September 2015

Investment Watch

Global market turmoil turned what was always going to be a hectic August into a chaotic one. Macro volatility aside, there's no hiding the fact that the corporate reporting season was patchy at best and concerning at worst.

Expectations continue to erode

Reporting season gave the market additional evidence to further temper its expectations toward more benign economic growth. Estimates of market earnings were already falling heading into August, as per steady downward revisions for FY15 and FY16 earnings forecasts over the preceding 6 months. While it's fair to say these low expectations were broadly met in FY15, it's concerning that FY16 earnings were revised down a further 1%. Reported numbers have re-affirmed investor caution.

Cloudy outlook statements

Investors are also finding it difficult to take much confidence from companies' FY16 outlook commentary and guidance. Outlook statements were more cautious than we have seen in the last few periods with caveats of 'uncertainty' in the economic outlook and reports of 'challenging conditions' dominating many outlook statements. Earnings guidance was in many cases below market expectations, or less committal than usual.

Where to from here: Updated Investment Strategy

We retain our caution for several reasons:

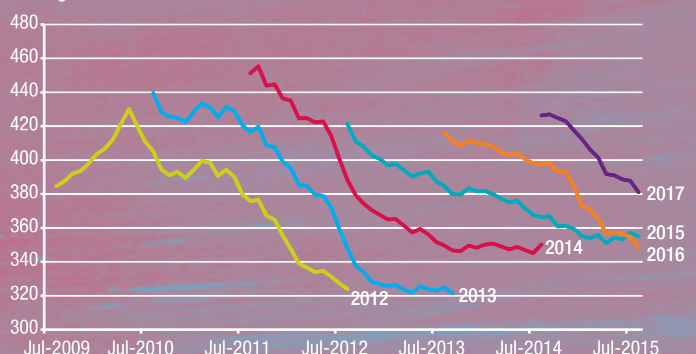
- Potential volatility around the first Fed funds rate rise which we expect before the end of 2015 (in line with Michael Knox's strategy – see page 2).
- Likely prolonged uncertainty around the trajectory of Chinese and global growth.
- The digestion of a weak corporate outlook and a void of new news into the seasonally difficult September – October period.
- Aggregate short interest which has continued to rise despite the markets pullback.

The Morgans Model Portfolios best explain our tactical positioning ahead of these macro risks. While we've raised cash levels, we also identify significant value on this pullback, raising our weightings in Banks and identifying new High Conviction opportunities. While August was disappointing, in these portfolios we are also pleased to demonstrate meaningful 12 month returns ranging from 4-15% versus the market which has eroded by 3% (including dividends) in what has been a very difficult 12 months for investors.

Our **commentary of reporting season** continues on **page 3**

Our refreshed **High Conviction** list post-reporting season can be found on **page 6**

ASX200 EPS estimates – Reporting season crystallised fresh downgrades to consensus earnings estimates across the market



Sources: Morgans, Factset

Important disclosures regarding companies that are the subject of this report and an explanation of recommendations can be found at the end of this document. Morgans Financial Limited ABN 49 010 669 726 AFSL 235410 A Participant of ASX Group A Professional Partner of the Financial Planning Association of Australia Level 29 123 Eagle Street Brisbane QLD 4000 Australia Phone 1800 777 946

Making sense of the volatility in China

Contents

This month we look at ...

An uninspiring reporting season 1

Making sense of the volatility in China 2

Reporting season themes driving more misses than hits 3

Large-cap healthcare – Investors should look past FX swings 3

Banks and capital levels – are we there yet? 4

Fixed interest – Volatility creates opportunities 4

Evaluating the outlook for oil 4

Wrapping up the retailers 5

The M&A trail in the transport sector 5

Looking ahead to the next catalyst 5

High Conviction Stocks 6-7

Visit our website to watch our Chief Economist, Michael Knox discuss his views on the Australian, U.S. and Chinese markets.

The high level of volatility in the Shanghai stock market has generated fears of a slowdown in the Chinese economy. In fact, the Chinese stock market plays a much smaller role in the Chinese economy than the US stock market does in the US economy or the Australian stock market does in the Australian economy.

Some international commentators have noted that relative to GDP, the Chinese stock market capitalisation is only around 8% that of the US. More importantly, the big corporations in China are all government owned rather than privately owned. This means they are not dependent on finance from the equities market.

A better gauge of the Chinese economy can be gained by looking at the Purchasing Managers Indices published every month by the National Bureau of Statistics. Our analysis tells us that we can explain almost 70% of variation in Chinese GDP by looking at the monthly numbers for the PMI non-manufacturing index and the PMI manufacturing index.

Contrary to popular believe, the non-manufacturing index better explains variation in Chinese GDP. This may be because it is official Chinese government policy to move from a manufacturing based economy to one based on services and domestic demand.

This year, the non-manufacturing PMI found its low in April at 53.4. This was significantly stronger than the manufacturing PMI for the same month of 50.1. Importantly the non-manufacturing PMI improved from then on. This index rose to 53.9 in July.

We conclude therefore that the Chinese economy probably bottomed out in April and has been improving ever since. The current level of both of these PMI measures suggests a level of Chinese GDP growth of around 7%.

US: Implications of the imminent lift-off in interest rates

In recent weeks we have seen the beginning of a severe correction in the US equities market. This correction is 'made in the USA'. Over the year to June, operating earnings per share of companies listed on the S&P500 have fallen by 10%. This decline has been mostly caused by the decline in the earnings of large oil companies.

This correction has taken the S&P500 from around 2100 down to an intra-day low of slightly above 1800. Since then, we have seen a significant recovery in equities prices. Unfortunately we think there will likely be another sell-off in US equities by year end.

We have long been forecasting this further correction as a result of the inevitable action by the US Federal Reserve on interest rates. The problem the Federal Reserve faces is that US unemployment is approaching the 'natural rate of unemployment' which Fed statements put at 5.1%. When unemployment falls below this level, US inflation begins to accelerate.

Should unemployment fall as low as 4%, inflation will begin to accelerate at an exponential pace. This high level of inflation would inevitably lead to a hard landing or deep recession in the US economy. The Fed needs to intervene by increasing rates to slow the US economy before the risk of such a hard landing is reached.

The Federal Reserve meets three times before the end of the year. The first time is in September, the second time is in late October and the third time is in December. We think it is virtually certain that the Fed will begin to increase interest rates at one of these meetings. The most likely occasion for 'lift off' will be the first meeting in September.

> The most likely result of an increase in the Fed Funds rate is that the market will sell off to test conditions. We think this sell off will bring the current US stock market correction to an end.

The equity market will initially overreact but the rebound will be swift

Such an increase in interest rates by the Federal Reserve will be the first since 2007. Many participants in the stock market will have not yet experienced an increase in the Fed Funds rate in their careers. This means that they will be in unfamiliar territory. The most likely result of an increase in the Fed Funds rate is that the market will sell off to test conditions. We think this sell off will bring the current period of US stock market correction to an end.

Our view is that the US economy will grow by 2.2% in calendar 2015. This growth rate will accelerate to 2.8% in 2016. This acceleration of growth rate in 2016 will also generate an acceleration of operating earnings per share growth. This increase in operating earnings per share growth will be eminent as soon as the results for the Q4 2015 are published in early 2016.

Operating earnings per share growth which fell by 10% for the year to Q2 2015 could rise by as much as 15% for the year to Q4 2015. When this uplift in earnings is announced, it should generate significant upside in US equities prices.

Reporting season themes driving more misses than hits

From page 1

While expectations were broadly met, there were more notable exceptions to the downside than the upside.

Stocks suffering meaningful FY16 downgrades were punished heavily against the nervous backdrop. The drivers ranged from stock specific (SEEK, IAG) to difficult sector conditions (Orica, Origin, Downer), to the difficult-to-predict impacts of swings in currency and interest rates (Computershare, Ansell, Cochlear). Several companies actually delivered excellent results (JB Hi Fi, Harvey Norman, Corporate Travel, Domino's Pizza), but were not rewarded for it, suggesting a high level of market uncertainty in their outlook.

On the positive side, among many of the stocks that beat market expectations were several out-of -favour companies recovering off cyclical low-points or recent downgrades such as The Reject Shop, Treasury Wines, GWA and Sims Metals. Clearly low expectations were exceeded here.

Genuine positive surprises were delivered by companies achieving higher cost reductions than expected (Medibank) and were generally concentrated among smaller companies capitalising on specific themes driving genuine revenue growth (Blackmores, Bellamy's, APN Outdoor).

Key outlook snapshots point to benign growth expectations

Company outlook	
CommBank	Sees good economic foundations though near-term global risks remain.
Telstra	Guiding for high single digit revenue, but low single digit earnings growth.
Wesfarmers	Retail looks positive despite competitive challenges but sees a challenging 12-24 months ahead in Industrials.
Woolworths	No guidance offered for 2016.
Asciano	Expects flat revenue growth. Reliant on economic conditions and cost out.

Analyst / Sector feedback	
Retail	Still very mixed aside from housing related categories. QLD is particularly bad (no confidence) although NSW is still firing.
Infrastructure Services	Toll road and airport traffic is still growing, but at trend or below. Municipal waste providers (a good proxy for business activity) suggest conditions are not improving.
Telco	The replacement cycle is kicking in but businesses are trying to build cost flexibility. This suggests business confidence is still weak.
IT Services	A good leading indicator of business confidence. Bouncing off the bottom although this is distorted by the replacement cycle.
Contractors	Downbeat. Not expecting any improvement. All guidance premised on macro inputs.
Healthcare	Our analysts note that 'Disease is independent of economic conditions'. A resilient sector still delivering meaningful EPS growth.

Large-cap healthcare – Investors should look past FX swings

While the large-cap heathcare sector has fared better than the broader market during reporting season last month, it was not completely immune from increased market volatility closing down c6.5%.

As the majority of these names are net exporters, foreign exchange (FX) is a big swing factor and adds an additional degree of ambiguity to the earnings outlook. However, the impact varies widely across the space, as was seen with FY15 results. Simply stated, AUD reporting stocks (eg Sonic, Ramsay, Cochlear, Healthscope and Sirtex) get a positive boost from a weaker AUD, but the quantum depends on individual hedges in place.

On the other hand, USD reporters (eg CSL, Resmed and Ansell) are negatively impacted by a strengthening USD, but the impact can be muted by any local cost hedge. Moreover, all of these companies get a valuation uplift on translation back to AUD. As such, there are a lot of moving parts when trying to determine the impact of FX on individual companies. Thus, we believe investors should attempt to filter out FX noise and look at companies on an underlying constant currency basis to better determine the earnings profile.

In this regard, we favour the healthcare service operators **Ramsay** and **Healthscope**, as consistent, double-digit constant currency profit growth is underpinned by strong industry dynamics, capacity expansion and a portfolio of high-return, low-risk assets. We also see considerable upside in medical device company **Resmed,** as it is a key beneficiary of the falling AUD, and is supported by new product roll-outs and a stable global pricing/regulatory environment.

For more information on FX exposure visit our website to read 'Healthcare Overall - FX Vagaries' published on 29 July 2015.

Banks and capital levels – are we there yet?

Overall we saw the recent bank reporting season as delivering relatively solid results with bad debts generally contained. It should be remembered that even ANZ, which saw a pick-up in its bad debt charge to 26bps of average gross loans, still has bad debts running comfortably below longer term levels. On capital raisings, we feel the large rights issues or placements in the sector are likely finished for the time being although we do believe underwriting of future dividends will occur. Our view, until recently, has been that the Australian banks were relatively expensive, trading at full valuations. The recent market correction is pulling them back to more average valuation levels, with further falls potentially creating some buying opportunities. However at present only one of the big four banks is trading below its longer term PE average level, that being ANZ, which remains our preferred pick on valuation grounds.

Banks – 12m forward PE ratio (x)

Source: Bloomberg

Fixed interest – Volatility creates opportunities

We have seen considerable volatility in the prices of ASX listed hybrid securities since NAB kicked off the significant capital raisings by the major banks. We have seen ANZ, CBA and NAB announce capital raisings which total A$13.5b. This significant amount of required capital, coupled with the volatile debt and equity markets, has resulted in the prices of a number of securities falling sharply over recent weeks. We believe that this weakness has created a number of opportunities for investors and while longer-dated securities have been the hardest hit from a price perspective, we retain a focus on securities with shorter terms to call. Our preferred investments are **ANZPA**, **CBAPC**, **GMPPA**, **NABHB** and **WBCHA**.

Evaluating the outlook for oil

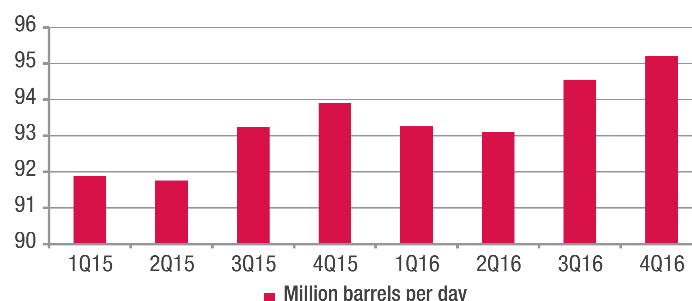
Amid broader market volatility, oil prices have proven to be especially sensitive to fluctuations in both currency markets and persistent fears around China and its implications for global growth. This has amplified market reactions to otherwise insignificant oil market data such as small inventory movements, anecdotal supply indicators, and seasonal demand forces. This is against a backdrop of a small but so far <1% surplus in aggregate supply versus resilient demand.

Initial signs of falling non-OPEC production and a willingness from OPEC to engage other producers have (so far) done little to support volatile oil prices. However we do take comfort from the fact that the cumulative effect of supply responses (which we now see occurring) typically take time to build and is the strongest fundamental driver for an eventual recovery in oil.

While the fundamental picture is not diabolical, short-term factors such as the resilience of US shale (until now), looming Iran exports and a stubborn Saudi Arabia have combined to sustain selling pressure across oil markets at a time of heightened uncertainty. However it is not all 'doom and gloom', with an absence of fundamental drivers behind the collapse in oil prices leaving the downtrend susceptible to a quick reversal in sentiment toward commodities. In our view, current conditions continue to present a unique once-in-a-cycle opportunity for long-term value investors capable of tolerating short-term volatility.

We retain our preference for high conviction stock **BHP** and **Oil Search** for exposure to the eventual recovery.

World oil demand



Sources: OPEC

Wrapping up the retailers

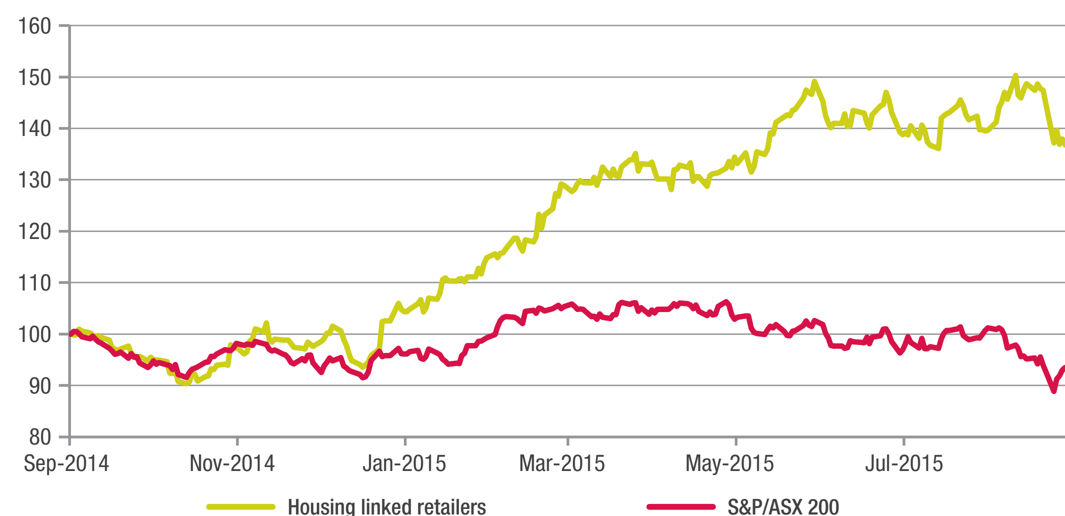
Reporting season produced a much improved performance from the retail sector in FY15 as businesses cycled the budget-impacted earnings last year and as a strong housing market buoyed housing-linked retailers. The highlight came once again from Domino's Pizza with the group reporting 40% NPAT growth. Despite a stellar share price performance, we believe there is still significant valuation upside particularly if the group acquires another Domino's master franchise which we believe will occur.

The housing-linked companies reported strong results including: JB Hi-Fi, Beacon Lighting, Adairs and Harvey Norman. The key question now is whether trading conditions are as good as they can get for these companies given the strong housing tailwind. We will continue to monitor this theme, but expect solid housing conditions have another 12 months to play out at least.

Within consumer staples, we see a challenging trading environment for all with Aldi's continued growth into the market and Woolworths' refocus on price in order to kick start sales growth. Wesfarmers remains our favoured play given the strong performance from its core retail businesses, while we think there is still too much risk to be overweight in Woolworths given the leadership transition and businesses under pressure.

Our key picks in the retail sector include: Domino's Pizza, Adairs, RCG Corporation, Burson Group and AP Eagers.

Performance of housing-linked retailers (ADH, BLX, JBH and HVN)



Source: FactSet

The M&A trail in the transport sector

Merger and Aquisition (M&A) activity in the transport sector has been hot in the last 6 months with Japan Post's acquisition of Toll Holdings in February, followed by Iron Mountain's bid for Recall, and Brookfield's recent bid for Asciano. Notably, each proposal has been made by an international player, making the target more attractive as the AUD declines.

We expect both the Recall and Asciano takeover proposals to be successful. In Recall's case, the synergies that Iron Mountain can achieve from a combination with Recall are far more substantial than any other party could extract. The acquisition requires regulatory approval and shareholder approval (both Iron Mountain and Recall), however we expect both to be achieved over the next 6 months. At current prices, the Iron Mountain offer implies a value of A$7.35, making the A$8.50 cash offer (for shareholders on the register prior to June 8th on up to 5,000 shares) look increasingly attractive. Brookfield's offer for Asciano implies A$9.06, with A$6.94 in cash and 0.0387 BIP units.

Watch this space for more M&A activity from Qube over the next year or two as management builds out the business. We expect them to have potential interest in Hutchison's port operations, Asciano's non-rail bulk operations that Brookfield may exit, and Toll's non-Express and freight forwarding businesses (e.g. bulk logistics) that are not likely to suit Japan Post's core business.

Looking ahead to the next catalyst

With reporting season drawing to a close, we can look ahead to the next set of events that will provide investors more clarity around company performance and the outlook for FY16, they include: AGM season, management roadshows, investor days and bank reporting season. At the results, FY16 outlook was generally underwhelming in a growth starved market we'll be closely watching for signs of a cyclical uplift.

- Trading updates from the retailers will be a good barometer of the economic climate and the updates of note for us include RCG, Adairs, Super Retail Group and Dominos Pizza.
- Following the acute focus on their financials, Slater and Gordon will be holding an accounting investor day late September/early October.
- After announcing a significant increase in its payout ratio at the result, Aurizon is hosting an investor day in October, we expect the focus will be on the cost-out program and initiatives underway for the company to hit its targeted EBIT margin in FY16-18.

Some other events to watch for: **Cardno** is holding an investor briefing post the AGM on 24 September; **Brickworks** is also expected to report on 24 September; and **Brambles** is holding their investor day in the US from 15-17 September.

High Conviction Stocks

In the digital edition, you may click on the stock tables for links to the latest company research reports from our website. You can also watch our analysts outline key reasons to buy our recently added stocks in short videos available here **www.morgans.com.au/high-conviction-stocks-september-2015**

Top 100

This month's changes

The low expectations entering into reporting season were generally met. We calculate ASX200 FY15 earnings declined 2% and earnings expectations for FY16 were revised down by 1%. We take little comfort from companies' FY16 guidance to sway us from our cautious approach to the next few months while global events take centre stage. We reiterate our confidence in our high conviction list and have reviewed our key picks post results. This month we add Challenger.

Amcor AMC

Price	$13.56	PE (x)	16.1
Price Target	$14.69	Yield	4.4%
Upside	8.4%	Gross Yield	4.4%

Amcor Limited is a global packaging company offering a range of packaging related products mainly servicing defensive sectors such as food, beverages, healthcare, personal and homecare, and tobacco.

Key reasons to buy

- AMC is a high quality, defensive business with exposure to higher growth emerging markets. AMC generates 95% of revenue from sectors such as food & beverage, healthcare, personal care and tobacco packaging. Given its defensive characteristics, we think the stock should be well supported in the current volatile environment.
- AMC reports earnings in USD. A fall in the AUD/USD is therefore positive when calculating our AUD-based valuation. We expect the AUD/USD to average 73c in FY16 and see upside to our numbers if it continues to depreciate further.
- AMC is always a potential capital management candidate given its strong FCF generation. AMC is around 60% of the way through implementing a US$500m buyback, which should provide support for the share price in the short term and we see potential for further capital management opportunities down the track.

ANZ Banking Group ANZ

Price	$27.42	PE (x)	10.4
Price Target	$34.59	Yield	7.1%
Upside	26.1%	Gross Yield	10.1%

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

Key reasons to buy

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

BHP Billiton BHP

Price	$24.63	PE (x)	16.9
Price Target	$30.50	Yield	7.5%
Upside	23.8%	Gross Yield	10.7%

BHP is the world's largest diversified resources company, with a large portfolio of highly diversified mining and energy interests across several key commodity markets and regions.

Key reasons to buy

- The demerger has removed a number of less profitable and smaller operations from BHP's asset portfolio, boosting its overall profitability and simplifying the business.
- We expect BHP's portfolio of predominantly high margin business segments will underpin its progressive dividend, supporting a fully franked dividend of 7.1%.
- BHP has flagged its interest in M&A in copper and oil markets – two of our preferred long-term commodity exposures and offers a superior combination of commodity and market exposures within resources, enhancing the company's ability to defend its strong margins.

Challenger CGF

Price	$6.97	PE (x)	12.2
Price Target	$7.90	Yield	4.4%
Upside	13.3%	Gross Yield	6.3%

Challenger (CGF) is an investment management firm managing more than $59.8 billion in assets. CGF focuses on providing Australians with financial security in retirement. Challenger operates two core investment businesses, Life division and Funds Management division.

Key reasons to buy

- We see CGF as likely to offer mid-to-high single digit EPS growth over the medium term. As the market gains further confidence in CGF's ability to maintain recent growth, we see a further re-rating closer towards a market PE level.
- CGF will benefit from a highly volatile equities market through its growing annuities platform as retirees will look to alternative asset class to provide security of income.
- The successful relaunch of the Care annuity and new platform distribution partnerships should help drive further sales growth.

Qantas QAN

Price	$3.50	PE (x)	6.0
Price Target	$4.65	Yield	8.6%
Upside	32.8%	Gross Yield	12.2%

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

Key reasons to buy

- The capacity growth outlook is the most favourable for some time in both the domestic and international markets, providing the opportunity for QAN to increase revenue via increased load factors and ticket prices.
- Lower oil prices and a A$2bn internal cost-out program are providing a material earnings benefit, with QAN likely to return to near record levels of profitability in FY16.
- News flow is a key share price driver of airline stocks and the next 6-12 months is likely to remain positive with monthly operating statistics, and the 1H FY16 result reinforcing the strong operating conditions.

Ramsay Healthcare RHC

Price	$61.42	PE (x)	28.1
Price Target	$73.11	Yield	1.9%
Upside	19.0%	Gross Yield	2.7%

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

Key reasons to buy

- RHC is benefitting from an aging population which uses more medical services.
- RHC consistently delivers above market earnings and dividend growth (last 17 years averaging 16.8% and 16.6% pa, respectively) and for the next three years is forecast to grow c13% pa.
- RHC is expected to benefit from further public hospital outsourcing opportunities.

Resmed RMD

Price	$7.27	PE (x)	18.0
Price Target	$8.91	Yield	2.5%
Upside	22.6%	Gross Yield	2.5%

Resmed is a world leader in the development and manufacturing of medical products to treat sleep apnoea

Key reasons to buy

- While recent results from the SERVE-HF clinical trial are disappointing, we believe it is ring-fenced from the broader business as the device used in the trial represents <2% of total devices sold and the trial was not targeting the core patient segment; we estimate the total earnings impact of <3%.
- The core respiratory and sleep-disorder breathing market remains intact, underpinned by a large and growing customer base, with favourable trends in obesity, aging, cardiovascular diseases and increasing diagnosis rates; RMD controls c40% of this market.
- It remains relatively early in a new platform cycle, with the roll-out of new products the most concentrated vs the last four major product platform launches over 15 years. The 4QFY15 result exceeded market expectations with double digit growth in the Americans (+53%), despite a competitors launch, and return of growth in masks (+6%).

High Conviction Stocks

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Sydney Airport SYD

Price	$5.84	PE (x)	n.m
Price Target	$6.10	Yield	5.1%
Upside	4.4%	Gross Yield	5.1%

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

Key reasons to buy

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

Source: IRESS, Morgans.

Priced at 2 September 2015.

Ex 100

This month's changes

We add GBST and remove Qube logistics and Admedus.

360 Capital Industrial Fund TIX

Price	$2.42	PE (x)	10.9
Price Target	$2.70	Yield	8.9%
Upside	11.5%	Gross Yield	8.9%

360 Capital Industrial Fund owns a portfolio of 21 industrial assets across Australia.

Key reasons to buy

- Strong portfolio metrics (Woolworths is the largest tenant) including a WALE of 5.8 years.
- Cashflows are supported by stable rents underpinned by long-term leases which average around 3.2% rental growth pa.
- An attractive distribution yield (paid quarterly).

Bellamy's BAL

Price	$6.04	PE (x)	35.6
Price Target	$6.10	Yield	1.0%
Upside	1.0%	Gross Yield	1.4%

Bellamy's Australia (BAL) is a Tasmanian-based organic food business, specialising in premium baby food and formula.

Key reasons to buy

- Bellamy's Organics is the fastest growing brand in the Australian baby food category. The infant formula category in Australia is one of the fastest growing categories in the grocery trade and 'organic' is the fastest growing segment of the global food and beverage industry.
- BAL is on a strong growth trajectory as its benefits from consumer's preference for organic food and Asia's demand for safe, high quality Australian food.
- Key share price catalysts include further profit upgrades, expansion in new markets or products, and corporate activity.

Burson Group BAP

Price	$3.53	PE (x)	20.7
Price Target	$3.97	Yield	3.1%
Upside	12.5%	Gross Yield	4.4%

BAP supplies replacement parts and consumables used in the service and repair of vehicles. It also includes the sale of accessories and maintenance products to vehicle owners. BAP operates over 120 Auto Parts stores across Australia. BAP is headquartered in Victoria.

Key reasons to buy

- We believe the acquisition of Metcash Auto was strategically sound and accelerates BAP's earnings growth significantly. We expect the modest forecast synergies will be exceeded. We expect the company will host a strategy day on the acquisition post reporting season providing a catalyst.
- We expect additional growth from BAP further expanding in the WA market and the group may decide to accelerate this rollout following Repco's acquisition of Covs in WA.
- The base trade business is highly resilient and continues to grow at 4-5% (like-for-like sales). We prefer the trade category over retail as consumers switch from DIY to DIFM (do it for me). BAP is also well placed in a falling AUD environment to pass on cost increases to its customers.

Corporate Travel Management CTD

Price	$10.79	PE (x)	27.8
Price Target	$13.20	Yield	2.0%
Upside	27.0%	Gross Yield	2.8%

Corporate Travel Management is an award-winning global provider of innovative and cost effective travel management solutions to the corporate market.

Key reasons to buy

- Operationally, the business is performing well. Domestic ticket prices are rising, its market share is rising, new acquisitions are performing well and the company is a key beneficiary of a falling AUD given about 50% of its earnings are in USD.
- FY16 guidance is for 25-30% EBITDA growth. More specifically, Asia is expected to grow by 25%, North America by 40%, Europe by 10-15% and ANZ by single digits due to a tough economy. As usual, we expect that guidance has been conservatively set. Guidance is based on an AUD of 75c. CTD also continues to look for further acquisitions in North America. These would be upside to guidance.
- Now that CTD operates in all the key corporate travel markets globally, we believe the company can win more regional and global client accounts. There is also the opportunity to cross sell clients between the different regions.

GBST GBT

Price	$4.41	PE (x)	21.7
Price Target	$6.10	Yield	2.6%
Upside	38.4%	Gross Yield	3.7%

GBST is an emerging global provider of fund administration and financial markets systems which are growing in popularity with major financial institutions.

Key reasons to buy

- GBST has an impressive recent track record of new contract wins with major global institutions.
- Prospects look good for some existing clients to upgrade from single to multiple applications.
- Despite heavy investment in new product development the company generates high levels of free cash flow.

Shine Corporate SHJ

Price	$2.25	PE (x)	11.3
Price Target	$3.56	Yield	1.8%
Upside	58.2%	Gross Yield	1.8%

Shine Corporate (SHJ) is a market leader in the area of damages-based plaintiff litigation. We believe there are a number of catalysts to drive SHJ's share price over the coming 12 to 18 months:

Key reasons to buy

- SHJ is looking to continue to increase its diversity of practice areas and revenue sources through acquisition. As we have seen in the past, acquisitions are highly accretive given the average acquisition multiple is 4-5x EBIT; and
- Reversal of Qld Workcover: It is likely that FY16 will be positively impacted by the reversal of the 5% threshold test on passing of new legislation (retrospective date of 1 Feb 2015). The introduction of the threshold test saw SHJ guide for an A$2-2.5m NPAT hit. Workcover has not been factored into guidance and as such would have a positive impact.

Villa World VLW

Price	$2.05	PE (x)	7.6
Price Target	$2.83	Yield	8.0%
Upside	38.1%	Gross Yield	11.5%

Villa World (VLW) is an integrated residential land developer and home builder delivering affordable housing across Queensland and Victoria.

Key reasons to buy

- We expect VLW to deliver strong earnings growth into FY16/17, supported by increased scale in its land portfolio and solid sector conditions. We expect residential volumes in QLD to continue to improve and VLW has the best placed portfolio amongst small cap developers to capture the upswing.
- VLW recently gave FY16 earnings guidance, expecting ~6% growth in underlying earnings. We see earnings tailwinds continuing and believe the group has the potential to outperform earnings expectations in FY16.
- We view VLW's valuation as attractive (around a 10% discount to peers) along with a 8% fully franked dividend yield.

Source: IRESS, Morgans

Priced at 2 September 2015.

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