ASX INVESTMENT TALKS

What type of portfolio suits your needs?

SPEAKER: George Boubouras, Equity Trustees
LOCATION: Melbourne
DATE: June 2013

ASX

Global equity valuations – multiple to expand further…

The recent global market correction implies valuations becoming more compelling. Market concern regarding US monetary stimulus will remain a short term headwind. Core view is for event risk to be lower vs previous years therefore multiple to expand further into year end…

World (MSCI) Equity Valuations

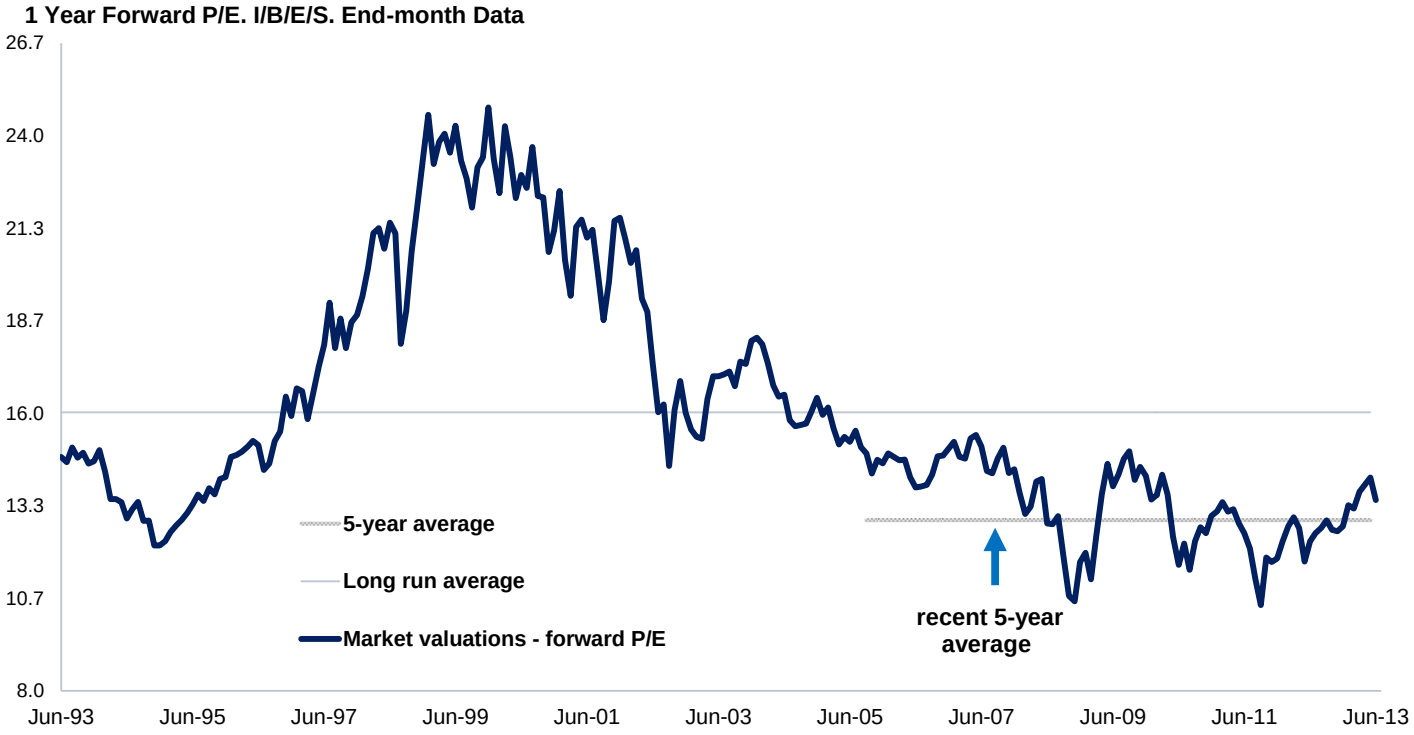
1 Year Forward P/E. I/B/E/S. End-month Data

Source: Bloomberg, IBES, Equity Trustees

US equity valuations – multiple to expand further…

The recent global market correction implies valuations becoming more compelling. Market concern regarding US monetary stimulus will remain a short term headwind. Core view is for event risk to be lower vs previous years therefore multiple to expand further into year end…

US Equity Valuations: S&P 500



Source: Bloomberg, IBES, Equity Trustees

US earnings yield remains compelling vs bond yields…

US earnings yield vs bond yield (EY/BY) remains compelling compared to long run average despite the recent rise in bond yields. The rise in yields from low base is reflective of improving conditions. However, the lower US rate environment looks set to remain in place given the limited inflation outlook…

US Bond Yield - Earnings Yield Ratio

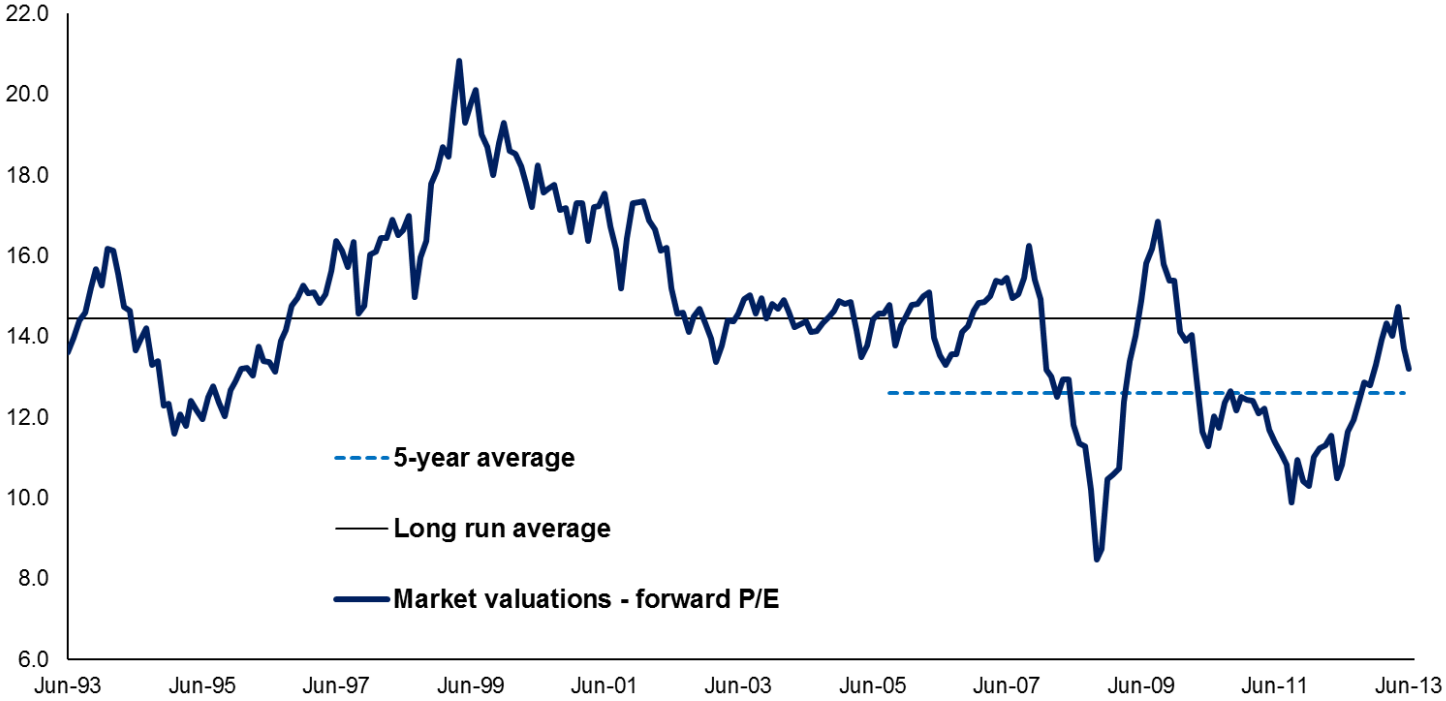
Source: Bloomberg, Datastream, IBES, Equity Trustees

Australian equity valuations more compelling…

The recent 10% correction implies Australian equity valuations becoming more compelling. The persistently higher AUD over the past year has created headwinds for earnings. A lower rate environment combined with an AUD below parity will eventually feed through to improved earnings.

ASX 200 12 Month Forward P/E Ratio

1 Year Forward P/E. I/B/E/S. End-month Data



Source: Bloomberg, IBES, Equity Trustees

Australian investor continue to chase the dividend…

Australian earnings yield vs bond yield (EY/BY) remains compelling despite the recent rise in bond yields. The slowing domestic growth profile suggests lower rates ahead. Demand for Australian bonds (AAA status) will keep bond yields below long run average levels. Therefore Australian equities will continue to offer attractive potential yields before the franking…

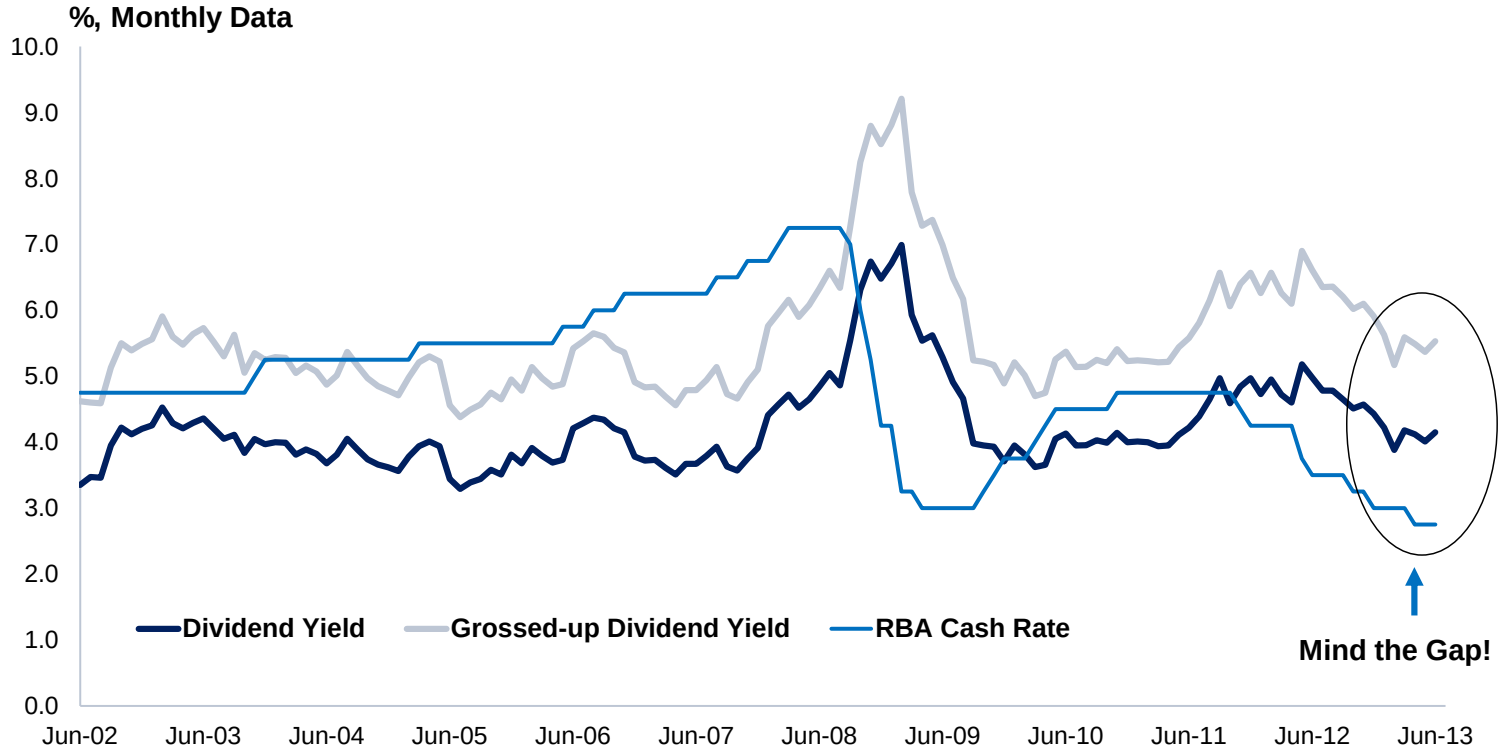
US Bond Yield - Earnings Yield Ratio

Source: Bloomberg, Datastream, IBES, Equity Trustees

Dividend looks more compelling with historic low cash rates…

Historic low Australian cash rates (& lower rates for longer) are supportive for dividends. Lower rates ultimately increases risk appetite…

ASX 200 Dividend Yield & Cash Rate



Source: Bloomberg, IRESS, RBA Bulletin, Equity Trustees

EQT Flagship Fund

Top 10 positions	Weighting
BHP Billiton	12.6%
Commonwealth Bank	10.5%
ANZ Banking Group	9.9%
Westpac Banking Corp.	7.8%
Telstra Corporation	7.1%
Rio Tinto	5.1%
Wesfarmers	5.0%
National Aust. Bank	3.0%
Oil Search	2.9%
Origin Energy	2.7%
No. of stocks held	36

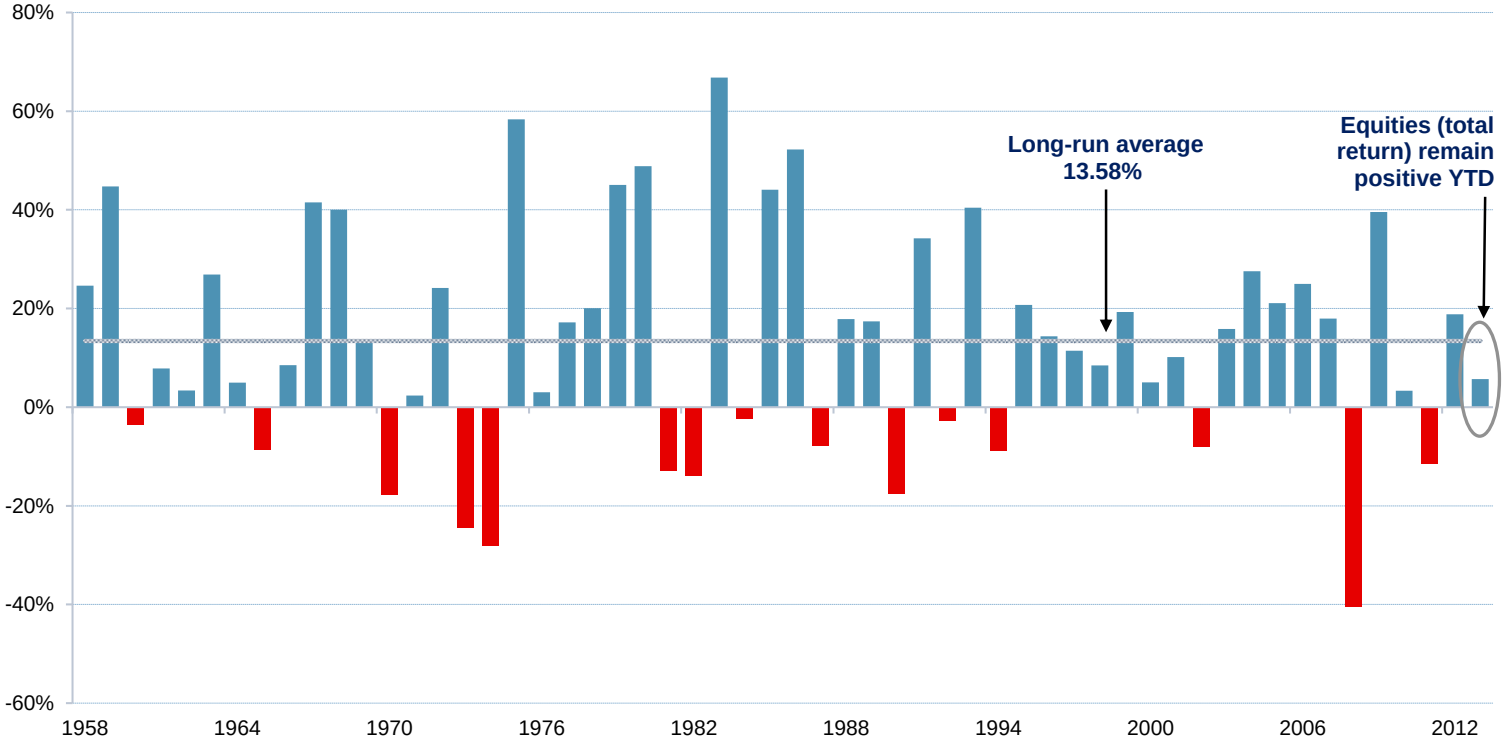
Risk Metrics	
Dividend yield (net)	4.5%
ASX 200 yield (net)	4.3%
Dividend yield (grossed up)	5.6%
ASX 200 yield (grossed up)	5.7%
10 year bond rate	3.4%
ß	0.96
Tracking error	2.2%

Source: Bloomberg, EQT

Australian equity performance over the long run…

Year-to-date total returns remain positive. Market remains on track for another positive calendar year return. The Australian equity market has averaged one negative annual return every 3.4 years over the past 50 years. Expected returns for equities are around 10.0%. It is a volatile asset class therefore diversify…

All Ordinaries Accumulation Index - Annual Performance



Source: Bloomberg, Datastream, RBA Bulletin, Equity Trustees

***Accumulation data. 2013 reading is data as of 19 June (YTD%)**

ResMed

VALUE DRIVERS

- ***Market Growth - Sleeping disorders impact 20% of the adult population yet awareness is low, and many patients go untreated. As awareness of sleep disorders grow and further research into the negative impacts of poor sleep is undertaken, growth in RMD's markets will accelerate. Additionally, OSA has a high incidence amongst the obese population, which is growing in the western world.***
- ***Global leader - RMD pioneered the treatment of OSA and has remained the global leader. RMD has continued to re-invest its profits in R&D to ensure that it has remained at the forefront of industry developments.***
- ***Benefits of home sleep testing - a constraint on market growth for OSA treatment has been the timely and costly process of being diagnosed. With the advent of home sleep testing this bottleneck has been removed, enabling quicker and more cost effective diagnosis of the condition.***

Price and Ratings	
EQT Rating	Buy
Current Price	$5.06
Consensus Price Target	$5.18
Price upside/downside	2.33%
Consensus Rating	Buy
EPS Growth	9.26%
ROE	18.85%

Market Data		
Market Cap. ($m)		7,208.8
Sector		Healthcare
Index Weight (ASX200)		0.31%
F/cast P/E		21.4
F/cast Gross/Net Div Yield	3.8% /	3.8%
F/cast Franking		0%
Current Year High/Low	$5.28	$2.93
Previous Year High/Low	$3.43	$2.37

DISCUSSION POINTS & SECTOR OUTLOOK

- ***OSA treatment is generally paid for by either governments or health insurers. With western governments cutting healthcare expenditure there are fears that RMD may face material margin pressures. An example of this was the competitive bidding process undertaken in the USA. Having now seen the impact of that process, we have greater confidence in our forecasts and do not anticipate any further disruptive shocks.***
- ***The benefits of home sleep testing are now becoming evident. Apart from increased sales, there is the added benefit of patients using the higher margin automated and bi-level CPAP devices once they start treatment.***
- ***RMD earns considerably higher margins on the sales of their masks, which have a short replacement cycle. While there is considerable intellectual property attached to masks, this market has the potential to come under margin pressure. RMD has the capability of offsetting this by ensuring that patients take advantage of their replacement quota - something which does not currently occur.***
- ***For Australian investors, the appreciation of the AUD against the USD has diminished returns. Given recent moves in the dollar, the impact is likely to reverse and this will provide a tailwind to the EPS and DPS growth that the company is likely to generate in the coming years.***

Source: Equity Trustees Limited

BHP Billiton

VALUE DRIVERS

- ***The primary source of BHP Billiton's growth over the last ten years (and for the foreseeable future) is the increasing level of industrialisation and urbanisation in China and other emerging Asian economies and the resulting increase in commodity demand that this generates.***
- ***From a company perspective, BHP Billiton has an advantage over most of its peers in the mining industry through the quality of its asset base - the company owns low cost, long life, large scale, tier 1 mines, which ensures that the company enjoys margins in excess of that of the broader industry.***
- ***BHP Billiton also differentiates itself from many of its peers through the high level of diversification in its asset base, both at a commodity level and also a geographic level. This level of diversification should lead towards a smoother earnings profile through the commodity cycle while maintaining its progressive dividend.***

Price and Ratings		
EQT Rating		Buy
Current Price		$32.99
Consensus Price Target		$38.54
Price upside/downside		16.8%
Consensus Rating		Buy
EPS Growth		14.4%
ROE		18.1%
Market Data		
Market Cap. ($m)		169,395.8
Sector		Materials
Index Weight (ASX200)		8.96%
F/cast P/E	5.1% /	3.6%
F/cast Gross/Net Div Yield		100%
F/cast Franking		100%
Current Year High/Low	$39.34	$30.09
Previous Year High/Low	$44.95	$30.75

DISCUSSION POINTS & SECTOR OUTLOOK

- ***At the company's recent half year result, BHP Billiton announced that CEO Marius Kloppers was to retire and be succeeded by Andrew Mackenzie, formerly Chief Executive Non-Ferrous.***
- ***Andrew Mackenzie's appointment has seen a refinement in BHP Billiton's strategy - a much greater focus on costs across the business and increasing productivity; reduced levels of capital expenditure going forward, with the expectation of no new major project announcements in the near term; and bringing further potential divestments to the table from assets that may not be core to the overall business.***
- ***The changes to the company's strategy have come about through a more subdued global economic environment, in particular the slowing of China's rate of economic growth and Europe's ongoing troubles. This is being compounded by increasing levels of supply in a number of key commodities, thus putting downward pressure on commodity prices.***
- ***While BHP Billiton's earnings have reduced over the last two years, we can identify a number of levers that could see it return to earnings growth - reduced cost levels, increased production and a falling Australian dollar.***

Source: Equity Trustees Limited

Core Australian Equity Income Portfolio

Top 10 positions	Weighting
Telstra Corporation	*11.4%*
Westpac Banking Corp.	*11.1%*
ANZ Banking Group	*10.8%*
National Aust. Bank	*10.6%*
Commonwealth Bank	*8.9%*
Duet Group	*4.6%*
AMP Limited	*4.2%*
Bunnings Warehouse	*3.5%*
SP Ausnet	*3.4%*
APA Group	*3.3%*
No. of stocks held	26

Risk Metrics	
Dividend yield (net)	*5.3%*
ASX 200 yield (net)	*4.3%*
Dividend yield (grossed up)	*7.1%*
ASX 200 yield (grossed up)	*5.7%*
10 year bond rate	*3.4%*
ß	*0.89*
Tracking error	*6.0%*

Source: Bloomberg, EQT

CBA

VALUE DRIVERS

- ***CBA is Australia's largest retail bank with the strongest retail footprint and customer base in Australia. This allows CBA to maintain a high level of deposit funding, which is cheaper than wholesale funding. The retail network also provides the ideal platform to cross sell wealth management products.***
- ***Since its privatisation CBA has dramatically improved its efficiencies and maintains a sector leading cost to income ratio. With its new core IT system, CBA is looking to drive these efficiencies gains even further.***
- ***CBA, like all the other big four banks, is a play on the domestic economy. A stronger economy will see improving credit growth and lower impairment charges, both vital ingredients in improving the bank's return on equity.***

Price and Ratings		
EQT Rating		Buy
Current Price		$68.36
Consensus Price Target		$68.67
Price upside/downside		0.45%
Consensus Rating		Hold
EPS Growth		3.23%
ROE		18.22%

Market Data		
Market Cap. ($m)		110,191.5
Sector		Financials
Index Weight (ASX200)		9.31%
F/cast P/E		14.3
F/cast Gross/Net Div Yield	7.5% /	5.3%
F/cast Franking		100%
Current Year High/Low	$74.18	$51.19
Previous Year High/Low	$52.85	$42.93

DISCUSSION POINTS & SECTOR OUTLOOK

- ***CBA recently provided a 3Q trading update. The update highlighted that credit growth remains tight, but CBA has been able to offset this by eking out net interest margin (NIM) improvement and has recorded lower bad debt charges, as the credit environment remains benign.***
- ***CBA has continued to strengthen its balance sheet via improved levels of customer deposits. The competition for these deposits has also dropped away, which has helped margins improve. The combination of an improved balance sheet and low credit growth means CBA is well placed to offer a special dividend later in the year.***
- ***In recent periods CBA has been losing share in the housing loan market. We see this as CBA showing price discipline rather than any failing in its business model.***
- ***Ian Narev recently took over as CEO and has indicated that he will continue with the strategies laid out by his predecessor, Ralph Norris. CBA's strategy is to invest in the areas of technology, customer focus and its balance sheet, areas it sees as its competitive advantage.***

Source: Equity Trustees Limited

ANZ

VALUE DRIVERS

- *ANZ's Asian expansion provides a point of difference to the other domestic banks and, if successful, will deliver growth well above what is possible in the relatively mature Australian market. Its Asian exposure has the benefits of providing a cheap source of funding for its domestic operations and dilutes its exposure to Australian housing.*
- *The Asian expansion is not without its risks but in Mike Smith, ANZ has a very experienced and disciplined CEO. The benefits of this is seen in the roll out of a focused Asian expansion strategy, including disciplined acquisitions.*
- *ANZ's strong consumer banking service provides a point of difference and allows them to compete domestically on terms other than just pricing.*

Price and Ratings	
EQT Rating	Buy
Current Price	$28.35
Consensus Price Target	$30.89
Price upside/downside	8.95%
Consensus Rating	Hold
EPS Growth	5.67%
ROE	15.18%

Market Data		
Market Cap. ($m)		77,791.0
Sector		Financials
Index Weight (ASX200)		6.58%
F/cast P/E		11.9
F/cast Gross/Net Div Yield	7.9% /	5.6%
F/cast Franking		100%
Current Year High/Low	$32.09	$21.00
Previous Year High/Low	$23.99	$18.50

DISCUSSION POINTS & SECTOR OUTLOOK

- *At its half year result, ANZ increased its dividend payout ratio. The move indicates that ANZ is comfortable with its capital position. The anticipation of low credit growth across its business, which is a negative given credit growth, the key driver of revenue growth, was no doubt a key consideration.*
- *Despite believing that the Asian growth strategy is an important differentiator for ANZ, there are a few lingering concerns - the main ones being that the Asian operations have lower returns than the core bank, and as the Asian growth outstrips the domestic operations it will be dilutive to group margins. The key will be whether the returns in Asia increase over time as ANZ's scale increases.*
- *In a theme common across all domestic banks, bad debts and impairments are running at historically low levels. While the lowering of the official cash rate by the RBA is supportive of the levels remaining low, any further downturn in the economy may prove detrimental going forward.*
- *With increasing earnings from Asia and a higher payout ratio, questions have emerged around the sustainability of ANZ's franking. Management raised the possibility of spinning out the Asian business so investors could decide for themselves whether they wanted to hold an Asian bank with no franking.*

Source: Equity Trustees Limited

Transurban

VALUE DRIVERS

- ***Revenue growth comes from a combination of toll increases and traffic growth. TCL's concessions link toll increases to inflation, which supports stable operating margins. While traffic volume growth does have a cyclical element, TCL's high quality asset portfolio roads should benefit from increasing structural demand.***
- ***TCL is not overly exposed to any development risks as a majority of their toll roads are either mature or undergoing brownfield expansion. Earnings, and therefore distributions, are more predictable as they are not reliant on meeting traffic forecasts relating to new, untried roads. The company also has a strong cost management strategy, reducing the risk of cost growth diluting earnings.***
- ***Given their scale and connections within Australia, TCL is well placed to participate in further expansion projects, which are likely to augment current growth.***

Price and Ratings	
EQT Rating	Hold
Current Price	$6.92
Consensus Price Target	$6.67
Price upside/downside	-3.6%
Consensus Rating	Hold
EPS Growth	16.4%
ROE	5.0%

Market Data		
Market Cap. ($m)		10,252.6
Sector		Industrials
Index Weight (ASX200)		0.87%
F/cast P/E		46.4
F/cast Gross/Net Div Yield	4.9% /	4.5%
F/cast Franking		23%
Current Year High/Low	$7.18	$5.56
Previous Year High/Low	$5.90	$4.72

DISCUSSION POINTS & SECTOR OUTLOOK

- ***Management has positioned TCL such that it has the potential to achieve distribution growth of 10% CAGR over the next 5 years. This growth is very attractive in a world of lower growth, lower yields and increased earnings volatility.***
- ***At their recent investor day, TCL provided a disappointing update on their M2 expansion. Costs have been greater than expected and traffic growth has not hit anticipated levels, as construction has run behind time. TCL needs to achieve a substantial lift in traffic of 16% for this expansion to generate its required returns. Any further disappointments on this project would be a major concern.***
- ***The NSW government recently announced that it had entered into an in-principle, non binding agreement with TCL to build the $3bn F3-M2 link. The government has indicated that it will fund 20% of the project, with TCL responsible for the remainder. While the project is a good illustration of the advantage TCL has as the incumbent operator in NSW, the project will rely on modifications to the M2 concession for it to generate sufficient returns.***
- ***TCL's current concessions expire between 2024 and 2048 and will need to be replaced. As the incumbent operator in Australia, there is a high likelihood that they will be able to participate in new toll road proposals such as the East West link project in Melbourne or WestConnex project in NSW.***

Source: Equity Trustees Limited

Worley Parsons

VALUE DRIVERS

- ***WorleyParsons benefits from the increasing demand for oil and other hydrocarbons, which is not only tied to the economies of the US and Europe, but also on emerging economies in Asia. Despite being reliant on the demand for oil, the company's revenue is not directly related to the oil price, ensuring more predictable earnings compared to other companies in the energy sector.***
- ***We like WorleyParsons in the mining/energy services sector because of its high proportion of low-risk contracts. The majority of the company's contracts have reimbursable costs built into them, and as the company does not perform construction work, there is little risk of losses on the execution of individual contracts.***
- ***With its growth over the years, both organically and via acquisition, WorleyParsons is now truly a global player in the energy services market. Its size now means it is now able to bid for larger contracts in its own right.***

Price and Ratings	
EQT Rating	Buy
Current Price	$19.88
Consensus Price Target	$22.20
Price upside/downside	11.7%
Consensus Rating	Buy
EPS Growth	8.7%
ROE	16.4%

Market Data		
Market Cap. ($m)		4,833.9
Sector		Energy
Index Weight (ASX200)		0.35%
F/cast P/E		13.49
F/cast Gross/Net Div Yield	6.3% /	4.4%
F/cast Franking		100%
Current Year High/Low	$28.40	$18.61
Previous Year High/Low	$29.86	$23.28

DISCUSSION POINTS & SECTOR OUTLOOK

- ***WorleyParsons have recently provided a trading update to the market, where they downgraded their 2013 financial year profit guidance from 'earnings growth' to a 2-7% fall in profit. The new guidance represented around a 10% decline on consensus numbers. The lower outlook was blamed on a softening of demand for resource infrastructure, particularly in Western Australia, as well as weaker demand in the Canadian oil sands market.***
- ***Despite the disappointment of the downgrade, we believe that the medium to longer term fundamentals of WorleyParsons' key Hydrocarbons business (which still accounts for around 70% of group profit) remains robust. We note that the global major oil companies are expected to increase their capital expenditure budgets in 2013. WorleyParsons is also well represented across the various products across the hydrocarbons market.***
- ***In recent times, WorleyParsons has had good success winning global framework agreements in its Improve business, which results in more annuity style revenue for the course of the contract. WorleyParsons now has 275 Improve contracts and this underpins revenue going forward.***

Source: Equity Trustees Limited

Summary: Investing is simple but not easy…

"Do you know the only thing that gives me pleasure? It's to see my dividends coming in"

John D Rockefeller

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