EVANS & PARTNERS

The Financial Engineer

Australian Equities Portfolio Review

1st May 2013

Australian Equities: Total Return (Capital + Income)

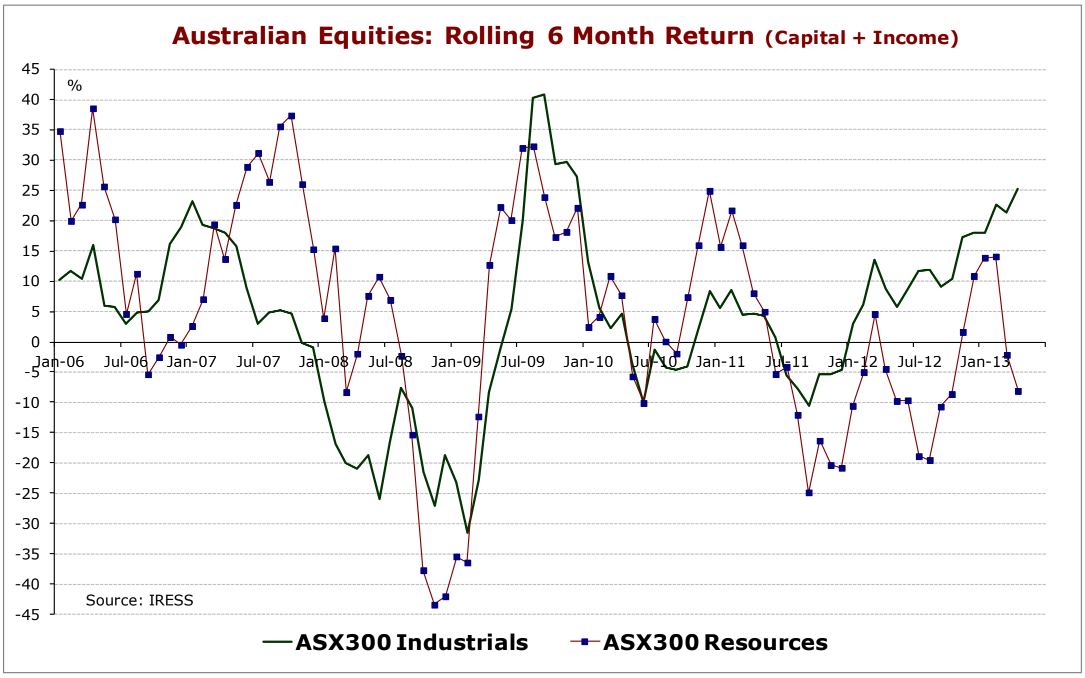
To period ending April 2013	Monthly	Quarterly	Annual
	% Change		
S&P/ASX300	4.3%	7.3%	22.7%
S&P/ASX300 Industrials	6.6%	13.6%	38.4%
S&P/ASX300 Resources	-4.2%	-12.3%	-16.0%
S&P/ASX300 Financials ex-REITs	8.6%	18.1%	46.7%
S&P/ASX300 REITs	8.2%	9.1%	33.9%

Technically, for Australia to endure a recession post a period of monetary policy easing would be unprecedented. Certainly, the prospect of further rate cut does help counter our fears that the macro pain will arrive in FY14. We are, however, very reluctant to assume – as the local equity market is now doing via the hefty valuations being applied to the large-cap industrials – that it is a given that the RBA will save us.

Current Opportunities

With respect to building an exposure to relatively defensive industrials, we are comfortable to buy **Envestra** at the current price.

With respect to building an exposure in the more cyclical sectors, three stocks which we are comfortable to buy at current prices – **Adelaide Brighton, Beach Petroleum, Sonic Healthcare.**



Market Outlook

Positives

- The Australian economy is not as healthy as the headline performance suggests. As this reality is slowly revealed by the fading contribution of the resources boom – and a rising unemployment rate - it will provide scope for further RBA leniency.
- While sluggish and variable across regions, the global economic recovery is proving durable. The medium term outlook for ~70% of the global economy ranges from reasonable to solid.
- Global equity market valuations are reasonable although profit momentum is fading.
- Global credit markets have recovered strongly over the past four years and are proving very resilient (ex. European banks) in the face of the sovereign debt fears in Europe.
- The opportunity cost of near-zero cash rates in the US and Europe is significant. Investors are growing in confidence and chasing higher yielding alternatives.
- Cash is still the investment of choice for most Australians; equities the least attractive. The contrarian is well-placed
- Global balance sheets are sound & conservative. Given extremely low borrowing costs & higher PE multiples a step-up in M&A activity is inevitable in the year ahead.

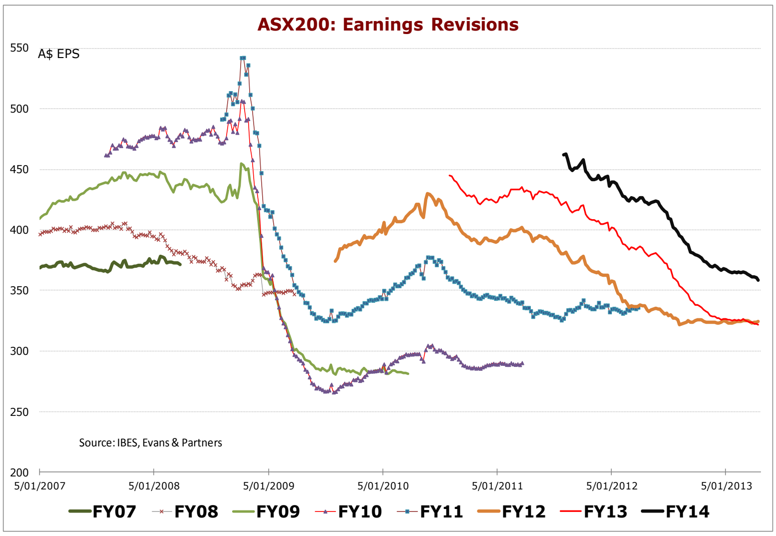
Negatives

- While the global economy is growing, the pace of recovery is constrained by a conservative & capital-hungry banking system, vulnerable asset prices, a circumspect OECD consumer and the slow reversal of unprecedented monetary & fiscal stimulus.
- Recession in Europe, along with softening export and construction sectors in China, has impacted the marginal investor's appetite for commodities & resource stocks. The worst has passed for the sector but 2013 is unlikely to deliver a strong recovery phase.
- Global political risk is high. Events in the Middle East have created a vacuum that will be an ongoing source of volatility. A military response against Iran in 2013 is probable. Policy tension between China and the West remains significant.
- Although easing, financial conditions in Australia are still restrictive. Access to credit is limited, the A$ is materially overvalued and FY13/14 is delivering fiscal restraint.
- In absolute terms, ASX Industrial valuations are now expensive. Relative to prevailing interest rates, however, the picture is more comfortable. Dividend income still offers a superior return to holding cash.
- The potential for industrial stocks to exceed FY13/14 earnings expectations continues to fade. Sluggish demand, A$ strength & widespread market share battles are ongoing drags.
- Policy outcomes in Australia will continue to deteriorate with a minority Government, a Green-controlled Senate and a seven month election campaign. Political risk is genuine.

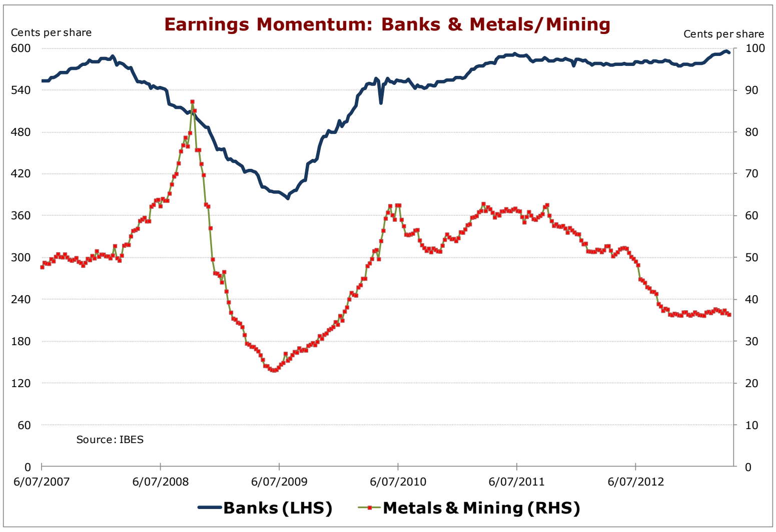
ASX200 Index Target May 2014 = 5150 - 5250

At the global level, the three core drivers of equity market performance – interest rates, profit expectations & risk appetite - remain generally supportive although the latter is clearly subject to wild fluctuations. Central banks remain generous, profit expectations – although variable across sectors - are proving relatively resilient and there should be sufficient encouraging news from ~70% of the global economy to underpin investor confidence.

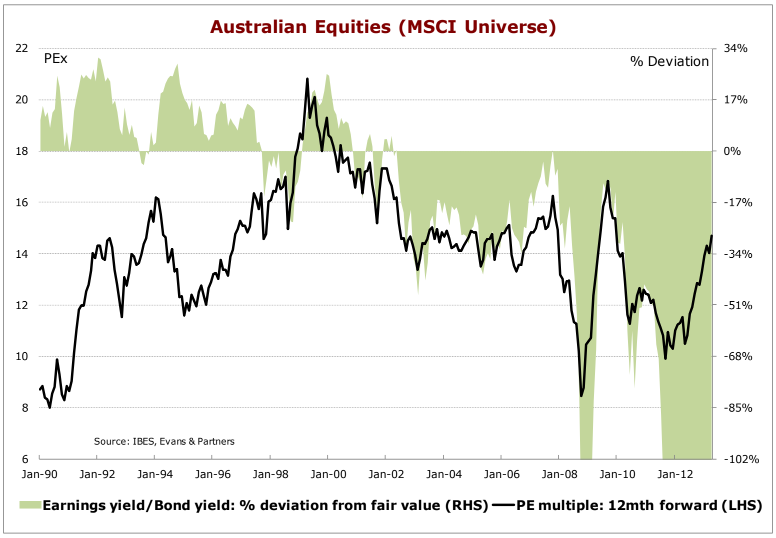
In Australia, balance sheet strength and yield provide a solid foundation but valuations are no-longer defensive. Earnings momentum is proving difficult to generate, particularly across the industrial universe which is a still burdened by cost pressures and an overvalued A$. The easing cycle from the RBA will assist on the margin, more-so if it can drag down the currency.



FY13 & 14 earnings estimates appear to have found a base but upgrades remain elusive. Mining, Energy and Utilities have been the primary sources of weakness over recent months. Healthcare and Financial Services have enjoyed upgrades. A weaker A$ remains the most likely positive catalyst for earnings in FY14.



While wholesale funding costs have improved, deposit competition remains and credit growth continues to languish. As such, the relative earnings resilience of the major banks will continue but earnings growth will be low-single digit at best. After rebounding early in the year, bulk commodity prices are again under pressure. While this was largely anticipated by the market, mining sector estimates are again trending down.



The Australian economy may be struggling but corporate financial health is robust and dividends sustainable. In the absence of positive earnings surprise, valuations are now looking expensive, particularly across the large-cap Industrials. As the cash rate declines, the marginal investor is focussing on the superior yields available across the ASX Industrials.

Portfolio Design: A few thoughts…

If the outlook for commodities/resources is truly as dire as the market now implies then Australia will be in recession by year end. This would be a function of a collapse in the terms of trade, a slump in business investment and a wave of job losses. Accordingly, if an investor wants to sell the resource majors at these levels then they should also be selling the domestic industrials (Banks, WES, WOW, TLS etc). The only 'buys' would be the A$ exposed global industrials who would be beneficiaries of material currency weakness.

To date, of course, this scenario is not evident. It has been a case of smashing the resources – particularly on a relative basis - while at the same time buying the A$ and the major domestic industrial stocks (refer Chart 1). This is a contradictory trade which we feel will be resolved, on this occasion, by a recovery in the resources stocks. This is not to suggest, however, that we are at all comfortable with valuations across the large-cap industrials.

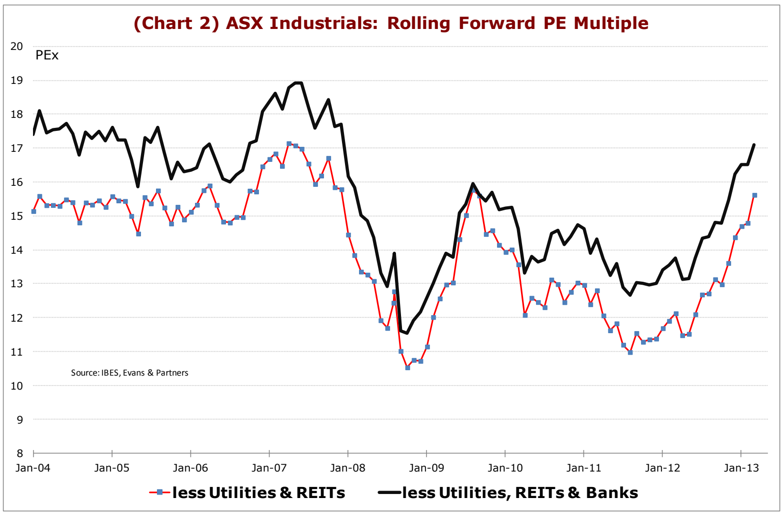
Over the past three years we have regularly discussed our view that Australia is on an intractable path to recession. Such is the fate of a narrow and increasingly uncompetitive economy with a high dependence on foreign capital. The point of maximum vulnerability is still likely to be from FY15 when the inevitable collapse in mining investment is underway. Recent news flow with respect to job losses, project cancellations and growing budget deficits, however, alongside falling commodity prices is leaving us wary that the macro pain may come sooner. In this regard, the seven month election campaign is clearly not helping. While hardly surprising, we are now receiving regular feedback that many are taking the "sitting on hands" option.

Are we being overly pessimistic?

On the plus side, the actions of the Reserve Bank are clearly having a positive effect – albeit mild. Housing activity – sales and residential construction (mores-so in NSW) – and consumer confidence has improved; the latter responding more to improving wealth rather than job security. We remain of the view that the RBA will keep easing until they see the A$ back in the low US$0.90's range.

Technically, for Australia to endure a recession post a period of monetary policy easing would probably be unprecedented. Certainly, the prospect of further rate cuts does help counter our fears that the macro pain will arrive in FY14. We are, however, very reluctant to assume – as the local equity market is now doing – that it is a given that the RBA will save us. In this regard, the policy tools that are doing the most damage are the overvalued A$ and broadening fiscal restraint – both of which are still entrenched. In addition, the fundamental cause of the recession – an uncompetitive economy exposed by falling terms of trade – is not a problem which monetary policy can directly resolve. A lower A$ would certainly assist, but the permanent solution will require structural reform (tax, labour market, regulation), productivity enhancing investment by both government and the private sector and a workforce with the relevant skills.

Our cautious view on Australia's medium term outlook has been one of the primary drivers of our strong recommendation for investors to diversify into offshore assets – particularly while the high A$ is providing such unprecedented spending power. At the asset class level, however, we are yet to explicitly embark on the logical steps one would take if you felt a recessionary environment was imminent. In the case of Australian equities this would involve aggressively reducing exposure to banks/financials – whose share prices typically halve when confronted by a recession and the accompanying issues for credit quality – and domestic-facing industrials. Portfolios would then have a large tilt in favour of defensive industrials (infrastructure, utilities – valuation permitting) and those stocks that would benefit from a weaker A$.



Forecasting of any description is inherently an error-ridden game. Accordingly, making big investment decisions purely on the back of a set of macro forecasts is a low quality/high risk strategy. Our reluctance to aggressively restructure equity portfolios at this point partly reflects this reality – we really don't know what the future will deliver.

What we do know, however, is what the market is saying about the future – this is reflected daily in the relative performance and valuation of asset classes, sectors and stocks. From this information we can tilt portfolios away from the relatively expensive in favour of the relatively cheap. History tells us that this is all that is required to protect against the unknown – if we are to endure a domestic recession in FY14 or FY15 then equity portfolios that have been managed along these lines will confront this reality in good shape. In this regard, they will now have a large exposure to offshore markets and the A$. Within Australian equity portfolios they would have spent 1H13 reducing exposure to the major industrial stocks (i.e. banks, **Woolworths, Wesfarmers**, **Telstra, Westfield** etc.) whose valuations are now stretched in both absolute and relative terms (refer Chart 2). In the absence of better ideas, this capital would have been allocated offshore or into cash.

In response to broadening valuation stress across the major domestic industrial stocks we have been taking profits and lifting the cash weighting in our discretionary portfolios. If individual stocks continue to appreciate on the back of PE multiple expansion alone, we will continue this process. If the market continues to run on the back of PE multiple expansion alone (to a point which breaches our year-ahead expectation for the ASX200 of 5150-5250) we will have to consider reducing exposure to the asset class in favour of cash.

The pundits are quick to argue that equities will continue to rise on the back of "weight of money" alone. We agree that the rotation out of low yielding cash/fixed interest into equities has barely begun – both globally and domestically – but portfolio performance is not derived from the "greater fool" theory. Overvalued cash/fixed interest markets are still a far better risk/return proposition than an overvalued equity market or stock. For an equity investor, safety or defensiveness is derived from the quality of the underlying company and its valuation, not low share price volatility.

From a portfolio design perspective we continue to maintain a low-beta bias via an exposure to both defensive and selective cyclical names. Our core themes are -

- A selective exposure to the major banks which are now all moving into expensive territory – less-so **NAB** which continues to offer a superior yield to its peers (5.7% for FY14). If valuation multiples continue to expand, we will steadily reduce exposure to the sector with **CBA** – as the most expensive – being first in line. For the sector, wholesale funding costs have eased and a more aggressive approach to costs – as reflected in **ANZ's** interim result – has underpinned cash earnings. The major long term issue, however, remains a challenging revenue environment.

  Within financial services, we favour **Computershare, ASX** and **BT Investment Management**. This is the one sector where sales volumes are genuinely depressed. As such, it offers the potential for a meaningful cyclical recovery – a fact the market is now embracing. Market turmoil through FY12 set-back the recovery in global financial activity – trading volumes, corporate activity & new issuance etc. FY13 has been brighter, but not to the point of driving upgrades (outside the valuation boost to FUM). We suspect the upgrades will come in FY14 as turnover continues to benefit from the improvement in confidence and low corporate borrowing costs and elevated PE multiples trigger a step-up in M&A activity

- A selective exposure to resources via **BHP Billiton**, **Woodside Petroleum, AWE** and **Beach Energy.** Valuations relative to the large-cap industrials are now looking attractive.

  We favour the superior commodity diversity of **BHP** to the iron-ore dominated **RIO**. Global steel production grew by 1.3% in 2012. Looking into 2013, a similar outcome is likely as stronger output in China is countered by the ongoing drag from Europe, the CIS and Japan. The structural upswing in new supply will also gather pace. After a strong start to the year, bulk commodity prices have weakened over the past month – more-so coking coal.
  The shaky foundations for the gold price have now been revealed but the ultimate test will come when US interest rates turn. In the meantime, the gold producers have been treated harshly by the market. We remain wary about the medium term outlook for the gold price but for those that aren't we prefer **Millennium Minerals** and **Doray.**

  The Australian energy sector is poised to deliver a material step-up in production over coming years. Congratulations to **Woodside Petroleum**. Mining and Energy stocks would attract broader shareholder support (i.e. a lower cost of capital) and less volatility if shareholders were confident that they would profit from the good times via high dividends. In this regard, the special dividend and 80% pay-out ratio were welcome. We put Woodside into our discretionary *Income Portfolio* last July with this scenario in mind. While reluctant to chase the stock above ~$38 (the **Shell** overhang remains) we are happy to hold and receive the ~5% fully franked dividend.

The shale gas revolution is spreading to Australia from the US. We remain comfortable holding **AWE** as it looks to quantify the resource accessible in the Perth basin and **Beach Energy** which we feel is well-placed over coming years to commercialise extensive unconventional resources in the Cooper Basin. In this regard, the farm-in deal with **Chevron** is a vote of confidence in the strategic value of this resource.

- A limited exposure to mining services. It is now clear that "cost-out" is the primary focus for the major miners in the year ahead and that contractors – particularly actual mining contractors – are under pressure as their services are by-passed to the benefit of the smaller sub-contractors. Our portfolio focus is therefore on those businesses that will benefit from the uplift in production volumes as the new mining capacity comes on stream. Prefer; **Tox Free Solutions, Aurizon Holdings, Orica.**

- An overweight exposure to healthcare, seeking organic growth and relative earnings certainty. Valuations at the moment, however, are full/expensive (less-so **Sonic Healthcare** which we are comfortable to acquire ~$13.00). Over recent months, we have been taking a little profit across our discretionary portfolios. (Prefer; **Sonic Healthcare**, **CSL, Ramsay Healthcare, Primary Healthcare**).

- A selective exposure to domestic cyclicals where structural decline, tight financial conditions or the fickle consumer have tainted many sectors. Again, valuations are full/expensive relative to FY13/14 prospects. Prefer **Woolworths, Adelaide Brighton.** We are not as confident as the market with respect to the brighter outlook for discretionary retailers. The spending power of Australian households remains under pressure from a weak job market and, in all likelihood, a range of tax increases through FY14/15.

- Yield enhancement and protection from earnings downgrades via an exposure to utilities and infrastructure. Again, valuations are full and we have been taking a little profit across our discretionary portfolios. (Prefer; **Sydney Airport**, **Envestra, AGL Energy**).

Current Opportunities

With respect to building an exposure to relatively defensive industrials, we are comfortable to buy **Envestra** at the current price.

With respect to building an exposure in the more cyclical sectors, three stocks which we are comfortable to buy at current prices – **Adelaide Brighton, Beach Petroleum, Sonic Healthcare.**

Changes to our Discretionary Portfolios: A relatively quiet month. As opportunities for reinvestment arose, we continued to trim exposure to the expensive large-cap industrials. We also participated in the equity raisings from **Envestra** and **Tox Free Solutions** to bolster existing holdings in the *Growth Portfolio*.

Evans & Partners Australian Equity Portfolios

GROWTH PORTFOLIO

BHP	BHP Billiton Limited
WBC	Westpac Banking Corporation
NAB	National Australia Bank Limited
CBA	Commonwealth Bank of Australia
NWS	News Corporation
AZJ	Aurizon Holdings Limited
ASX	ASX Limited
ENV	Envestra Limited
ABC	Adelaide Brighton Limited
WOW	Woolworths Limited
SHL	Sonic Healthcare Limited
AGK	AGL Energy Limited
CSL	CSL Limited
AIX	Australian Infrastructure Fund
BXB	Brambles Limited
RHC	Ramsay Health Care Limited
SYD	Sydney Airport
CPU	Computershare Limited
WES	Wesfarmers Limited
WPL	Woodside Petroleum Limited
TOX	Tox Free Solutions Limited
ORI	Orica Limited
BPT	Beach Energy Limited
AWE	AWE Limited
CMG	Chandler Macleod Group Limited

INCOME PORTFOLIO

WBC	Westpac Banking Corporation
NAB	National Australia Bank Limited
CBA	Commonwealth Bank of Australia
BHP	BHP Billiton Limited
IHD	iShares S&P/ASX High Dividend
ASX	ASX Limited
ABC	Adelaide Brighton Limited
TLS	Telstra Corporation Limited
WES	Wesfarmers Limited
WOW	Woolworths Limited
AIX	Australian Infrastructure Fund
SHL	Sonic Healthcare Limited
CCL	Coca-Cola Amatil Limited
AGK	AGL Energy Limited
WRT	Westfield Retail Trust
WPL	Woodside Petroleum Limited
SYD	Sydney Airport
AZJ	Aurizon Holdings Limited
SKI	Spark Infrastructure Group
BXB	Brambles Limited
CMG	Chandler Macleod Group Limited
RIO	RIO Tinto Limited

FINANCIAL SUMMARY

Growth Portfolio

	FY13	**FY14**
EPS Growth	6%	11%
PE Multiple	16.9	15.2
Dividend Yield	3.9%	4.1%

Source: Bloomberg. As at 30th April 2013

Income Portfolio

	FY13	**FY14**
EPS Growth	5%	9%
PE Multiple	14.9	13.9
Dividend Yield	4.7%	5.0%

Source: Bloomberg. As at 30th April 2013

CHANGES MADE DURING APRIL

Growth Portfolio

Removed -

Included -

Reduced exposure to -

WBC, CBA

Added exposure to -

BHP, ENV (via placement), TOX (via placement).

Income Portfolio

Removed -

Included -

Reduced exposure to -

CBA, WOW, TLS

Added exposure to -

BHP, SHL, SKI

Portfolio weights are available from your Evans & Partners Adviser

Stock Watch: *ANZ Banking Group (ANZ)*

We have upgraded our recommendation

We have upgraded our ANZ recommendation to *Neutral* (previously *Negative*) following its 1H13 results because two out of three of our key concerns are being addressed:

- Net interest margin (NIM) is stabilising.
- Costs are declining.
- Asian Institutional cash earnings appear to be turning around.

However, the reasons we have not upgraded to *Positive* are:

- We expect low single digit earnings growth through to FY15F driven by low revenue growth. 1H13 revenue declined by -0.5%.
- The strong 1H13 result was driven by one-off factors which are unlikely to be repeated, such as a 13% decline in 1H13 bad-debt impairment expense and an 8% cost decline.
- There is little reason why its ANZ's NIM should remain above its peer group. We expect ANZ will underperform the sector in NIM performance.
- As is the case with the other major banks, the stock is trading in at a premium to our blended valuation of ~$30.75.

Sector View – Feeding the Yield Hungry

We expect that ANZ's share price, like the other major banks, will continue to be supported by its dividend yield because:

- Payout ratios are still comfortable. So far in 1H13, bank payout ratios are within the 65-74% range. ANZ is at the bottom of this range, but has given guidance that going forward it will increase to a 65-70% range (refer Table below).
- Earnings are sustainable. The key earnings risk is an unexpected bad debt cycle. However, at the moment leading indicators are largely benign (apart from a rising unemployment rate). ANZ reported a 15% decline in 1H13 new impaired loans.
- Alternative yields remain low. Yield seeking investors have been supporting major banks because their yields are superior to other low-risk alternatives, such as government bonds and cash. The major bank dividend yields are still historically much higher than the competing 10-year Australian government bond yield.

We will reassess our portfolio preferences once the bank reporting season is complete. WBC reports on Friday, 3 May. NAB report on Thursday, 9 May. CBA has already reported its 1H13 results.

Dividend Payout Ratios	FY08	FY09	FY10	FY11	FY12	FY13F	FY14F
ANZ	83%	70%	63%	63%	66%	66%	67%
CBA	75%	79%	74%	73%	78%	83%	83%
NAB	81%	73%	72%	69%	74%	76%	73%
WBC	72%	74%	70%	74%	77%	75%	74%

Source: Company Reports, EAP

Stock Watch: *Sonic Healthcare (SHL)*

SONIC HEALTHCARE SHL

Year end	June	2012A	2013E	2014E	2015E
KEY FINANCIALS					
EBITDA	$m	624	648	705	776
NPAT adjusted	$m	316	330	368	421
EPS Growth	%	6.9%	3.6%	10.3%	13.6%
ROE	%	12.3%	12.4%	13.1%	14.1%
Debt/Debt+Equity	%	38%	35%	31%	27%
VALUATION METRICS					
EV/EBITDA	x	10.8	10.4	9.4	8.3
PER	x	16.4	15.9	14.4	12.7
Dividend Yield	%	4.4%	4.5%	4.8%	5.1%
Franking	%	41%	45%	40%	40%

Source: Company data, Evans & Partners Research estimates

Sonic Healthcare is the cheapest stock in the ASX200 Healthcare Index, for reasons well known by the market:

- **USA:** weak market and a litany of fee cuts.
- **Germany:** ~11% quota cuts for 2HFY13E in the statutory insurance scheme.
- **Australia:** pathology spend growth capped at 5%.

While these regulatory challenges are well known, we have seen no evidence that things have changed since the 1FY13 result. Earnings momentum remains poor and recent data points (1QCY13 result releases from listed US peers) do not suggest this is turning around.

We have produced a downside valuation scenario for Sonic Healthcare of $12.38. Under this scenario, the regulatory challenges that have beset them in the last 2 years continue across our forecast period (FY14+). Specifically, this scenario factors in:

- **Revenue:** instead of our generic 3-5%pa revenue growth assumption across these markets, we use:
  - **Australia:** Revenue growth stays ~5%pa in line with the Pathology Funding Agreement;
  - **USA:** After a difficult FY13, where US$ revenue falls 2%, we assume no growth in FY14 and only modest recovery to 2%pa from FY16; and
  - **Germany:** 11% fee quota cuts on the "EBM" statutory insurance scheme (affecting ~50% of SHL Germany's revenue) for 1HCY13 remain in place across the forecast period, partially offset by the continuation of 5%pa revenue growth in the rest of the business, producing a 2%pa revenue growth for SHL Germany

- **EBIT Margins:** instead of assuming recovery from record low FY13 margins, we assume:
  - **Australia:** 17% margin continues through the forecast period with no improvement.
  - **USA:** 15% continues through the forecast period.
  - **Germany:** 15% continues through the forecast period.

In our view, this scenario represents a quite bearish outcome in that it assumes:

- **Internal initiatives fail:** no success for SHL's management initiatives in terms of procurement savings, operational enhancements and infrastructure rationalisation across any of these markets;

- **Australia:** no benefit from the upcoming review into collection centre rental arrangements investigating whether there has been rorting in this industry leading to excessive and unjustified costs;

- **USA – no benefit from ObamaCare:** the introduction of ObamaCare in CY14 (up to 30m people added to the US health insured base) sees no improvement in Pathology volumes above current estimates for industry volume growth of 2-3%pa;

- **USA – no market share gain:** despite being the smallest national operator, SHL sees no improvement in market share; and

- **Germany:** the 11% quota cuts applying to 1HFY13 continue indefinitely and are never reversed.

We would therefore regard SHL shares as good buying below $13.00 to the extent it factors in such a negative outcome.

Stock Watch: *News Corporation (NWS)*

We see the upcoming News Corporation company separation as a catalyst for value realisation & multiple expansion in the US media & entertainment assets held within '21st Century Fox'. We believe that '21st Century Fox' could re-rate higher and trade closer to the EV multiple of its media & entertainment peers.

At this point (pending the release of more detail) we value the NWS group post-separation using a sum-of-the-parts valuation approach, at A$33.70/share (21st Century Fox A$29.16 & the new News Corporation A$4.54).

'21st Century Fox' - New media & entertainment company, hosting News Corporation's i) Cable Network Programming business, ii) Filmed Entertainment, iii) Television, iv) Direct Broadcast Satellite Television, and vi) BSkyB & other Pay TV investments outside of Australia.

'The new News Corporation' will be the global publishing & information services company, comprised of businesses across i) News & Information Services, ii) Cable Network Programming (Fox Sports Aus.), iii) Digital Real Estate (REA 61.6%), iv) Book Publishing, v) Other - Education & vi) FOXTEL (50%).

- The new 'News Corporation' will be well capitalised with an estimated cash balance of US$2.6bn and no debt. This provides the business with ample firepower to make further acquisitions.

21st Century Fox

Division	EBIT 14e	EBIT (x) Low	EBIT (x) High	Total Low	Total High
Fox Film & TV Production	1,129	8.0	9.0	9,029	10,157
Fox TV & Broadcasting	872	8.0	9.0	6,972	7,844
Cable (Consolidated)	4,586	10.5	11.5	48,148	52,733
Direct Broadcast Satellite	60	7.5	8.5	449	509
Other	(354)	4.0	6.0	(1,418)	(2,126)
TOTAL OPERATING VALUE (US$m)	**6,291**			**63,180**	**69,117**
Associates - BSkyB & Other				12,581	12,581
Minority Adjustment				(4,058)	(4,058)
GROSS BUSINESS VALUE (US$m)				**75,761**	**81,697**
Net Debt - 31/12/2012 (Including $675m from SKY TV sale)				(10,576)	(10,576)
NET SHAREHOLDER VALUE				**65,185**	**71,121**
TOTAL ADR's (diluted m @ 30/6/12)				2,247	2,247
NET VALUE/ADR (US$)				US$29.00	US$31.65
NET VALUE/SHARE (A$)				A$27.89	A$30.43
Average Val'n (US$):				US$30.33	
A$/US$ - 12m fwd:				$1.040	
Average Val'n (A$):				**$29.16**	

Source: Company Data, Evans & Partners Research Estimates

New News Corporation

Division	EBIT 14e	EBIT (x) Low	EBIT (x) High	Total Low	Total High
News & Information Services	416	6.0	7.0	2,497	2,913
Cable Network Programming	128	8.5	9.5	1,091	1,220
Book Publishing	80	5.5	6.5	440	520
Education	(120)	1.0	1.0	(120)	(120)
Other (Corporate)	(180)	6.0	8.0	(1,080)	(1,440)
TOTAL OPERATING VALUE (US$m)	**324**			**2,828**	**3,092**
REA Group Investment (fully consolidated) @ Market Value				4,098	4,098
Foxtel (50%)				3,405	3,405
GROSS BUSINESS VALUE (US$m)				**10,331**	**10,596**
Estimated Net Cash Position (US$m)				2,600	2,600
Minority Interest (REA, 38.4% not owned)				(1,573)	(1,573)
News Of The World (Potential Liability)				(369)	(369)
Potential Publishing Restructuring Liabilities				(500)	(500)
NET SHAREHOLDER VALUE				10,488	10,753
TOTAL ADR's (diluted m @ 30/6/12)				2,247	2,247
NET VALUE/ADR (US$)				US$4.67	US$4.78
NET VALUE/SHARE (A$)				**A$4.49**	**A$4.60**
Average Val'n (US$):				US$4.73	
A$/US$ - 12m fwd:				$1.040	
Average Val'n (A$):				**$4.54**	

Source: Evans & Partners Research Estimates

News Corporation (pre-demerger) is trading at 8.9x FY14 EV/EBIT (adjusted earnings multiples excluding associate values & earnings), a discount to global peers. NWS continues to trade at a EV/EBITDA discount of 10-15% compared to both **Walt Disney** & **Time Warner**.

The pending company split and removal of publishing exposure may provide '21st Century Fox' with the catalyst to re-rate inline, if not higher than global peers given:

- '21st Century Fox' earnings base would comprise of 76% content creation & aggregation, and 24% Free & Pay TV distribution. Both Walt Disney & Time Warner maintain capital intensive businesses (parks & resorts and publishing respectively).

Cable Growth & Valuation Uplift: News Corporation's Cable operations underpin group earnings growth and are estimated to make up ~70% of group EBIT by FY14, up from ~60% in FY12. Both Domestic and International cable operations are supported by positive growth outlooks including 1) favourable affiliate fee renegotiations (Regional Sports/Fox News Networks), 2) the launch of a national sports channel, 'Fox Sports 1', and 3) increasing pay TV penetration and greater scale across emerging markets.

Our valuation uplift is largely driven by an increase in the valuation multiple we apply to the cable business (from 10x to 11x). Our logic underpinned by the **Discovery Communications** multiple expansion from 11.5x to 12.9x over the past 12 months. Every 1.0x increase in our average cable multiple assumption, will add ~US$4.6bn to gross business value to 21st Century Fox, or ~$2/share from A$29.16 to A$31.12**. We maintain our Positive recommendation.**

Stock Watch: *Woolworths (WOW)*

In Woolworths latest quarterly sales result there was considerable speculation around the performance of *Masters* (Home Improving business) with suggestions it was grossly underperforming.

In our *"The Big Questions for Woolworths"* dated April 24, 2013 we analysed 3Q13 sales result in terms of the underlying annualised sales performance for *Masters*.

These are the key points from our research:

- We don't think it's in the disaster category and it is still too premature to make any firm judgments on *Masters* but on our very rough estimates it still has a long way to go. However, we are yet to see a big marketing push and stores probably take up to three years to really hit their straps.

- Established stores (open for more than 12 months) are probably not doing quite enough at this stage to achieve breakeven, perhaps $22-23m p.a.

On very rough estimates *Masters* will need to achieve well in excess of $22m for each mature store to generate an adequate return. At $25m per average store (current dollars) returns appear adequate particularly if the store base gets to 125+ (scenarios 5 & 8 in the table below). At $28m annualised revenue, returns are very attractive based on our assumptions (scenarios 3, 6 & 9).

MASTERS SCENARIOS	1	2	3	4	5	6	7	8	9
Store Base	75	75	75	125	125	125	150	150	150
Annualised Sales Per Store Post Year 1	22	25	28	22	25	28	22	25	28
Masters Revenues	1,650	1,875	2,100	2,750	3,125	3,500	3,300	3,750	4,200
Gross Margin @ 33%	545	619	693	908	1,031	1,155	1,089	1,238	1,386
CODB @ $6.0m per store	450	450	450	750	750	750	900	900	900
Overheads	100	100	100	150	150	150	175	175	175
EBIT - $m	**-6**	**69**	**143**	**8**	**131**	**255**	**14**	**163**	**311**
EBIT Margin - %	**-0.3%**	**3.7%**	**6.8%**	**0.3%**	**4.2%**	**7.3%**	**0.4%**	**4.3%**	**7.4%**

What if *Masters* does not work?

In our valuation, we do not place any value on the Home Improvement business other than the capital invested to date into *Masters*.

If we assume *Masters* fails and Woolworths need to write down the estimated capital invested in the business of ~$1.5bn (including Lowe's 33% share) the impact would be a ~$1.30 or ~4.0% decrease to our valuation.

However, the upside for Woolworths if *Masters* is half as successful as *Bunnings* could add in excess of ~$2.0 to our valuation.

The impact of *Masters* is relatively small in the overall scheme of things. Woolworths' high quality Food & Liquor business accounts for over 85% of the overall business.

Valuation and Recommendation: We maintain our **Positive** recommendation with a $35.24 blended valuation as:

- WOW's strong franchise should continue to grow share,

- less development expenditure or increased property sales should provide capital management flexibility,

- we expect valuation risk to continue to be on the upside for this high quality business.

Woolworths Earnings Forecasts & Ratios @ $36.24

Yr to June	12A	13E	14E	15E
EBITDA ($m)	4273	4520	4774	5091
Rep NPAT ($m)	1817	2253	2504	2697
Adj NPAT ($m)	2237	2348	2504	2697
EPS (¢)	183	190	202	217
EPS Gth (%)	4.8	3.6	6.3	7.7
PER (x)	19.8	19.1	17.9	16.7
PEG Ratio (x)	4.1	2.8		
DPS (¢)	126	135	142	154
Yield (%)	3.5	3.7	3.9	4.2
Franking (%)	100%	100%	100%	100%
ROE (%)	22.0%	22.0%	22.0%	22.0%
EV/EBITDA (x)	11.4	10.6	10.0	9.3
Net Debt/EBITDA (x)	0.9	0.7	0.6	0.5
Int. Cover (x)	11.9	13.3	15.6	18.9
Valuation (blended)				**$35.24**

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