Portfolios

Income Portfolio

Commonwealth Bank of Australia	Rio Tinto
Westpac Banking Corporation	Hills Industries
St. George Bank	West Australian Newspapers
Australian Gas Light Company	Rural Press
Macquarie Communications Infrastructure Group	Alesco
Tabcorp Holdings	Foster's Group
Promina Group	Publishing & Broadcasting
Woolworths	Ten Network
Wesfarmers	Australand Holdings
Coca-Cola Amatil	Alinta

Source: GSJBW Research

Our changes to the Income Portfolio during January 2006:

Nil

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	8.1%
Price to Earnings Ratio	15.5x
Average Yield	5.0%
Franking	86%

Source: GSJBW Research estimates

Defensive Portfolio

BHP Billiton	Foster's Group
Commonwealth Bank of Australia	Brambles Industries
Woolworths	Rio Tinto
St. George Bank	Sonic Healthcare
Origin Energy	Ramsay Health Care
Tabcorp Holdings	Mirrabooka Investments
Promina Group	Coca-Cola Amatil
Publishing & Broadcasting	Australian Gas Light Company
Macquarie Communications Infrastructure Group	Wesfarmers
Australian Foundation Investment Company	Rinker Group
National Australia Bank	

Source: GSJBW Research

Our changes to the Defensive Portfolio during January 2006:

Removed: Westpac Banking Corporation

Reduced: Commonwealth Bank of Australia; Rio Tinto

Added: National Australia Bank

Increased: BHP Billiton

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

Earnings per Share Growth	15.9%
Price to Earnings Ratio	15.5x
Average Yield	4.0%
Franking	89%

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	Rio Tinto
Commonwealth Bank of Australia	Coca-Cola Amatil
Woolworths	News Corporation, Inc.
St. George Bank	Sonic Healthcare
Origin Energy	Axa Asia Pacific
Macquarie Communications Infrastructure Group	Australian Gas Light Company
Promina Group	Alesco
National Australia Bank	Billabong International
Brambles Industries	Rinker Group
Publishing & Broadcasting	Wesfarmers
Australian Foundation Investment Company	Healthscope
Computershare	

Source: GSJBW Research

Our changes to the Balanced Portfolio during January 2006:

Removed: Westpac Banking Corporation

Reduced: Rio Tinto; Origin Energy; St George Bank; Commonwealth Bank of Australia; Healthscope

Added: National Australia Bank

Increased: BHP Billiton; Computershare; Rinker Group; Australian Gas Light Company; Australian Foundation Investment Company

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

Earnings per Share Growth	18.7%
Price to Earnings Ratio	15.8x
Average Yield	3.7%
Franking	83%

Source: GSJBW Research estimates

Growth Portfolio

BHP Billiton	Sonic Healthcare
Woolworths	Rinker Group
St. George Bank	Computershare
Australian Foundation Investment Company	Alesco
National Australia Bank	Symbion Health
Origin Energy	Billabong International
Alinta	Salmat
Rio Tinto	Macquarie Airports
Promina Group	Toll Holdings
News Corporation, Inc.	Cochlear
Aristocrat Leisure	Healthscope
Brambles Industries	

Source: GSJBW Research

Our changes to the Growth Portfolio during January 2006:

Removed: Commonwealth Bank of Australia

Reduced: Healthscope; Rio Tinto; St George Bank

Added: National Australia Bank

Increased: Alinta; Australian Foundation Investment Company; Billabong International; Sonic Healthcare; Rinker Group; Toll Holdings; BHP Billiton; Computershare

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

Earnings per Share Growth	20.2%
Price to Earnings Ratio	15.3x
Average Yield	3.1%
Franking	91%

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 in January

STOCK	ASX CODE	SHORT-TERM Recommendation		LONG-TERM Recommendation	
		NEW	OLD	NEW	OLD
Australian Agricultural	AAC	Marketperform	Underperform	No change	Hold
Colorado Group	CDO	Underperform	Marketperform	No change	Hold
Resolute Mining	RSG	Underperform	Marketperform	Sell	Hold
Virgin Blue Holdings	VBA	Outperform	Marketperform	Buy	Hold
Toll Holdings	TOL	Underperform	Marketperform	No change	Hold
Healthscope Limited	HSP	Marketperform	Outperform	Hold	Buy
Alumina Limited	AWC	Outperform	Marketperform	No change	Hold
PaperlinX Limited	PPX	Underperform	Marketperform	No change	Sell
Macquarie Communications	MCG	Outperform	Marketperform	No change	Buy
Bendigo Mining	BDG	Outperform	Marketperform	No change	Hold
Seven Network	SEV	Outperform	Marketperform	No change	Hold
Patrick Corporation	PRK	No change	Marketperform	Buy	Hold
Computershare	CPU	No change	Marketperform	Hold	Buy
Woodside Petroleum	WPL	No change	Marketperform	Hold	Buy
UNITAB Limited	UTB	No change	Marketperform	Hold	Buy

Source: GSJBW Research

Referred to in Document:

Company Name	Stock Code	Share Price (as at 31 Jan 2006)	Valuation	Short Term Recommendation	Long Term Recommendation
Australian Agricultural	AAC	\$1.66	\$1.77	Marketperform	Hold
Australian Foundation Investment	AFI	\$4.58	\$4.25	n/a	n/a
Australian Gas Light	AGL	\$18.00	\$13.55	Not Rated	Not Rated
Australian Infrastructure Fund	AIX	\$2.25	\$2.37	Marketperform	Hold
Aristocrat Leisure	ALL	\$11.55	\$13.00	Outperform	Buy
Alinta	ALN	\$10.85	\$11.18	Outperform	Buy
Alesco Corporation	ALS	\$9.33	\$8.40	Marketperform	Buy
Australand	ALZ	\$2.00	\$1.83	Marketperform	Buy
Australian Worldwide Exploration	AWE	\$2.64	\$2.00	Outperform	Buy
Alumina	AWC	\$7.51	\$6.16	Outperform	Hold
AXA Asia Pacific	AXA	\$5.45	\$5.10	Marketperform	Buy
Billabong International	BBG	\$14.77	\$13.60	Outperform	Buy
Bendigo Mining	BDG	\$2.46	\$1.07	Outperform	Hold
BHP Billiton	BHP	\$25.80	\$17.51	Outperform	Buy
Brambles Industries	BIL	\$9.92	\$10.60	Outperform	Buy
Commonwealth Bank of Australia	CBA	\$44.65	\$40.70	Marketperform	Hold
Coca-Cola Amatil	CCL	\$7.68	\$8.80	Marketperform	Buy
Colorado Group	CDO	\$3.20	\$4.66	Underperform	Hold
Cochlear	COH	\$46.15	\$45.21	Outperform	Buy
Computershare	CPU	\$6.89	\$6.10	Marketperform	Hold
Foster's Group	FGL	\$5.27	\$6.25	Outperform	Buy
G.U.D Holdings	GUD	\$7.90	\$9.00	Marketperform	Hold
Hills Industries	HIL	\$4.70	\$4.30	Outperform	Hold
Healthscope	HSP	\$4.27	\$4.49	Marketperform	Hold
Macquarie Airports	MAP	\$3.11	\$3.52	Outperform	Buy
Macquarie Communications	MCG	\$5.76	\$6.71	Outperform	Buy
Macquarie Infrastructure Group	MIG	\$3.53	\$4.05	Marketperform	Hold
Mirraboooka Investments	MIR	\$1.70	\$1.73	n/a	Buy
National Australia Bank	NAB	\$33.88	\$31.39	Marketperform	Hold
Newcrest Mining	NCM	\$26.20	\$9.32	Marketperform	Buy
News Corporation, Inc	NWS	\$22.13	\$26.00	Outperform	Buy
Origin Energy	ORG	\$7.30	\$7.13	Outperform	Buy
Oilsearch	OSH	\$3.84	\$2.95	Outperform	Buy
Pacific Brands	PBG	\$2.20	\$2.85	Marketperform	Hold
Publishing & Broadcasting	PBL	\$16.58	\$16.05	Marketperform	Buy
Promina	PMN	\$5.13	\$5.30	Marketperform	Buy
PaperlinX	PPX	\$3.43	\$3.70	Underperform	Sell
Patrick Corporation	PRK	\$6.80	\$6.50	Marketperform	Buy
Ramsay Healthcare	RHC	\$9.67	\$9.22	Marketperform	Hold
Rinker Group	RIN	\$16.78	\$16.80	Outperform	Buy
Rio Tinto	RIO	\$75.82	\$70.25	Outperform	Buy
Resolute Mining	RSG	\$1.46	\$1.12	Underperform	Sell
Rural Press	RUP	\$11.40	\$9.35	Marketperform	Hold
Seven Network	SEV	\$8.15	\$8.80	Outperform	Hold
St George Bank	SGB	\$30.30	\$28.58	Marketperform	Hold
Sonic Healthcare	SHL	\$14.99	\$14.12	Outperform	Buy
Salmat	SLM	\$3.46	\$4.59	Marketperform	Buy
Santos	STO	\$13.10	\$10.21	Marketperform	Hold
Symbion Health	SYB	\$3.45	\$3.15	Outperform	Buy
Tabcorp Holdings	TAH	\$15.19	\$17.30	Underperform	Hold
Ten Network	TEN	\$2.97	\$3.30	Marketperform	Hold
Tassal Group	TGR	\$1.20	\$1.23	Marketperform	Buy
Toll Holdings	TOL	\$11.33	\$13.00	Underperform	Hold
UNiTAB	UTB	\$12.58	\$13.10	Marketperform	Hold
Virgin Blue Holdings	VBA	\$1.68	\$1.97	Outperform	Buy
West Australian Newspapers	WAN	\$8.48	\$8.20	Marketperform	Hold
Westpac Banking Corporation	WBC	\$23.27	\$20.87	Underperform	Hold
Wesfarmers	WES	\$38.05	\$36.13	Marketperform	Hold
Woolworths	WOW	\$17.25	\$17.85	Outperform	Buy
Woodside Petroleum	WPL	\$45.22	\$26.20	Marketperform	Hold

Source: IRESS, GSJBW Research

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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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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.

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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

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Distribution of Recommendations - As at 31 December 2005

Short Term	Overall	Corporate relationship* in last 12 months	Long Term	Overall	Corporate relationship* in last 12 months
Underperform	16%	10%	Sell	8%	5%
Marketperform	61%	62%	Hold	63%	60%
Outperform	22%	28%	Buy	29%	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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