

AUSTRALIA



## EQUITY STRATEGY

## Notes from the Field

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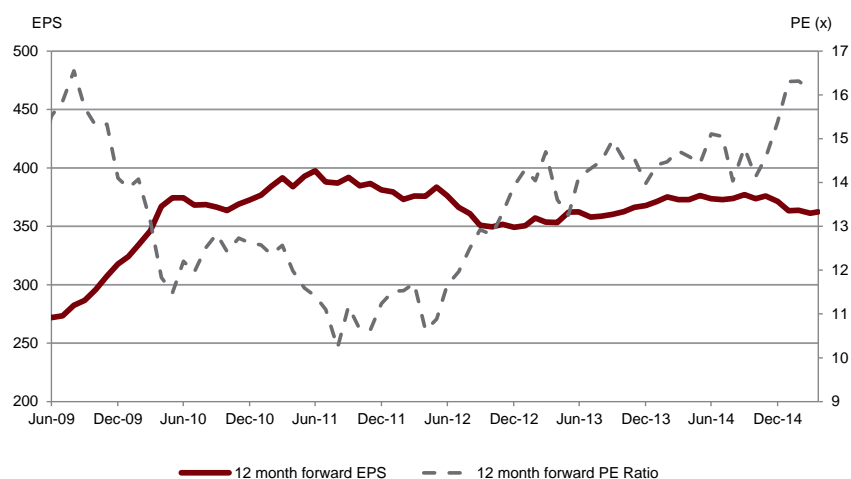
## Related Research

[Investment Strategy - 2Q 2015](#) Published 14 April is our Quarterly Strategy publication covering all aspects of Asset Allocation, Economics and Investing strategies.

## High conviction stocks

With the S&P/ASX200 trading at elevated levels on a forward PE of 16x against a backdrop of weak consumer and business confidence, we think the balance of risks are tilted to the downside ahead of the May 'confession season'. Analysts continue to revise down earnings expectations and we stress caution holding onto stocks priced for perfection. We prefer earnings certainty over earnings growth.

Figure 1: Benign earnings expectations – tread carefully



SOURCE: MORGANS, BLOOMBERG

### May: A heap of new inclusions ▶

We add **Carsales**, **Qantas** and **Sydney Airports** into the S&P/ASX100 high conviction list while **Bellamy's** and **Qube Logistics** make the grade and make it to our ex-ASX100 list.

### May: Exclusions ▶

We have removed **Macquarie Group** due to strong share price appreciation. The stock has re-rated and now lies in line with its historical PE multiple. We remove **Transurban** due to a strong run following the March traffic statistics; however, we still like the stock relative to other yield alternatives due to its proven network strategy. We remove **Seek.com** due to the lack of short-term re-rating catalysts.

### Mitigating the risks ▶

Exercise caution into May. Analysts' expectations for FY15 earnings growth have been marked down to 0% with FY16 only marginally better at 2%. Subdued levels of business and consumer confidence suggest that investors should hold higher levels of cash over this seasonally weaker period. We recommend trimming overweight positions in **Medibank** as we see margin pressure and slowing top-line growth as medium-term challenges that will weigh on growth making it difficult to justify a forward PE of 23x. Investors should also trim positions in **Sirtex** as we see risks around product adoption given the results of recent clinical studies.

'High conviction stocks' are those we think offer the highest risk adjusted returns over a 12 month timeframe, supported by a higher-than-average level of confidence. They are typically our preferred sector exposures.

**Additions this month:**

Carsales.com (CAR), Qantas (QAN), Sydney Airport (SYD). Qube Logistics (QUB), and Bellamy's (BAL).

**Removals this month:**

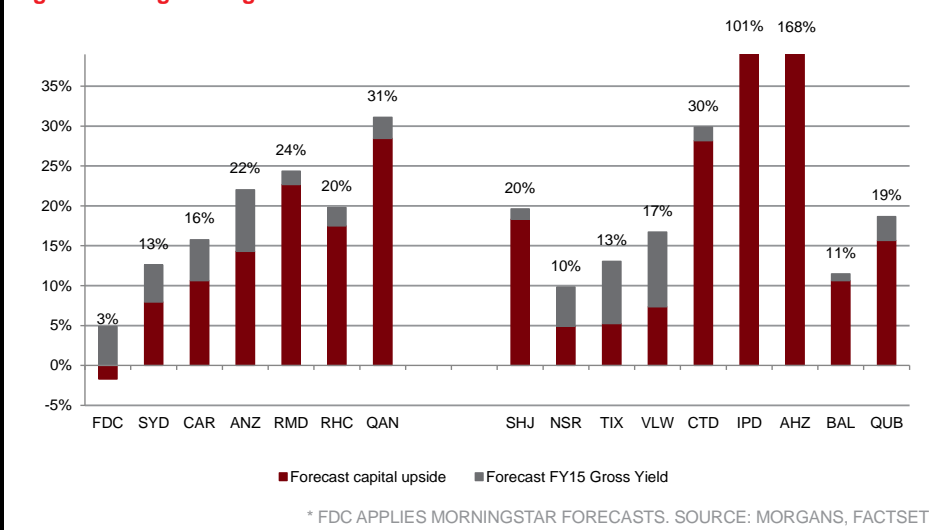
SEEK.com (SEK), Macquarie Group (MQG), and Transurban (TCL).

**Figure 2: Morgans' high conviction lists**

Company		Price (A\$ps)	PE FY15 (x)	Price Target (A\$ps)	Capital upside	Gross Forecast Yield	Forecast TSR
<b>ASX 100 Stocks</b>							
Federation Centres	FDC	2.95	16	2.90	-2%	5%	3%
Sydney Airports	SYD	5.39	71	5.82	8%	5%	13%
Carsales.com	CAR	9.44	22	10.44	11%	5%	16%
ANZ Bank	ANZ	33.99	13	38.85	14%	8%	22%
ResMed	RMD	8.07	25	9.90	23%	2%	24%
Ramsay Health Care	RHC	62.59	33	73.54	17%	2%	20%
Qantas	QAN	3.39	12	4.35	28%	3%	31%
<b>Ex-ASX 100 Stocks</b>							
Shine Corporate	SHJ	3.03	18	3.58	18%	1%	20%
National Storage	NSR	1.62	19	1.69	5%	5%	10%
360 Capital Industrial Fund	TIX	2.58	11	2.72	5%	8%	13%
Villa World	VLW	2.29	9	2.46	7%	9%	17%
Corporate Travel	CTD	10.69	37	13.70	28%	2%	30%
Impedimed	IPD	0.85	NA	1.70	101%	0%	101%
Admedus	AHZ	0.08	NA	0.20	168%	0%	168%
Bellamy's	BAL	3.48	47	3.85	11%	1%	11%
Qube Logistics	QUB	2.79	26	3.23	16%	3%	19%

SOURCE: MORGANS, \* FDC APPLIES MORNINGSTAR FORECASTS  
 Prices as at 30 April 2015

**Figure 3: Morgans' high conviction lists : Forecast 12-month TSR**



'Active opportunities' are catalyst driven, high conviction trades over a 3-4 month timeframe.

We accept higher risk in this list, target returns of 10-20% and apply 10-15% stop loss limits.

These positions are reviewed daily – Contact your adviser for up to date ideas.

**Active opportunities (trading) ideas**

**Figure 4: Morgans' active opportunities list**

Active Opportunities	Entry Date	Entry Price (A\$ps)	Current Price (A\$ps)	Return to Date	Trading Target (A\$ps)	Stop Loss (A\$ps)
iiNet	IIN 29/04/2015	10.05	9.97	-1.1%	11.00	9.00

SOURCE: MORGANS

## ASX100 high conviction stocks – 3 reasons to buy



*ANZ is among the top 20 banks in the world, operating in 33 countries with the largest exposure to Asia of the Aussie major banks.*

### ANZ Bank (ANZ)

- With further interest rate cuts looking likely in Australia, we think the domestic banks should continue to perform well.
- ANZ offers the best value of the major banks (on a PER and yield basis), and should deliver ROE expansion as it gains economies of scale across its Asian operations.
- ANZ has the largest currency exposure and has leverage to Asian lending where growth should comfortably exceed the anemic growth in domestic lending.



*Carsales.com (CAR) is the market leader in the online classifieds markets for automobiles and other forms of transport and leisure equipment.*

### Carsales.com (CAR)

- Market conditions in the new and used car markets have begun to improve in 2015. Dealer enquiry volumes - the principal driver of profit - are showing solid growth again.
- We expect that competitors who have been over-spending on marketing will be forced to reign in advertising campaigns in the second half of 2015 as financial realities bite. CAR should be able to raise prices again in FY16.
- Foreign operations of Carsales have tended to be overlooked. We expect strong growth from all offshore operations in FY15 and FY16.



*ResMed is a world leader in the development & manufacturing of medical products to treat sleep apnoea.*

### ResMed (RMD)

- 2Q15 results exceeded market expectations with double digit sales growth (+14%).
- New product (AirSense 10 platform) launch is likely to drive sales growth in subsequent quarters, reflected in forecast earnings growth of 13% pa over the next three years.
- Strong balance sheet with net cash of approx. US\$700m.



*Ramsay Healthcare (RHC) is Australia's largest private hospital operator and more recently has expanded its operations into the UK, France and parts of Asia, where now about 25% of its revenue is generated.*

### Ramsay Health Care (RHC)

- RHC is benefitting from an aging population which uses more medical services.
- RHC consistently delivers above market earnings growth (last three years averaging 18.0%pa) and for the next three years is forecast to grow at 15% pa.
- RHC is expected to benefit from further public hospital outsourcing opportunities.



*Sydney Airport (SYD) is the 100% owner of a long-term leasehold of Kingsford Smith Airport, Australia's busiest airport.*

### Sydney Airport (SYD)

- SYD provides exposure to Australia's premier aeronautical infrastructure asset and prime retail space leveraged to Asian travel growth, as well as commercial property and airport car parking.
- Interest costs are expected to fall materially, as out-of-the-money interest rate swaps expire and are replaced at far lower interest rates.
- The combination of solid earnings growth and falling interest costs should generate strong distribution growth and potential for capital management initiatives.

SOURCE: MORGANS

## ASX100 high conviction stocks (cont.) – 3 reasons to buy



*Federation Centres (FDC) is a significant owner and manager of Australian retail assets.*

### Federation Centres (FDC)

- The new merged entity will be a top 30 stock with a market cap of c\$11bn and the 3rd largest REIT with \$22bn of assets under management.
- We expect given the increased size and scale the merged group will become meaningful for both offshore and domestic investors.
- The deal is expected to be highly accretive and we expect it will deliver a yield of around 6%.



*Qantas (QAN) is the largest airline in Australia providing domestic and international passenger services via its Qantas and Jetstar brands, as well as possessing the largest loyalty program in Australia in Qantas Loyalty.*

### Qantas (QAN)

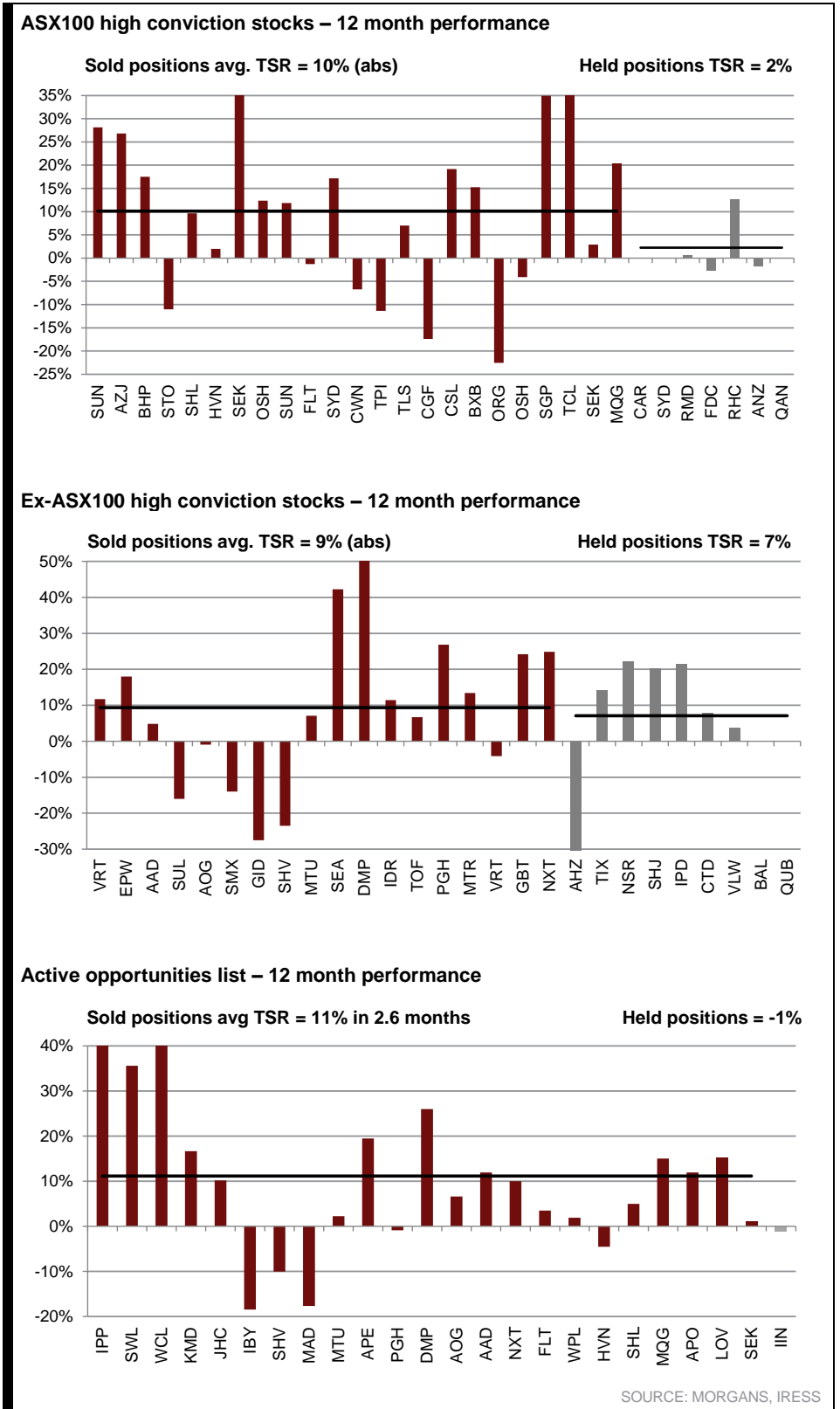
- The capacity growth outlook is the most favourable for some time in both the domestic and international markets, providing the opportunity for QAN to increase revenue via increased load factors and ticket prices.
- Lower oil prices and a A\$2bn internal cost-out program are providing a material earnings benefit, with QAN likely to return to near record levels of profitability in FY16.
- News flow is a key share price driver of airline stocks and the next 6-12 months is likely to remain positive with QAN's investor day (May 12), monthly operating statistics, and full year result (Aug 20) reinforcing the strong operating conditions.

SOURCE: MORGANS

## High conviction performance ▶

We are pleased to report that Morgans high conviction stocks have significantly outperformed the broader market in the last 12 months.

*Large caps picks have generated an average TSR of 10% from sold positions in an average of 6 months.*



*Small cap picks have generated an average TSR of 9% from sold positions in an average of 4 months.*

*Active opportunities (trading ideas): Sold positions in the last 12 months have averaged an 11% return in just over 2 months.*

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