

# Morningstar™ Equities Research Daily Roundup

## 18 February 2013

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## Today's Research

ASX Code	Company Name	Previous Recommendation	New Recommendation	Reason
MHI-NZ	Michael Hill International	Hold	Hold	
ANZ	ANZ Bank	Accumulate	Accumulate	
CQR	Charter Hall Retail	Hold	Hold	
DUE	DUET	Reduce	Reduce	
MIN	Mineral Resources	Sell	▲ Reduce	
RIO	Rio Tinto	Accumulate	Accumulate	

## Research Highlights

### Michael Hill International MHI-NZ | 1.220

First half results in line, second quarter soft

**Recommendation: Hold**

#### Event

MHI reported first half results that were in line with our forecasts. Underlying NPAT increased 5.9% to NZD 27.9 million on revenue growth of 8.7%

EBITDA increased 4% but underlying margins dropped 60 basis points to 13.6%.

the Australian division was the standout achieving 12% growth in operating earnings reflecting reasonably strong same store sales (SSS) growth and new store rollouts.

Dividends increased by 25% to 2.5 cents per share (cps) and signals management's confidence in the firm's future cash flows

#### Impact

Consumer spending has started to pick up in NZ due to a buoyant housing market. On the other hand consumer spending in Australia continues to remain challenging. However, the recent cuts to interest rates instituted by the RBA might revive consumer confidence.

We maintain our FY13 and FY14 forecasts of NZD 39.6 million and NZD 42.7 million respectively and our fair value of NZD 1.05 per share.

### ANZ Bank ANZ | 27.77

1Q13 profits in line: on track for an impressive

FY13

**Recommendation: Accumulate**

#### Event

No major surprises in the three months to 31 December 2012 (1Q13) with the unaudited cash NPAT increasing an impressive 6.3% to \$1.53 billion from \$1.44 billion in 1Q12. Net interest margin (NIM) is not quantified, but management noted a flat outcome relative to September 2012. We estimate 1Q13 NIM around 2.28% and inline with our full year expectations.

#### Impact

The Asian growth strategy is gaining momentum with good volume growth and the Australian franchise continues to efficiently manage costs and margins. Our positive view is intact but constrained revenue growth and flat margins demonstrate challenges of soft

economic conditions in Australia and New Zealand in calendar 2012.

There are no changes to our FY13 NPAT forecast of \$6.4 billion, but we increase medium term earnings forecasts due to an improved outlook for margins.

Despite the constrained revenue growth in the quarter we see no threat to our dividend forecast, underscoring our major bank thesis. We believe the major banks are reliable sources of attractive fully franked dividends despite market and economic challenges. The differentiated super-regional growth strategy is on track and we are confident ANZ management is capable of delivering. We remain upbeat on the bank's medium-to long-term prospects.

### Charter Hall Retail CQR | 3.88

1H13 result: Larger sub-regional outperforms neighbourhood centres

**Recommendation: Hold**

#### Event

CQR's first half 2013 operating profit of \$45.9m, with earnings per security up 6% on the prior corresponding period (pcp). Key drivers were rent increases and incremental income from recent developments and acquisitions. A 13.3 cent distribution was declared, up on the 13.0 cents in the pcp.

Full year reaffirmed guidance for operating earnings of 29.5 to 30.0 cents per unit, with a distribution payout of 85%-95%, giving a wide full year distribution range of between 25 and 28.5 cents.

#### Impact

We believe CQR has a solid foundation for ongoing income growth underpinned by the 53% of annual base rent sources from Woolworths and Wesfarmers tenants. The balance of income is derived from specialty tenants, with a weighting towards non-discretionary food and service based offerings.

We revise our forecasts to incorporate a full divestment of CQR's Polish and German assets by June 2015, with expected proceeds before transaction costs expected to match current market values of \$109m and \$233m respectively. As these assets are highly leveraged, cash inflows before transaction costs will be around \$50m, but overall group gearing will decrease from the current 38.7% to around 31%.

There was largely no movement in the value of the \$1.6bn of Australian assets, but we believe lower borrowing costs support a contraction in the capitalisation rates used to value these assets over the next 12 months. Our fair value estimate increases by 10% to \$3.90, due to a solid outlook for income growth and a reduction in our weighed average cost of capital to 9.0%.

## Research Highlights

### DUET DUE | 2.18

#### 1H13: Another soft result

##### Recommendation: Reduce

##### Event

DUET reported another soft underlying result in first half fiscal 2013. While revenue and EBITDA increased modestly, the higher share count and other factors saw proportionate 'cash EPS' fall 9% to 9.3 cents per security (cps).

The Dampier to Bunbury Pipeline (DBP) recorded flat gas transportation revenue of \$213m. United Energy was the best performer with revenue increasing 6% to \$220m as tariffs increased to compensate for expansion.

Multinet Gas performed relatively well though earnings were depressed by transition costs relating to in-housing management. Multinet faces major near-term headwinds from the current regulatory reset, which takes effect from early 2013.

Financial leverage (net debt/RAB) increased from 76.7% to 77.5% (after balance date). The fact that the share count and leverage are rising while profit is broadly flat is a signal that distribution guidance for 3% growth per annum over the medium term is not sustainable longer term.

##### Impact

Our estimate of earnings eased 4% to \$46m and EPS fell 11% to 4.1 cps. The result is tracking modestly below our full year expectations, which downgrade marginally.

Our fair value estimate is unchanged. We continue to believe DUET is overvalued.

### Mineral Resources MIN | 10.86

#### Iron ore weighs on solid crushing growth

##### Recommendation: Reduce

##### Event

Mineral Resources reported an underlying AUD 63 million net profit for the first half of fiscal 2013, 30% below the underlying net profit in the prior half. The fall was attributed to iron ore price weakness despite mining services and iron ore production growth. As usual, operational and financial details were scant. Iron ore production increased 13% to 2.5 million tonnes but no cash cost, grade, realised pricing, resource or reserve information was provided. There is insufficient disclosure to understand the financial performance of the iron ore and contracting segments.

##### Impact

The mining services business appears to be performing well and increased profit before tax by AUD 50 million. Based upon the limited information provided, we estimate iron ore production was loss making and that mining service margins were greater than our forecast. Iron ore price strength should improve earnings in the second half as will the new crushing and screening contracts. We update our model for higher crushing margins and stronger second half iron ore earnings which increases our fiscal 2013 net profit forecast by 19% to AUD 141 million. Higher long term crushing margin forecasts increase our fair value estimate by 16% to AUD 7.50 per share.

### Rio Tinto RIO | 70.15

#### Walsh's Fighting Words Light on Detail

##### Recommendation: Accumulate

##### Event

Underlying 2012 profit fell 40% to USD 9.3 billion in line with our recently downgraded forecast and consensus. Earnings per share fell 38% to USD 5.02. Iron ore's dominance again featured with USD 14.3 billion EBIT, higher than the overall group's USD 13.4 billion, despite falling 29% due to lower prices. That bizarre outcome reflects losses in aluminium even though a considerable portion is excised in the Pacific Aluminium departure lounge. Pacific Aluminium houses Rio's Australian aluminium assets ready for divestment. The portion being retained managed break-even at best. The copper division recorded a 43% decline in EBIT to USD 2.0 billion in line with expectations, softer copper prices detracting.

While there were no operational surprises dividends did surprise on the upside, the full year increasing 15% to USD 1.67 per share on a 33% payout. This backs up a Sam Walsh pledge to "[balance] capital returns to shareholders and capital expenditure". The new CEO has moved quickly to stamp his style on Rio. He targets USD 5 billion in cumulative cash cost savings by 2014, a reduction in capital expenditure to USD 13 billion in 2013 versus 2012's USD 17.5 billion, and a 40% decline in exploration spending to USD 1.2 billion in 2013. Rio's operating costs in 2012 were USD 31 billion.

##### Impact

Our fair value estimate remains AUD 95 per share. Our 2013 earnings forecast is AUD 6.76 per share, up 39% on 2012 with higher iron ore and copper volumes and, we hope, recovering aluminium prices. Our 2014 forecast is AUD 7.23 per share, more modest growth assuming an even more robust recovery in aluminium.

Walsh now carries the weight of expectation for a Rio rejuvenation. The bar is set high and scrutiny will be exacting. Dividends will be paid on April 11, shares trade ex-entitlements on March 6.

## News Digest

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- 08:42 PDN **Paladin Energy Reports Net Loss of US\$193.5m for the Half Year to 31 December 2012****  
 Paladin Energy reported a net loss of US\$193.5m for the half-year ended 31 December 2012. Revenues from ordinary activities were US\$195.5m, up 13% from the same period last year. Basic and Diluted EPS was (23.1) US cents compared to (14.9) US cents last year. The net operating cash inflow was US\$49.3m compared to an outflow of US\$78.0m in the pcp. No dividend was declared. The company also reported record half year combined production of 4.120Mlb U3O8, an increase of 34% over the December 2011 half year achieving 97% of nameplate production for the half year. FY2013 production guidance of 8.0-8.5Mlb U3O8 remains on target.
- 16:07 AMC **Amcor Announces US\$114.8m Acquisition of AGI-Shorewood Tobacco Packaging Operations****  
 Amcor announced that it has agreed to acquire select printing assets of AGI-Shorewood's Tobacco Packaging and Specialty Folding Carton Operations for US\$114.8m. The acquired business has plants or assets in each of South Korea, USA, Mexico and China. The acquisition excludes the AGI-Shorewood plant in Smiths Falls, Canada. For the 2012 calendar year the acquired business had sales of US\$126.0m and EBITDA of US\$22.0m. The EBITDA purchase multiple is 5.2 times based on the last 12 months of earnings. Net synergy benefits are anticipated to be approximately US\$13.0m and the net cash cost to achieve these synergies is expected to be approximately US\$20.0m. The acquisition is expected to deliver a return on investment of more than 20% by the end of year three.
- 14:24 IAU **Intrepid Mines Responds to ASX Price Query, No New Information****  
 Intrepid Mines responded to an ASX share price query stating that it is not aware of any information which, if known, could be an explanation for the recent trading in its securities. The company confirmed that it is in compliance with the ASX listing rules.
- 14:02 PRU **Perseus Mining Announces Half Year Results, Provides Production Guidance****  
 Perseus Mining announced a NPAT of \$32.497m or 6.16 cents per share for the six-month period ended 31 December 2012, representing a return on funds employed of 7.6%. The increase is attributable to the Edikan gold mine being in commercial production in the current period whereas it was in commissioning during the previous period. Revenue of \$147.065m was earned from the sale of 98,865oz of gold at an average sale price during the period of US\$1,520/oz. The company also reported that the forecast of gold production for the second half of the fiscal year ending 30 June 2013 has been modified from previously announced levels to 105,000oz to 125,000oz resulting in a forecast full financial year production range of 208,700 to 228,700oz. This is due to the impact of the crusher downtime on the availability of mill feed and therefore gold production during the March 2013 quarter.
- 13:54 AQA **Aquila Resources Provides Update on Settlement - Belvedere Hard Coking Coal Project****  
 Aquila Resources referred to its announcement dated 1 February 2013 regarding completion of the option exercised by Vale Belvedere, a wholly-owned subsidiary of Vale S.A., to acquire the 24.5% venture interest in the Belvedere Coal JV (Belvedere) held by BD Coal, a wholly-owned subsidiary of the company, and the settlement of all legal proceedings and disputes in relation to Belvedere for an aggregate of \$170m. The company confirmed that the parties have now received all relevant indicative approvals under the Qld Mineral Resources Act for the transfer of BD Coal's venture interest in Belvedere to Vale and the agreement between the parties is now unconditional. Completion is expected to occur in late February 2013.
- 11:45 BRU **Buru Energy Provides Operations Update****  
 Buru Energy provided an update on its exploration program and operations at the Ungani Field production test. Highlights

## News Digest

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include: strong continued production performance at Ungani Field with initial data gathering phase close to completion with production logging and field shut-in planned; currently drilling Yulleroo 4 appraisal well targeting the major upside in the Basin Centred Gas System (BCGS) in the Yulleroo area; Cyrene 1 well coring high potential Goldwyer Shale with strong oil and gas shows; and Laurel Basin Centred Gas System evaluation by RISC identifies at least 47 TCF of gas net to the company in the regional Laurel Formation BCGS, including over 6 TCF in the Yulleroo regional area.

### 10:20 APN **APN News and Media Trading Halted, Pending Company Announcement**

The securities of APN News and Media will be placed in trading halt session state, at the request of the company, until the earlier of the commencement of normal trading on Tuesday, 19 February 2013 or when the announcement is released to the market.

### 09:51 SGM **Sims Metal Management Announces UK Investigation Findings and Goodwill Impairment**

Sims Metal Management announced on 21 January 2013 that the board had established a special committee to investigate inventory valuation issues in the company's UK business. The committee has determined that a write-down of inventory of \$78m will be required, versus a preliminary assessment of circa \$60m. The write-down adjustment has been independently verified by the company's external auditor PricewaterhouseCoopers. \$16m of the inventory write-down will impact first half Fiscal 2013 results, and the balance will be reflected in the restatement of prior period results.

### 09:46 LNC **Linc Energy Announces Oil and Gas Division Results for Second Quarter 2013**

Linc Energy announced its second quarter 2013 financial results for its wholly-owned subsidiary Linc Energy Resources, Inc. (LER). LER is the head entity of the company's Oil and Gas Group headquartered in Houston, Texas. For the three months ended 31 December 2012, LER's total revenues were US\$26.2m, which were comprised of US\$26.2m of oil revenues and US\$7,200 of gas revenues. During the quarter, LER sold 257,012 barrels of oil and 3,727 Mcf of natural gas net to its revenue interest, with daily sales averaging 3,784 gross (2,800 net) BOEPD for the period (99% oil). The average sales price was US\$101.75 per Bbl of oil and US\$1.93 per Mcf of natural gas, amounting to an average sales price for the quarter of US\$101.53 per BOE or US\$100.78 per BOE including the effect of hedges.

### 09:38 BDR **Beadell Resources Provides Tucano Update**

Beadell Resources provided an update on recent progress of the newly commissioned 100%-owned Tucano CIL Gold Plant in Brazil, reporting that in spite of anticipated heavy wet season rainfall in January and February 2013, the earthmoving fleet has exceeded expectations and is consistently above budget for tonnes moved, and at lower cost. Total material moved at ~US\$2.10 per tonne for the year to date is significantly below the expected costs during ramp up. Further productivity and cost improvements are expected over the ensuing months with the arrival of additional new earthmoving equipment. CIL Gold Plant throughput has accelerated rapidly and is presently close to an annualised rate of 4 million dry tonnes per annum, 14% over the 3.5Mtpa nameplate capacity and within two months of commissioning.

### 10:41 DUE **DUET Group Reports Net Loss of \$46.6m for the Half Year to 31 December 2012**

DUET Group reported a net loss of \$46.6m for the half-year ended 31 December 2012. Revenues from ordinary activities were \$641.1m, up 6.7% from the same period last year. Basic and Diluted EPS was (1.28) cents compared to 8.52 cents last year. Net operating cash flow was \$307.81m compared to \$371.28m last year. The interim dividend declared was 8.250 cents compared with 8.000 cents last year.

### 09:06 CQR **Charter Hall Retail REIT Reports NPAT of \$15.8m for the Half Year to 31 December 2012**

## News Digest

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Charter Hall Retail REIT reported NPAT of \$15.8m for the half-year ended 31 December 2012. Revenues from ordinary activities were \$93.5m, up 17% from the same period last year. Basic and Diluted EPS was 5.08 cents compared to (5.24) cents last year. Net operating cash flow was \$38.3m compared to \$42.0m last year. The interim dividend declared was 13.30 cents compared with 13.00 cents last year.

### **08:52 BKN Bradken Announces Appendix 3C Buy Back**

Bradken announced an on-market buy-back of the number of new shares issued under the company's dividend reinvestment plan (DRP), to offset the dilution from new shares issued under the DRP. The period of the buy-back is unlimited.

### **08:49 WDC Westfield Group Announces Changes Relating to Buy Back - Appendix 3D**

Westfield Group provided an Appendix 3D announcing changes relating to its buy-back. The company reported that it now intends to buy back up to 149.94m shares, as part of the extension of the time frame under which the group will undertake the buy-back. The group intends to complete the on-market buy-back within 12 months from 15 February 2013.

### **08:58 ANZ ANZ Banking Group Provides Trading Update for 3 Months to 31 December 2012**

ANZ Banking Group announced an unaudited cash profit for the three months to 31 December 2012 of \$1.53bn, up 6.2% on the same period in 2012 (first quarter 2012: \$1.49bn). Unaudited statutory profit after tax was \$1.36bn. Revenue growth reflected the constrained business environment. Reasonable volume growth, particularly in Asia, was offset by margin pressure in NZ and in the International and Institutional Banking division. The group's APRA Basel III CET1 ratio at 31 December 2012 was 7.7% which equates to 9.7% on a fully harmonised basis, unchanged from the 2012 full year. Payment of the final 2012 dividend had a 30 basis point impact towards the end of the quarter. The group had completed circa 50% of the 2013 full year term wholesale funding task by the end of December 2012.

## Dividends Declared and Payable

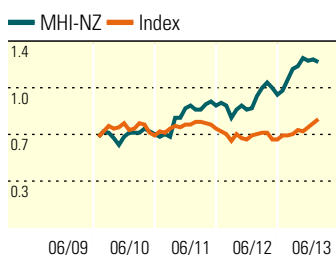
ASX Code	Company Name	Ex Dividend Date	Dividend Pay Date	Amount	Franking%
BLD	Boral	19 Feb, 13	25 Mar, 13	5.00	100.00
CPU	Computershare	19 Feb, 13	19 Mar, 13	14.00	20.00
DMP	Domino's Pizza Enterprises	19 Feb, 13	12 Mar, 13	15.50	100.00
SAI	SAI Global	19 Feb, 13	27 Mar, 13	6.80	100.00
WES	Wesfarmers	19 Feb, 13	28 Mar, 13	77.00	100.00
OZL	OZ Minerals	20 Feb, 13	12 Mar, 13	20.00	0.00
ANN	Ansell	21 Feb, 13	20 Mar, 13	16.00	0.00
COH	Cochlear	21 Feb, 13	12 Mar, 13	125.00	40.00
KOV	Korvest	21 Feb, 13	13 Mar, 13	26.00	100.00
MCR	Mincor Resources	21 Feb, 13	22 Mar, 13	2.00	100.00
AGKHA	FRN 08-JUN-39	22 Feb, 13	08 Mar, 13	167.00	
EAX	Energy Action	22 Feb, 13	14 Mar, 13	0.00	0.00
CKL	Colorpak	25 Feb, 13	02 Apr, 13	1.75	100.00
NVT	Navitas	25 Feb, 13	15 Mar, 13	9.30	100.00
WOR	WorleyParsons	25 Feb, 13	22 Mar, 13	41.50	100.00
XVGHA	LN 09-DEC-13	25 Feb, 13	09 Mar, 13	0.00	
CTN	Contango Microcap	28 Feb, 13	22 Mar, 13	3.80	20.00
CWNHA	UNSEC.FRN 14-SEP-72	28 Feb, 13	14 Mar, 13	201.00	
ELI	Emerging Leaders Investment	28 Feb, 13	15 Mar, 13	3.50	100.00
REA	REA Group	28 Feb, 13	20 Mar, 13	16.00	100.00
SKI	Spark Infrastructure	28 Feb, 13	15 Mar, 13	0.00	0.00
AKG	Academies Australasia Group	01 Mar, 13	15 Apr, 13	2.50	100.00
BENHA	BOND 17-MAR-14	01 Mar, 13	15 Mar, 13	108.00	
CTXHA	UNSEC.FRN 15-SEP-37	01 Mar, 13	15 Mar, 13	187.40	
IANG	PERP.RESET EXCH.NOTE	01 Mar, 13	15 Mar, 13	119.82	
NCK	Nick Scali	01 Mar, 13	28 Mar, 13	6.00	100.00
XVGZI	6.50% LN 15-MAR-33	01 Mar, 13	15 Mar, 13	3,250.00	
AMM	Amcom Telecommunications	04 Mar, 13	28 Mar, 13	2.00	100.00
CLH	Collection House	04 Mar, 13	05 Apr, 13	3.60	100.00
NABHB	UNSEC.NOTE 18-JUN-22	04 Mar, 13	18 Mar, 13	144.90	
ANZHA	FRN 20-JUN-22	05 Mar, 13	20 Mar, 13	145.48	
CSL	CSL	05 Mar, 13	05 Apr, 13	48.66	0.00
HBSHB	BOND 20-JUN-17	05 Mar, 13	20 Mar, 13	178.77	
MYBG	SUB.NOTE 20-DEC-17	05 Mar, 13	20 Mar, 13	250.00	
CCP	Credit Corp Group	06 Mar, 13	22 Mar, 13	20.00	100.00
NWS	News Corp	06 Mar, 13	17 Apr, 13	0.00	0.00
NWSLV	News Corporation	06 Mar, 13	17 Apr, 13	0.00	0.00
RIO	Rio Tinto	06 Mar, 13	11 Apr, 13	0.00	0.00
XQLQY	3.50% LN 21-SEP-17	06 Mar, 13	21 Mar, 13	175.00	
LEI	Leighton	07 Mar, 13	28 Mar, 13	60.00	50.00
NST	Northern Star Resources	07 Mar, 13	04 Apr, 13	1.00	100.00
ORGHA	FRN 22-DEC-71	07 Mar, 13	22 Mar, 13	172.00	
TAHHB	UNSEC.FRN 22-MAR-37	07 Mar, 13	22 Mar, 13	172.00	
XQLQH	6.0% LN 14-SEP-17	07 Mar, 13	14 Mar, 13	300.00	
XQLQI	6.5% LN 14-MAR-33	07 Mar, 13	14 Mar, 13	325.00	
CCV	Cash Converters International	08 Mar, 13	29 Mar, 13	2.00	100.00
DOW	Downer EDI	08 Mar, 13	15 Apr, 13	10.00	70.00
FXL	FlexiGroup	08 Mar, 13	18 Apr, 13	7.00	100.00
NBL	Noni B	08 Mar, 13	27 Mar, 13	2.50	100.00
XCLWK	5.25% LN 15-MAR-19	08 Mar, 13	15 Mar, 13	262.50	
DWS	DWS	13 Mar, 13	04 Apr, 13	5.50	100.00
HLNG	11.25% CN 17-JUN-16	13 Mar, 13	27 Mar, 13	281.25	
RWH	Royal Wolf	13 Mar, 13	03 Apr, 13	4.50	0.00
XCLWP	3.00% LN 20-SEP-25	13 Mar, 13	20 Mar, 13	75.00	
XCLWV	2.50% LN 20-SEP-30	13 Mar, 13	20 Mar, 13	62.50	
DVAG	11% CN 30-SEP-14	14 Mar, 13	28 Mar, 13	0.61	
PRYHA	BOND 28-SEP-15	14 Mar, 13	28 Mar, 13	175.00	

# Michael Hill International Limited MHI-NZ

## Snapshot

Business Risk	Medium
Price Risk	Medium
Moat Rating	None
Fair Value \$	1.05
Market Cap \$Mil	467
Morningstar Style Box	
Last Price \$	1.22
52 Week High/Low \$	1.26/0.88
Shares Issued Mil	383
Sector	GICS - Retailing

## Price vs. Market



	06/11	06/12	06/13e	06/14e
NPAT (\$Mil)	34.5	36.5	39.6	42.7
EPS ¢	9.0	9.5	10.3	11.1
EPS Chg %	29.9	5.8	8.4	7.9
DPS ¢	4.0	4.0	5.0	5.0
Franked %	0.0	0.0	0.0	0.0
Div Yld %	4.9	4.3	4.1	4.1
P/E x	9.1	9.8	11.8	11.0

Source: Morningstar analyst estimates.

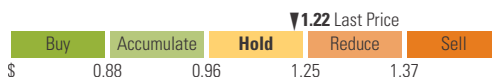
## Business Description

Michael Hill International (MHI-NZ) is a retail jewellery chain with 237 stores between Australia, New Zealand, Canada and the US. MHI employs over 2,000 full and part time staff in retailing, manufacturing and administration and has approximately 3,500 shareholders.

## First half results in line, second quarter soft

Analyst Recommendation: **Hold**

17 February 2013



► We maintain our FY13 and FY14 forecasts of NZD 39.6 million and NZD 42.7 million respectively and our fair value of NZD 1.05 per share.

## Investment Rating

MHI is a high quality jewellery retailer with a strong position in the Australasian market. Store expansion in Australia and Canada offers good long term growth potential offsetting the more mature New Zealand market. MHI is not immune to cyclicalities exacerbated by the discretionary nature of jewellery retailing. The stock generally tends to under perform during periods of rapidly rising gold and diamond prices. MHI would suit patient investors with a higher appetite for risk.

## Recommendation Impact

No change.

## Event

- MHI reported first half results that were in line with our forecasts. Underlying NPAT increased 5.9% to NZD 27.9 million on revenue growth of 8.7%
- EBITDA increased 4% but underlying margins dropped 60 basis points to 13.6%.
- the Australian division was the standout achieving 12% growth in operating earnings reflecting reasonably strong same store sales (SSS) growth and new store rollouts.
- Dividends increased by 25% to 2.5 cents per share (cps) and signals management's confidence in the firm's future cash flows

## Impact

- Consumer spending has started to pick up in NZ due to a buoyant housing market. On the other hand consumer spending in Australia continues to remain challenging. However, the recent cuts to interest rates instituted by the RBA might revive consumer confidence.



# Michael Hill International Limited MHI-NZ

**Nachi Moghe**

Morningstar Analyst

## Analyst Note

### Good all round performance

MHI reported first half results that were in line with our forecasts. Underlying NPAT increased 5.9% to NZD 27.9 million on revenue growth of 8.7%. EBITDA increased 4% but underlying margins dropped 60 basis points to 13.6%. We attribute this to significantly higher unallocated expenses which increased from NZD 11.2 million to NZD 14.4 million. The company's margins were higher across all geographies with New Zealand delivering record high margins of 20.5%. In terms of growth, the Australian division was the standout achieving 12% growth in operating earnings reflecting reasonably strong same store sales (SSS) growth and new store rollouts. Australia is the firm's largest market accounting for 73% of operating earnings and has good long term prospects. We expect growth momentum to continue with 10-15 new store rollouts per annum. In the US, MHI is taking a measured approach, so the cautiousness is understandable. In a low but stable economic growth, we expect losses in the US to decrease overtime as sales leverage translates into higher margins.

Operating cash flow reduced from NZD 46.8 million to NZD 28.2 million reflecting higher inventory, receivables and miscellaneous items offset to some extent by payables and cash obtained from the Professional Care Plan. We think the weaker than expected second quarter performance resulted in the company carrying higher inventories than otherwise might have been the case. Nonetheless dividends increased by 25% to 2.5 cents per share (cps) and signals management's confidence in the firm's future cash flows. However there are two outstanding issues involving the NZ and Australian tax departments which could potentially dent the firm's cash flows somewhat in the future. In the case of NZ, the disputed amount is NZD 21.2 million after tax, while the magnitude of the Australian dispute is unknown. The company is trying to reach an agreement with both the tax departments but if unsuccessful would seek legal recourse to resolve the matter. However there is no certainty that MHI would win the case in which case it would be liable for taxes in one or both countries. MHI has not made any provisions for this liability and does believe it needs to be provided for.

While the second quarter performance was lacklustre, overall sales increased in all geographies in the first half on a constant currency SSS basis due to a relatively strong first quarter. Consumer spending has started to pick up in NZ due to a buoyant housing market. On the other hand consumer spending in Australia continues to remain challenging. However, the interest rate cuts instituted in the recent past might revive consumer confidence. MHI continues to pursue growth opportunities in Australia and Canada through new store openings. We maintain our FY13 and FY14 forecasts of NZD 39.6 million and NZD 42.7 million respectively and our fair value of NZD 1.05 per share.

The company's core Australian business (73% of PBT) delivered constant current SSS growth of 4.2%, reflecting easier base period comparisons (SSS fell 1.5% in the previous corresponding period). Consumer spending continues to remain subdued because of lacklustre economic activity outside of the mining industry. The company added seven new stores in Australia taking the total store count to 160. Consequently overall revenues grew by 10.8% in local currency terms but 9% in NZD's due to the depreciation of the AUD against the NZD. Operating margins increased from 16.6% to 17.2% as a result of stronger sales.

New Zealand continued to do well under current economic circumstances. SSS increase 3% in the first half on the back of a whopping 9.2% growth in the same period last year. We think MHI managed to gain share and was able to attract customers with an improved product offering. Operating margins increased from 20% to 20.5% as a result of higher sales. One new store was closed in NZ giving a total of 52 stores as at 31 Dec 2012.

MHI's Canadian business continues to see strong top line growth due to new store additions. Overall revenues grew 21.6% in local currency terms as MHI added five new stores to take the total number of stores to 42. This is just 10 below its NZ operations. Canadian SSS grew 3.9% during the period and operating margins increased slightly to 5.1%. We think in the long term Canada could be potentially as big as the Australian business is now due to the size of the population. However we are a bit disappointed that after being in Canada for so long

## Michael Hill International Limited MHI-NZ

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### Nachi Moghe

Morningstar Analyst

the company's operating margins at 5% continues to be well below that of Australia and New Zealand. We think more work needs to be done on the cost front to get margins closer to MHI's two big markets. Also, margins will gradually improve as the company achieves scale.

The US segment's operating loss decreased from USD 1.43 million to USD 1.27 million driven by good sale leverage underscored by a respectable 4.2% growth in SSS. The company continues to emphasis on top line growth and margin enhancement in the nine US stores currently in operation. We don't envisage MHI to expand anytime soon until existing stores achieve profitability.

Sales for the Professional Care Plan (PCP) were NZD 18.1 million (pcp 14.4 million). Sales brought forward to the profit and loss account amounted to NZD 5.06 million (pcp 1.47 million). Deferred revenue carried on the balance sheet increased to NZD 44.5 million from NZD 24.3 million. PCP sales are brought to revenue in the profit and loss account (from the balance sheet) over the life of the plans in proportion to the expected cost of meeting commitments under the PCP's. The commitments are an estimate based on the firm's own experience and overseas research. The PCP provides an import source of cash flow for the firm.

# Michael Hill International Limited MHI-NZ

## Bulls Points

- ▶ MHI has a strong management team that has demonstrated over the long term their potential to remain profitable while continuing to expand in adverse economic and industry conditions.
- ▶ The company's brand holds tremendous value within Australasia, with its products being widely recognised as good quality.
- ▶ Vertical integration allows MHI to create their own designs, keep a close eye on quality, cut costs and advertise the brand all at the same time.
- ▶ A centralised marketing, buying and distribution centre based in Brisbane has led to a streamlining of operations, giving the company quick efficient decision-making abilities.

## Bears Points

- ▶ Jewellery retailing remains highly cyclical so earnings can often be unpredictable.
- ▶ MHI is a price-taker. When buying in inventory, their overheads are at the mercy of fluctuating global prices.
- ▶ Because of the company's geographical spread it faces foreign exchange risk when converting back to NZD.
- ▶ Questions still remain regarding the business in Canada and the US. The Canadian operations are just break-even and the US may be exited.

## Key Valuation Assumptions

Cost of Equity %	11.5
Weighted Avg Cost of Capital %	11.1
Long Run Tax Rate %	13.1
Stage II EBI Growth Rate %	2.5
Stage II Investment Rate %	14.4
Perpetuity Year	6.0

## Offshore expansion to continue

**Thesis** Last Updated: 17 Feb 2013

MHI is a jewellery retailer and manufacturer with operations in New Zealand (52 stores), Australia (146 stores), Canada (33 stores) and the US (9 stores). MHI holds a dominant industry position within Australasia and is hoping for similar success in Canada and the US. Scale, branding and cost-cutting abilities support the company's position and performance in Australasia. Near-term industry profitability is pressured by the economic climate and fierce competition.

Being a cyclical, growth-oriented company, MHI may prove volatile at times but is well managed and positioned in Australasia. The management team has demonstrated over the long term that they can remain profitable and continue to expand in adverse conditions. The strength of the management team was also recognised with chairman Michael Hill winning the 2008 Ernst & Young Entrepreneur of the Year award.

MHI benefits from vertical integration. Although the company is involved with end retailing it also manufactures its own products. In fact, the company's manufacturing plant in Brisbane is the largest jewellery manufacturing plant in Australasia. This has given MHI greater control over designs, quality, operating costs and advertising. The centralised marketing, buying and distribution centre, also in Brisbane, has streamlined operations and lifted flexibility.

There are various risks. The cyclical nature of the industry will keep earnings volatile. The company's input costs (gold, silver and diamonds) remain at the mercy of global markets. Increased competition from internet and in-store outlets could potentially lead to reduced profits. Foreign exchange risk also affects the business and this will only get more pronounced as the company pursues more opportunities offshore. The Canadian and US expansions still remain questionable - these highly-fragmented and competitive markets are proving difficult.

MHI has a strong record of producing returns on capital above the cost of capital, meaning the business consistently creates value for shareholders. MHI's ROE has also been outstanding over the long term. Nevertheless, the company's free cash flow generation is very volatile as inventory management

can be difficult given changeable customer demand, fluctuating global prices for inputs and foreign exchange movements. Therefore, shrewd inventory and cash management remains a critical component in the success of the business during difficult times.

Within New Zealand the business has reached maturity. Offshore growth, particularly in Australia and Canada, will be the main focus. Revenue growth is expected to remain in the mid to high single-digit range.

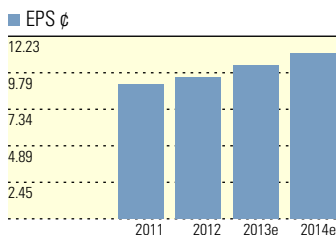
The underlying business is strong within Australasia. A strong brand, scale-related efficiencies, streamlined operations and vertical integration all combine to give MHI a solid foundation for the future. We see MHI's stock as a high to medium-risk investment, which would suit a long-term, growth-oriented investor.

**Valuation** Last Updated: 22 Aug 2011

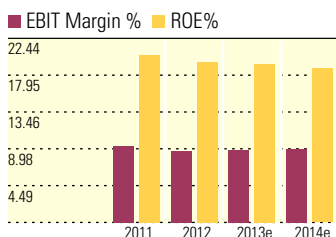
Based on our DCF model, our fair value for MHI increases 8 cents to NZ\$1.05 and our recommendation is to Accumulate. Our model assumes a WACC of 11% and a terminal growth rate of 2.5%. Our fair value equates to an FY12 P/E ratio of 11.2x and an FY13 P/E ratio of 10.3x. Over the medium term, ROE and ROIC are expected to remain at very satisfactory levels with ROE at ~18% and ROIC at ~21% - far exceeding the cost of capital.

# Michael Hill International Limited MHI-NZ

## EPS



## EBIT Margin vs. ROE



## Risk Last Updated: 16 Feb 2012

Being a discretionary cyclical retailer, MHI is susceptible to economic downturns. During these times the company may have to resort to deep discounting, leading to reduced margins. The volatility of input prices is also a risk. Global prices for gold and diamonds have a considerable impact on profitability and inventory levels. Therefore, inventory management remains a top priority for the company as it has been historically erratic. Additionally, MHI's geographic spread means the business faces foreign exchange risks when converting profits back to NZD.

Expansion into the US is a risky endeavour. The US market is highly fragmented and competitive, so establishing the business there may be unsuccessful. We have seen this firsthand with MHI closing 8 of its 17 stores. The Canadian business has also been disappointing with the company expecting it to be more profitable at this stage of its development. Lastly, given the highly-competitive nature of retailing MHI is at risk of other firms acquiring market share. The company must continually adjust to contemporary trends to remain competitive.

## Financial Overview

### Growth

We anticipate revenue growth to stay strong (8-9% over the next five years) as offshore expansion continues to fuel sales. This expansion is assumed to be generated from new store rollouts, with 20 new stores expected for FY12, 21 for FY13 and 21 for FY14.

### Profitability

MHI's ROIC, ~21%, is assumed to remain above its WACC, meaning the company will continue to produce value for shareholders. MHI's ROE is expected to remain above 18% for the next five years. Margins will still be under pressure over the medium-term with adverse economic conditions and competition providing significant headwinds.

### Financial Health

MHI has no problem with its debts, interest coverage stands at 7.9x and gearing is low at 17%. The working capital ratio is 3.3:1, which is very good.

## Strategy Analysis Last Updated: 16 Feb 2012

MHI's current strategy is to continue the adaptation and development of the "Michael Hill" brand. Management has identified branding as their main catalyst through which to continue controlled and profitable growth. This strategy has already been exemplified by the company's changes to marketing, store designs, stock displays, stock ranges and websites. Also, in pursuit of greater margins MHI has started to focus more on higher priced diamond jewellery, rather than gold and silver products. This manoeuvre is expected to boost same store revenues and generate higher margins.

Additionally, the company has held a long-term strategy of wanting to establish 1,000 stores worldwide within 20 years. They expect this store growth, at least in the short to mid-term, to come from Australia and Canada, with management seeing the potential for 120+ stores across Canada. In keeping with this strategy, MHI has furthered its geographic spread with a push into Eastern Canada where they have established a separate retail management team.

Recently, the company has not made any additional comment on this long-term strategy and has reduced its enthusiastic outlook. Canadian store expectations are now ~100, while the 1000 stores expectation has been hushed. Anticipated store rollouts for FY12, FY13 and FY14 have also been reduced from earlier forecasts.

# General Financials

Financials	Historical			Forecast		
	06/10	06/11	06/12	06/13	06/14	06/15
<b>Per Share</b>						
Sales ¢	115.8	127.7	133.3	141.3	149.8	158.8
Adjusted Earnings ¢	6.9	9.0	9.5	10.3	11.1	11.5
Free Cash Flow ¢	2.9	11.9	13.3	1.5	8.0	8.3
Net Tangible Assets ¢	41.7	46.4	50.6	56.2	62.3	68.8
Book Value ¢	41.7	46.5	50.6	56.2	62.3	68.8
Dividends ¢	4.0	4.0	4.0	5.0	5.0	5.0
Franking %	0.0	0.0	0.0	0.0	0.0	0.0
<b>Growth %</b>						
Sales Revenue	7.7	10.4	4.4	6.0	6.0	6.0
EBITDA	31.5	23.0	-0.4	7.4	7.0	4.0
Pre-Tax Profit	53.4	29.3	5.1	8.3	7.9	3.6
EPS	67.6	29.9	5.8	8.4	7.9	3.5
DPS	60.0	0.0	0.0	25.0	0.0	0.0
Free Cash Flow per share	-	315.4	11.6	-88.8	440.3	3.4
<b>Profit &amp; Loss (\$Mil)</b>						
Sales Revenue	443.7	489.9	511.5	542.2	574.7	609.2
EBITDA	46.6	57.3	57.0	61.2	65.5	68.1
Depreciation	9.9	11.3	12.3	13.1	13.9	14.7
Amortisation	0.2	0.1	0.0	0.0	0.0	0.0
EBIT	36.5	45.8	44.6	48.1	51.7	53.4
Interest Expense	5.6	5.8	4.1	4.1	4.1	4.1
Interest Income	0.0	0.0	1.5	1.5	1.5	1.5
Profit Before Tax	30.9	40.0	42.0	45.5	49.1	50.9
Tax	4.4	5.5	5.5	6.0	6.5	6.7
Reported NPAT	26.5	34.5	36.5	39.6	42.7	44.2
Non-Recurring Items After Tax	0.0	0.0	0.0	0.0	0.0	0.0
<b>Adjusted NPAT</b>	<b>26.5</b>	<b>34.5</b>	<b>36.5</b>	<b>39.6</b>	<b>42.7</b>	<b>44.2</b>
Free Cash Flow	11.0	45.6	50.9	5.7	30.9	31.9
Effective Tax Rate %	14.2	13.7	13.1	13.1	13.1	13.1
<b>Cash Flow (\$Mil)</b>						
Receipts from Customers	0.0	0.0	0.0	541.5	574.0	608.4
Payments to Suppliers	0.0	0.0	0.0	-475.1	-506.1	-536.6
Other Operating Cashflow	0.0	0.0	0.0	-44.9	-20.2	-23.1
<b>Net Operating Cashflow</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>21.5</b>	<b>47.7</b>	<b>48.7</b>
Capex	-10.3	-14.0	-18.1	-18.0	-19.0	-19.0
Acquisitions & Investments	0.0	0.0	0.0	0.0	0.0	0.0
Sales of Investments & Subsidiaries	0.3	0.2	0.2	0.0	0.0	0.0
Other Investing Cashflow	0.0	0.0	0.0	0.0	0.0	0.0
<b>Net Investing Cashflow</b>	<b>-10.1</b>	<b>-13.9</b>	<b>-17.9</b>	<b>-18.0</b>	<b>-19.0</b>	<b>-19.0</b>
Proceeds from Issues	0.0	0.0	0.1	0.0	0.0	0.0
Proceeds from Borrowings	-8.3	-12.0	-11.5	19.0	-2.1	-9.0
Dividends Paid	-11.5	-15.3	-19.1	-18.2	-19.2	-19.2
Other Financing Cashflow	0.0	0.1	0.0	0.0	0.0	0.0
<b>Net Financing Cashflow</b>	<b>-19.8</b>	<b>-27.2</b>	<b>-30.6</b>	<b>0.8</b>	<b>-21.3</b>	<b>-28.1</b>
Net Increase Cash	-29.8	-41.0	-48.5	4.3	7.3	1.6
Cash at Beginning	23.5	6.3	8.5	12.1	16.4	23.7
Exchange Rate Adjustment	12.6	43.3	52.0	0.0	0.0	0.0
Cash at End	6.3	8.5	12.1	16.4	23.7	25.3

# General Financials

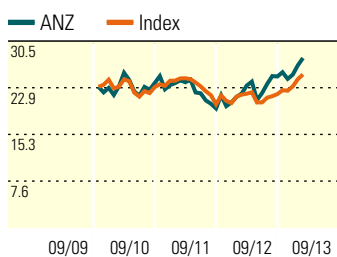
Financials	Historical			Forecast		
	06/10	06/11	06/12	06/13	06/14	06/15
<b>Balance Sheet (\$Mil)</b>						
Cash & Equivalents	6.3	8.5	12.1	16.4	23.7	25.3
Accounts Receivable	5.5	8.6	11.8	12.6	13.3	14.1
Inventory	150.9	173.1	187.0	198.0	209.2	223.1
Other Short-Term Operating Assets	3.3	0.0	0.0	0.0	0.0	0.0
<b>Total Current Assets</b>	<b>165.9</b>	<b>190.1</b>	<b>210.9</b>	<b>227.0</b>	<b>246.3</b>	<b>262.5</b>
Property Plant & Equipment, Net	34.9	42.2	47.1	52.0	57.2	61.5
Goodwill, Net	0.0	0.0	0.0	0.0	0.0	0.0
Other Intangibles	0.3	0.2	0.1	0.0	0.0	0.0
Other Long-Term Operating Assets	0.0	0.0	1.4	1.4	1.4	1.4
Deferred Tax Assets	57.8	60.6	64.1	64.1	64.1	64.1
Long-Term Non-Operating Assets	0.0	0.0	0.0	0.0	0.0	0.0
<b>Total Assets</b>	<b>258.8</b>	<b>293.1</b>	<b>323.6</b>	<b>344.5</b>	<b>369.0</b>	<b>389.5</b>
Accounts Payable	43.8	51.4	51.3	57.2	60.3	64.8
Short-Term Debt	0.0	0.0	0.0	0.0	0.0	0.0
Other Short-Term Operating Liabilities	2.2	5.8	17.5	17.5	17.5	17.5
<b>Total Current Liabilities</b>	<b>46.0</b>	<b>57.2</b>	<b>68.8</b>	<b>74.7</b>	<b>77.8</b>	<b>82.3</b>
<b>Total Long-Term Debt</b>	<b>51.7</b>	<b>45.4</b>	<b>33.1</b>	<b>52.1</b>	<b>49.9</b>	<b>41.0</b>
Long-Term Operating Liabilities	1.2	1.4	2.1	2.1	2.1	2.1
Deferred Tax Liabilities	0.0	10.7	25.4	0.0	0.0	0.0
Long-Term Non-Operating Liabilities	0.0	0.0	0.0	0.0	0.0	0.0
<b>Total Liabilities</b>	<b>98.9</b>	<b>114.7</b>	<b>129.3</b>	<b>128.8</b>	<b>129.8</b>	<b>125.4</b>
Preferred Stock	0.0	0.0	0.0	0.0	0.0	0.0
Minority Interest	0.0	0.0	0.0	0.0	0.0	0.0
<b>Total Equity</b>	<b>159.9</b>	<b>178.4</b>	<b>194.4</b>	<b>215.7</b>	<b>239.2</b>	<b>264.2</b>
<b>Profitability %</b>						
EBITDA Margin	10.5	11.7	11.1	11.3	11.4	11.2
EBIT Margin	8.2	9.4	8.7	8.9	9.0	8.8
Net Profit Margin	6.0	7.0	7.1	7.3	7.4	7.2
Free Cash Flow Margin	2.5	9.3	10.0	1.1	5.4	5.2
Return on Equity	17.1	20.4	19.6	19.3	18.8	17.6
Return on Assets	10.4	12.5	11.8	11.8	12.0	11.7
Return on Invested Capital(w/Goodwill)	22.6	30.6	27.4	8.5	21.8	21.0
ROIC (w/Goodwill) Less WACC	11.5	19.5	16.3	-2.6	10.6	9.9
<b>Leverage &amp; Liquidity</b>						
Net Debt to Capital %	21.5	16.5	9.2	13.3	9.1	5.1
Net Debt/(Net Debt + Equity) %	22.1	17.1	9.8	14.2	9.9	5.6
Net Debt/Equity %	28.4	20.7	10.8	16.6	11.0	5.9
Net Debt/EBITDA x	1.0	0.6	0.4	0.6	0.4	0.2
EBIT/Net Interest Expense x	6.6	7.9	17.4	18.8	20.2	20.9
Current Ratio (Current Assets/Current Liabilities) x	3.6	3.3	3.1	3.0	3.2	3.2
Dividend Payout Ratio %	57.8	44.5	42.1	48.5	45.0	43.4
Net Cash Per Share ¢	-11.9	-9.6	-5.5	-9.3	-6.8	-4.1
<b>Valuation</b>						
Price/Earnings x	9.9	9.1	9.8	11.8	11.0	10.6
PEG Ratio x	0.1	0.3	1.7	1.4	1.4	3.0
EV/EBITDA x	6.6	6.1	6.7	8.0	7.5	7.2
EV/EBIT x	8.5	7.6	8.5	10.2	9.5	9.2
Free Cash Flow Yield %	4.2	14.6	14.2	1.2	6.6	6.8
Dividend Yield %	5.8	4.9	4.3	4.1	4.1	4.1
Price/(OCF per share) x	20.7	7.2	6.9	21.8	9.8	9.6
Price/(FCF per share) x	24.0	6.9	7.1	81.9	15.2	14.7
Price/Sales x	0.6	0.6	0.7	0.9	0.8	0.8
Price/NTA x	1.7	1.8	1.8	2.2	2.0	1.8
Price/Book x	1.6	1.8	1.8	2.2	2.0	1.8

# Australia & New Zealand Banking Group Ltd ANZ

## Snapshot

Business Risk	Medium
Price Risk	Medium
Moat Rating	Narrow
Fair Value \$	32.00
Market Cap \$Mil	76,190
Morningstar Style Box	
Last Price \$	27.77
52 Week High/Low \$	28.25/20.26
Shares Issued Mil	2,744
Sector	GICS - Banks

## Price vs. Market



	09/11	09/12	09/13e	09/14e
NPAT (\$Mil)	5,652.0	6,011.0	6,420.3	6,820.7
EPS ¢	218.4	225.3	235.8	245.5
EPS Chg %	17.2	3.1	4.7	4.1
DPS ¢	140.0	145.0	153.0	160.0
Franked %	100.0	100.0	100.0	100.0
Div Yld %	6.2	6.6	5.5	5.8
P/E x	10.3	9.8	11.8	11.3

Source: Morningstar analyst estimates.

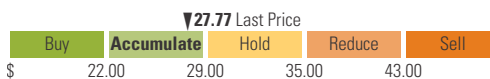
## Business Description

ANZ Banking Group Ltd (ANZ) provides a range of banking and financial products and services to retail, small business, corporate and institutional clients. The Group conducts its operations primarily in Australia and New Zealand and the Asia Pacific region. It also operates in a number of other countries including the United Kingdom and the United States.

## 1Q13 profits in line: on track for an impressive FY13

Analyst Recommendation: **Accumulate**

15 February 2013



## Investment Rating

ANZ is a major bank operating retail and business banking franchises in Australia, New Zealand, Asia, the Pacific, Europe and America. ANZ aims for superior long-term growth and differentiated returns from its 'super-regional' strategy of capturing banking and fee-based business associated with trade flows between these countries and regions. This is a creative response to challenging conditions in Australian banking and we think it will succeed. The risks for shareholders include management overreach leading to inadequate risk control, underpricing for risk due to thin interest margins, higher capital levels, disappointments on cost efficiency, and economic downturns and financial crises in Asia. The stock is recommended for long-term risk tolerant portfolios.

## Event

► No major surprises in the three months to 31 December 2012 (1Q13) with the unaudited cash NPAT increasing an impressive 6.3% to \$1.53 billion from \$1.44 billion in 1Q12. Net interest margin (NIM) is not quantified, but management noted a flat outcome relative to September 2012. We estimate 1Q13 NIM around 2.28% and inline with our full year expectations.

## Impact

► The Asian growth strategy is gaining momentum with good volume growth and the Australian franchise continues to efficiently manage costs and margins. Our positive view is intact but constrained revenue growth and flat margins demonstrate challenges of soft economic conditions in Australia

and New Zealand in calendar 2012.

► There are no changes to our FY13 NPAT forecast of \$6.4 billion, but we increase medium term earnings forecasts due to an improved outlook for margins.

► Despite the constrained revenue growth in the quarter we see no threat to our dividend forecast, underscoring our major bank thesis. We believe the major banks are reliable sources of attractive fully franked dividends despite market and economic challenges. The differentiated super-regional growth strategy is on track and we are confident ANZ management is capable of delivering. We remain upbeat on the bank's medium-to long-term prospects.

## Recommendation Impact

We increase our fair value estimate from \$31.00 to \$32.00 and maintain our moderate earnings per share growth outlook.

# Australia & New Zealand Banking Group Ltd ANZ

David Ellis

Morningstar Analyst

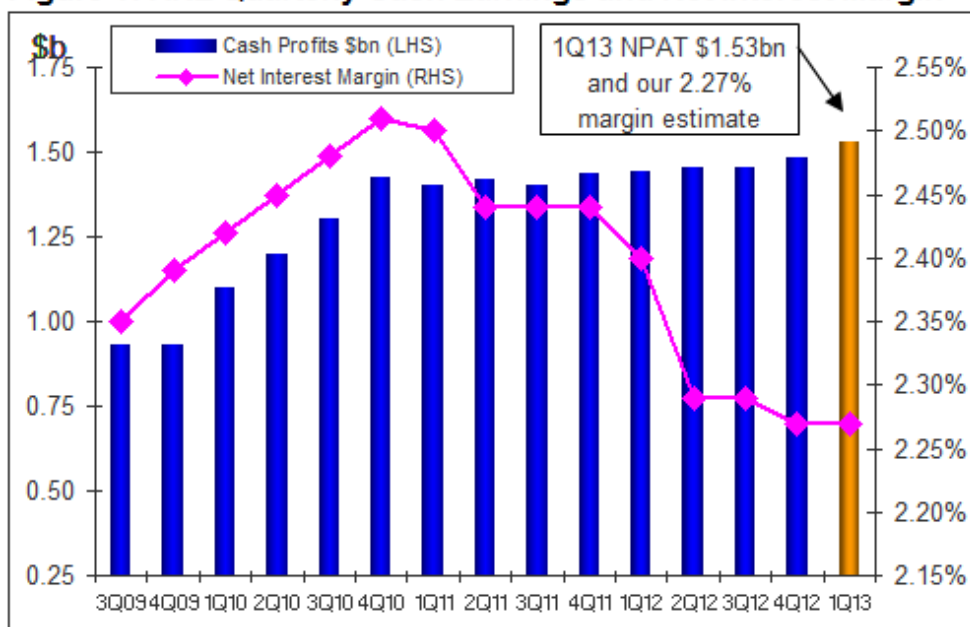
## Analyst Note

### First quarter cash profits in line: on track for an impressive FY13

No major surprises in the three months to 31 December 2012 (1Q13) with the unaudited cash NPAT increasing an impressive 6.3% to \$1.53 billion from \$1.44 billion in 1Q12. First quarter earnings improved 3.4% on our \$1.48 billion estimate for 4Q12. The Asian growth strategy is gaining momentum with good volume growth and the Australian franchise continues to efficiently manage costs and margins. Our positive view is intact but constrained revenue growth and flat margins demonstrate challenges of soft economic conditions in Australia and New Zealand in calendar 2012. Net interest margin (NIM) is not quantified, but management noted a flat outcome relative to September 2012. We estimate 1Q13 NIM around 2.28% and inline with our full year expectations.

There are no changes to our FY13 NPAT forecast of \$6.4 billion, but we increase medium term earnings forecasts due to an improved outlook for margins. We increase our fair value estimate from \$31.00 to \$32.00 and maintain our moderate earnings per share growth outlook. Despite the constrained revenue growth in the quarter we see no threat to our dividend forecast, underscoring our major bank thesis. We believe the major banks are reliable sources of attractive fully franked dividends despite market and economic challenges. The differentiated super-regional growth strategy is on track and we are confident ANZ management is capable of delivering. We remain upbeat on the bank's medium-to long-term prospects.

**Figure 1: ANZ Quarterly Cash Earnings and Net Interest Margin**



Source: ANZ Presentations/Morningstar estimates

Bad debts of \$311 million are better than expected due to seasonal differences, with full year FY13 bad debt guidance maintained (up 10% on FY12). Asset quality improved significantly – this is a big positive with impaired assets down 6% and loans 90 days past due declining 4%. No reference to ROE but we expect no change from the 15.2% reported in 2H12. Capital levels remain strong and the 12% increase in deposits far outweighed the 7.6% uplift in loans. Funding pressure remains, but we expect solid margins and improved revenue growth to deliver a full year profit around \$6.4 billion and we maintain our number one ranking for this narrow-moat bank.



# Australia & New Zealand Banking Group Ltd ANZ

David Ellis

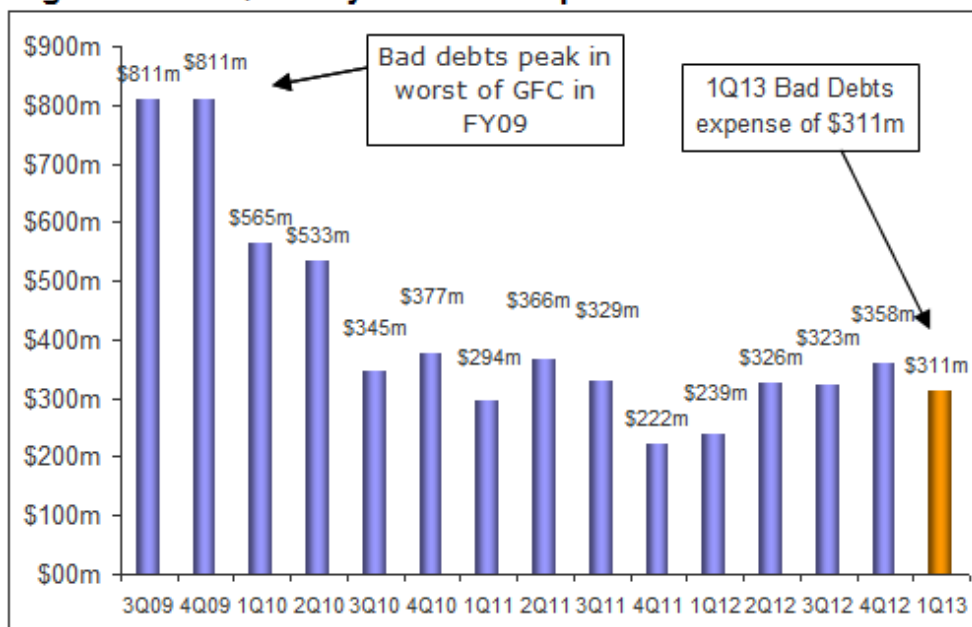
Morningstar Analyst

**Table 1: APRA Banking Statistics - Home Loan Growth**

31-Dec-12	12mth Mvt	6mth Mvt	3mth Mvt
SUN	12.8%	5.9%	3.3%
ANZ	6.4%	1.7%	1.6%
BEN	6.1%	2.8%	1.2%
BOQ	5.6%	1.8%	1.0%
CBA Group	3.7%	1.5%	0.9%
NAB	7.7%	3.5%	1.9%
OTHER	5.1%	1.5%	1.1%
WBC Group	3.6%	1.8%	1.1%
Bank Total	5.2%	2.1%	1.3%
Annualised	5.2%	4.2%	5.2%

Source: APRA Banking Statistics/Morningstar

Importantly, we expect income growth to exceed cost growth over FY13, with the cost-to-income ratio set to improve further. Costs declined slightly in 1Q13 and continued focus on tight cost management will lift productivity. This is a key source of earnings growth and needs to accelerate to catch up to best-in-peer group Westpac (WBC).

**Figure 2: ANZ Quarterly Bad Debt Expense**

Source: ANZ Presentations/Morningstar

Strong growth in non-interest income is a highlight, with Global Markets income up 26% to \$544 million for the quarter. The Asian businesses contributed significantly to the strong customer sales result. We expect more revenue growth in Global Markets due to higher fee income from inter-regional trade flows and increased

# Australia & New Zealand Banking Group Ltd ANZ

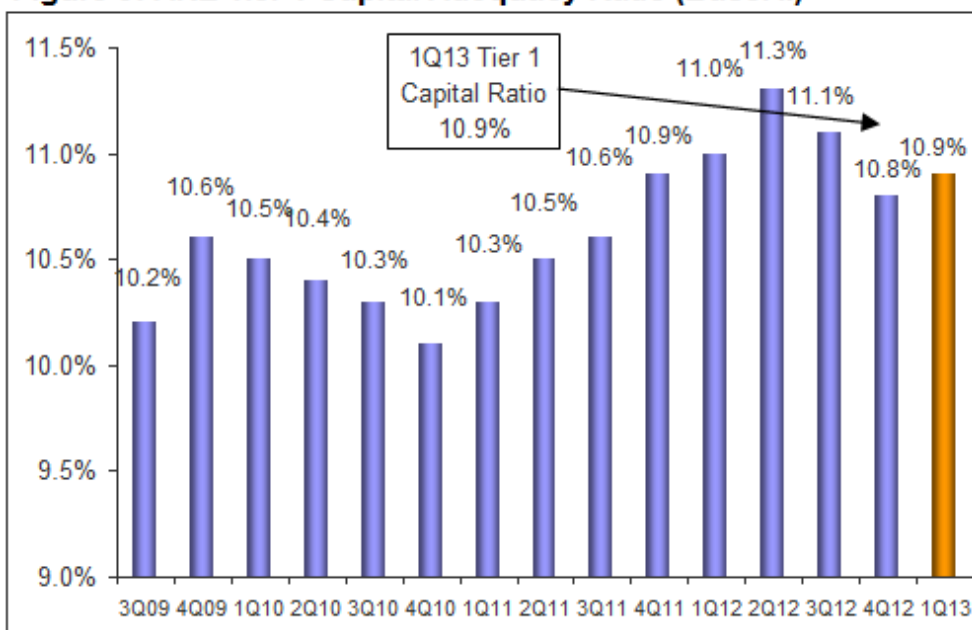
David Ellis

Morningstar Analyst

customer sales and servicing transactions, particularly in ANZ's Asian operations.

The conservative 65% dividend payout ratio for FY13 is confirmed, but remains well below major bank peers currently in the 70-75% range. Capital ratios declined slightly in the quarter due to the payment of the FY12 final dividend with the APRA Basel III Common Equity Tier 1 (CET1) ratio down from 8.0% at 30 September to 7.7% at 31 December. ANZ's CET1 ratio of 7.7% comfortably exceeds the 7.0% minimum requirement. The organic capital growth trailed somewhat due to further investment in the Asian growth strategy and solid loan growth. Funding remains under control with loan growth more than fully funded by deposit growth and about 50% of the FY13 term wholesale funding task of \$21 billion already completed.

**Figure 3: ANZ Tier 1 Capital Adequacy Ratio (Basel II)**



Source: ANZ Presentations/Morningstar

Net interest margins are expected to remain steady around the 2.28% reported in 2H12 despite loan repricing in the second half of calendar 2012. Lower interest rates impact deposit mix with an increasing number of customers switching into lower margin products. Lower margins on customer deposits and capital are concerning, but management noted some improvement since the start of calendar 2013. There is margin upside if the recent improvement in wholesale funding costs continues through 2013 and into 2014.

Credit quality improved with impaired assets declining 6% since September 2012 with the collective provision as a proportion of credit risk weighted assets steady at 1.08%. No change to our full year loan impairment expense forecast of \$1.4 billion, in line with guidance of a 10% increase on FY12. Despite low total system credit growth in Australia of less than 4% in the year to 31 December 2012, ANZ's residential loan book increased 6.4% and commercial lending up a slower 3%. Retail deposits increased 12.4% outperforming the 8.9% growth in retail deposits for the banking system.

# Australia & New Zealand Banking Group Ltd ANZ

David Ellis

Morningstar Analyst

**Table 2: APRA Banking Stats. - Household Deposit Growth**

31-Dec-12	12mth Mvt	6mth Mvt	3mth Mvt
SUN	6.2%	1.9%	-1.8%
ANZ	12.4%	7.1%	3.1%
BEN	6.8%	5.9%	2.6%
BOQ	1.0%	0.5%	1.0%
CBA Group	7.4%	5.3%	2.2%
NAB	12.7%	6.9%	2.0%
OTHER	1.7%	-0.7%	-0.6%
WBC Group	10.9%	8.0%	3.8%
Bank Total	8.9%	5.6%	2.3%
Annualised Growth	8.9%	11.3%	9.0%

Source: APRA Monthly Banking  
Statistics/Morningstar

# Australia & New Zealand Banking Group Ltd ANZ

## Bulls Points

- ▶ Net interest margins are higher than peers.
- ▶ Bad debts could surprise with further improvement in credit quality.
- ▶ The super-regional strategy will produce strong earnings growth to make up for the subdued growth available in the Australian banking system.
- ▶ There are signs of an improvement in Australian business lending. If this extends it should advantage ANZ, which has an above-average exposure to business banking.

## Bears Points

- ▶ Australian credit growth is soft, exerting pressure on ANZ's net interest income growth. The banking system will not return to pre-GFC growth rates any time soon.
- ▶ The super-regional strategy requires substantial upfront investment in banking infrastructure. This will restrain regional earnings growth until ANZ can drive faster banking and fee income.
- ▶ Expansion into Asia increases US\$ exposure. A\$ appreciation dampens the translation into A\$, the reporting currency, of earnings growth in Asia.
- ▶ The normalisation of bad debt expense from GFC highs removes a convenient source of earnings growth at a time when little top line growth is available in Australia.

## Key Valuation Assumptions

Weighted Avg Cost of Equity %	10.3
Long Run Tax Rate %	28.0
Stage II Growth Rate %	8.5
Perpetuity Year	15.0

## Asian push to create third operating platform

**Thesis** Last Updated: 25 Oct 2012

ANZ Banking Group (ANZ) is one of the four major Australian banks. It offers a full suite of banking and financial services to the consumer, business and corporate sectors. It also has substantial banking operations in New Zealand and operates throughout the South Pacific. More recently it has taken equity interests in banks and financial institutions in China, Malaysia, Laos and Guam adding to those in Indonesia and Cambodia. The ANZ franchise is robust and while it has no apparent competitive advantage within the Australian and New Zealand banking oligopoly a narrow moat rating is justified.

ANZ's strength has been Business and Institutional banking although in recent years there has been a conscious move to expand the Personal/Consumer banking operations in both Australia and New Zealand. The goal was to become Australasia's leading, most respected and fastest growing major bank - a stretch target perhaps. Earnings growth over the past five years has been at the top end of peer group performance.

The architect of the early change in strategy and growth in underlying cash earnings was CEO John McFarlane. His 10 year tenure ended in October 2007 with the appointment of new CEO Mike Smith. Previously the head of HSBC's Asian operations - which are larger than the ANZ Group - the appointment clearly signaled an increasing focus on Asian expansion. He was also global head of Commercial Banking for HSBC bringing added experience to the underperforming Institutional Banking operation. CEO Mike Smith is driving a super regional bank strategy with a target of 20% of group earnings to come from the Asian/Pacific region by 2012 and 25-30% by FY17. ANZ maintains its acquisition strategy is disciplined and measured.

With a favourable view on the Asian expansion strategy we can see upside following the successful integration of the RBS businesses in Hong Kong, the Philippines, Indonesia, Taiwan, Singapore and Vietnam. Importantly, ANZ has hired experienced bankers to drive the strategy across Asia. If any Australian major bank CEO can deliver on an Asian growth strategy, it is Mike Smith. We argue he has the experience and drive to execute the strategy, but the longer term challenge is continuing the Asian

growth strategy when Mike Smith eventually retires. ANZ increased its exposure to wealth management with the purchase of the remaining 51% of the JV with ING in 2009. Wealth management is seen as strong growth segment of the financial services sector, offering significant potential for cross selling services and products and improving revenues streams.

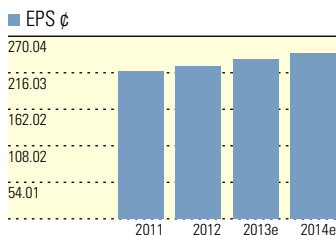
A revamp of the Australian banking distribution network is required to keep up with a rapidly growing and evolving banking market. The \$1.5 billion upgrade to ANZ's Australian retail distribution and product capability is focused on improving mobile banking services, improving operational efficiency and ultimately increasing product and service cross sell.

**Valuation** Last Updated: 15 Feb 2013

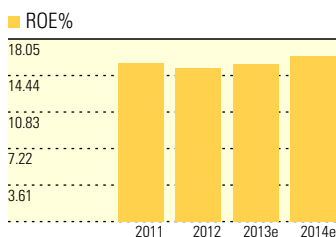
Our fair value of \$32 is based on a DCF methodology with a 10.5% cost of equity. Cash earnings are expected to increase moderately in FY13 with further improvement in FY14. Solid loan growth, steady net interest margin and improving cost efficiency should drive ROE. EPS will benefit from improved credit quality and an expanding exposure to south east Asia. Our narrow moat major banks enjoy strong competitive advantages in a regulated oligopoly. Importantly, the major banks are price makers delivering higher ROEs, despite tougher capital and regulatory requirements. The ability to reprice loans to partially recoup higher funding costs reinforces the major banks' strong competitive positions.

# Australia & New Zealand Banking Group Ltd ANZ

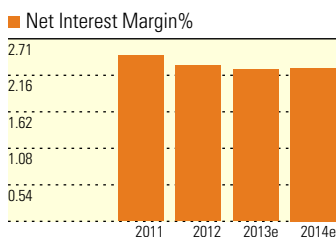
## EPS



## ROE



## Net Interest Margin%



## Risk Last Updated: 07 Jun 2012

ANZ is a leveraged financial group with operations spanning the consumer, business and large corporate and institutional segments of the economy. It is therefore exposed to changes in economic conditions which affect these operations. Adverse movements in interest rates, inflation, unemployment and exchange rates reduce economic activity. Banks are bankers to the economy. Loss of market share in any of the above segments coupled with ongoing contraction in net interest margins would have a detrimental impact on net interest income, which represents 65-70% of total operating income. A sharp increase in impairment losses would cut cash earnings. The particular risks from the super-regional strategy include management overreach leading to inadequate risk control, under-pricing for risk due to thin interest margins, higher capital levels, disappointments on cost efficiency, and economic downturns and financial crises in Asia.

## Financial Overview

### Growth

Loan volume growth at or around system over the medium term should underpin growth in net interest income while non-interest income should grow at a similar rate, supported by fee income from Asia.

### Profitability

Net interest margins should stabilise despite intense competition for deposit funding and moderate credit growth. The main risk to margins is sharply higher wholesale funding costs.

### Financial Health

ANZ has an efficient capital structure and a strong balance sheet. The Basel III fully harmonised Common Equity Tier 1 capital ratio at 31 December 2012 was a relatively high 9.7%. The APRA Basel III Common Equity Tier 1 ratio was 7.7% at December 2012. Both ratios exceed regulatory minimums.

## Strategy Analysis Last Updated: 15 Feb 2013

ANZ's 'super-regional' strategy launched by CEO Mike Smith in 2007 targets an increasing proportion of earnings from Asia, the Pacific, Europe and America (APEA) at the expense of traditional markets in Australia and New Zealand. ANZ aims to grow in APEA by i) capturing banking business associated

with trade and investment flows between the various countries and ii) cross-selling fee-based services to institutional banking clients. The proportion of earnings sourced from APEA is steadily increasing from 12% in FY07. The initial target of 20% by FY12 has been upgraded to 25-30% by FY17. With this strategy, unique among Australian banks, ANZ aims to differentiate itself from peers and provide superior earnings growth. The offshore plan is intended to make up for a subdued outlook for banking growth in Australia and New Zealand. To maintain earnings growth in Australia despite contracting business credit and a bruising price war in home lending ANZ aims to increase cross-sell of wealth management. This follows the acquisition of ING's 51% interest in the ING-branded joint venture in 2009. A revamp of the Australian banking distribution network is required to keep up with a rapidly growing and evolving banking market.

# Bank Financials

Financials	Historical			Forecast		
	09/10	09/11	09/12	09/13	09/14	09/15
<b>Per Share</b>						
Adjusted Earnings ¢	186.3	218.4	225.3	235.8	245.5	261.4
Free Cash Flow ¢	122.3	71.6	102.9	285.7	288.0	228.6
Net Tangible Assets ¢	1,018.2	1,195.6	1,277.5	1,258.0	1,250.1	1,321.5
Book Value ¢	1,231.7	1,431.1	1,510.3	1,486.1	1,473.6	1,540.6
Dividends ¢	126.0	140.0	145.0	153.0	160.0	170.0
Franking %	100.0	100.0	100.0	100.0	100.0	100.0
<b>Growth %</b>						
Net Revenue	9.8	6.5	4.6	6.0	5.5	7.2
Net Interest Income	10.7	5.7	5.5	7.4	5.1	7.2
Provision for Doubtful Debts	-40.4	-33.5	2.9	10.0	7.7	5.0
EPS	15.9	17.2	3.1	4.7	4.1	6.5
DPS	23.5	11.1	3.6	5.5	4.6	6.2
NTA	-16.1	17.4	6.8	-1.5	-0.6	5.7
Free Cash Flow	–	-43.8	48.1	183.4	2.9	-19.0
<b>Profit &amp; Loss (\$Mil)</b>						
Net Interest Income	10,862.0	11,481.0	12,111.0	13,004.7	13,666.5	14,644.2
Non Interest Income	4,920.0	5,331.0	5,468.0	5,633.7	5,992.9	6,436.1
Net Revenue	15,782.0	16,812.0	17,579.0	18,638.4	19,659.4	21,080.3
Provision for Doubtful Debts	1,820.0	1,211.0	1,246.0	1,371.1	1,476.9	1,550.1
Non Interest Expense	6,971.0	7,718.0	8,022.0	8,341.9	8,701.0	9,226.7
Profit Before Tax	6,991.0	7,883.0	8,311.0	8,925.5	9,481.5	10,303.5
Income Tax	1,960.0	2,222.0	2,294.0	2,499.1	2,654.8	2,885.0
Outside Equity Int.	6.0	9.0	6.0	6.0	6.0	6.0
<b>Adjusted NPAT</b>	<b>5,025.0</b>	<b>5,652.0</b>	<b>6,011.0</b>	<b>6,420.3</b>	<b>6,820.7</b>	<b>7,412.5</b>
Reported NPAT	4,501.0	5,355.0	5,661.0	6,420.3	6,820.7	7,412.5
Free Cash Flow	3,299.0	1,853.0	2,745.0	7,780.4	8,002.7	6,482.2
<b>Balance Sheet (\$Mil)</b>						
Cash	21,521.0	24,899.0	36,578.0	35,862.4	39,323.5	53,905.5
Due from Banks	5,481.0	8,824.0	17,103.0	17,931.2	19,661.7	21,562.2
Trading Securities	23,515.0	16,074.0	43,602.0	43,602.0	44,038.0	52,845.6
Loans and Advances	349,321.0	396,337.0	427,823.0	448,495.9	469,591.4	496,065.1
Property Plant & Equipment, Net	2,158.0	2,125.0	2,114.0	2,486.8	2,880.0	3,301.6
Goodwill and Other Intangibles	6,630.0	6,964.0	7,082.0	7,082.0	7,082.0	7,082.0
Other Assets	123,113.0	139,265.0	107,825.0	109,993.2	114,150.9	133,098.6
<b>Total Assets</b>	<b>531,739.0</b>	<b>594,488.0</b>	<b>642,127.0</b>	<b>665,453.6</b>	<b>696,727.6</b>	<b>767,860.5</b>
Deposits	311,472.0	368,729.0	397,123.0	436,835.3	480,518.8	528,570.7
Due to Other Banks	20,521.0	23,012.0	30,538.0	32,064.9	33,668.1	35,351.6
Short-Term Debt	–	–	–	0.0	0.0	0.0
Long-Term Debt	59,714.0	56,551.0	63,098.0	67,278.6	54,022.5	63,795.7
Additional Debt	12,316.0	11,993.0	11,914.0	14,768.5	11,858.6	14,003.9
Other Liabilities	93,561.0	96,249.0	98,234.0	73,121.5	74,795.3	81,540.9
<b>Total Liabilities</b>	<b>497,584.0</b>	<b>556,534.0</b>	<b>600,907.0</b>	<b>624,068.8</b>	<b>654,863.4</b>	<b>723,262.8</b>
Minority Interest	64.0	48.0	49.0	49.0	49.0	49.0
<b>Total Equity</b>	<b>34,155.0</b>	<b>37,954.0</b>	<b>41,220.0</b>	<b>41,384.7</b>	<b>41,864.2</b>	<b>44,597.7</b>

# Bank Financials

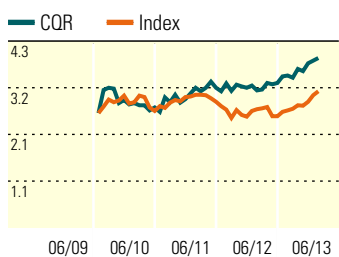
Financials	Historical			Forecast		
	09/10	09/11	09/12	09/13	09/14	09/15
<b>Profitability %</b>						
Net Interest Margin	2.48	2.46	2.31	2.25	2.27	2.28
Non-Interest Income/Revenue	31.2	31.7	31.1	30.2	30.5	30.5
Efficiency Ratio	44.2	45.9	45.6	44.8	44.3	43.8
Bad Debts to Gross Loans Ratio	0.52	0.32	0.30	0.31	0.32	0.32
Return on Average Assets	1.0	1.0	1.0	1.0	1.0	1.0
Return on Average Equity	15.1	15.7	15.2	15.6	16.4	17.2
Return on Tangible Equity	16.4	17.3	16.6	18.7	19.6	19.8
Dividend Payout Ratio	67.6	64.1	64.4	64.9	65.2	65.0
<b>Leverage</b>						
Assets/Equity x	15.6	15.7	15.6	16.1	16.7	17.2
Tangible Common Equity/Tangible Assets %	5.1	5.1	5.2	5.1	4.9	4.8
Tier 1 Ratio %	10.6	10.1	10.9	10.8	10.5	10.1
<b>Valuation</b>						
Price/Earnings x	12.3	10.3	9.8	11.8	11.3	10.6
Free Cash Flow Yield %	5.3	3.2	4.7	10.3	10.4	8.2
Dividend Yield %	5.5	6.2	6.6	5.5	5.8	6.1
Price/(FCF per share) x	18.8	31.5	21.5	9.7	9.6	12.1
Price/NTA x	2.3	1.9	1.7	2.2	2.2	2.1
Price/Book x	1.9	1.6	1.5	1.9	1.9	1.8

# Charter Hall Retail REIT CQR

## Snapshot

Business Risk	Medium
Price Risk	Medium
Moat Rating	None
Fair Value \$	3.90
Market Cap \$Mil	1,296
Morningstar Style Box	
Last Price \$	3.88
52 Week High/Low \$	4.06/2.95
Shares Issued Mil	334
Sector	GICS - Real Estate

## Price vs. Market



	06/11	06/12	06/13e	06/14e
NPAT (\$Mil)	85.2	86.3	94.6	101.2
EPS ¢	28.0	28.8	29.6	30.3
EPS Chg %	-15.6	3.0	2.7	2.4
DPS ¢	24.8	26.1	26.5	26.5
Franked %	0.0	0.0	0.0	0.0
Div Yld %	8.2	8.1	6.8	6.8
P/E x	10.8	11.1	13.1	12.8

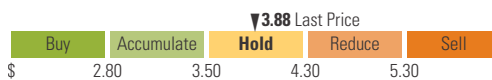
Source: Morningstar analyst estimates.

## Business Description

Charter Hall Retail REIT (CQR) is a sector specific Australian listed property trust, or A-REIT, offering exposure primarily to the supermarket anchored neighbourhood and sub-regional shopping centre markets in Australia, New Zealand, USA and Europe. Charter Hall Retail REIT is managed by Charter Hall Retail Management Limited.

## 1H13 result: Larger sub-regional outperforms neighbourhood centres

Analyst Recommendation: **Hold** 15 February 2013



## Investment Rating

CQR is a sector specific Australian listed property trust (A-REIT), owning predominantly grocery-anchored neighbourhood and sub-regional shopping centres in Australia. Approximately 10% of assets are in New Zealand, USA and Europe, which are being sold. Around 50% of earnings come from major supermarket tenants, with the balance from specialty retailers, predominantly selling everyday items. CQR has less exposure to the more volatile discretionary retail category, but its smaller size malls provides less leverage to booming retail markets. These factors, and progress on selling offshore assets and lower gearing makes CQR a medium-risk stock that is suitable for income investors with a moderate risk tolerance.

## Event

- ▶ CQR's first half 2013 operating profit of \$45.9m, with earnings per security up 6% on the prior corresponding period (pcp). Key drivers were rent increases and incremental income from recent developments and acquisitions. A 13.3 cent distribution was declared, up on the 13.0 cents in the pcp.
- ▶ Full year reaffirmed guidance for operating earnings of 29.5 to 30.0 cents per unit, with a distribution payout of 85%-95%, giving a wide full year distribution range of between 25 and 28.5 cents.

## Impact

- ▶ We believe CQR has a solid foundation for ongoing income growth underpinned by the 53% of annual

base rent sources from Woolworths and Wesfarmers tenants. The balance of income is derived from specialty tenants, with a weighting towards non-discretionary food and service based offerings.

- ▶ We revise our forecasts to incorporate a full divestment of CQR's Polish and German assets by June 2015, with expected proceeds before transaction costs expected to match current market values of \$109m and \$233m respectively. As these assets are highly leveraged, cash inflows before transaction costs will be around \$50m, but overall group gearing will decrease from the current 38.7% to around 31%.
- ▶ There was largely no movement in the value of the \$1.6bn of Australian assets, but we believe lower borrowing costs support a contraction in the capitalisation rates used to value these assets over the next 12 months. Our fair value estimate increases by 10% to \$3.90, due to a solid outlook for income growth and a reduction in our weighed average cost of capital to 9.0%.

## Recommendation Impact

Our Hold recommendation is unchanged.



# Charter Hall Retail REIT CQR

## Tony Sherlock

Morningstar Analyst

## Analyst Note

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## Capital expenditure and acquisitions

CQR's construction underway increased from \$84.4m at June 2012 to \$96.8m, with the commencement of a \$15.2m re-development of a centre in South Hedland, WA. In addition to this CQR board has approved a further \$36m for two redevelopments projects in Orange, NSW and Lansell Square, VIC. We are supportive of an expanded development pipeline as development is generally EPS accretive. Re-development of existing assets typically generate unlevered cash yields of around 9.5% and fully leveraged yields of around 11 to 12%, well above CQR's 9% weighted average cost of capital.

CQR advised that it was changing its strategy with regard to the retail assets it was targeting for inclusion in the portfolio, upsizing the range from a \$20m to \$80m range to a \$20m to \$100m range. This comes as no major surprise as CQR's recent acquisitions have been skewed towards sub-regional centres, rather than the smaller neighbourhood centres. This strategy appears to have delivered for CQR, with the Australian sub-regional centres substantially outperforming the neighbourhood and freestanding centres in terms of growth in Net Operating Income (NOI) and specialty rent growth (see below)

## Performance of assets in the Australian portfolio

Asset Type	No.	Occupancy	Portfolio Weight	Specialty Rent Growth	Same Property NOI Growth
Sub-regional	14	98.8%	34.2%	6.5%	7.8%
Neighbourhood	41	97.9%	53.0%	2.1%	2.7%
Freestanding	19	100.0%	11.1%	n/a	0.9%
Household retail	1	98.5%	1.7%	n/a	-10.4%
Total	75	98.5%	100.0%	3.7%	3.0%

We are also supportive of CQR acquiring additional assets, but expect nearly all future acquisitions and the bulk of future investment to be directed towards sub-regional centres. While neighbourhood malls are

# Charter Hall Retail REIT CQR

**Tony Sherlock**

Morningstar Analyst

relatively defensive, we consider them to be higher risk than sub-regional malls. This is partly due to the fact that their small size makes them highly susceptible to a new competitor, which is likely if the catchment area experiences strong population growth. In this context, we are supportive of CQR's heightened focus on sub-regional shopping centres, which we believe offer more defensive earnings than smaller neighbourhood malls.

The company indicated it was actively pursuing a series of opportunities, but would not elaborate on either timing or magnitude. CQR also stated it was targeting upsizing its Australian assets from the current \$1.6bn to around \$2.0bn over the medium-term. Increasing the fund to this size will require a further capital raising if Australian gearing is to be retained in the low 30's.

### Asset values

CQR re-valued 34% of its portfolio during the half, with the \$1.6bn of Australian assets increasing by \$0.4m. This was partly offset by \$6.8m in transaction costs during the period. The offshore assets declined in value, by \$19m, largely due to ongoing economic weakness in Poland and Germany.

With the Australian sub-regional and neighbourhood centres valued at capitalisation rate of 8.3%, these assets offer attractive yields for income investors and a wide spread bond yields. We expect these capitalisation rates are likely to contract over the next twelve months by up to 20 basis points, raising asset values and narrowing the gap between CQR's share price and net tangible assets (NTA) per security of \$3.31.

# Charter Hall Retail REIT CQR

## Bulls Points

- This is the only A-REIT to offer exposure primarily to grocery anchored neighbourhood and sub-regional shopping centres with a non-discretionary spending foundation.
- It enjoys a high level of occupancy, tenant diversification and base rent security from global top 30 grocery retailers.
- The redeployment of capital from lower yielding offshore investments to Australia will simplify the business structure and reduce operational risks.
- The bulk of income is sourced from property rentals with limited contribution from higher risk development activities.

## Bears Points

- It offers significant exposure to the neighbourhood and sub-regional shopping centre sub-sectors which is a highly competitive portion of the retail property sector which puts capital and leasing values under pressure.
- The impending sale of the higher yielding European assets will dilute FY14 and FY15 earnings, due to repatriated capital generating lower relative returns.
- A continuation of the moderating sales growth for the major supermarket chains will result in lower long-term rent growth.

## Key Valuation Assumptions

Cost of Equity %	10.0
Weighted Avg Cost of Capital %	9.0
Long Run Tax Rate %	1.0
Stage II EBI Growth Rate %	4.0
Stage II Investment Rate %	16.7
Perpetuity Year	15.0

## Thesis Last Updated: 15 Feb 2013

CQR is a sub-sector specific A-REIT investing in an internationally diversified portfolio of 91 retail properties with a book value of \$2.06bn as at December 2012. The trust traditionally targets well located supermarket based shopping centres leased to substantial tenants for either acquisition or development followed by active asset management.

The recent focus on management has been on acquisition and re-development of sub-regional shopping centres. We consider CQR to be a moderate risk property trust based on the quality of the retail property assets in its current portfolio, which may make it unsuitable for the risk adverse investor.

Competing supermarkets developed or owned by other investors could erode the turnover of CQR's supermarkets leading to reduced turnover rental levels. Competing trusts could potentially also acquire large portfolios of supermarket based property and replicate the nature of investment offered by CQR. Due to these competitive threats we assign no moat rating to CQR.

The trust is currently geographically diverse, however the continuing sales process of its European, US and New Zealand assets and acquisition of Australian based assets, with the equity returned, will eventually result in the trust owning exclusively Australian shopping centres. It offers the defensive nature of income based on non-discretionary spending and quality tenant fundamentals, but is offset partially by exposure to only one property market sub-sector.

CQR enjoys a high level of occupancy and tenant diversification with around 50% base rental income secured by the top 10 tenants, comprising global top 30 grocery retailers, and only limited income from higher risk development activities.

The use of derivatives leads to potentially significant impacts on both the income statement and the balance sheet at each period end and adds further complication and potentially significant costs to the asset disposal process.

We consider CQR a medium risk stock, suitable for income investors with a moderate to low risk tolerance. Risk will further reduce as CQR progresses

the divestment of its offshore operations, reduces gearing and focuses exclusively Australia.

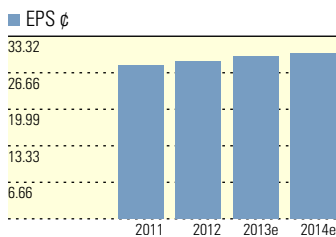
## Valuation Last Updated: 15 Feb 2013

We value CQR using a discounted cash flow methodology using a 10% cost of equity and 9.0% weighted average cost of capital. We have assumed that equity returned from the sale of assets will be used to reduce debt or will be re-invested in domestic assets.

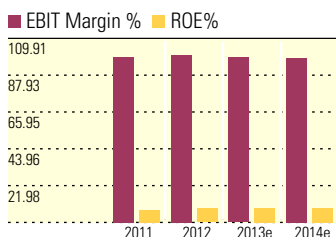
We have a Fair Value of \$3.90 per unit, which is at an 18% premium to the December 2012 net tangible assets of \$3.31 per unit.

# Charter Hall Retail REIT CQR

## EPS



## EBIT Margin vs. ROE



## Risk Last Updated: 18 Oct 2012

Whilst predominant exposure to the non-discretionary spending grocery sector provides CQR with a defensive profile, the extent of discretionary spending reliant specialty shops and significant exposure to the sub-regional and neighbourhood shopping centre sectors renders CQR vulnerable to any downturn in consumer spending or property market conditions.

## Financial Overview

### Growth

Specialty rents are expected to grow in the long-term at roughly CPI plus 1%, with periodic boosts from redevelopment and asset sales. With CQR's specialty rents relatively low, we expect solid near-term rental growth from forthcoming rent reviews.

### Profitability

Rental revenue growth has historically slightly exceeded inflation. Outgoings generally track inflation, while fees are a percentage of trust total assets. Positive outcomes from specialty rent reviews and reduced debt costs are likely to increase profitability in the short to medium term.

### Financial Health

The balance sheet is in reasonable shape, though the high balance sheet gearing (net debt/ total tangible assets less cash) of 40.4% is expected to reduce to around 31% following the divestment of US and European assets.

## Strategy Analysis Last Updated: 17 Feb 2012

CQR seeks to provide unitholders with a secure income stream and the prospect of capital growth by achieving scale in the retail sector enhanced by active asset management, refurbishment, development and recycling capital to reduce debt through disposal of mature, lower growth assets.

# General Financials

Financials	Historical			Forecast		
	06/10	06/11	06/12	06/13	06/14	06/15
<b>Per Share</b>						
Sales ¢	46.1	45.8	45.2	44.8	44.1	42.1
Adjusted Earnings ¢	33.1	28.0	28.8	29.6	30.3	30.0
Free Cash Flow ¢	67.3	38.4	51.7	33.0	51.5	97.8
Net Tangible Assets ¢	400.6	351.0	338.1	357.6	347.4	350.7
Book Value ¢	400.6	351.0	338.1	357.6	347.4	350.7
Dividends ¢	26.5	24.8	26.1	26.5	26.5	27.0
Franking %	0.0	0.0	0.0	0.0	0.0	0.0
<b>Growth %</b>						
Sales Revenue	-62.7	1.4	-2.9	5.8	2.9	-4.7
EBITDA	-58.9	0.7	-4.3	5.5	2.4	-5.6
Pre-Tax Profit	-40.2	-15.3	1.3	10.7	7.0	-0.9
EPS	51.6	-15.6	3.0	2.7	2.4	-0.9
DPS	-24.3	-6.4	5.2	1.5	0.0	1.9
Free Cash Flow per share	-99.7	-42.9	34.5	-36.2	56.2	89.8
<b>Profit &amp; Loss (\$Mil)</b>						
Sales Revenue	137.6	139.5	135.4	143.3	147.5	140.5
EBITDA	138.8	139.8	133.8	141.1	144.5	136.4
Depreciation	0.0	0.0	0.0	0.0	0.0	0.0
Amortisation	0.0	0.0	0.0	0.0	0.0	0.0
EBIT	137.6	138.0	135.3	141.1	144.5	136.4
Interest Expense	37.0	52.8	49.0	45.6	42.3	35.1
Interest Income	0.0	0.0	0.0	0.0	0.0	0.0
Profit Before Tax	100.6	85.2	86.3	95.5	102.2	101.3
Tax	1.9	0.0	0.0	1.0	1.0	1.0
Reported NPAT	73.8	62.2	9.7	73.1	101.2	100.3
Non-Recurring Items After Tax	-24.9	-23.0	-76.6	-21.5	0.0	0.0
<b>Adjusted NPAT</b>	<b>98.7</b>	<b>85.2</b>	<b>86.3</b>	<b>94.6</b>	<b>101.2</b>	<b>100.3</b>
Free Cash Flow	200.7	117.1	154.9	105.5	172.1	326.7
Effective Tax Rate %	1.9	0.0	0.0	1.0	1.0	1.0
<b>Cash Flow (\$Mil)</b>						
Receipts from Customers	135.1	138.9	135.5	141.5	147.0	141.2
Payments to Suppliers	-1.6	3.9	7.8	-0.6	-2.1	-5.5
Other Operating Cashflow	-60.5	-49.2	-54.9	-46.5	-43.3	-36.1
<b>Net Operating Cashflow</b>	<b>73.0</b>	<b>93.6</b>	<b>88.4</b>	<b>94.3</b>	<b>101.6</b>	<b>99.6</b>
Capex	-92.4	-236.7	-143.7	-183.6	-70.8	-19.3
Acquisitions & Investments	0.0	0.0	0.0	122.8	99.4	211.7
Sales of Investments & Subsidiaries	132.2	187.7	60.3	0.0	0.0	0.0
Other Investing Cashflow	0.0	0.0	0.0	0.0	0.0	0.0
<b>Net Investing Cashflow</b>	<b>39.8</b>	<b>-49.0</b>	<b>-83.4</b>	<b>-60.8</b>	<b>28.6</b>	<b>192.3</b>
Proceeds from Issues	0.0	-12.0	-8.0	118.9	0.0	0.0
Proceeds from Borrowings	-120.6	31.5	91.4	-70.0	-40.0	-200.0
Dividends Paid	-79.3	-58.3	-77.7	-83.4	-84.0	-89.2
Other Financing Cashflow	0.0	0.0	0.0	0.0	0.0	0.0
<b>Net Financing Cashflow</b>	<b>-199.9</b>	<b>-38.8</b>	<b>5.7</b>	<b>-34.5</b>	<b>-124.0</b>	<b>-289.2</b>
Net Increase Cash	-87.1	5.8	10.7	-0.9	6.2	2.8
Cash at Beginning	107.2	14.3	14.3	23.8	22.9	29.0
Exchange Rate Adjustment	-5.8	-5.8	-1.2	0.0	0.0	0.0
Cash at End	14.3	14.3	23.8	22.9	29.0	31.8

# General Financials

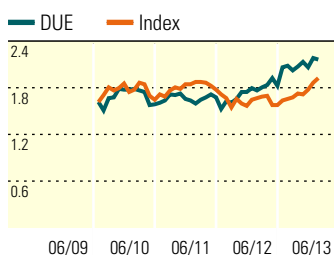
Financials	Historical			Forecast		
	06/10	06/11	06/12	06/13	06/14	06/15
<b>Balance Sheet (\$Mil)</b>						
Cash & Equivalents	14.3	14.3	23.8	22.9	29.0	31.8
Accounts Receivable	15.2	13.0	12.5	14.3	14.7	14.1
Inventory	0.0	0.0	0.0	0.0	0.0	0.0
Other Short-Term Operating Assets	111.3	104.7	171.5	171.5	171.5	171.5
<b>Total Current Assets</b>	<b>140.8</b>	<b>132.0</b>	<b>207.8</b>	<b>208.7</b>	<b>215.3</b>	<b>217.4</b>
Property Plant & Equipment, Net	2,032.1	1,737.9	1,726.3	1,787.1	1,758.5	1,566.1
Goodwill, Net	0.0	0.0	0.0	0.0	0.0	0.0
Other Intangibles	0.0	0.0	0.0	0.0	0.0	0.0
Other Long-Term Operating Assets	32.2	35.5	10.5	10.5	10.5	10.5
Deferred Tax Assets	5.5	0.0	0.0	0.0	0.0	0.0
Long-Term Non-Operating Assets	0.0	0.0	0.0	0.0	0.0	0.0
<b>Total Assets</b>	<b>2,210.6</b>	<b>1,905.4</b>	<b>1,944.6</b>	<b>2,006.3</b>	<b>1,984.2</b>	<b>1,794.0</b>
Accounts Payable	26.6	23.2	27.3	28.9	29.7	28.3
Short-Term Debt	0.0	6.3	3.0	3.0	3.0	3.0
Other Short-Term Operating Liabilities	0.0	67.3	67.7	67.7	67.7	67.7
<b>Total Current Liabilities</b>	<b>26.6</b>	<b>96.8</b>	<b>98.0</b>	<b>99.6</b>	<b>100.4</b>	<b>99.0</b>
<b>Total Long-Term Debt</b>	<b>921.5</b>	<b>721.4</b>	<b>791.6</b>	<b>721.6</b>	<b>681.6</b>	<b>481.6</b>
Long-Term Operating Liabilities	0.0	0.0	0.0	26.8	26.8	26.8
Deferred Tax Liabilities	13.5	12.7	14.8	14.8	14.8	14.8
Long-Term Non-Operating Liabilities	54.5	4.7	26.8	0.0	0.0	0.0
<b>Total Liabilities</b>	<b>1,016.1</b>	<b>835.6</b>	<b>931.2</b>	<b>862.8</b>	<b>823.6</b>	<b>622.2</b>
Preferred Stock	0.0	0.0	0.0	0.0	0.0	0.0
Minority Interest	0.0	0.0	0.0	0.0	0.0	0.0
<b>Total Equity</b>	<b>1,194.5</b>	<b>1,069.8</b>	<b>1,013.4</b>	<b>1,143.5</b>	<b>1,160.6</b>	<b>1,171.7</b>
<b>Profitability %</b>						
EBITDA Margin	100.9	100.2	98.8	98.5	98.0	97.1
EBIT Margin	100.0	98.9	99.9	98.5	98.0	97.0
Net Profit Margin	71.7	61.1	63.7	66.0	68.6	71.4
Free Cash Flow Margin	145.9	83.9	114.4	73.6	116.7	232.4
Return on Equity	8.5	7.5	8.3	8.8	8.8	8.6
Return on Assets	3.3	4.1	4.5	4.8	5.1	5.3
Return on Invested Capital(w/Goodwill)	5.2	8.2	11.4	7.5	7.6	7.6
ROIC (w/Goodwill) Less WACC	-3.8	-0.8	2.3	-1.5	-1.4	-1.4
<b>Leverage &amp; Liquidity</b>						
Net Debt to Capital %	42.9	39.7	42.6	37.6	35.5	27.3
Net Debt/(Net Debt + Equity) %	43.2	40.0	43.2	38.0	36.1	27.9
Net Debt/Equity %	76.0	66.7	76.1	61.4	56.5	38.6
Net Debt/EBITDA x	6.5	5.1	5.8	5.0	4.5	3.3
EBIT/Net Interest Expense x	3.7	2.6	2.8	3.1	3.4	3.9
Current Ratio (Current Assets/Current Liabilities) x	5.3	1.4	2.1	2.1	2.1	2.2
Dividend Payout Ratio %	80.1	88.7	90.7	89.6	87.5	89.9
Net Cash Per Share ¢	-304.2	-234.1	-257.2	-219.4	-196.2	-135.5
<b>Valuation</b>						
Price/Earnings x	8.7	10.8	11.1	13.1	12.8	12.9
PEG Ratio x	0.2	-0.7	3.7	4.8	5.3	-15.1
EV/EBITDA x	12.7	11.7	12.9	13.7	13.4	14.2
EV/EBIT x	12.8	11.9	12.8	13.7	13.4	14.2
Free Cash Flow Yield %	23.4	12.7	16.1	8.5	13.3	25.2
Dividend Yield %	9.2	8.2	8.1	6.8	6.8	7.0
Price/(OCF per share) x	11.8	9.9	10.9	13.2	12.8	13.0
Price/(FCF per share) x	4.3	7.9	6.2	11.8	7.5	4.0
Price/Sales x	6.2	6.6	7.1	8.7	8.8	9.2
Price/NTA x	0.7	0.9	0.9	1.1	1.1	1.1
Price/Book x	0.7	0.9	0.9	1.1	1.1	1.1

# DUET Group DUE

## Snapshot

Business Risk	Medium
Price Risk	Medium
Moat Rating	None
Fair Value \$	1.70
Market Cap \$Mil	2,549
Morningstar Style Box	
Last Price \$	2.18
52 Week High/Low \$	2.27/1.69
Shares Issued Mil	1,169
Sector	GICS - Utilities

## Price vs. Market



	06/11	06/12	06/13e	06/14e
NPAT (\$Mil)	107.4	99.3	102.5	106.1
EPS ¢	10.0	9.3	9.0	8.8
EPS Chg %	-13.5	-7.5	-3.6	-1.6
DPS ¢	20.0	16.0	16.5	17.0
Franked %	0.0	0.0	0.0	0.0
Div Yld %	11.9	9.2	7.6	7.8
P/E x	16.7	18.8	24.4	24.7

Source: Morningstar analyst estimates.

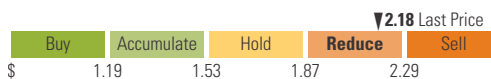
## Business Description

DUET Group (DUE) is an owner of regulated energy utility infrastructure business in Australia. DUE is managed jointly by AMP Capital Investors Limited and Macquarie Capital Group Limited. DUE consists of two stapled registered managed investment schemes and an Australian public company.

## 1H13: Another soft result

Analyst Recommendation: **Reduce**

15 February 2013



## Investment Rating

DUE is a diversified energy infrastructure owner. The portfolio comprises majority interests in the Dampier to Bunbury Pipeline (DBP), United Energy (UED) and Multinet Gas (MNG). DUE is much improved after restructuring to simplify and de-risk. The majority of shareholder returns should come from distributions. DUE is internally managed from December 2012. It was formerly managed by AMP and Macquarie Group. It is suitable for income investors at the right price.

## Event

- DUET reported another soft underlying result in first half fiscal 2013. While revenue and EBITDA increased modestly, the higher share count and other factors saw proportionate 'cash EPS' fall 9% to 9.3 cents per security (cps).
- The Dampier to Bunbury Pipeline (DBP) recorded flat gas transportation revenue of \$213m. United Energy was the best performer with revenue increasing 6% to \$220m as tariffs increased to compensate for expansion.
- Multinet Gas performed relatively well though earnings were depressed by transition costs relating to in-housing management. Multinet faces major near-term headwinds from the current regulatory reset, which takes effect from early 2013.
- Financial leverage (net debt/RAB) increased from 76.7% to 77.5% (after balance date). The fact that the share count and leverage are rising while profit is broadly flat is a signal that distribution guidance for 3% growth per annum over the medium term is not sustainable longer term.

## Impact

► Our estimate of earnings eased 4% to \$46m and EPS fell 11% to 4.1 cps. The result is tracking modestly below our full year expectations, which downgrade marginally.

► Our fair value estimate is unchanged. We continue to believe DUET is overvalued.

## Recommendation Impact

No change to our Reduce recommendation.

# DUET Group DUE

## Adrian Atkins

Morningstar Analyst

## Analyst Note

DUET reported another soft underlying result in first half fiscal 2013. While revenue and EBITDA increased modestly, the higher share count and other factors saw proportionate 'cash EPS' fall 9% to 9.3 cents per security (cps). Cash EPS ignores depreciation and amortisation. Proportionate revenue increased 4.5% to \$437.3m and EBITDA increased 4% to \$317.5m, both excluding customer contributions. But revenue and EBITDA growth was more than offset by the 8% increase in securities on issue. Proportionate cash earnings slipped 2% to \$106.1m.

Our estimate of earnings eased 4% to \$46m and EPS fell 11% to 4.1 cps. The result is tracking modestly below our full year expectations, which downgrade marginally. Our fair value estimate is unchanged. We continue to believe DUET is overvalued.

The Dampier to Bunbury Pipeline (DBP) recorded flat gas transportation revenue of \$213m. Total revenue increased 1% to \$225m, excluding customer contributions. Proportionate EBITDA increased just 1% to \$155m and earnings fell 3% to \$54m. Gas throughput was flat at 157PJ and regulated asset base (RAB) was flat at \$3,591m.

The DBP is practically ex-growth with flat volumes and tariffs increasing at CPI minus 2.5% annually until contracts end on 31 December 2015. In 2016, we expect tariffs to fall as the pipeline reverts to regulation, unless new contracts can be agreed with shippers. More generous contracts outside the regulatory framework are usually agreed when the shippers want the pipeline to expand. We don't expect further material expansion so assume tariffs will fall either on regulation or cheaper contracts. Up to the end of 2011, tariffs on the DBP grew each year with CPI, leading some to extrapolate growth and overvalue the asset, in our opinion.

Interestingly, DUET set up a new business called DBP Services to buy unregulated gas assets and provide unregulated services near the DBP in Western Australia. We think this is a good idea given increasing gas activity (new gas production and LNG export facilities) in the north of the state could lead to opportunities, such as storage. Returns would likely be superior to regulated businesses. At this stage DBP Services is immaterial, contributing just \$0.5m to EBITDA in the half.

United Energy was the best performer with revenue increasing 6% to \$220m as tariffs increased to compensate for expansion of the RAB. EBITDA increased 18% to \$147m, helped by lower operating costs as the prior period contained transition costs relating to bringing management in-house. Capital expenditure continues at an elevated pace, feeding in to RAB which rose 6% to \$1,952m over the past year. RAB growth drives future revenues via tariff increases of CPI plus 4.3% in 2013 and CPI plus 8.1% in 2014 and 2015. Growth will slow over the longer term.

Multinet Gas performed relatively well though earnings were depressed by transition costs relating to in-housing management. We expect costs to fall once this process completes, similar to United Energy. Revenue increased 8% to \$111m and EBITDA increased 1% to \$78m. Multinet faces major near-term headwinds from the current regulatory reset, which takes effect from early 2013. The draft decision was harsh, particularly the cost of equity allowance. We expect the cost of equity allowance to improve modestly in the final decision, but remain well below prior years. This directly impacts profit. RAB increased 3% to \$1,066m.

Financial leverage (net debt/RAB) increased from 76.7% to 77.5% (after balance date). The fact that the share count and leverage are rising while profit is broadly flat is a signal that distribution guidance for 3% growth per annum over the medium term is not sustainable longer term.



# DUET Group DUE

## Bulls Points

- Revenues are highly secure over the medium term, underpinned by regulation and contracts.
- DUET is relatively simple and transparent following the restructure with three majority stakes in Australian gas and electricity infrastructure assets.
- Leverage is now broadly in line with peers and should be sustainable except in a severe credit crisis.

## Bears Points

- Regulatory returns are likely to fall at upcoming resets to reflect lower costs of debt and equity, relating to the lower risk free rate.
- Potential question marks over earnings quality relating to management adjustments. Positively, customer contributions are now excluded from reported adjusted earnings.
- Poor track record with aggressive growth at the top of the cycle. We view management internalisation in late 2012 positively.

## Key Valuation Assumptions

Cost of Equity %	11.0
Weighted Avg Cost of Capital %	8.1
Long Run Tax Rate %	0.0
Stage II EBI Growth Rate %	3.0
Stage II Investment Rate %	13.3
Perpetuity Year	15.0

## Thesis Last Updated: 15 Feb 2013

DUET (DUE) is a stapled investment trust with majority stakes in Australian gas and electricity infrastructure assets. It is internally managed from December 2012. It was formerly managed by AMP and Macquarie. A substantial equity raising in mid 2011 reduced gearing to a reasonable level while, at the same time, sale of minority interests simplified the portfolio to three majority stakes in decent Australian infrastructure assets.

DUE's portfolio comprises 80% of the Dampier to Bunbury Pipeline (DBP), 100% of Multinet Gas and 66% of United Energy. The DBP is a high pressure gas transmission pipeline running down Western Australia's coast from the gas fields in the north-west to markets in the south-west. Multinet is a gas distributor in Victoria and United Energy is an electricity distributor in Victoria.

DUE is much improved and de-risked following the portfolio simplification, equity raising and distribution cut in 2011. Two more issues have been addressed by management internalisation and excluding customer contributions to more accurately reflect true earnings.

The operating environment of the underlying assets is generally very stable. Growth is driven by rising populations, energy intensity and industrial activity. The assets are low growth except United Energy which is installing smart electricity meters and upgrading its network to cope with rising demand in peak periods. Medium-term capex obligations are considerable at United Energy. The improved balance sheet and the ongoing distribution reinvestment plan help.

The vast majority of revenues are regulated or under long-term contracts, providing predictable and stable earnings until the next regulatory reset or contract expiry. Regulatory resets in Australia occur every five years and we expect lower returns to reflect the lower cost of debt and equity. DUE has disproportionately large exposure to the mineral extraction and processing sectors in Western Australia through the DBP representing potential counterparty risk if the sector weakens. The DBP reverts to regulation in 2016 which is expected to result in lower returns.

We view management internalisation, the improved balance sheet and the simpler, more transparent portfolio favourably. However, lower regulatory returns and limited retained earnings should see DUET's distribution growth disappoint.

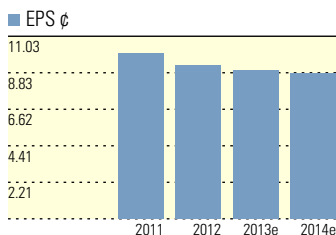
## Valuation Last Updated: 15 Feb 2013

Our fair value estimate for DUET is AUD 1.70 per security which implies a forward fiscal-year price/earnings of 18 times, an enterprise value/EBITDA of 9.2 times, an enterprise value/regulated asset base (EV/RAB) of 1.1 times and a distribution yield of 9.7%. DUET should trade on a lower EV/RAB multiple than peers as Alcoa, the foundation customer on the DBP, is on a perpetual, low-cost contract reducing returns on assets. Our valuation is derived from a discounted cash flow model with an 11% cost of equity.

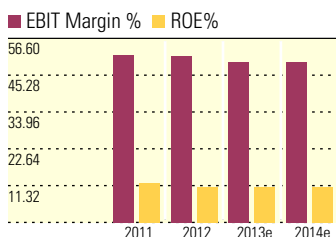
Significant capex at United Energy will drive revenues higher in the medium term but the rising debt balance and the distribution reinvestment plan will limit growth in earnings per security (EPS). Low growth is expected at other assets over the next few years with downside to revenues likely as the DBP reverts to regulation in 2016. We expect EPS to grow through each five-year regulatory period then fall following resets. Long-term EPS growth should be minimal.

# DUET Group DUE

## EPS



## EBIT Margin vs. ROE



## Risk Last Updated: 26 Nov 2012

Risk improves from medium-high to medium following the equity raising and restructure mid 2011. Concerns over high gearing, major upcoming debt maturities and substantial capex requirements recede. The simpler portfolio reduces concerns over complexity and transparency. Ongoing risks include adverse regulatory rulings and the possibility of credit markets deteriorating. Management internalisation reduces conflicts of interest. The DBP is highly exposed to the volatile resources sector which could be a risk if conditions deteriorate.

## Financial Overview

### Growth

Moderate revenue growth is expected over the next few years on elevated capex at United Energy. Long-term revenue growth should be modest and the DRP is a headwind for EPS growth.

### Profitability

EBITDA margins are solid - 73% in 1H13 - but net profitability is low due to hefty depreciation and interest expenses. Profitability depends on favourability of regulatory decisions.

### Financial Health

Financial health is reasonable. Gearing measured as proportionate net debt/RAB is 78% at 1H13.

## Strategy Analysis Last Updated: 04 Apr 2012

DUE focuses on regulated and contracted utilities with stable and predictable revenue streams. The portfolio is diversified across energy sources and utility sectors within Australia. Historically, DUE looked to expand via acquisitions in OECD countries but no acquisitions are expected in the foreseeable future given more expensive debt post GFC and a poor track record. Current focus is on delivering organic growth commitments including smart electricity meters in Victoria. An equity raising and asset transactions mid 2011 reduced risk and simplified the portfolio to three majority stakes. Management is cleaning DUE up, making it more transparent and ensuring gearing and distributions are sustainable.

# General Financials

Financials	Historical			Forecast		
	06/10	06/11	06/12	06/13	06/14	06/15
<b>Per Share</b>						
Sales ¢	66.9	73.9	77.5	75.6	73.0	70.1
Adjusted Earnings ¢	11.6	10.0	9.3	9.0	8.8	8.6
Free Cash Flow ¢	10.4	54.6	27.7	40.6	36.0	40.7
Net Tangible Assets ¢	-69.4	-51.8	-51.2	-56.8	-49.3	-45.9
Book Value ¢	78.6	85.6	86.3	83.0	81.0	75.7
Dividends ¢	20.0	20.0	16.0	16.5	17.0	17.5
Franking %	0.0	0.0	0.0	0.0	0.0	0.0
<b>Growth %</b>						
Sales Revenue	5.2	10.3	5.0	4.3	1.5	0.7
EBITDA	5.1	10.9	5.8	1.5	1.5	-0.7
Pre-Tax Profit	3.7	-13.5	-7.5	3.1	3.5	2.0
EPS	3.6	-13.5	-7.5	-3.6	-1.6	-2.8
DPS	-17.0	0.0	-20.0	3.1	3.0	2.9
Free Cash Flow per share	-3.4	425.5	-49.2	46.4	-11.3	13.1
<b>Profit &amp; Loss (\$Mil)</b>						
Sales Revenue	716.7	790.8	830.1	865.9	878.9	884.6
EBITDA	516.7	573.3	606.5	615.4	624.4	620.1
Depreciation	127.9	146.1	147.8	155.1	157.7	157.3
Amortisation	11.3	20.3	32.9	32.9	32.9	32.9
EBIT	377.5	406.9	425.7	427.4	433.7	429.9
Interest Expense	253.3	299.4	326.3	325.0	327.7	321.8
Interest Income	0.0	0.0	0.0	0.0	0.0	0.0
Profit Before Tax	124.3	107.4	99.4	102.5	106.1	108.1
Tax	0.1	0.1	0.1	0.0	0.0	0.0
Reported NPAT	124.2	107.4	99.3	102.5	106.1	108.1
Non-Recurring Items After Tax	0.0	0.0	0.0	0.0	0.0	0.0
<b>Adjusted NPAT</b>	<b>124.2</b>	<b>107.4</b>	<b>99.3</b>	<b>102.5</b>	<b>106.1</b>	<b>108.1</b>
Free Cash Flow	111.1	584.0	296.7	464.7	433.2	513.5
Effective Tax Rate %	0.1	0.1	0.1	0.0	0.0	0.0
<b>Cash Flow (\$Mil)</b>						
Receipts from Customers	716.7	790.8	976.6	862.4	877.6	884.1
Payments to Suppliers	-199.9	-217.5	-388.1	-199.7	-246.4	-245.4
Other Operating Cashflow	-216.7	-257.3	-348.0	-325.0	-327.7	-321.8
<b>Net Operating Cashflow</b>	<b>300.0</b>	<b>316.0</b>	<b>240.5</b>	<b>337.7</b>	<b>303.5</b>	<b>316.9</b>
Capex	-444.3	-231.8	-289.4	-198.0	-198.0	-125.2
Acquisitions & Investments	0.0	0.0	0.0	0.0	0.0	0.0
Sales of Investments & Subsidiaries	0.7	200.2	0.1	0.0	0.0	0.0
Other Investing Cashflow	3.4	-1.6	0.0	0.0	0.0	0.0
<b>Net Investing Cashflow</b>	<b>-440.2</b>	<b>-33.2</b>	<b>-289.4</b>	<b>-198.0</b>	<b>-198.0</b>	<b>-125.2</b>
Proceeds from Issues	126.2	230.1	188.6	113.4	122.8	93.8
Proceeds from Borrowings	192.3	-17.9	-293.1	-74.2	-23.6	-1.5
Dividends Paid	-193.4	-199.6	-201.8	-189.0	-204.7	-221.0
Other Financing Cashflow	-0.8	0.1	0.0	0.0	0.0	0.0
<b>Net Financing Cashflow</b>	<b>124.3</b>	<b>12.6</b>	<b>-306.3</b>	<b>-149.8</b>	<b>-105.5</b>	<b>-128.7</b>
Net Increase Cash	-15.9	295.5	-355.2	-10.1	0.0	63.0
Cash at Beginning	561.9	434.1	462.3	222.7	50.0	50.0
Exchange Rate Adjustment	-111.9	-267.2	115.6	-162.7	0.0	0.0
Cash at End	434.1	462.3	222.7	50.0	50.0	113.0

# General Financials

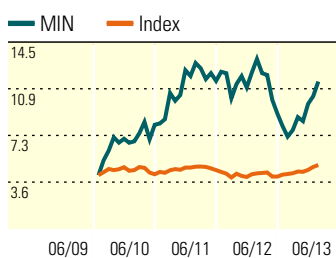
Financials	Historical			Forecast		
	06/10	06/11	06/12	06/13	06/14	06/15
<b>Balance Sheet (\$Mil)</b>						
Cash & Equivalents	434.1	462.3	222.7	50.0	50.0	113.0
Accounts Receivable	78.0	80.8	81.5	85.1	86.3	86.9
Inventory	0.0	0.0	0.0	0.0	0.0	0.0
Other Short-Term Operating Assets	32.0	23.5	53.3	53.3	53.3	53.3
<b>Total Current Assets</b>	<b>544.1</b>	<b>566.6</b>	<b>357.6</b>	<b>188.4</b>	<b>189.7</b>	<b>253.3</b>
Property Plant & Equipment, Net	4,129.4	4,203.8	4,311.5	4,354.4	4,394.8	4,362.7
Goodwill, Net	0.0	0.0	0.0	0.0	0.0	0.0
Other Intangibles	1,584.8	1,605.4	1,634.8	1,601.9	1,568.9	1,536.0
Other Long-Term Operating Assets	0.0	0.0	0.0	0.0	0.0	0.0
Deferred Tax Assets	12.1	46.7	59.9	59.9	59.9	59.9
Long-Term Non-Operating Assets	44.3	25.4	34.0	34.0	34.0	34.0
<b>Total Assets</b>	<b>6,314.8</b>	<b>6,447.8</b>	<b>6,397.8</b>	<b>6,238.6</b>	<b>6,247.2</b>	<b>6,245.8</b>
Accounts Payable	218.2	258.4	317.5	368.2	376.4	395.5
Short-Term Debt	1,044.3	1,012.5	259.6	100.0	100.0	100.0
Other Short-Term Operating Liabilities	98.5	69.6	108.0	108.0	108.0	108.0
<b>Total Current Liabilities</b>	<b>1,361.0</b>	<b>1,340.5</b>	<b>685.1</b>	<b>576.3</b>	<b>584.4</b>	<b>603.5</b>
<b>Total Long-Term Debt</b>	<b>3,449.4</b>	<b>3,406.8</b>	<b>3,939.7</b>	<b>4,025.1</b>	<b>4,001.5</b>	<b>4,000.0</b>
Long-Term Operating Liabilities	0.0	0.0	0.0	0.0	0.0	0.0
Deferred Tax Liabilities	436.7	398.7	378.6	378.6	378.6	378.6
Long-Term Non-Operating Liabilities	225.7	251.3	307.6	307.6	307.6	307.6
<b>Total Liabilities</b>	<b>5,472.8</b>	<b>5,397.3</b>	<b>5,311.1</b>	<b>5,287.7</b>	<b>5,272.2</b>	<b>5,289.8</b>
Preferred Stock	0.0	0.0	0.0	0.0	0.0	0.0
Minority Interest	0.0	0.0	0.0	0.0	0.0	0.0
<b>Total Equity</b>	<b>841.6</b>	<b>916.1</b>	<b>924.0</b>	<b>950.9</b>	<b>975.0</b>	<b>956.0</b>
<b>Profitability %</b>						
EBITDA Margin	72.1	72.5	73.1	71.1	71.0	70.1
EBIT Margin	52.7	51.4	51.3	49.4	49.4	48.6
Net Profit Margin	17.3	13.6	12.0	11.8	12.1	12.2
Free Cash Flow Margin	15.5	73.8	35.7	53.7	49.3	58.0
Return on Equity	14.1	12.2	10.8	10.9	11.0	11.2
Return on Assets	2.0	1.7	1.5	1.6	1.7	1.7
Return on Invested Capital(w/Goodwill)	7.9	8.4	7.7	8.1	8.2	8.2
ROIC (w/Goodwill) Less WACC	-0.2	0.3	-0.4	-0.0	0.1	0.1
<b>Leverage &amp; Liquidity</b>						
Net Debt to Capital %	76.1	74.2	77.6	80.3	79.8	78.9
Net Debt/(Net Debt + Equity) %	82.8	81.2	81.1	81.1	80.6	80.7
Net Debt/Equity %	482.4	431.9	430.4	428.6	415.5	417.0
Net Debt/EBITDA x	7.9	6.9	6.6	6.6	6.5	6.4
EBIT/Net Interest Expense x	1.5	1.4	1.3	1.3	1.3	1.3
Current Ratio (Current Assets/Current Liabilities) x	0.4	0.4	0.5	0.3	0.3	0.4
Dividend Payout Ratio %	172.4	199.4	172.4	184.4	193.0	204.4
Net Cash Per Share ¢	-379.2	-369.6	-371.5	-355.8	-336.4	-315.7
<b>Valuation</b>						
Price/Earnings x	14.6	16.7	18.8	24.4	24.7	25.5
PEG Ratio x	4.1	-1.2	-2.5	-6.8	-15.8	-9.0
EV/EBITDA x	11.4	10.0	9.6	10.3	10.1	10.2
EV/EBIT x	15.6	14.1	13.7	14.8	14.5	14.7
Free Cash Flow Yield %	6.1	32.5	15.9	18.6	16.5	18.7
Dividend Yield %	11.8	11.9	9.2	7.6	7.8	8.0
Price/(OCF per share) x	6.1	5.7	7.2	7.4	8.7	8.7
Price/(FCF per share) x	16.3	3.1	6.3	5.4	6.1	5.4
Price/Sales x	2.5	2.3	2.3	2.9	3.0	3.1
Price/NTA x	-2.4	-3.2	-3.4	-3.8	-4.4	-4.7
Price/Book x	2.2	2.0	2.0	2.6	2.7	2.9

# Mineral Resources Limited MIN

## Snapshot

Business Risk	High
Price Risk	High
Moat Rating	None
Fair Value \$	7.50
Market Cap \$Mil	2,127
Morningstar Style Box	
Last Price \$	11.45
52 Week High/Low \$	13.33/6.19
Shares Issued Mil	186
Sector	GICS - Commercial Serv/Supp

## Price vs. Market



	06/11	06/12	06/13e	06/14e
NPAT (\$Mil)	134.9	175.8	141.0	117.8
EPS ¢	77.5	95.2	76.3	63.7
EPS Chg %	25.2	22.7	-19.8	-16.5
DPS ¢	42.0	46.0	46.0	46.0
Franked %	100.0	100.0	100.0	100.0
Div Yld %	3.8	4.0	4.0	4.0
P/E x	14.1	11.9	15.0	18.0

Source: Morningstar analyst estimates.

## Business Description

Mineral Resources Limited (MIN) a leading, integrated, Australian based mining services and processing company with operations in contract crushing, general mine services, infrastructure provision and recovery of base metal concentrate for export. MIN's market brands of service provider are PIHA, Crushing Services International, Process Minerals International; and brands of minerals producer are Polaris Metals and Mesa Minerals.

## Iron ore weighs on solid crushing growth

Analyst Recommendation: **Reduce**

15 February 2013



## Investment Rating

Mineral Resources is a Western Australian mining services provider and producer of iron ore and manganese. The mining services business generates relatively defensive recurring earnings from the provision of crushing and screening services to the iron ore sector. Iron ore sales grew from 220,000 in fiscal 2008 to 3.8 million tonnes in fiscal 2012 and are expected to be over 4 million tonnes in fiscal 2013. An excellent financial track record is overshadowed somewhat by poor disclosure of iron ore resources, reserves and divisional profitability. Regular fully franked dividends are a key attraction but exposure to the iron ore price and AUD/USD exchange rate make the shares suitable for high risk tolerant investors only.

## Event

► Mineral Resources reported an underlying AUD 63 million net profit for the first half of fiscal 2013, 30% below the underlying net profit in the prior half. The fall was attributed to iron ore price weakness despite mining services and iron ore production growth. As usual, operational and financial details were scant. Iron ore production increased 13% to 2.5 million tonnes but no cash cost, grade, realised pricing, resource or reserve information was provided. There is insufficient disclosure to understand the financial performance of the iron ore and contracting segments.

## Impact

► The mining services business appears to be performing well and increased profit before tax by AUD 50 million. Based upon the limited information

provided, we estimate iron ore production was loss making and that mining service margins were greater than our forecast. Iron ore price strength should improve earnings in the second half as will the new crushing and screening contracts. We update our model for higher crushing margins and stronger second half iron ore earnings which increases our fiscal 2013 net profit forecast by 19% to AUD 141 million. Higher long term crushing margin forecasts increase our fair value estimate by 16% to AUD 7.50 per share.

## Recommendation Impact

At AUD 11.45 a share our recommendation is Reduce.

# Mineral Resources Limited MIN

**Gareth James**

Morningstar Analyst

## Analyst Note

Mineral Resources reported an underlying AUD 63 million net profit for the first half of fiscal 2013, 30% below the underlying net profit in the prior half. The fall was attributed to iron ore price weakness despite mining services and iron ore production growth. As usual, operational and financial details were scant. Iron ore production increased 13% to 2.5 million tonnes but no cash cost, grade, realised pricing, resource or reserve information was provided. There is insufficient disclosure to understand the financial performance of the iron ore and contracting segments.

Management said the full year fiscal 2013 result will be '...significantly skewed towards a strong second half performance...supported by increased contracting and production tonnages and continued strength of iron demand and pricing...'. However, we have reservations about the long term viability of the iron ore business and at our long term price forecast of USD 90 per tonne (2013 prices, delivered China) we expect it to be loss making. The business has option value for when iron ore prices are favourable.

The mining services business appears to be performing well and increased profit before tax by AUD 50 million. Based upon the limited information provided, we estimate iron ore production was loss making and that mining service margins were greater than our forecast. Iron ore price strength should improve earnings in the second half as will the new crushing and screening contracts. We update our model for higher crushing margins and stronger second half iron ore earnings which increases our fiscal 2013 net profit forecast by 19% to AUD 141 million. Higher long term crushing margin forecasts increase our fair value estimate by 16% to AUD 7.50 per share. But while mining services earnings may prove resilient, iron ore production may not necessarily be profitable at more normal prices.

An interim fully franked dividend of AUD 0.16 per share was announced, in line with the prior period and our forecast. The dividend will cost as much as AUD 30 million, depending on the dividend reinvestment plan which provides capital for growth. If the second half dividend is also maintained, a further AUD 60 million will be needed. The dividend is somewhat surprising considering the lower cash flow in the half. Operating cash flow fell 11% to AUD 93 million and free cash out flow (operating less investing) was AUD 145 million. The result was a 68% fall in cash to just AUD 25 million. Net debt tripled to AUD 328 million and gearing jumped from 11% to 26%. We estimate over AUD 300 million of debt facilities remain which should be ample to fund future planned development.

Admittedly, cash outflows were due to 'investment' in the business, however, we doubt iron ore production will make an attractive return at our long term price forecast of USD 90 per tonne (landed China, 2012 prices). We estimate Mineral Resources currently needs an iron ore price of around USD 120 per tonne (62% iron, delivered China) to break even, at a net profit level, and that the iron ore business lost around AUD 15 million during the half. Mine life is also unclear and may prove short lived as no reserves are reported. The lack of disclosure remains our key concern and influences our cautious approach towards the stock.

# Mineral Resources Limited MIN

## Bulls Points

- ▶ An excellent track record of long term revenue, profit and dividend growth.
- ▶ Exposure to Chinese economic growth.
- ▶ Strong growth potential from higher iron ore and manganese sales and mining services sales.
- ▶ Crushing and screening profits should be relatively resilient to a downturn in the mining sector.
- ▶ Low net debt means the company should withstand a downturn in the mining sector relatively well.

## Bears Points

- ▶ Significant and growing exposure to the volatile iron ore price is likely to increase earnings volatility and may cause profits to fall.
- ▶ A lack of disclosure of resources, reserves and segmental profitability details means earnings visibility is poor and fair value uncertainty is high.

## Key Valuation Assumptions

Cost of Equity %	13.0
Weighted Avg Cost of Capital %	9.3
Long Run Tax Rate %	30.0
Stage II EBI Growth Rate %	3.0
Stage II Investment Rate %	30.0
Perpetuity Year	10.0

## Thesis Last Updated: 28 Sep 2012

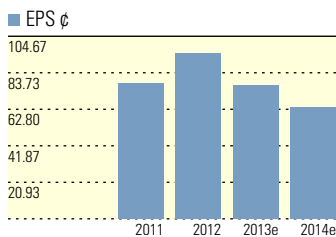
Mineral Resources was formed in January 2006 by the merger of Crushing Services International (CSI), Process Minerals International (PMI) and PIHA. All three businesses are based in Western Australia and are involved in the mining and mining services sectors. CSI provides contract crushing services to the mining industry via a build own operate. PIHA provides pipelaying and cable installation services and manufactures polyethylene pipe fittings. Process Minerals International (PMI) has title to the reject fines manganese product from past and future processing operations from the Woodie Woodie tenements in the north-west of Western Australia. The acquisition of Polaris Metals enabled the expansion of iron ore production, which is expected to reach over 4 million tonnes in fiscal 2013. An excellent financial track record is overshadowed somewhat by poor disclosure of iron ore resources, reserves and divisional profitability. Regular fully franked dividends are a key attraction but exposure to the iron ore price and AUD/USD exchange rate make the shares suitable for high risk tolerant investors only.

## Valuation Last Updated: 15 Feb 2013

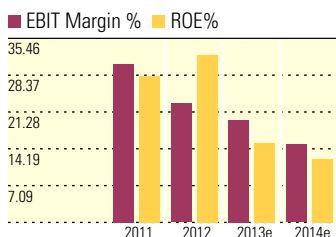
We assume the majority of fiscal 2012 gross profit is attributable to mining services operations and will grow by 25% in fiscal 2013. We forecast a 22% increase in iron ore sales to 4.6 million tonnes but an 11% drop in revenue due to a 27% fall in the iron ore price. We forecast a fiscal 2013 gross profit of AUD 398 million implying a 38% margin. We assign a high risk rating due to iron ore price exposure and a 11% weighted average cost of capital. Our fair value estimate is AUD 7.50 a share implying an equity value of AUD 1.4 billion, a historic PE ratio of 7.9x and a fiscal 2013 PE ratio of 9.8x. We forecast dividend cover (EPS/DPS) to fall from 2.1x in fiscal 2012 to 1.7x in fiscal 2013. We expect the dividend to be maintained at AUD 0.46 a share and to be fully franked implying a yield of 7.2% before franking benefits at fair value.

# Mineral Resources Limited MIN

## EPS



## EBIT Margin vs. ROE



## Risk Last Updated: 28 Sep 2012

Mineral Resources is highly exposed to the iron ore sector with the iron ore price and the AUD/USD exchange rate key profit drivers. A weaker iron ore price or strong Australian dollar could reduce revenue from iron ore sales and impact the crushing and screening business. Fortescue Metals accounted for 30% of revenue in fiscal 2012 and as a relatively high cost producer of iron ore could be considered a meaningful credit risk. A slowing of Chinese economic growth could reduce steel production and iron ore demand. A lack of disclosure of resource, reserve and segmental profitability means future earnings visibility is poor.

replace. Iron ore sales rose are in increasing contributor to earnings with sales growing from 220,000 tonnes in fiscal 2008 to 3.8 million tonnes in fiscal 2012. Ore was historically sourced from third parties but future sales will be from company owned mines.

## Financial Overview

### Growth

Mineral Resources grew significantly following listing on the ASX in 2006. Underlying net profit grew impressively from AUD 25 million in fiscal 2007 to AUD 176 million in fiscal 2012. Future growth will come from additional crushing and screening contracts and iron ore production growth.

### Profitability

We assume gross profit is split in a similar ratio to revenue implying a gross profit margin of 34% for iron ore sales in fiscal 2012. Profits may be impacted in fiscal 2013 by the 28% slide in iron ore price from USD 145 a tonne in fiscal 2012 (CFR China) to USD 105 in the first half.

### Financial Health

Mineral Resources is in good financial health having been consistently profitable for the past decade. Operating cash flow has also been consistently positive and growing. Net debt of AUD 328 million is relatively low and manageable.

## Strategy Analysis Last Updated: 28 Sep 2012

Mineral Resources operates in the mining services and mining sectors in Western Australia. The core business and underlying earnings growth driver is subsidiary Crushing and Screening International (CSI), a provider of ore crushing and screening services mainly to the iron ore sector. Major clients are Fortescue Metals and Rio Tinto. CSI builds, owns, and operates processing plants at mines making it an integral part of the production process and difficult to



# General Financials

Financials	Historical					Forecast		
	06/08	06/09	06/10	06/11	06/12	06/13	06/14	06/15
<b>Per Share</b>								
Sales ¢	201.9	206.9	219.2	354.0	529.3	569.9	629.5	605.0
Adjusted Earnings ¢	36.6	38.4	61.9	77.5	95.2	76.3	63.7	53.4
Free Cash Flow ¢	45.5	-0.7	64.0	-23.6	-73.2	-3.2	121.3	109.0
Net Tangible Assets ¢	86.1	106.7	127.5	184.2	238.4	268.7	286.5	293.9
Book Value ¢	94.4	114.8	316.7	348.6	484.8	515.1	532.8	540.2
Dividends ¢	19.4	19.4	20.0	42.0	46.0	46.0	46.0	46.0
Franking %	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
<b>Growth %</b>								
Sales Revenue	67.7	5.1	22.0	93.4	58.8	7.7	10.5	-3.9
EBITDA	129.9	-14.8	39.6	127.3	24.9	18.2	-8.5	-7.4
Pre-Tax Profit	161.9	-19.4	51.2	155.9	7.3	-10.2	-16.4	-16.2
EPS	120.4	4.9	61.3	25.2	22.7	-19.8	-16.5	-16.2
DPS	103.7	0.0	3.4	110.0	9.5	0.0	0.0	0.0
Free Cash Flow per share	123.6	-101.6	-	-144.2	-	-	-	-10.1
<b>Profit &amp; Loss (\$Mil)</b>								
Sales Revenue	248.2	260.9	318.5	616.1	978.2	1,053.1	1,163.2	1,118.0
EBITDA	87.1	74.2	103.7	235.6	294.3	347.8	318.2	294.5
Depreciation	19.6	18.4	19.3	26.3	68.7	140.0	143.5	147.1
Amortisation	-	-	-	-	-	0.0	0.0	0.0
EBIT	67.5	55.8	84.4	209.3	225.6	207.8	174.7	147.4
Interest Expense	2.2	3.3	5.1	5.6	6.4	6.4	6.4	6.4
Interest Income	1.8	1.5	2.4	5.3	5.0	0.0	0.0	0.0
Profit Before Tax	67.0	54.0	81.7	208.9	224.2	201.4	168.3	141.0
Tax	19.9	9.9	-15.5	58.4	47.1	60.4	50.5	42.3
Reported NPAT	47.1	44.1	97.2	150.5	242.2	141.0	117.8	98.7
Non-Recurring Items After Tax	2.1	-4.3	7.2	15.6	66.4	0.0	0.0	0.0
<b>Adjusted NPAT</b>	<b>45.0</b>	<b>48.4</b>	<b>90.0</b>	<b>134.9</b>	<b>175.8</b>	<b>141.0</b>	<b>117.8</b>	<b>98.7</b>
Free Cash Flow	56.0	-0.9	93.0	-41.1	-135.2	-5.9	224.1	201.4
Effective Tax Rate %	29.7	18.3	-19.0	28.0	21.0	30.0	30.0	30.0
<b>Cash Flow (\$Mil)</b>								
Receipts from Customers	250.8	257.5	364.0	630.9	894.9	1,042.2	1,147.3	1,124.6
Payments to Suppliers	-146.0	-185.7	-193.3	-438.1	-602.7	-704.1	-810.4	-829.2
Other Operating Cashflow	-8.1	-25.9	-19.7	-2.1	-49.4	-48.6	-67.3	-47.0
<b>Net Operating Cashflow</b>	<b>96.8</b>	<b>45.9</b>	<b>151.0</b>	<b>190.7</b>	<b>242.9</b>	<b>289.6</b>	<b>269.6</b>	<b>248.4</b>
Capex	-41.1	-48.2	-58.9	-151.6	-275.5	-300.0	-50.0	-51.5
Acquisitions & Investments	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Sales of Investments & Subsidiaries	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other Investing Cashflow	0.0	0.0	-2.3	-6.6	-103.7	0.0	0.0	0.0
<b>Net Investing Cashflow</b>	<b>-41.1</b>	<b>-48.2</b>	<b>-61.2</b>	<b>-158.1</b>	<b>-379.2</b>	<b>-300.0</b>	<b>-50.0</b>	<b>-51.5</b>
Proceeds from Issues	1.7	1.1	58.7	37.5	66.7	0.0	0.0	0.0
Proceeds from Borrowings	-12.2	31.6	-2.2	-17.2	40.7	0.0	0.0	0.0
Dividends Paid	-15.0	-25.2	-25.5	-46.9	-75.3	-85.0	-85.0	-85.0
Other Financing Cashflow	0.0	0.0	-1.1	-0.0	0.0	0.0	0.0	0.0
<b>Net Financing Cashflow</b>	<b>-25.5</b>	<b>7.5</b>	<b>29.8</b>	<b>-26.6</b>	<b>32.1</b>	<b>-85.0</b>	<b>-85.0</b>	<b>-85.0</b>
Net Increase Cash	30.1	5.3	119.6	6.0	-104.2	-95.4	134.6	111.9
Cash at Beginning	19.5	49.6	54.9	174.5	180.5	76.3	-19.2	115.4
Exchange Rate Adjustment	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Cash at End	49.6	54.9	174.5	180.5	76.3	-19.2	115.4	227.3

# General Financials

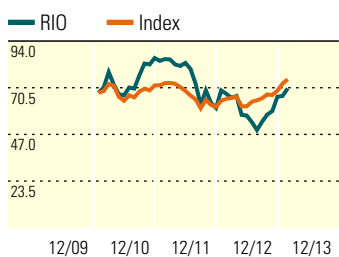
Financials	Historical					Forecast		
	06/08	06/09	06/10	06/11	06/12	06/13	06/14	06/15
<b>Balance Sheet (\$Mil)</b>								
Cash & Equivalents	49.6	54.9	174.5	180.5	76.3	-19.2	115.4	227.3
Accounts Receivable	19.4	36.8	56.8	109.4	141.9	152.8	168.7	162.2
Inventory	14.3	16.3	30.4	17.0	67.1	48.9	59.2	57.5
Other Short-Term Operating Assets	1.1	0.8	0.8	6.1	1.8	1.8	1.8	1.8
<b>Total Current Assets</b>	<b>84.3</b>	<b>108.8</b>	<b>262.4</b>	<b>312.9</b>	<b>287.1</b>	<b>184.3</b>	<b>345.1</b>	<b>448.7</b>
Property Plant & Equipment, Net	120.4	157.0	214.7	319.5	584.1	744.1	650.6	555.1
Goodwill, Net	-	-	-	-	-	0.0	0.0	0.0
Other Intangibles	10.2	10.2	300.4	306.9	476.1	476.1	476.1	476.1
Other Long-Term Operating Assets	4.3	2.6	4.5	6.3	4.9	4.9	4.9	4.9
Deferred Tax Assets	4.4	10.1	62.7	24.4	83.7	83.7	83.7	83.7
Long-Term Non-Operating Assets	-	-	-	-	-	0.0	0.0	0.0
<b>Total Assets</b>	<b>223.6</b>	<b>288.8</b>	<b>844.8</b>	<b>970.1</b>	<b>1,435.9</b>	<b>1,493.1</b>	<b>1,560.5</b>	<b>1,568.5</b>
Accounts Payable	39.0	40.5	142.8	91.7	162.4	163.6	198.2	192.5
Short-Term Debt	0.0	0.0	14.1	64.4	34.8	34.8	34.8	34.8
Other Short-Term Operating Liabilities	35.1	19.3	23.7	35.6	18.6	18.6	18.6	18.6
<b>Total Current Liabilities</b>	<b>74.1</b>	<b>59.8</b>	<b>180.6</b>	<b>191.6</b>	<b>215.7</b>	<b>217.0</b>	<b>251.5</b>	<b>245.8</b>
Total Long-Term Debt	0.0	45.0	45.0	37.7	152.3	152.3	152.3	152.3
Long-Term Operating Liabilities	20.1	24.4	25.5	10.7	9.4	9.4	9.4	9.4
Deferred Tax Liabilities	13.4	14.9	108.0	102.5	141.8	141.8	141.8	141.8
Long-Term Non-Operating Liabilities	-	-	-	-	-	0.0	0.0	0.0
<b>Total Liabilities</b>	<b>107.6</b>	<b>144.0</b>	<b>359.1</b>	<b>342.6</b>	<b>519.2</b>	<b>520.4</b>	<b>555.0</b>	<b>549.3</b>
Preferred Stock	-	-	-	-	-	0.0	0.0	0.0
Minority Interest	0.0	0.0	25.5	20.9	20.9	20.9	20.9	20.9
<b>Total Equity</b>	<b>116.0</b>	<b>144.8</b>	<b>485.7</b>	<b>627.5</b>	<b>916.8</b>	<b>972.7</b>	<b>1,005.5</b>	<b>1,019.2</b>
<b>Profitability %</b>								
EBITDA Margin	35.1	28.4	32.6	38.2	30.1	33.0	27.4	26.3
EBIT Margin	26.0	23.4	24.6	30.5	22.9	19.7	15.0	13.2
Net Profit Margin	19.0	16.9	30.5	24.4	24.8	13.4	10.1	8.8
Free Cash Flow Margin	22.6	-0.4	29.2	-6.7	-13.8	-0.6	19.3	18.0
Return on Equity	49.1	33.8	32.1	28.2	32.2	15.3	12.2	10.0
Return on Assets	24.7	17.2	17.2	16.6	20.1	9.6	7.7	6.3
Return on Invested Capital(w/Goodwill)	45.7	28.0	19.1	18.2	22.7	12.8	10.4	8.7
ROIC (w/Goodwill) Less WACC	36.4	18.7	9.8	9.0	13.4	3.5	1.1	-0.6
<b>Leverage &amp; Liquidity</b>								
Net Debt to Capital %	-74.6	-7.3	-33.5	-14.8	11.0	17.8	6.8	-4.2
Net Debt/(Net Debt + Equity) %	-74.6	-7.3	-33.5	-14.8	11.0	17.8	6.8	-4.2
Net Debt/Equity %	-42.7	-6.8	-25.1	-12.9	12.4	21.7	7.3	-4.0
Net Debt/EBITDA x	-0.6	-0.1	-1.1	-0.3	0.4	0.6	0.2	-0.1
EBIT/Net Interest Expense x	148.6	30.8	31.1	562.7	162.2	32.3	27.1	22.9
Current Ratio (Current Assets/Current Liabilities) x	1.1	1.8	1.5	1.6	1.3	0.8	1.4	1.8
Dividend Payout Ratio %	52.9	50.4	32.3	54.2	48.3	60.3	72.2	86.1
Net Cash Per Share ¢	40.3	7.8	79.4	45.1	-60.0	-111.6	-38.8	21.7
<b>Valuation</b>								
Price/Earnings x	13.2	9.7	10.6	14.1	11.9	15.0	18.0	21.4
PEG Ratio x	0.1	2.0	0.2	0.6	0.5	-0.8	-1.1	-1.3
EV/EBITDA x	6.2	6.2	8.1	7.7	7.5	6.4	7.0	7.6
EV/EBIT x	8.4	7.5	10.7	9.7	9.9	10.7	12.7	15.1
Free Cash Flow Yield %	9.4	-0.2	9.7	-2.2	-6.4	-0.3	10.6	9.5
Dividend Yield %	4.0	5.2	3.0	3.8	4.0	4.0	4.0	4.0
Price/(OCF per share) x	6.1	10.2	6.3	10.0	8.7	7.3	7.8	8.5
Price/(FCF per share) x	10.6	-513.5	10.3	-46.3	-15.5	-357.0	9.4	10.5
Price/Sales x	2.4	1.8	3.0	3.1	2.1	2.0	1.8	1.9
Price/NTA x	5.6	3.5	5.1	5.9	4.8	4.3	4.0	3.9
Price/Book x	5.1	3.2	2.1	3.1	2.3	2.2	2.1	2.1

# Rio Tinto Limited RIO

## Snapshot

Business Risk	Medium
Price Risk	Medium
Moat Rating	Narrow
Fair Value \$	95.00
Market Cap \$Mil	30,568
Morningstar Style Box	
Last Price \$	70.15
52 Week High/Low \$	72.30/48.37
Shares Issued Mil	436
Sector	GICS - Materials

## Price vs. Market



	12/11	12/12	12/13e	12/14e
NPAT (\$Mil)	15,053.9	8,987.5	12,527.8	13,388.1
EPS ¢	782.3	485.3	676.4	722.9
EPS Chg %	0.2	-38.0	39.4	6.9
DPS ¢	140.4	161.3	188.3	212.3
Franked %	100.0	100.0	100.0	100.0
Div Yld %	1.8	2.7	2.7	3.0
P/E x	9.1	11.5	10.4	9.7

Source: Morningstar analyst estimates.

## Business Description

Rio Tinto Limited (RIO) is one of the world's largest international mining groups, involved in every stage of metal and mineral production. Rio Tinto comprises five principal product groups - Aluminium, Copper, Diamonds & Minerals, Energy and Iron Ore - plus two support groups: Technology & Innovation and Exploration.

## Walsh's Fighting Words Light on Detail

Analyst Recommendation: **Accumulate**

15 February 2013



## Investment Rating

RIO is a diversified global resource leader with a portfolio of world class assets in aluminium, coal, copper, diamonds, gold, iron ore, industrial minerals and uranium. A top three miner behind BHP and Vale. Operations span six continents but sovereign risk is low with most assets in Australia, the US, Europe and Canada. The balance sheet was weakened by the Alcan acquisition but improved post a forced major US\$15.2bn equity raising in 2009 and ongoing asset sell-downs. Net debt to equity is currently a modest 20%. A recent departure from famed conservatism placed a cloud over the board but management at the asset level remains solid.

## Event

► Underlying 2012 profit fell 40% to USD 9.3 billion in line with our recently downgraded forecast and consensus. Earnings per share fell 38% to USD 5.02. Iron ore's dominance again featured with USD 14.3 billion EBIT, higher than the overall group's USD 13.4 billion, despite falling 29% due to lower prices. That bizarre outcome reflects losses in aluminium even though a considerable portion is excised in the Pacific Aluminium departure lounge. Pacific Aluminium houses Rio's Australian aluminium assets ready for divestment. The portion being retained managed break-even at best. The copper division recorded a 43% decline in EBIT to USD 2.0 billion in line with expectations, softer copper prices detracting.

► While there were no operational surprises dividends did surprise on the upside, the full year increasing 15% to USD 1.67 per share on a 33% payout. This backs up a Sam Walsh pledge to

"[balance] capital returns to shareholders and capital expenditure". The new CEO has moved quickly to stamp his style on Rio. He targets USD 5 billion in cumulative cash cost savings by 2014, a reduction in capital expenditure to USD 13 billion in 2013 versus 2012's USD 17.5 billion, and a 40% decline in exploration spending to USD 1.2 billion in 2013. Rio's operating costs in 2012 were USD 31 billion.

## Impact

- Our fair value estimate remains AUD 95 per share. Our 2013 earnings forecast is AUD 6.76 per share, up 39% on 2012 with higher iron ore and copper volumes and, we hope, recovering aluminium prices. Our 2014 forecast is AUD 7.23 per share, more modest growth assuming an even more robust recovery in aluminium.
- Walsh now carries the weight of expectation for a Rio rejuvenation. The bar is set high and scrutiny will be exacting. Dividends will be paid on April 11, shares trade ex-entitlements on March 6.

## Recommendation Impact

Unchanged.

# Rio Tinto Limited RIO

**Mark Taylor**

Morningstar Analyst

## Analyst Note

### Walsh's fighting words light on detail

Underlying 2012 profit fell 40% to USD 9.3 billion in line with our recently downgraded forecast and consensus. Earnings per share fell 38% to USD 5.02. Iron ore's dominance again featured with USD 14.3 billion EBIT, higher than the overall group's USD 13.4 billion, despite falling 29% due to lower prices. That bizarre outcome reflects losses in aluminium even though a considerable portion is excised in the Pacific Aluminium departure lounge. Pacific Aluminium houses Rio's Australian aluminium assets ready for divestment. The portion being retained managed break-even at best. The copper division recorded a 43% decline in EBIT to USD 2.0 billion in line with expectations, softer copper prices detracting.

There were no operational surprises and our fair value estimate remains AUD 95 per share. Our 2013 earnings forecast is AUD 6.76 per share, up 39% on 2012 with higher iron ore and copper volumes and, we hope, recovering aluminium prices. Our 2014 forecast is AUD 7.23 per share, more modest growth assuming an even more robust recovery in aluminium. Dividends however did surprise on the upside, the full year increasing 15% to USD 1.67 per share on a 33% payout. This backs up a Sam Walsh pledge to "[balance] capital returns to shareholders and capital expenditure". The new CEO has moved quickly to stamp his style on Rio. He targets USD 5 billion in cumulative cash cost savings by 2014, a reduction in capital expenditure to USD 13 billion in 2013 versus 2012's USD 17.5 billion, and a 40% decline in exploration spending to USD 1.2 billion in 2013. Rio's operating costs in 2012 were USD 31 billion.

These are fighting words that will please a market focused on income rather than growth. That said when pressed for detail at the results presentation, Walsh struggled to convincingly enunciate the means by which transformation will occur. He was clear on the big picture though stressing capital would only be invested in assets which "after prudent assessment, offer attractive returns that are well above our cost of capital." Music to our ears but the proof's in the pudding!

Walsh also targets significant cash proceeds from divestment of non-core businesses in 2013. One wonders how far the For Sale list might extend. Sovereign risk has been highlighted again for Rio with on-going political concerns at Oyu Tolgoi copper/gold in Mongolia (now commissioning), Simandou iron ore in Guinea (still requiring of an assured fiscal regime) and Mozambique coal where difficulties led to a USD 2.9 billion impairment charge. Scrap the lot we say for a decent Aussie oil and gas play. Sovereign risk is low and the energy hedge a bonus. Does building competing iron ore mines in high sovereign risk locales only appear nuts to us?

Headline profit plunged to a USD 3.0 billion loss including USD 14.4 billion in impairments, predominantly aluminium assets, but also including Mozambique coal. This was partially offset by recognition of USD 1.0 billion deferred tax asset deductible against future Mineral Resources Rent Tax liability. Nothing particularly new in this! Further, Rio received USD 1.4 billion from Chalco for Simandou and USD 0.9 billion for the Oyu Tolgoi rights offering. Neither hit the P&L, instead appearing as proceeds from share issues.

Net operating cash flow halved to USD 9.5 billion due to lower prices, exacerbated by lower dividends from Escondida copper in Chile due to capital expenditure. Net debt climbed from USD 12.1 billion to USD 19.7 billion, 34% net debt to equity beginning to push the friendship again. The clamp-down on costs and capital expenditure might not just be driven by a desire for excellence. The balance sheet is sending early warning signals as well. Still EBIT interest cover at over 20 times remains very comfortable.

Walsh now carries the weight of expectation for a Rio rejuvenation. The bar is set high and scrutiny will be exacting. Dividends will be paid on April 11, shares trade ex-entitlements on March 6.

# Rio Tinto Limited RIO

**Mark Taylor**  
Morningstar Analyst

Full Year Result	FY11	FY12	%Chg
Sales (US\$m)	60,537	50,967	-15.8
Underlying EBITDA (US\$m)	27,546	17,834	-35.3
Underlying EBIT (US\$m)	23,850	13,393	-43.8
Pre-Tax Profit (US\$m)	23,115	12,817	-44.6
Underlying NPAT (US\$m)	15,549	9,303	-40.2
NPAT (US\$m)	5,826	-2,990	-151.3
EPS (US cents)	808	502	-37.8
DPS (US cents)	145	167	15.2
Payout Ratio	18%	33%	85.3
EPS (AUS cents)	782	485	-38.0
DPS (AUS cents)	140	161	14.8
EBIT Margin	39%	26%	-33.3
EBITDA Margin	46%	35%	-23.1
ROIC	17%	9%	-45.1
Net Operating Cash Flow	19,784	9,489	-52.0
Net Debt	12,134	19,737	62.7
Net Debt to Equity	20%	34%	66.0
Divisional EBIT (US\$m)	FY11	FY12	%Chg
Iron Ore	20,170	14,316	-29.0
Energy	1,792	206	-88.5
Industrial Minerals	391	736	88.2
Aluminium	665	-8	-101.2
Copper	3,429	2,149	-37.3
Diamonds	34	-65	-291.2
Group & Unallocated	-2,631	-3,941	49.8
TOTAL	23,850	13,393	-43.8

# Rio Tinto Limited RIO

## Bulls Points

- ▶ Rio is one of the direct beneficiaries of the increasing appetite for natural resources in China.
- ▶ Rio's cash flow base is diversified, and the company is less susceptible to the vagaries of the market than single-commodity producers are.
- ▶ The company is run exceptionally well and enjoys a broad portfolio of first-class, low-cost assets.
- ▶ Growing producer concentration is slowly tipping pricing power away from the end user toward miners like Rio.
- ▶ As staple commodities for developing nations, prices for iron ore and copper in particular are performing very strongly. Two thirds of Rio's value derives from iron ore and copper.

## Bears Points

- ▶ Sovereign risk heightened following the Australian government's intended Resource Super Profits Tax. The softer replacement Mineral Resource Rent Tax has reduced, but not erased, this risk.
- ▶ The global economy is cooling off. Demand for natural resources in China may have peaked, and the Chinese economy could begin to slow.
- ▶ Diversified miners' stocks always trade at discount valuations to pure plays. Investors interested in gaining exposure to a specific commodity would be better off investing in pure plays.
- ▶ Rio is subject to the long-term supply/demand balance for metals, the major factor in determining its profitability. The firm is top-heavy in iron ore and needs more balance in its product mix.
- ▶ Chinese mineral investment, for production rather than profit's sake, risks eroding some of the limited pricing power mining companies have more recently won.

## Key Valuation Assumptions

Cost of Equity %	11.0
Weighted Avg Cost of Capital %	10.4
Long Run Tax Rate %	26.0
Stage II EBI Growth Rate %	5.0
Stage II Investment Rate %	21.7
Perpetuity Year	15.0

## Thesis Last Updated: 16 Jan 2013

Rio Tinto is a top-tier global miner along with BHP Billiton BHP, Brazil's Vale VALE, and U.K.-based Anglo American AAUKY. A world-class asset base and capable management make Rio Tinto one of the few miners to earn more than its cost of capital through the commodity cycle. Geographic and product diversification give the company relatively stable cash flows and lower operating risk than many of its mining peers. Most revenue comes from the relative safe havens of Australia, North America, and Europe, though operations span half a dozen continents.

Through selective acquisitions and grass-roots exploration, Rio Tinto has assembled a large portfolio of long-lived, low-cost assets. Operations include world-class hubs in aluminum, coal, copper, diamonds, gold, iron ore, industrial minerals, and uranium. This competitive resource base sets Rio Tinto apart from most of the rest of the pack and supports above-average returns for both the resource industry generally and its more select diversified mining peers.

Rio Tinto's operating practices are geared toward creating long-term economic value. The company is constantly seeking to enhance efficiency. Planning horizons and existing operations ensure average production levels should be sustained for at least 20 years. The company has a portfolio of quality projects under development or appraisal and a focused exploration program to seek out and secure new opportunities for profitable expansion. A more recent focus on Alcan-related debt reduction saw much new investment relegated to the back burner. The strategic partnership with Ivanhoe Mines IVN to develop its Oyu Tolgoi copper and gold deposits enhances Rio Tinto's portfolio. Oyu Tolgoi is the largest undeveloped copper deposit in the world.

Rio's board came under criticism for leveraging up the balance sheet to acquire Alcan right at the cusp of the credit crisis. Planned asset sales were late to be realized, necessitating drastic expenditure cutbacks. A USD 15 billion entitlement issue significantly reduced balance sheet pressure, and Rio Tinto is now conservatively leveraged.

Rio has limited pricing power over most of its products. The notable exception is in iron ore, where,

along with BHP and Vale, Rio is a member of the global seaborne export oligopoly, with 25% share. Minimal pricing power is aggravated by the volatile and cyclical nature of commodity prices. However, we do assign a narrow economic moat to Rio Tinto, given the firm's large, low-cost, and irreplicable operations. The lack of comparable megadeposits and increasingly prohibitive capital costs pose barriers to entry. Additionally, some pricing power outside of iron ore is shifting toward producers, including in aluminum and copper, though to a lesser extent.

## Valuation Last Updated: 15 Feb 2013

There were no operational surprises and our fair value estimate remains AUD 95 per share. Our 2013 earnings forecast is AUD 6.76 per share, improved on 2012 with higher iron ore and copper volumes and we hope recovering aluminium prices. Our 2014 forecast is AUD 7.23 per share, higher again assuming even more robust recovery in aluminium. Stronger iron ore output is in line with company guidance for expansion in the Pilbara from 2012's record 199 million tonnes to 290 million tonnes by end 2013 and then 360 million tonnes by first half 2015. Targets are slightly improved on prior estimates as discussed below.

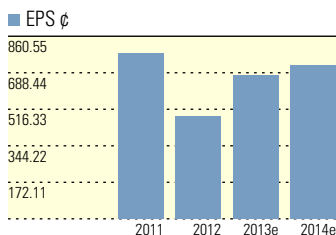
Iron ore delivered 75% of group EBIT in 2011 and 100% in fiscal 2012. Despite a 15% easing in second half 2012 FOB iron ore fines prices to USD 110 per tonne.

Around 50% of our Rio Tinto fair value estimate derives from iron ore. The next largest contributor is aluminium at 30% followed by copper at 15%. The 30% for aluminium assumes alumina prices improve to over USD 400 per tonne, up from current USD 330 per tonne levels for spot.

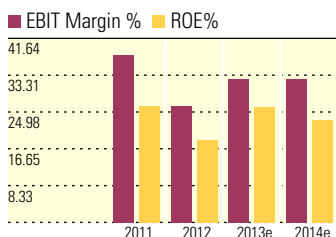
Key long-term valuation assumptions in 2013 dollars are: USD 90 per metric ton iron ore fines delivered China; USD 88 per metric ton thermal coal; USD 3.15 per pound copper; USD 1.60 per pound aluminum; and a long-term Australian dollar/U.S. dollar exchange rate of 1.00. Our fair value estimate employs a 12% cost of equity which translates to an 11% weighted average cost of capital on an assumed 10% debt to 90% equity split.

# Rio Tinto Limited RIO

## EPS



## EBIT Margin vs. ROE



## Risk Last Updated: 16 Apr 2012

Significant environmental and operating risks are associated with mining. Some of the company's assets have country-specific risks. Overall, Rio Tinto offers broad diversification, low costs, and a strong financial position. Because of the volatility in the underlying commodity prices, we think our fair value estimate carries a medium uncertainty rating.

## Financial Overview

### Growth

Rio has increased production of most commodities significantly since 2001 and has numerous development projects lined up. This, along with rising commodity prices, has resulted in revenue growing from US\$10.8 billion to over US\$58 billion in 2011.

### Profitability

The company is now on strong financial footing. Returns on invested capital have averaged 17% during the past five years and remain at high double digits following fiscal 2009's aluminum-affected 9%. Rio Tinto has now largely sold the lower-margin, noncore aluminum assets held longer than expected because of the global financial crisis. The five-year average EBITDA margin is a healthy 40% and rising.

### Financial Health

The USD 40 billion Alcan acquisition in 2007 saw interest coverage plummet to 5 times and leverage rise to 172%. A USD 15 billion restorative entitlement issue, asset sales, and strong cash flows returned debt/equity to sub 10%, albeit later than expected on account of the global financial crisis. Debt/equity has again risen to 20% following re-invigorated capital investment and share buy-back programs. Interest coverage remains over 20 times.

## Strategy Analysis Last Updated: 16 Apr 2012

RIO's aim is to invest in and operate large, long term, cost competitive mines and businesses. The Group concentrates on the discovery of Tier 1 orebodies and the development of Group assets into large scale, long life and low cost operations to ensure the Group can operate profitably at every stage of the commodity cycle.

# General Financials

Financials	Historical			Forecast		
	12/10	12/11	12/12	12/13	12/14	12/15
<b>Per Share</b>						
Sales ¢	3,108.7	3,045.8	2,658.7	3,182.2	3,316.3	3,464.2
Adjusted Earnings ¢	780.6	782.3	485.3	676.4	722.9	641.7
Free Cash Flow ¢	554.8	-80.3	-422.3	326.3	670.2	549.9
Net Tangible Assets ¢	2,427.6	2,166.8	2,536.2	2,512.9	3,035.8	3,460.0
Book Value ¢	3,250.9	2,643.4	2,444.7	3,020.6	3,543.5	3,967.6
Dividends ¢	116.9	140.4	161.3	188.3	212.3	222.9
Franking %	100.0	100.0	100.0	100.0	100.0	100.0
<b>Growth %</b>						
Sales Revenue	20.3	-2.8	-16.0	19.7	4.2	4.5
EBITDA	61.6	-0.9	-33.1	41.7	5.6	-7.7
Pre-Tax Profit	102.3	2.6	-42.3	43.8	6.9	-11.2
EPS	76.4	0.2	-38.0	39.4	6.9	-11.2
DPS	108.1	20.1	14.9	16.7	12.8	5.0
Free Cash Flow per share	11.5	-114.5	-	-	105.4	-17.9
<b>Profit &amp; Loss (\$Mil)</b>						
Sales Revenue	60,306.4	58,608.8	49,238.7	58,934.5	61,417.9	64,157.7
EBITDA	25,985.3	25,759.7	17,242.8	24,428.3	25,785.2	23,797.4
Depreciation	4,077.5	3,578.3	4,290.4	5,310.5	5,815.8	6,290.4
Amortisation	0.0	0.0	0.0	0.0	0.0	0.0
EBIT	21,907.8	22,181.4	12,952.4	19,117.8	19,969.4	17,507.0
Interest Expense	1,160.7	822.9	668.5	1,473.8	995.2	670.9
Interest Income	176.5	111.3	112.1	176.4	70.0	70.0
Profit Before Tax	20,923.6	21,469.8	12,395.9	17,820.5	19,044.2	16,906.2
Tax	5,779.6	6,415.9	3,408.4	4,633.3	4,951.5	4,395.6
Reported NPAT	15,144.0	15,053.9	8,987.5	12,527.8	13,388.1	11,885.0
Non-Recurring Items After Tax	0.0	0.0	0.0	0.0	0.0	0.0
<b>Adjusted NPAT</b>	<b>15,144.0</b>	<b>15,053.9</b>	<b>8,987.5</b>	<b>12,527.8</b>	<b>13,388.1</b>	<b>11,885.0</b>
Free Cash Flow	10,763.3	-1,545.0	-7,820.5	6,043.1	12,411.7	10,184.8
Effective Tax Rate %	27.6	29.9	27.5	26.0	26.0	26.0
<b>Cash Flow (\$Mil)</b>						
Receipts from Customers	58,881.6	58,713.3	49,688.0	56,987.6	61,111.7	63,819.9
Payments to Suppliers	-33,256.8	-31,649.6	-31,742.8	-37,157.6	-35,484.4	-39,284.7
Other Operating Cashflow	-6,027.5	-7,909.8	-8,777.9	-4,640.3	-4,409.0	-5,492.5
<b>Net Operating Cashflow</b>	<b>19,597.2</b>	<b>19,154.0</b>	<b>9,167.2</b>	<b>15,189.7</b>	<b>21,218.3</b>	<b>19,042.7</b>
Capex	-4,929.6	-12,474.6	-16,861.2	-10,106.7	-9,491.2	-9,302.5
Acquisitions & Investments	0.0	0.0	0.0	0.0	0.0	0.0
Sales of Investments & Subsidiaries	3,118.2	-5,571.7	-691.7	0.0	0.0	0.0
Other Investing Cashflow	0.0	0.0	0.0	-10,606.0	0.0	0.0
<b>Net Investing Cashflow</b>	<b>-1,811.4</b>	<b>-18,046.3</b>	<b>-17,552.9</b>	<b>-20,712.7</b>	<b>-9,491.2</b>	<b>-9,302.5</b>
Proceeds from Issues	545.7	-4,871.7	1,350.6	0.0	0.0	0.0
Proceeds from Borrowings	-10,134.3	5,633.7	7,620.5	13,015.2	-8,023.0	-5,710.0
Dividends Paid	-1,899.1	-2,164.8	-2,935.0	-3,451.2	-3,704.1	-4,030.1
Other Financing Cashflow	0.0	0.0	0.0	-11,156.0	0.0	0.0
<b>Net Financing Cashflow</b>	<b>-11,487.7</b>	<b>-1,402.8</b>	<b>6,036.1</b>	<b>-1,592.0</b>	<b>-11,727.1</b>	<b>-9,740.1</b>
Net Increase Cash	6,298.2	-295.1	-2,349.5	-7,115.0	0.0	0.0
Cash at Beginning	4,583.2	10,242.0	9,907.3	7,615.0	500.0	500.0
Exchange Rate Adjustment	572.8	-18.6	-200.9	0.0	0.0	0.0
Cash at End	11,454.1	9,928.4	7,356.8	500.0	500.0	500.0



# General Financials

Financials	Historical			Forecast		
	12/10	12/11	12/12	12/13	12/14	12/15
<b>Balance Sheet (\$Mil)</b>						
Cash & Equivalents	11,454.1	9,928.4	7,356.8	500.0	500.0	500.0
Accounts Receivable	6,043.7	5,865.0	5,138.6	7,265.9	7,572.1	7,909.9
Inventory	5,149.4	5,138.0	5,927.9	6,514.7	6,702.3	7,626.5
Other Short-Term Operating Assets	2,434.0	354.3	1,084.9	1,123.0	1,123.0	1,123.0
<b>Total Current Assets</b>	<b>25,081.2</b>	<b>21,285.7</b>	<b>19,508.3</b>	<b>15,403.6</b>	<b>15,897.4</b>	<b>17,159.4</b>
Property Plant & Equipment, Net	60,658.3	62,897.7	72,583.3	79,927.2	83,602.6	86,614.7
Goodwill, Net	16,582.9	7,926.2	2,679.9	2,774.0	2,774.0	2,774.0
Other Intangibles	6,171.5	7,701.6	6,403.2	6,628.0	6,628.0	6,628.0
Other Long-Term Operating Assets	2,439.4	2,730.2	2,923.4	3,026.0	3,026.0	3,026.0
Deferred Tax Assets	2,017.1	1,815.3	3,244.1	750.0	750.0	750.0
Long-Term Non-Operating Assets	9,151.1	11,380.6	6,243.8	3,000.0	3,000.0	3,000.0
<b>Total Assets</b>	<b>122,101.6</b>	<b>115,737.2</b>	<b>113,586.1</b>	<b>111,508.8</b>	<b>115,678.0</b>	<b>119,952.1</b>
Accounts Payable	7,113.5	9,082.2	8,930.5	6,592.6	6,740.9	7,816.4
Short-Term Debt	2,615.9	1,400.9	2,152.4	0.0	0.0	0.0
Other Short-Term Operating Liabilities	4,211.8	4,006.2	2,269.3	2,349.0	2,349.0	2,349.0
<b>Total Current Liabilities</b>	<b>13,941.1</b>	<b>14,489.3</b>	<b>13,352.3</b>	<b>8,941.6</b>	<b>9,089.9</b>	<b>10,165.4</b>
<b>Total Long-Term Debt</b>	<b>14,825.7</b>	<b>19,708.6</b>	<b>23,757.1</b>	<b>39,834.2</b>	<b>31,811.1</b>	<b>26,101.1</b>
Long-Term Operating Liabilities	3,359.7	1,097.9	1,289.7	1,335.0	1,335.0	1,335.0
Deferred Tax Liabilities	5,654.0	6,012.2	4,575.4	4,456.5	6,816.3	7,870.0
Long-Term Non-Operating Liabilities	14,472.7	17,107.2	14,558.0	1,000.0	1,000.0	1,000.0
<b>Total Liabilities</b>	<b>52,253.1</b>	<b>58,415.1</b>	<b>57,532.6</b>	<b>55,567.2</b>	<b>50,052.3</b>	<b>46,471.5</b>
Preferred Stock	0.0	0.0	0.0	0.0	0.0	0.0
Minority Interest	6,783.2	6,456.6	10,777.7	0.0	0.0	0.0
<b>Total Equity</b>	<b>69,848.4</b>	<b>57,322.1</b>	<b>56,053.5</b>	<b>55,941.6</b>	<b>65,625.6</b>	<b>73,480.5</b>
<b>Profitability %</b>						
EBITDA Margin	43.1	44.0	35.0	41.4	42.0	37.1
EBIT Margin	36.3	37.8	26.3	32.4	32.5	27.3
Net Profit Margin	25.1	25.7	18.2	21.3	21.8	18.5
Free Cash Flow Margin	17.8	-2.6	-15.9	10.2	20.2	15.9
Return on Equity	25.7	26.4	18.7	26.1	23.2	18.0
Return on Assets	12.4	12.7	7.8	11.7	12.4	10.6
Return on Invested Capital(w/Goodwill)	20.6	19.6	6.4	17.1	16.5	13.0
ROIC (w/Goodwill) Less WACC	10.2	9.1	-4.0	6.7	6.1	2.6
<b>Leverage &amp; Liquidity</b>						
Net Debt to Capital %	7.4	15.5	26.1	41.1	32.1	25.7
Net Debt/(Net Debt + Equity) %	8.7	18.0	29.1	41.3	32.3	25.8
Net Debt/Equity %	9.5	22.0	41.0	70.3	47.7	34.8
Net Debt/EBITDA x	0.2	0.4	1.1	1.6	1.2	1.1
EBIT/Net Interest Expense x	22.3	31.2	23.3	14.7	21.6	29.1
Current Ratio (Current Assets/Current Liabilities) x	1.8	1.5	1.5	1.7	1.7	1.7
Dividend Payout Ratio %	15.0	17.9	33.2	27.8	29.4	34.7
Net Cash Per Share ¢	-308.6	-581.1	-1,001.8	-2,123.9	-1,690.7	-1,382.4
<b>Valuation</b>						
Price/Earnings x	11.3	9.1	11.5	10.4	9.7	10.9
PEG Ratio x	0.1	45.3	-0.3	0.3	1.4	-1.0
EV/EBITDA x	5.8	6.1	7.5	6.1	5.8	6.3
EV/EBIT x	6.9	7.1	10.0	7.8	7.5	8.5
Free Cash Flow Yield %	7.4	-1.1	-7.1	4.7	9.6	7.8
Dividend Yield %	1.6	1.8	2.7	2.7	3.0	3.2
Price/(OCF per share) x	7.4	7.7	12.1	8.6	6.1	6.8
Price/(FCF per share) x	13.5	-95.0	-14.2	21.5	10.5	12.8
Price/Sales x	2.4	2.5	2.2	2.2	2.1	2.0
Price/NTA x	3.1	3.5	2.4	2.8	2.3	2.0
Price/Book x	2.3	2.9	2.4	2.3	2.0	1.8