UPDATE

31 October 2008

Private Wealth Management

Portfolio Strategy Review - October 2008

Investment Strategy | Australia

Private Wealth Management Investment Strategy

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Key Points:

- Pressure on equity markets continued through October, as investors shifted their focus from weakness in the global financial system to the increasing likelihood and implications of a global recession. The Australian equity market (S&P/ASX200) did not escape the carnage and finished the month down 12.6%; its worst monthly performance since the October '87 crash (-45%).
- Volatility (as measured by the VIX Index) hit new record highs during October, resulting in risk aversion remaining high. Investors continued to switch out of equities, focused on increasing defensive positions. Commodity prices came under significant pressure on the back of increasing concerns over China's economic growth and from the continued deleveraging of hedge funds. Resource and Energy stocks were major casualties as investors continued to switch out of these sectors. REITs were impacted by a number of large fund raisings, combined with concerns around refinancing and asset sales. **Healthcare, Telecoms and Utility sectors outperformed** while the REIT, Energy and Industrials sectors lagged.
- The RBA surprised the market by cutting interest rates 100bp in early October (consensus -50bp). Domestic interest rate expectations moved lower during the month, reflecting the deteriorating outlook offshore, a weaker oil price and further RBA rhetoric highlighting the slowing domestic economic momentum. By month-end the market was pricing in a further 100bp reduction by December 2008. Macro data remained below trend while employment growth slowed (but remained positive). The AUD was decimated, finishing the month at 66.2¢ (-13.0¢); but off its lows of 60.1¢; levels last seen in April 2003.
- While equity markets look cheap on several valuation metrics, earnings risks from the slowing macro environment remain (domestic and offshore), as do weakness in commodity prices and the broader implications from the global financial crisis. While identifying market bottoms remains difficult, we believe valuations are attractive and sentiment sufficiently negative to warrant selective exposure to domestic cyclicals, including financials and materials. A subdued recovery or a prolonged slowdown remain the key risks. We continue to monitor opportunities in the Resources ahead of an expected improvement in news flow from China in 2009.

Goldman Sachs is currently acting as Financial Advisor to BHP Billiton and as such is an associate of BHP Billiton for the purpose of the Takeover Code.

Performance Table – October 2008

	Accumulation Index Performance Since		
	30/09/2008	30/04/2008	31/10/2007
S&P/ASX 200	-12.6%	-26.5%	-37.8%
S&P/ASX 200 Industrials	-10.3%	-21.5%	-37.3%
S&P/ASX 200 Resources	-18.5%	-37.3%	-38.7%
S&P/ASX Small Ordinaries	-24.8%	-43.3%	-53.3%

	Relative Index Performance to S&P/ASX 200		
	1 Month	6 Months	12 Months
Consumer Discretionary	-5.8%	-5.6%	-13.5%
Consumer Staples	6.9%	13.0%	16.1%
Energy	-6.9%	6.8%	21.9%
Financials	1.8%	4.2%	-4.2%
Healthcare/Biotech	10.5%	19.9%	33.3%
Industrials	-5.9%	-3.3%	-10.8%
Information Technology	1.7%	18.8%	31.5%
Materials	-4.8%	-15.0%	-5.0%
REITS	-12.6%	-13.6%	-17.4%
Telecommunication Services	10.1%	17.2%	26.7%
Utilities	9.4%	4.5%	8.0%

Source: IRESS, GSJBW Research estimates

ASX 200 Leading Contributors in October 2008

Top & Bottom 10 Pts Contributors over October - ASX 200

1.	QGC	+4.4	BHP	-49.9
2.	WOW	+3.5	WES	-27.6
3.	BEN	+2.1	WPL	-20.3
4.	FGL	+1.9	STO	-16.5
5.	GFF	+1.7	CBA	-15.4
6.	AMC	+1.7	NCM	-15.2
7.	BXB	+1.6	GPT	-15.2
8.	SHL	+0.9	AMP	-14.4
9.	TTS	+0.7	ANZ	-13.5
10.	AGK	+0.6	WOR	-13.3

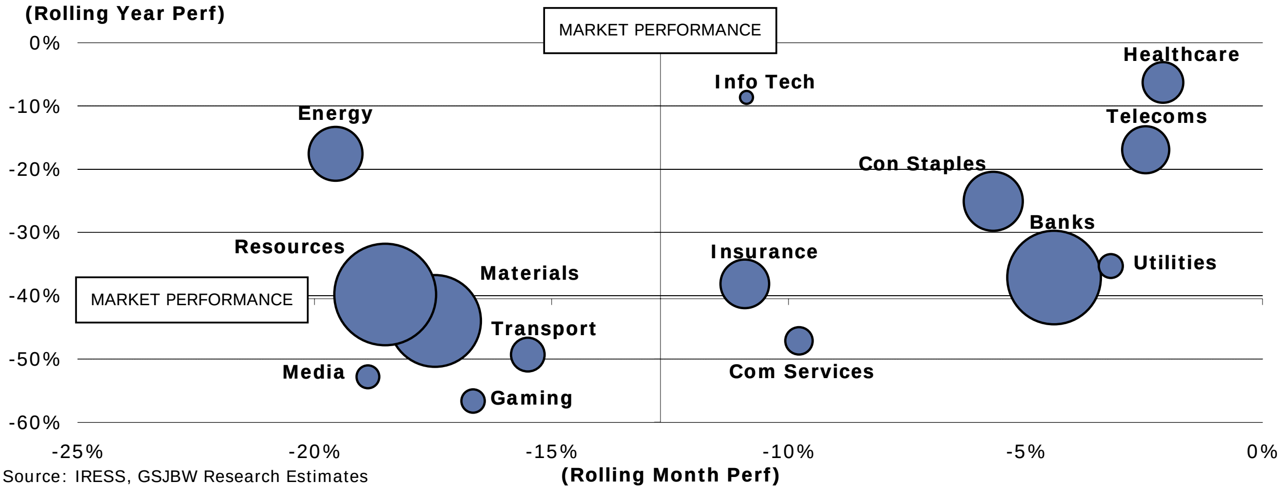
The ASX 200 Index decreased by 583 pts in the month of October

Source: IRESS

Sector Performance for month – October 2008

Sector Performance - 1 Month vs 1 Year Absolute Performance

As at 31 October 2008



Source: IRESS, GSJBW Research Estimates

CONSUMER DISCRETIONARY

Media

News Corporation (-2.9%) shares ended the month lower although rallied from its lows intra month. At its AGM during the month, Mr Murdoch highlighted NWS's strong balance sheet (US$5b cash and average debt maturity of more than 22 years), its continued acquisition focus, plans to increase subscription-based businesses and expand its presence in emerging markets.

Fairfax Media (-27.3%), APN News & Media (-24.9%) and **West Australian Newspapers (-31.7%)** all saw share price falls on the back of continued concerns over diminished advertising spend and earnings risk. Separately, APN's CEO, Brendan Hopkins, extended his contract for a further three years from April 2009.

Consolidated Media Holdings' (-16.3%) shares bounced from intra month lows after reaffirming it was under no obligation to provide further funding to PBL Media. In addition, James Packer, John Alexander and their alternatives have all resigned from PBL's board.

Retail

Billabong (-13.0%) ended the month lower, but gained some support towards month-end. At its AGM, management upgraded FY09 EPS guidance to between 12% and 16% growth (previously 8% to 12%).

Gaming

On limited news flow, **Tatts Group (+5.0%)** fell initially but regained strength by month end. **Tabcorp (-15.2%)** shares deteriorated as it provided a trading update at the bottom of the consensus range and quantified the earnings impact of the disruption of Project Star at its Investor Day.

Aristocrat (-41.2%) plunged following another profit warning. It now expects FY08 NPAT to be $120-150m, significantly down from previous guidance of $190-200m. Key drivers of the downgrade were deterioration in global operating conditions, with many operators deferring spend, resulting in slower than anticipated uptake of the Generation 7 platform and games.

At its AGM, **Crown (-17.8%)** provided a trading update and indicated that revenue growth from 1 July to 21 October was 4%. This compares to EBITDA guidance at the FY08 result of 4-6% growth for FY09 at its AGM. Crown also highlighted that the City of Dreams is fully funded and on schedule to open 1st half CY09. This was previously announced by MPEL on 17 October.

CONSUMER STAPLES

Woolworths (+2.2%) finished the month up, reporting a solid 1Q09 sales result with group sales up 9.6% (GSJBW +8.9%). Australian Food & Liquor continues to report impressive results with comparable stores sales growth of 6.0%. WOW has now delivered 16 consecutive quarters of 3% or greater comparable store sales growth. **Metcash (+1.5%)** and **Goodman Fielder (+19.1%)** also finished the month up on little company-specific news flow.

Wesfarmers (-24.6%) traded lower, dragged lower by negative sentiment towards coal. WES held an investor briefing day during October. Key points were 1Q09 sales growth rates generally slowed, reflecting the tighter consumer spending conditions. WES commented that it remains very confident in its ability to refinance its near-term debt obligations.

Nielsen data showed that the Australian beer and wine markets continue to perform well despite the slowing economy, a positive for both **Lion Nathan (-5.2%)** and **Foster's Group (+3.6%)**.

ENERGY

The oil price continued its sharp retreat declining ~35% from US$100/bbl to a low of US$62/bbl before finishing the month at US$66/bbl. Hedge fund deleveraging, combined with slowing global demand as the financial crisis spread to emerging markets, was seen as the main reason for the fall. During the month OPEC moved to cut production by 1.5mmbopd in an attempt to rebalance the market.

Woodside Petroleum (-17.9%) continued to retreat broadly in line with the oil price. WPL's 3Q activities report saw production in line with our expectations (21.7 vs 21.5mmboe). Revenue slightly lower ($1,774m vs $1,832m) due to larger oil hedge losses more than offsetting higher than expected LNG/dogmas realisations. Development projects are on track, with Pluto 30% complete, a Browse site location decision is expected 4Q CY08 and a Sunrise development concept selection expected during 1H CY09.

Oil Search (-19.6%) bounced from intra-month-lows following the announcement that it had signed a $435m five-year credit facility. In addition, AGL's sale of its interest in PNG saw an attractive see-through valuation emerge for OSH stake in the PNG LNG project - reinforcing OSH's current discount to our valuation.

AWE (-2.3%) rallied off lows mid month, but still remained in negative territory by month-end. Its 3Q production report saw production and revenue broadly in line with our estimates; however production guidance for FY09 of 9.3mmboe came in below our current forecast of 10.2mmboe.

FINANCIALS ex PROPERTY TRUSTS

Banks

Commonwealth Bank (-5.4%) finished the month lower, announcing it will purchase the BankWest retail business for $2.1bn from HBOS Australia. This will be funded by a $2bn equity raising. **ANZ Banking Group (-7.4%)** reported cash earnings were in line with our expectations. Provisions, however, were above market expectations, driven by NZ and an additional $300m collective provision charge for concentration risk in the institutional bank. **NAB (-1.1%)** bounced from mid-month lows, having moved forward its result to 21 October. NAB reported cash earnings of $3,916m, in line with our expectations. **Westpac Bank (-5.6%)** received formal approval this month from the Treasurer, Wayne Swan, for the purchase of SGB. In addition, WBC reported its FY08 result, with cash earnings growth of 6% to $3,726m. Key focus for the market was on capital and whether the merged entity will be appropriately capitalised. **Macquarie Group (-20.5%)** confirmed that it had sold its interest in the HK platform of Macquarie Goodman Asia (MGA) to JV partner Goodman Group for $A200m.

Insurance

Among the life insurers, **AMP (-22.5%)** and **AXA (-12.5%)** both finished the month lower. In AXA's case, this was aided by the strengthening US$, though offset by the further blow-out of credit spreads and ongoing concerns about its tight capital position. Among the general insurers, **Suncorp (-13.9%)** had a particularly volatile month after it confirmed in early October that it had received "several approaches… expressing interest in acquiring the banking and wealth management operations".

Diversified Financials

ASX (-0.8%) was supported by investors during October despite falling trading volumes and the extension of the short selling ban. The wealth managers had a tough month given equity market falls and, in some cases, large redemptions from fixed income / mortgage funds as investors transferred money to the banks (given their newly-guaranteed status).

REAL ESTATE INVESTMENT TRUSTS

The A-REIT 200 Index was again down heavily (-25.3%) in October and the downside pressure only appears to be increasing as prices decline. Compounding this are moderating fundamentals for leasing demand which is reducing rental growth prospects and increasing the risk of lower occupancy. **Stockland (-26.5%)** raised $300m, **CFS Retail Property Trust (-9.3%)** raised $325m, **GPT Group (-42.3%)** raised $1.6bn through a 1-for-1 entitlement issue at a 45% discount to trading price and its lowest price in decades (if ever - recall GPT was the first listed REIT in Australia, listing in 1971), and **Goodman Group (-60.3%)** raised $955m at sub its mid 1990s IPO price. These capital raisings ranged from being opportunistic (SGP and CFX) to more defensive (GPT and GMG) and investors are now expecting many more REITs will need to raise capital at very expensive prices to cover the risk of not being able to roll debt maturities.

HEALTHCARE

At its AGM this month, **Healthscope (-6.3%)** mentioned that it did not expect any impact from the change in MLS thresholds, given that it has contracts in place with health funds for the next 1 -3 years and is not anticipating volumes to be materially affected. **Cochlear (-3.9%)** confirmed its guidance for double-digit core earnings growth (10%-20%) in FY09, contingent on the future FX moves. At its AGM, **CSL (-2.4%)** also confirmed its guidance and now expects to achieve the upper end of the range between $810m and $850m at constant currency. Despite having a net cash position, **Resmed (-8.3%)** extended its loan facility by US$50m (Tranche D) for general corporate purposes. It was a quiet month for **Sonic Healthcare (+4.7%)** (holding its AGM on 20 November), **Ansell (-0.8%)** (7 November), **Primary Healthcare (-10.7%)** (28 November) and **Sigma Pharmaceuticals (+5.4%)**. For ANN, spot latex price is currently MYR 433/kg, down 24% in the last 4 weeks.

INFORMATION TECHNOLOGY

Computershare (-9.7%) was sold down early in the month as investors worried about the company's exposure to weaker markets and interest rates.

INDUSTRIALS

Capital Goods

The diversified engineers all experienced material declines this month with **United Group (-25.4%), Transfield Services (-46.4%)** and **Downer EDI (-22.5%)** all impacted by the deteriorating macro environment and concerns over industry capex plans. **WorleyParsons (-50.7%)** once again largely traded in line with the oil price this month (lower) and was sold off heavily. **Boart Longyear (-61.2%)** came under pressure this month as the credit squeeze began to see some junior and intermediate miners look to conserve cash.

Chemicals

Incitec Pivot (-21.1%) and **Nufarm (-26.5%)** were both sold off on fears of a collapse in fertilizer/soft commodity prices and declines in the stock price of global peers (some of which posted weaker-than-anticipated earnings growth in October). In addition, **Orica (-7.6%)** came under pressure due to concerns over mining volumes, which in turn affected IPL through the acquired Dyno Nobel operations.

Commercial Services

Meanwhile, the market reacted positively to **Brambles' (+3.1%)** announcement that CHEP USA had reached an agreement with Wal-Mart – thus removing a risk factor hanging over the stock.

Transportation

A difficult month for the airline stocks, as concerns over falling air traffic and A$ seemed to outweigh any benefits from declining oil prices. Early in the month, **Virgin Blue (+9.5%)** announced that the launch of its long haul international airline, V Australia, will be delayed to 28 February 2009 (was 15 December, 2008) due to an ongoing strike at The Boeing Company. Meanwhile, **Qantas (-22.7%)** fell on the back of news that the planned IPO of its frequent flyer program would again be postponed.

Toll Holdings (-12.2%) held its AGM at the end of the month and reaffirmed its guidance that YTD results for FY09 were "tracking well ahead of last year". **Asciano (-33.5%)** dropped sharply as the market again turned on stocks with high gearing levels and potential refinancing risk, despite robust September quarter operating statistics.

Infrastructure

Macquarie Communications Group (-37.0%) was sold off heavily again as investors continued to avoid highly-leveraged vehicles while, **Macquarie Airports (-20.7%)** reported weakening traffic growth across its airports during September. **Australian Infrastructure Fund (-24.1%)** was weaker as investors became increasingly wary of the impact of a slowdown in the domestic economy. **Macquarie Infrastructure Group (-15.2%)** ended the month lower after again reporting disappointing traffic data for the September quarter on its key roads. **Transurban (-3.4%)** held up relatively well compared to other stocks in the sector whilst **ConnectEast (-11.0%)** struggled again on the release of another set of poor traffic growth figures.

MATERIALS

Building Materials

Boral (-26.3%) guided FY09 NPAT of $200m, 19% down from FY08 NPAT of $247m and 9.1% below our current forecast of $220m, while **James Hardie (-14.5%)** was light on company-specific news flow this month but was weighed down by weak economic data points related to the US housing market. JHX experienced a slight bounce near the end of the month due to a stronger than expected reading for US New Home Sales. In October, **CSR (-12.9%)** downgraded its EBIT guidance at a group level, driven by weaker expectations for the Building Products division. Also, **Adelaide Brighton (-26.5%)** presented at a conference mid-month and commented that "2008 NPAT will be towards the lower end of guidance $120m-$126m".

Steel

Among steel stocks, **Sims Group (-50.0%)** halved. Similarly, driven by weaker HRC prices in both East Asia and the US, **Bluescope (-39.8%)** also declined sharply. Meanwhile, concerns related to **OneSteel's (-25.0%)** iron ore exposure saw the stock end the month weaker.

Diversified Resources

As the global credit crisis intensified in early October, we became aware of many examples of interruptions to business for resources companies, and sentiment on the short-term demand outlook for raw materials continued to sour. Both **BHP Billiton (-9.7%)** and **Rio Tinto (-8.2%)** declined in light of weaker commodity prices and concerns towards China's economic growth outlook.

Base Metals, Coal and Iron Ore

PanAust (-60.4%), **Equinox (-57.3%), Aditya Birla (-75.9%)** and **OZ Minerals (-41.1%)** all experienced significant declines during the month as investors rushed to exit the sector at any price. The coal stocks **Felix Resources (-27.2%), Macarthur (-42.8%)** and **Centennial (-4.9%)** were also impacted as sentiment around the potential coal price negotiations for FY10 declined with the spot prices. Elsewhere, in base metals, nickel producer **Minara (-36.2%)** announced a $210m rights issue, underwritten by its 56.1% shareholder Glencore, while **Perilya (-21.7%)** continued its recent slide on a 29.3% fall in the zinc price. Producers of non-exchange traded commodities fared not much better than the base metals producers: **Fortescue (-36.7%)**, **Alumina (-30.9%)** and **Iluka (-23.4%)**. No stocks in the sector achieved price gains during October highlighting the negative sentiment towards the sector although most stocks, although most stocks finished off their lows.

Precious Metals

Newcrest (-24.7%) was the best of the larger gold plays, while **Lihir Gold (-30.4%)** posted a slightly larger decline. Among the small cap gold stocks **Bendigo Mining (-39.5%)** and **Avoca (-25.4%)** were also marked down aggressively.

TELECOMMUNICATION SERVICES

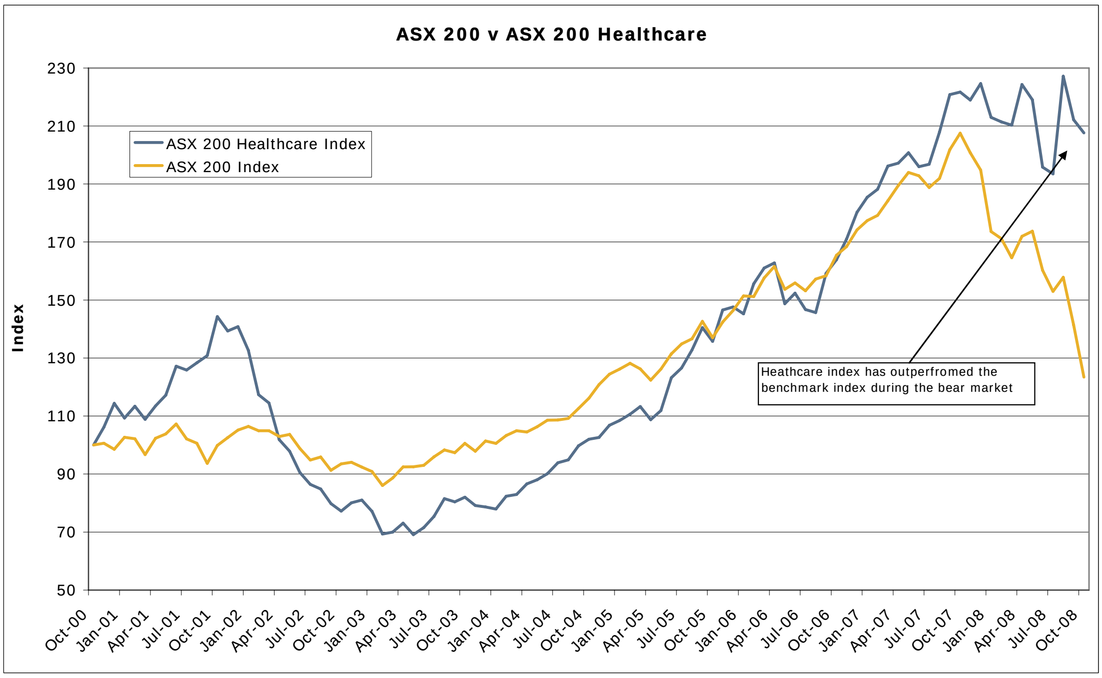
Telstra (-1.4%) weaken this month; at its Investor Conference, TLS indicated it had not seen a huge impact from the slowing economy and reiterated its stance on National Broadband Network. **SingTel (-7.1%)** shares fell on concerns over its valuation and exposure to the emerging markets.

UTILITES

Origin Energy (-2.6%) finished the month lower. News flow revolved around the CSG LNG JV with ConocoPhillips. **AGL Energy (+2.0%)** rose during October after agreeing to two large transactions. First, AGK surprised the market by announcing the sale of its 22% stake in QGC for $1.2bn. As part of the transaction, AGK has the option to acquire direct gas acreage (for $856m) and Condamine Power Station (for ~$170m). It then announced an agreement to sell its PNG assets for $1.1bn. **APA Group (-3.9%)** declined during the month despite announcing it has entered an exclusive arrangement with a consortium led by Marubeni Corporation of Japan to invest in its unlisted vehicle. **SP AusNet (+5.8%)** strengthened, **Envestra (-2.3%)** ended the month lower on the back of broader market weakness and **Spark Infrastructure (+0.7%)** was broadly flat.

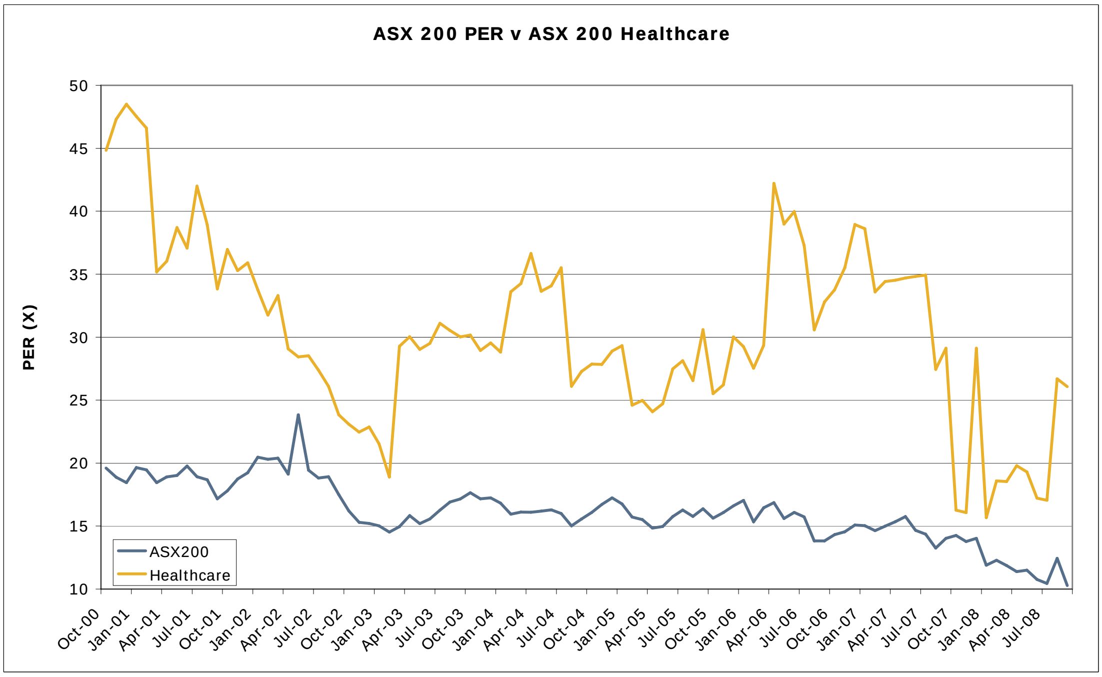
Ever since the destabilisation of credit markets globally, equity markets have borne the brunt of a swift sell-off, as investors seek the relative comfort of less volatile asset classes.

Of the stocks most severely punished, names with highly cyclical cash flows (Media sector) or high levels of gearing (A-REIT sector) have featured strongly on the sell list. However, not all equities have been sold off as aggressively. The chart below shows the returns of the ASX 200 compared to the ASX 200 Healthcare index, which has outperformed the benchmark since the onset of the bear market late last year.



Source: IRESS, GSJBW Research estimates

Given healthcare earnings tend to outpace those of the broader industrial stocks, the sector generally trades at a PE premium to the market, as demonstrated in the chart below. Generally this reflects the sector's defensive earnings streams, underpinned by an ageing population, government reimbursement, and products and services that are medically necessary.



Source: IRESS

That said, the sector is vulnerable to regulatory reform. Changes to the Medicare Levy introduced by the Federal Government at the last budget cast some doubt over the margins received by private hospital providers (health insurers being their main source of margin growth). These reforms make it easier for individuals below a certain income bracket to abandon private health insurance, thereby reducing the bargaining power of private hospital providers. In our view, while having some impact on margins, we do not expect to see any material change in patient numbers through private hospitals and thereby expect volumes to stay consistent. This is due to our expectation that demand for private hospital beds will remain strong in light of supporting demographics such as an ageing population, and with increased pressure on an already overburdened public hospital sector.

In the private hospital segment, we prefer Healthscope **(HSP)** over Ramsay (**RHC)**. Our analysis shows that HSP is the cheapest stock in the sector whereas RHC continues to trade at an 11% premium to HSP. While this has historically been the case, RHC has highlighted a number of brownfield expansions in Australia and Indonesia which have scope for significant upside, however these projects do increase its risk profile. To that end, gearing levels are relatively high compared to HSP. On balance, we do not see RHC's premium as justified. Conversely, HSP has an attractive growth profile with a pick-up in its pathology business.

Moving on to the more specialised healthcare providers, we favour **CSL** while recognising the significant premium investors must pay for such a stock.

Strong demand for blood plasma products globally continues to be a boon for CSL earnings. In addition, the international roll-out of the Gardasil vaccine, a world first vaccination against the HPV virus, provides additional support to its earnings profile. While having an advanced product suite, CSL provides investors with upside given its substantial investment in new product development. On the company's estimates, it plans to increase research and development expenditure by ~17% over the 2009 fiscal period.

While the stock looks expensive, it provides an attractive EPS growth profile of ~35% in 2009 (due in part to the depreciation in the A$), with relatively low risk to earnings given the specialised nature of the blood plasma market and consistent supply / demand fundamentals.

Cochlear (**COH**) has an impressive product portfolio and continues to be a market leader in implantable devices for the severe and profound hearing impaired. We expect softer unit sales in the US due to the slower US economic growth, however some of this will be mitigated by a fall in the Australian dollar, with over 90% of sales being in foreign currencies. From a balance sheet and risk perspective, COH maintains a relatively low gearing level, and is cash flow positive. However for what is a sound company, the stock continues to trade at a substantial premium to the market and its peers. During volatile periods where investors face earnings downgrades across the industrial sector, quality inevitably comes at a price, and investors must weigh up whether they are willing to pay for these attributes. The same can also be said of Resmed (**RMD**), which sustains a specialised suite of products and an impressive track record in penetrating international markets.

RMD plans to implement new product launches in self diagnostics and sleep improvement technologies. We believe this will continue to drive the stock's strong earnings momentum, as awareness of sleep apnea gains traction. In keeping with its peers that have significant exposure in offshore markets, we expect the weaker Australian dollar will provide an added boost to the stock over the medium term.

Another way to invest in the healthcare sector is through the pathology stocks, of which we prefer Sonic **(SHL).** The key driver of SHL's earnings will be its plans to expand and grow its business in the US and Europe. The company has a successful track record of both major and bolt-on acquisitions which provide cost and operational efficiencies (for example the company expects to achieve EUR 25m in synergies from its acquisitions of Schottdorf and Bioscientia in Germany). However, at its current levels, we view this as already priced into the stock. That said, the company has a solid EPS growth profile, with a forecast of 19% growth for FY09. The main drag on the stock is radiology where there is ongoing pressure from radiologists for wage increases, and increased competition from smaller independent operators and hospitals.

Our least preferred sector exposure is the generic drugs manufacturing segment. Sigma Pharmaceuticals (SIP) will face ongoing risks to its earnings, as competition in the generic drugs market intensifies. The stock is also exposed to regulatory pricing reforms, which will place pressure on its margins, limiting its growth options. As such, we see no reason to be holders of SIP when there are superior investments elsewhere in the sector.

Healthcare stock summary table:

	PER (x)		EPS Growth (%)		Div Yield (%)	
	2008	2009	2008	2009	2008	2009
ANN	17.6	13.9	10.7	26.9	2.1	2.5
COH	27.6	22.9	13	20.6	2.6	3.1
CSL	28.7	21.2	34.2	35.1	1.3	1.7
HSP	13.9	12.7	7.3	9.7	4.5	4.9
PRY	22.4	17.7	-34.7	26.8	5.9	4.4
RHC	16.9	14.9	11.4	13.7	3.2	3.6
RMD	30.6	23.8	-8	28.4		
SHL	18.7	15.9	12.2	17.6	3.8	4.5
SIP	13.4	13.3	-13.8	1.1	5.6	5.8

Source: GSJBW Research estimates

Mining Services: WorleyParsons

WorleyParsons (WOR) is a provider of professional services to the energy, resource and infrastructure industries. WOR offers a range of services including feasibility studies, design, project services, upgrade services and maintenance services. WOR uses an alliance-based approach to provide services for a significant proportion of the company's contracts.

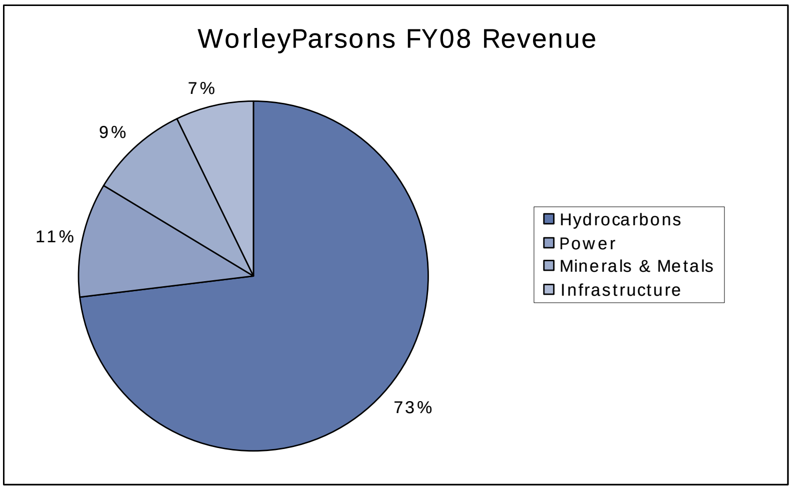
Hydrocarbons are WOR's primary business contributor in terms of earnings, delivering complex projects in developing markets including the Middle East and South East Asia. WOR provides design and project services for fixed offshore facilities, floating production systems, offshore and onshore pipelines, and onshore gas plants, production facilities and terminals.

Slowing Global Growth

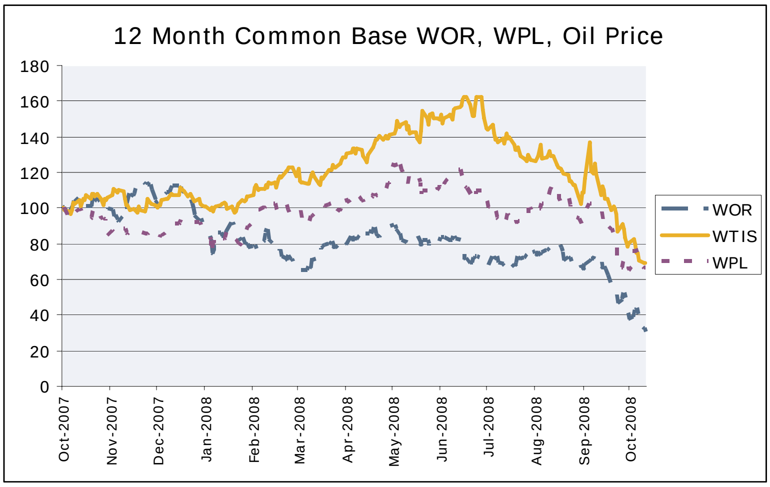
In a slowing global economic landscape, capital investment activity in energy and resources is also likely to be affected. Reduced commodity prices are likely to cloud the viability of marginal projects and difficult financing conditions will probably lead to deferral of projects. Capital investment decisions in the energy and resources industry are generally made on the basis of producers' assumptions about long-term average output prices. Long-term average price assumptions are considerably less volatile than spot prices.

The volatility in the metals sector is likely to mean there's a more significant reduction in capital investment in that segment compared with hydrocarbons, in which WOR specialises. Single commodity exploration and production companies, especially those in high-cost regions are most exposed, and income from WOR's Minerals and Metals are likely to be most affected. WOR has limited exposure to junior companies globally, with the exception of Canada which comprises around 30% of group earnings where WOR has a majority market share and, as a result, services a wider range of companies.

At recent Investor Day, WOR indicated the falling oil price has not had a dramatic impact on its business, work in hand or projects in the sector, but is expecting the Canadian oil sands market to slow. The company also highlighted that demand is likely to be driven by brownfield projects vs greenfield projects; major existing projects have seen very little impact; upstream offshore and deepwater markets remain robust; WORs largest customers - the international oil companies and the national oil companies - have considerable cash reserves and have commented that they remain committed to 2009 capex programs. WOR feels that no change to its strategy or strategic direction is needed or expected.



Source: GSJBW Research estimates



Source: IRESS, GSJBW Research estimates

Non-Conventional energy sources most at risk

Most at risk are non-conventional, relatively high cost of production energy supplies such as deepwater, heavy oil sands as well as fields in remote and inaccessible regions sitting higher on the cost curve. The majority of WOR earnings are generated from conventional projects but it should be noted that WOR has considerable expertise in non-conventional engineering design for projects where the production costs are higher particularly in the Canadian oil sands region. This will have near term earnings impacts but puts the company in a more advantageous long-term position when conventional hydrocarbon reserves deplete.

Funding to impact capital projects

Credit market deterioration has had an immediate effect on the availability of project financing for all companies but places more pressure on smaller, more leveraged exploration vehicles. The major global oil companies are less likely to be affected given the cash reserves built up over times of elevated commodity prices. A high proportion of WOR's earnings, however, are derived from blue-chip clients such as ExxonMobil, Shell, BP, Chevron, ConocoPhillips and major Middle Eastern players.

Labor flexibility a positive

At 85% of the group's costs in FY08, professional labour comes in the form of full-time employees and contractors. The company's ideal full-time to contractor ratio is 70%/30% but at present the contract percentage is higher than 30%. This gives WOR the ability to adjust size of workforce to match workflow and is the key difference between WOR and many of its construction peers that get involved with the construction process, allowing staff to quickly relocate in the event of a project cancellation.

Forecasts

The current oil price is below the marginal cost of production (US$85) and therefore we expect hydrocarbon development projects to be delayed. The Canadian heavy oil producers fall into this category and note WOR exposure to this market as a concern. The impact on FY09 to be relatively minor compared to FY10 and FY11 as WOR's current order book should keep utilisation levels up in the short term. We are currently looking for ~17% EPS growth in FY09.

Valuation comparison to global peers

Our long maintained view is that WOR deserves to trade at a premium to its global peers, as it is a pure services and EPCM play as opposed to its peers, which also carry construction risk. We continue to believe that long-established engineering companies without construction risk deserve a PE premium of 20-25%. On our current numbers, WOR is trading on an 09 PER of 8.2x.

Financials

The company currently has debt/equity gearing for 2009 of 38% with interest cover of 15.7x, implying a safe level of debt. The shares are currently trading on a 2009 yield of 6.75% with a dividend cover of 1.8x.

Macro catalyst to drive the rerating

Despite the company's indication that the oil price has not had an impact on its business, we believe an improvement in the macro outlook will be the catalyst that drives the stock's rerating.

STOCK RECOMMENDATION SUMMARY

Code	Name	Price ($) 31-Oct-08	Recommendation
AMP	AMP Limited	5.41	HOLD
ANN	Ansell Limited	12.60	HOLD
ANZ	Australia and New Zealand Banking Group Limi	17.36	HOLD
AUB	Austbrokers Holdings Limited	3.80	BUY
AXA	AXA Asia Pacific Holdings Limited	4.40	HOLD
BBG	Billabong International Limited	11.92	HOLD
BLD	Boral Limited	4.51	BUY
BXB	Brambles Limited	7.94	HOLD
CBA	Commonwealth Bank of Australia	40.30	SELL
COH	Cochlear Limited	57.00	HOLD
CPU	Computershare Limited	8.40	BUY
CSL	CSL Limited	36.40	HOLD
HSP	Healthscope Limited	4.31	BUY
MCG	Macquarie Communications Infrastructure Grou	1.60	BUY
MCU	Mitchell Communication Group Limited	0.39	BUY
MQG	Macquarie Group Limited	29.40	HOLD
NAB	National Australia Bank Limited	23.99	BUY
NWS	News Corporation	14.85	BUY
ORG	Origin Energy Limited	15.70	BUY
ORI	Orica Limited	19.35	BUY
OST	OneSteel Limited	3.45	BUY
OZL	OZ Minerals Limited	0.95	BUY
PRY	Primary Health Care Limited	4.60	HOLD
QBE	QBE Insurance Group Limited	25.50	BUY
RHC	Ramsay Health Care Limited	10.10	HOLD
RMD	ResMed Inc.	4.95	HOLD
SDM	Sedgman Limited	1.29	BUY
SGB	St George Bank Limited	27.70	HOLD
SHL	Sonic Healthcare Limited	13.71	HOLD
SIP	Sigma Pharmaceuticals Limited	1.26	SELL
TLS	Telstra Corporation Limited	4.12	BUY
TOL	Toll Holdings Limited	5.98	HOLD
UGL	United Group Limited	9.51	BUY
WBC	Westpac Banking Corporation	20.28	HOLD
WDC	Westfield Group	16.40	HOLD
WES	Wesfarmers Limited	21.47	BUY
WOR	WorleyParsons Limited	14.95	HOLD
WOW	Woolworths Limited	27.80	HOLD
WPL	Woodside Petroleum Limited	41.88	HOLD

Source: IRESS, GSJBW Research

Research Analyst Certification

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Hold (H)	Stock is expected to perform in line with the S&P/ASX 200 for 12 months
Buy (B)	Stock is expected to outperform the S&P/ASX 200 for 12 months

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CS	Coverage Suspended. GSJBW has suspended coverage of this company.
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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 2 years. Designed to reflect "turnaround stories" or to highlight companies Goldman Sachs JBWere analysts believe will allocate capital poorly in the estimated timeframe.
Earnings Momentum:	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
Catalysts:	A qualitative and quantitative assessment of a company's long term catalysts 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

EVA™ Trend: [1]	ROE is used as a proxy for EVA. Rating takes into account the expected level and trend of ROE over the next 2-3 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

Strategy:	Used instead of industry structure as many REIT investors are intra rather than inter sector focussed.
EPU Growth:	Ranking of Earnings Per Unit growth relative to other listed Real Estate Investment Trusts. Used instead of EVA™ Trend.
Yield:	Yield relative to the REIT sector average. Used instead of Earnings revision.

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Buy	29%	29%

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