

Best Stock Ideas



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Here we provide our monthly update of Morningstar's *Best Stock Ideas* which features our most vetted, highest quality investment ideas trading at attractive prices. These ideas are intended to have broad application in a variety of equity strategies, but individuals should consider their personal investment goals and positioning before investing. We provide brief descriptions of each best idea below and encourage investors to read our most recent stock reports for a more detailed appraisal.

Additions to Best Stock Ideas

SP AusNet (SPN)

Regulated electricity and gas infrastructure investor SP AusNet (SPN) returns to Best Stock Ideas due to a relatively soft share price. Despite trading in the hold zone and close to fair value, in a market where high conviction buy opportunities are few and far between, we like the capital protection qualities of this business and healthy 7.8% (unfranked) distribution yield. Almost 90% of revenue is regulated, providing predictable and stable cash flow.

Thorn Group (TGA)

Thorn's share price dipped after a flat first half fiscal 2012 result which was dragged lower by weaker earnings from a recently acquired debt collection business. The core Radio Rentals/Rentlo (RR&R)

electrical and household appliances rental business again delivered robust growth however, and we retain our positive view overall. We are impressed that RR&R has been able to continue to grow revenues despite declining installations of TVs and PCs through the gradual move to more expensive items like furniture and an expanded Thorn branded product offering. The business benefits from the current cost-conscious consumer climate. Unemployment is likely to rise in the next couple of years, but not severely enough to dramatically hurt demand.

Removals from Best Stock Ideas

Commonwealth Bank (CBA)

CBA, Australia's biggest bank, drops out of *Best Stock Ideas* after just one month following a 3% share price rise in that time. At just a 2% discount to fair value, it is not cheap enough to remain on the list, but it remains a core holding in our large cap portfolios. CBA has a lower risk profile than the other majors, a stronger funding mix and an expanding technological advantage. Medium-term concerns over higher funding costs and a potential blow-out in bad debts are built into the share price.

Premier Investments (PMV)

This discretionary retail investment company also drops out of the list following a 21% jump in the

Additions

- ▶ SP AusNet (SPN)
- ▶ Thorn Group (TGA)

Removals

- ▶ Commonwealth Bank (CBA)
- ▶ Premier Investments (PMV)

Under Review

- ▶ Regional Express Holdings (REX)

★ Denotes new entry to Best Ideas

Code	Name	Price \$	Fair Value \$	Price/FV	Mkt Cap \$bn	Moat Rating	Business Risk	FY13 PE	FY13 Yld %	Franked %	Morningstar Recommendation	Notes
Banks												
ANZ	ANZ Bank	25.38	31.00	0.76	64.16	Narrow	Medium	10.4	6.2	100	Accumulate	Earnings growth is underpinned by ANZ's Asian expansion strategy, steady business and home lending, and cost savings. Management is strong, capital levels are high and the yield is attractive.
NAB	National Aust. Bank	25.88	31.00	0.76	54.45	Narrow	Medium	9.8	7.4	100	Accumulate	Continues to aggressively win market share boosting earnings, particularly in retail and business banking. Risks are higher than major bank peers, with NAB's UK banks continuing to drag on earnings.
WBC	Westpac	25.34	29.00	0.86	77.65	Narrow	Medium	11.5	6.8	100	Accumulate	WBC benefits from its multi-brand distribution strategy, strong market share, relatively low bad debts, improving margins and the best cost-to-income ratio.
Industrials & Infrastructure												
QUB	Qube Holdings	1.54	1.80	0.85	1.42	None	Medium	15.0	3.7	100	Accumulate	One of Australia's largest port logistics operators with majority stakes in stevedoring and land logistics businesses as well as minority stakes in several related businesses.
MTS	Metcash	3.64	4.40	0.80	3.08	Narrow	Low	11.3	7.4	100	Buy	A defensive and reliable business with 20% marketshare in the Australian food and grocery market. Upside comes through new store expansion and hardware exposure through Mitre 10.

Table 1 – Best Stock Ideas (Continued)

★ Denotes new entry to Best Ideas

Code	Name	Price \$	Fair Value \$	Price/FV	Mkt Cap \$bn	Moat Rating	Business Risk	FY13 PE	FY13 Yld %	Franked %	Morningstar Recommendation	Notes
★ SPN	SP AusNet	1.06	1.10	0.95	3.49	Narrow	Medium	11.5	7.8	33	Hold	We like the capital protection qualities of this business and healthy 7.8% (unfranked) distribution yield. Almost 90% of revenue is regulated, providing predictable and stable cash flow.
WTF	Wotif.com Holdings	4.58	5.50	0.87	1.02	None	Medium	14.0	6.3	100	Accumulate	WTF is a leading online discount accommodation bookings provider. Modest earnings growth is being delivered by scale efficiencies and the growing use of the internet to make accommodation bookings.
Insurance												
QBE	QBE	13.02	18.00	0.60	12.88	Narrow	Medium	9.7	7.2	14	Buy	Despite sharply lower recent profits due to higher individual and catastrophe claims and low bond yields, we expect a solid recovery in profits in the next few years. Long term value remains.
Resources												
BHP	BHP Billiton	33.97	50.00	0.68	108.83	Narrow	Medium	8.8	4.4	100	Accumulate	A balanced suite of world class, long life assets in conjunction with a power-house balance sheet and strong management.
ORG	Origin Energy	11.35	15.00	0.70	11.63	None	Medium	13.3	4.4	100	Buy	ORG is set to provide solid earnings growth through energy retailing, gas production and power generation.
RIO	Rio Tinto	56.86	90.00	0.64	111.6	Narrow	Medium	6.9	2.9	100	Buy	A large discount to fair value and world class, long life assets. Now recovered from balance sheet over-gearing.
WPL	Woodside Petroleum	34.30	73.00	0.46	27.72	Narrow	High	13.5	4.5	100	Buy	As Australia's premier oil play, Woodside Petroleum's operations encompass liquid natural gas, natural gas, condensate, crude oil and liquefied petroleum gas.
Small Cap												
SXL	Southern Cross Media	1.03	1.50	0.72	0.76	None	High	7.2	9.7	100	Accumulate	SXL own a series of regional TV and radio stations and the Austereo metropolitan radio assets. Regional TV and radio earnings tend to be less cyclical than metropolitan equivalents.
★ TGA	Thorn Group	1.97	2.00	0.91	0.26	None	Medium	9.1	5.6	100	Hold	The core electrical and household appliances business is delivering earnings growth despite declining installations of TVs and PCs through the gradual move to more expensive items like furniture and an expanded Thorn branded product offering.

share price since the release of commendable fiscal 2012 results in late September. Margins have expanded considerably through cost cuts, focus on more profitable lines and an expanded online offering. The stock is now trading slightly above fair value but is retained in the small cap portfolio. We expect modest sales growth in a tough retail environment in the next few years driven by young brands Dotti, Peter Alexander and Smiggle, offset by declining Just Jeans and Jay Jays. The AUD 300 million in cash provides interesting opportunities to add to the brand portfolio at discounted prices but of course there is little transparency around any such moves.

Under Review

We temporarily remove Regional Express Holdings (REX) from the list following this week's profit guidance downgrade. We are reviewing our fair value in light of higher than expected costs and en-route rebates. We will have our updated view published online in the next few days.

How we select Best Stock Ideas

Best Stock Ideas comprise the most compelling stocks held in our equities model portfolios – Balanced, Income, Growth and Small Cap.

Naturally, we expend a great deal of effort to ensure that all of our approximately 230 Australia and New Zealand stock recommendations are accurate. However, our model portfolio holdings have passed through an additional layer of scrutiny – our rigorous portfolio committee process – making them the very best of our best ideas. These recommendations should have the widest application among our varied clients and their respective investment needs. The complete list of portfolio holdings, each portfolio's strategy, and each portfolio's performance are available on the Morningstar Adviser Research Centre™ platform, along with detailed company research reports produced by our experienced analyst team. Individual investors interested in including Morningstar's equities model portfolios in their investment planning should speak to their adviser.

In addition to starting with our model portfolio holdings, we have several additional criteria to increase the odds of outperformance and likelihood of meeting the average investor's portfolio needs. Namely, our *Best Stock Ideas* trade at material discounts to fair value, exclude companies that receive our very-high risk rating, and are biased toward companies with sustainable competitive advantages ('economic moats' in Morningstar vernacular). To keep the list manageable, we'll always provide around 15 best ideas, but of course depending on market conditions, the share of buy recommendations in our complete coverage universe will fluctuate.

Morningstar's *Best Stock Ideas* is not intended to represent a well diversified portfolio, so investors should consider each business with reference to existing holdings and risk appetite. For example, depending on the opportunities provided by the market, we'll occasionally feature small capitalisation stocks on this list. Investors need to be comfortable with the tendency for these shares to be volatile due to lower scale, less diverse operations, and less share liquidity compared to larger capitalisation companies. Again, for a comprehensive portfolio approach, we recommend our model portfolios. Nonetheless, our *Best Stock Ideas* provide a solid starting point for a variety of investment strategies.