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quantanalysis

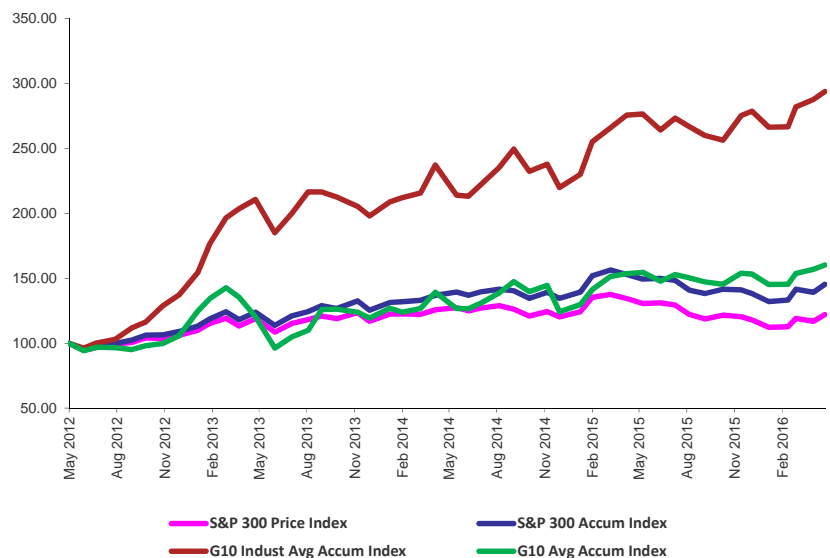
GARY - Growth At Reasonable Yield

QUANTITATIVE ANALYSIS

GARY goes high as RBA goes Lowe

- *Note: The forecast data in this report is based on Thomson/IBES consensus data.*
- **Macro outlook:** Central bank currency wars, political election cycles and corporate survival mode will continue to put downward pressure on growth rates and interest rates. RBA has been pushed into interest rate easing cycle as deflation worries starts to bite. New RBA governor, Philip Lowe is likely to inherit an economy at the early stages of the new rate cut cycle to fight deflation. The Federal Budget showed that there are no plans in the fiscal policy outlook to deliver structural change driven recovery in the economy. The global growth worries, weak US reporting season and weak local fiscal policy outlook continue to support lower interest rates for longer than expected. The Australian equity market's sustainable dividend yield will attract investors in an environment of low rates and low growth. The GARY approach allows the investor to get the exposure to recovering growth with the protection of the yield thematic.
- **GARY (Growth At Reasonable Yield) screen allows us to pick stocks with good yield, good growth and cheap value multiples compared to the overall historical market trend.** Resources and related Service stocks carry higher risk due to global growth worries while Property related stocks carry the bubble risk.
- **GARY Industrial picks are:** large cap (LLC), mid cap (SPO), small cap (FXL, CWP, VLW and GDI) and micro cap (MYS, AFG and PPC).
- **GARY Resource and related picks are:** none.
- **The performance of the GARY Top 10 (G10) picks shows that Industrial ideas have consistently outperformed since May 2012 while Resources and related companies remain volatile.** The performance analysis is calculated using a maximum 10 ideas by equal weighting. The calculation does not take transaction costs into account.

FIG.1: GARY TOP TEN (G10) PERFORMANCE

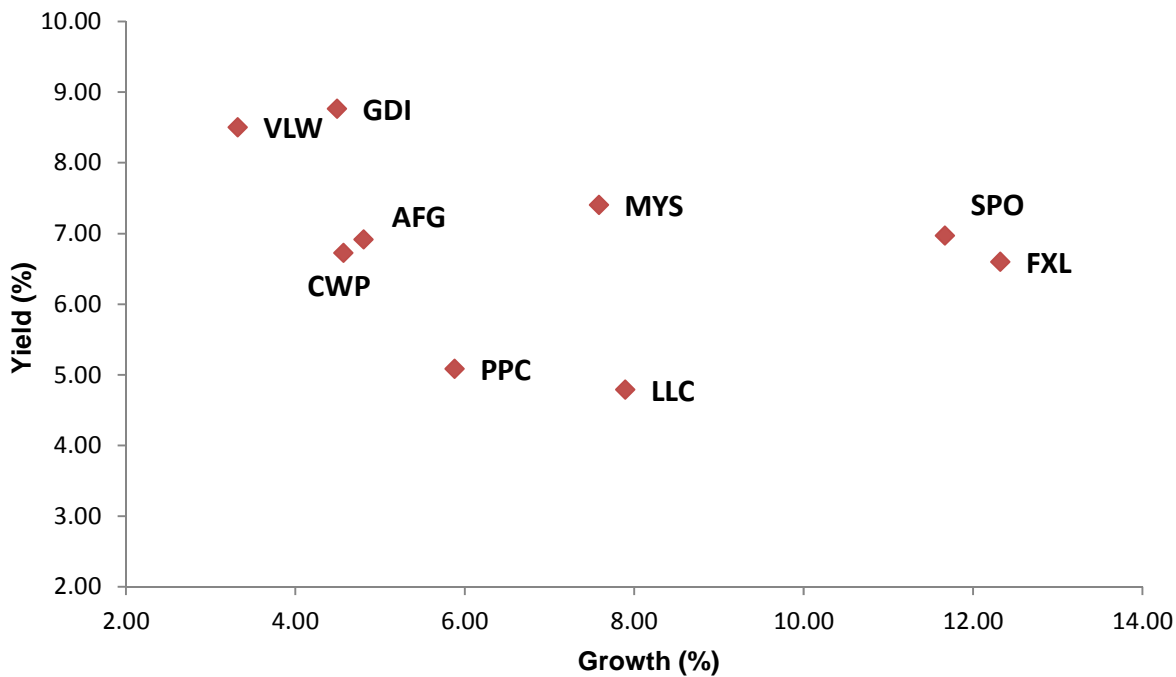


Source: ASX, Baillieu Holst, Bloomberg, IRESS, Thomson

Model Process

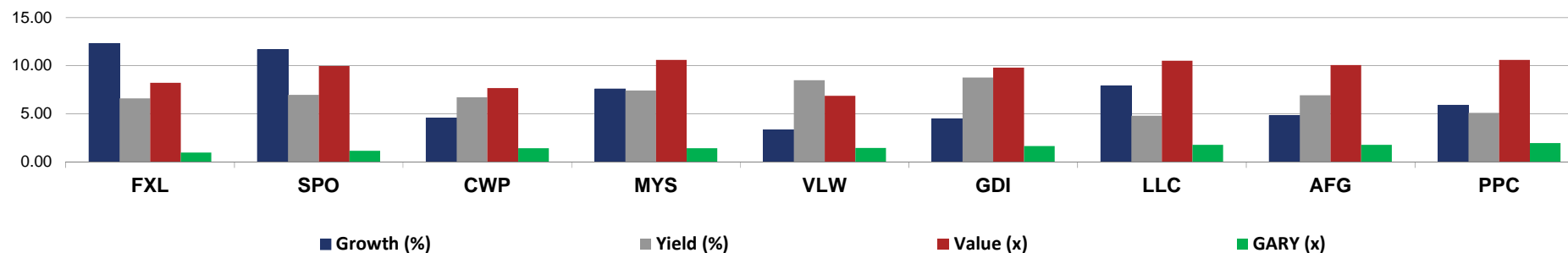
- GARY identifies companies that are able to deliver growth and yield at a reasonable cost. The screen starts with all stocks in the All Ordinaries using Thomson/IBES consensus data, and then removes stocks with yield/growth expectations below 2.39% (that is, below the bond rate) for the next two-year average and stocks with market caps below \$200 million. Infrastructure and Utilities stocks have been included, with cash flow being substituted for earnings in growth and value measures due to their unique accounting requirements.
- The screen removes stocks with consensus recommendations below BUY and total expected returns less than 10%. On multiples GARY removes stocks with price-earnings above 12 (that is, the market long-term average less 1 standard deviation), dividend yield below 100bps premium to bond yield and growth above 13% (that is, the market long-term) from the first forecast year to the second forecast year.
- GARY is an average of GARP (Growth At Reasonable Price) and DARP (Dividend yield At Reasonable Price). GARP is the cost of PE per 1% of growth and DARP is the cost of PE per 1% of dividend yield. Growth is calculated over the first to second forecast years, and value and yield are two forecast year averages.

FIG.2: GARY TOP TEN STOCKS



Source: ASX, Baillieu Holst, Bloomberg, IRESS, Thomson

FIG.3: GARY MULTIPLES FOR THE TOP TEN



Source: ASX, Baillieu Holst, Bloomberg, IRESS, Thomson

FIG.4: THE GARY TOP TEN SCREEN

Code	Company Name	GICS	Price (\$)	Market Cap (\$mn)	Target Price (\$)	Rating	Total Return Expectations (%)	Growth (%)	Yield (%)	Value (x)	GARP (x)	DARP (x)	GARY (x)	Size
FXL	FLEXIGROUP LTD	40202010	2.47	920	2.91	Buy	23.97	12.32	6.60	8.22	0.67	1.25	0.96	Small
SPO	SPOTLESS GROUP HOLDINGS LTD	20201070	1.27	1,395	1.67	Buy	38.19	11.67	6.97	9.97	0.85	1.43	1.14	Mid
CWP	CEDAR WOODS PROPERTIES LTD	40403030	4.29	338	5.90	Buy	44.15	4.57	6.72	7.67	1.68	1.14	1.41	Small
MYS	MYSTATE LTD	40102010	3.91	344	4.70	Buy	27.39	7.58	7.40	10.60	1.40	1.43	1.41	Micro
VLW	VILLA WORLD LTD	40403030	2.10	239	2.50	Buy	27.33	3.32	8.50	6.86	2.07	0.81	1.44	Small
GDI	GDI PROPERTY GROUP LTD	40402040	0.89	480	1.03	Buy	23.93	4.49	8.76	9.78	2.18	1.12	1.65	Small
LLC	LENDLEASE GROUP	40403010	13.12	7,640	15.57	Buy	23.21	7.90	4.79	10.51	1.33	2.19	1.76	Large
AFG	AUSTRALIAN FINANCE GROUP LTD	40102010	1.07	230	1.40	Buy	37.57	4.81	6.92	10.05	2.09	1.45	1.77	Micro
PPC	PEET LTD	40403030	0.93	453	1.36	Buy	51.35	5.88	5.08	10.58	1.80	2.08	1.94	Micro

Source: ASX, Baillieu Holst, Bloomberg, IRESS, Thomson

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