June 2016

Investment Watch

Implications of a lower for longer interest rate environment

May has defied the weight of investor apathy and continued its positive run through what is normally a seasonally weaker period, buoyed by another rate cut and improving US economic data. The ASX 200 finished up another 2% led by the interest rate sensitive Utilities (2%), Financials (4%) and Telecoms (5%) as investors once again resumed their chase for yield.

This month we put the spotlight on the domestic economy. We explain why we think another two cuts in the RBA's cash rate is a distinct possibility and the implications for risk assets such as stocks and real estate. Investor appetite for yield will not abate in the short term, and we identify our preferred income exposures in Utilities and Infrastructure (page 4) Banks (page 6), and REITs (page 5).

June also has all the makings of an intriguing month for investors, with the macro-economic calendar punctuated by the 'Brexit' vote (23 June) and the US central bank decision on interest rates (15 June). Both events have the potential to derail positive momentum from February. Without the strains in credit markets from earlier in the year, a vastly improved US economy and commodity prices rebounding sharply off their lows—not withstanding some speed humps—we don't believe the pre-conditions for a sharp correction are in place as was the case in the first two months of this year.

While the macro backdrop for equities remains supportive in our view, we don't discount the need for fundamental support through improving company profits. The lack of positive momentum has exacerbated share price valuations, and at some point investors will question the viability of valuations if earnings remain lacklustre. For now, we maintain our preference for quality earnings matched by income certainty. We identify a number of stocks that will excel in this backdrop.

Searching for yield – our preferred exposures

Westpac (WBC)	We continue to view it as the major bank with the lowest risk profile. We believe downside risks to earnings and dividends are least for the domestically focused bank. Westpac is a research high-conviction idea.
360 Capital Industrial Fund (TIX)	Pure Australian industrial REIT with potential ASX 200 inclusion in CY16 and an attractive distribution yield paid quarterly.
Aventus Retail Fund (AVN)	Exposure to large format retail segment (first mover); prospectus forecasts are on track and the stock offers an attractive 7% yield as well as organic/ acquisition growth options.
Sydney Airport (SYD)	The combination of solid earnings growth and falling interest costs should generate strong distribution growth.

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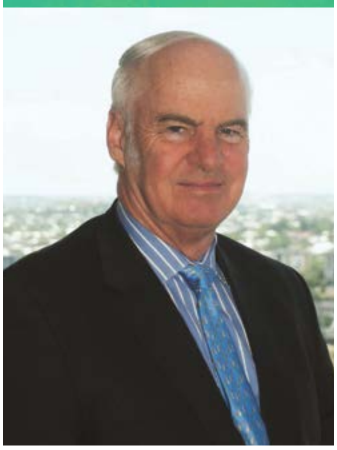
Visit our website to watch our Chief Economist, Michael Knox discuss his views on the macro-economic environment.



The Australian Economy, Cash Rates & Equities

When we look at GDP, we are looking at the real level of output for the economy. When the statistician calculates GDP, he takes away the price effect. At the moment, Australia is experiencing a fall in its terms of trade. This means that national income is declining relative to GDP. So people are employed and they are producing a healthy quantity of output; the problem is the price they are receiving for what they produce has been going down.

Put another way, the output side of the economy is fine. It is just that inflation is too low. Last year Australian GDP grew by 2.5%. This year in 2016, we expect that GDP growth to lift to 2.8%. Next year in 2017, we think that GDP growth will rise further again to 3.0%.

The problem is when we look at inflation. The RBA tries to keep Australian inflation in line with the long-term average achieved by the US Federal Reserve. Since the early 1990s, the Federal Reserve has been achieving an average inflation rate of around 2.5%. Ian McFarlane, the Governor of the RBA before Glenn Stevens, achieved an average inflation rate of 2.4%. Glenn Stevens has achieved an inflation rate of almost exactly 2.5%.

Inflation is important because it allows the RBA to cut real interest rates (the cash rate minus inflation) into negative territory when it needs to provide stimulus for the economy. Inflation is also important at times of high unemployment. A little bit of inflation means that real wages can fall (wages can fall relative to inflation). This decline in real wages makes it more attractive to employ people who were previously unemployed. Unemployment then falls. A little bit of inflation, say 2.5%, is good for the economy.

The March quarter saw a surprisingly low level of inflation. Core inflation (CPI excluding food and energy prices) grew by only 1.7%. This is 0.8% below the RBA's target of around 2.5%. This low inflation meant that the RBA's cash rate was rising in real terms (a stable cash rate was rising relative to falling inflation). The RBA had to cut the cash rate to make sure that real interest rates did not go up.

The RBA gave us one 25 bps rate cut in May 2016. However, inflation is 0.8% below the RBA target. This tells us we will need two more 25 bps rate cuts in coming months. We think the next will be in August. We think there will be another cut after that in November. This means we expect a total decline in the cash rate of 75 bps or 0.75%.

We will need two more 25bps rate cuts in the coming months

These declining cash rates will maintain a constant level of real short-term interest rates (interest rates minus inflation). This means the cash rate will be falling at the same rate as inflation. When the RBA does this it will maintain the current level of support for the Australian economy.

We think the Australian economy will improve this year to a 2.8% growth rate. This modestly stronger growth rate will give support for earnings per share of Australian companies. This will provide continued upward pressure for the Australian market for equities.

For more coverage of the economy refer to our note published 3 May 2016 **"For extraordinary times"**.

Morgans' Cash Rate Forecast

Source: Morgans, RBA

Strategy – staying on top of the macro-economic environment

June has all the makings of an intriguing month for equity markets. The numerous macro crosswinds will test investors' nerves but we think opportunities will present themselves to those that are prepared to be tactical with their strategy. Investing in the market over the month of June has been historically fraught with danger, and there are a number of events that could cause some turbulence for markets.

We outline our key macro calls and our preferred ways to play them.

- **Australian Economy** – Following the disappointing Q1 2016 inflation release, market expectations for a rate cut have increased with the market now pricing in another cut in August. We forecast 1-2 more in 2016.
- **Brexit (23 June)** – The possibility of Britain leaving the EU has cast a cloud over the direction of the UK economy and could unravel the EU. We think the risks are overplayed. Analysis of polling in previous referendums tells us they tend to have a status quo bias and more often than not, the 'change' option tends to lose ground as polling day approaches.
- **Federal election campaigning (2 July)** – Elections have historically been a source of uncertainty for the domestic equity market. However, our analysis finds the market is more likely to rally into elections. Markets have tended to look through the political uncertainty.
- **US FOMC meeting (14-15 June)** – Michael Knox believes the market is losing sight of improvement in the US economy. He sees the Fed lifting rates sooner than the market currently expects, which has the potential to disrupt risk assets. Without clarity on the pace or trajectory of rate rises, bouts of volatility will be a permanent fixture.

For more refer to note on **"Embracing macro uncertainty"** published 18 May 2016.

Embracing macro uncertainty – our key picks

	Stock	Rationale
The chase for yield	Aventus (AVN), 360 Capital Industrial Fund (TIX), AusNet Services (AST), Sydney Airport (SYD), Telstra (TLS) and Westpac (WBC)	Lower interest rates (we see enough reasons for the RBA to move on another 1-2 cuts in the cash rate) will continue to drive the demand for high quality sustainable yield.
'Brexit' stay vote	CYBG (CYB)	CYB derives all of its revenue from the UK. The bank has cautioned "uncertainty around the outcome of the referendum could lead to adverse effects for the UK economy which could also adversely impact CYBG Group".
	PWR (PWH)	PWR has a large exposure to the UK with 60% of revenue denominated in Sterling. We estimate for every 1p depreciation against the AUD, earnings would decline by 2%.
The election sugar-hit	Challenger (CGF)	The Murray FSI recommended that super funds be required to pre-select a comprehensive retirement income product (CIPRs) or annuity style products for members. While no timeframe has been set, we think news flow will continue to benefit CGF.
	Sydney Airport (SYD)	In a signal of commitment, the Government is promising an additional $115 million to continue preparatory works for a Western Sydney airport at Badgerys Creek.
	Smartgroup (SIQ)	With the stated changes to the fringe benefits tax off the agenda, the major risk for SIQ has been removed. Despite a strong share price run, we think there is upgrade potential to our FY16 EPS as the year progresses and the medium-term growth profile remains solid.
US rate rise = lower AUD exacerbated by lower domestic rates	ResMed (RMD)	With shares supported by structural growth, an evolving health informatics platform, and an undemanding valuation, we remain comfortable with its valuation.
	CSL (CSL)	We view this stock as a core portfolio holding, while FY16 is a reinvestment year where underlying earnings growth slows, we remain confident in the future growth trajectory as it is underpinned by strong organic growth.
	IPH Limited (IPH)	IPH is a beneficiary of a strengthening USD. We think the share price reaction to the rising AUD and a strong result is overdone. Another key share price catalyst is news on an acquisition with its A$108m war chest.

The case for Aussie shares in retirement

The 2016 Federal Budget contained a number of unexpected announcements that appeared at first glance as though they may severely impact the position of many self-funded retirees. However, the effect of the changes need not derail the comfortable retirement investors have been planning for if the right strategies are put in place – strategies that still allow retirees the ability to fund their retirement tax effectively.

One such strategy is the use of franking credits from listed Australian shares. Franking credits provide a tax benefit on dividends paid to the investor. This means the actual return from that particular share is 'grossed up' to reflect the tax benefit provided. No other investment provides this relief.

Case study

Scott and Sally are 65 years of age and have total assets of $5.2 million. They have each rolled the maximum amount of $1.6 million into an account-based pension in their self-managed super fund, and are drawing the minimum pension income of 5% pa. In addition they have a jointly owned portfolio of fully franked Australian shares with a current value of $2 million. The shares pay a dividend yield of 5%.

Grossed-up effect of yield

Assets / Income	Scott	Sally
Assets in Account Based Pension	$1,600,000	$1,600,000
Australian share portfolio (fully franked dividends)	$1,000,000	$1,000,000
Total Assets	$2,600,000	$2,600,000
Account-based pension income	$80,000	$80,000
Dividends	$50,000	$50,000
Total Income	**$130,000**	**$130,000**
Personal Tax payable / (tax refund)	($5,239)	($5,239)
Franking credits refunded to SMSF in pension phase	$22,286	
Total combined tax refund (Scott, Sally & SMSF)	**$32,764**	

Source: Morgans.
Assumptions: SMSF portfolio invested in a balanced asset allocation with a 40% allocation to fully franked Australian Shares.

As a result of investing in fully franked shares outside super Scott and Sally are still eligible for a combined personal tax refund of $10,478 in addition to the refunded franking credits received by the super fund.

Talk to your Morgans adviser about how the measures will affect you, and what strategies can help to give you the best financial outcome.

Infrastructure – Understanding interest rate sensitivities

Transport infrastructure has outperformed energy infrastructure stocks in recent periods, given it typically benefits from volume growth and its pricing is not directly linked to interest rates. The revenues of regulated utilities factor in interest rates through the regulated revenue cap calculation. Thus, lower interest rates can result in falling revenues, as is evident from the energy regulator's final decision for the Victorian distribution networks (albeit the impact on cashflows will be partly mitigated by decline in actual interest costs).

If interest rates continue to decline, we expect transport infrastructure will continue to outperform. As an extreme sensitivity, if we assume current 10-year government bond rates of 2.25% pa for the risk free rate and hold all else constant, our valuation of Transurban would lift to $16.13 ps and Sydney Airport (SYD) to $11.30 ps. Under such a scenario, the valuation upside for APA Group and AusNet Services (AST) is more limited to $9.93 ps and $1.87 ps, respectively.

However, if the lower interest rates are accompanied by lower inflation rates, the upside valuation is less. Pricing is typically linked to CPI, and with relatively low operating costs, a decrease in CPI may result in an increase in operating earnings. Interest costs are typically highly hedged and/or fixed. Distributable cashflow thus may weaken. As a sensitivity, if we assume a long-term CPI assumption of 2.0% pa instead of 2.5% pa then the TCL valuation upside would reduce to $15.11 ps and SYD to $10.73 ps. APA's valuation would be $9.17 ps and AST would be $1.82ps. Given these sensitivities, we continue to have a preference for transport infrastructure stocks, with **Sydney Airport** our top pick as we estimate it has the greatest unrealised value across the sector. **AusNet Services** is currently our preference amongst the regulated utilities.

We are wary that a rise in US short-term rates could ultimately translate into higher Australian long bond rates and thus impact infrastructure stocks. Historically, there has been an 81% correlation between US short and long bond rates, and an 88% correlation between US and Australian long bond rates. Thus, a rising US short rate could transmit into a higher Australian long bond rate. This could see a steepening of the yield curve, as the RBA cuts the short rate but long bonds rise with the US. Lower deposit rates will likely continue to attract retail investors to yield equities, but the higher long bonds could reduce institutional interest as the higher rates are fed into valuation models.

Visit our website to view our recent **Sydney Airport note** published 20 May 2016.

REITs expected to remain attractive

REITs continue to perform well with the sector returning around 12% year to date versus the broader market returning around 3.5%. With interest rates forecast to fall, we expect the sector will remain attractive to investors with a yield focus. We also note that most REITs go ex distribution at the end of June. Importantly, balance sheets also remain in good shape.

We expect merger & acquisition activity to remain a core thematic in 2016. Recently, GPT Metro Office Fund received a bid from Growthpoint. A second bidder has also now emerged with Centuria Metropolitan REIT also announcing a non-binding, indicative bid for the group. This follows recent activity with Dexus Property Group's failed takeover bid for Investa Office Fund which if successful, would have made it one of the largest listed REITs with a market capitalisation of around A$10 billion.

With the upcoming reporting season we expect most REITs to deliver earnings and distributions in line with guidance targets. We also expect most groups to post NTA growth with capitalisation rates continuing to drive revaluations (which we expect to continue over the next 6-12 months albeit at a slower rate). Outlook commentary for many groups will likely focus on upcoming leasing expiries (FY17 and FY18) with markets mixed, particularly for office.

Our preferred REITs currently include:

- **360 Capital Industrial Fund** – pure Australian industrial REIT with potential ASX 200 inclusion in CY16 and an attractive distribution yield paid quarterly.
- **Aventus Retail Fund** – exposure to large format retail segment (first mover); prospectus forecasts are on track and the stock offers an attractive 7% yield as well as organic/acquisition growth options.

For yield, we also highlight Cromwell Property Group, which continues to offer an attractive 8% distribution yield in FY17 paid quarterly and Asia Pacific Data Centre Group, which owns three data centre assets and we forecast a FY17 distribution yield of around 7%.

For diversified large cap exposure we are still comfortable with Stockland Group and for offshore exposure Westfield Group.

Bellamy's Australia – field notes from China

Having attended the Bellamy's Australia investor day and meeting with a number of industry experts in China during May, we came away just as positive on the opportunity for Australian food exporters. Following all the food scandals, food safety is one of the top concerns amongst Chinese people, dairy in particular. China is the largest e-retail market in the world with an online population of >520m (compared to 200m in the US). E-commerce is growing at three times the rate of GDP and is expected to comprise 24.2% of total consumption by 2020. Baby care products currently represent 32% of sales, beauty 25% and healthy products and food 24%. Government efforts to regulate cross border e-commerce have caused volatility in the listed food stocks during 2016. While there are likely to be further changes that may cause some short-term disruption, we note that the changes are focused on levelling the playing field for domestic retailers as opposed to attempting to stop e-commerce. It is also about ensuring food safety.

There is a big opportunity for Bellamy's in China given the infant formula market grew by 20% to over US$20bn in 2015. Removal of the one child policy will see more babies born in the future. 70% of Chinese mothers formula feed their babies. Bellamy's has been importing product into China since 2008. The company has a strong team on the ground in China which continues to expand and has established itself as one of the top online stores on Tmall Global with Bellamy's Organic a top 15 formula brand. Management said that it is well placed to deal with China regulatory change. The company reiterated FY16 earnings guidance which we believe may prove to be conservative, though 2H16 is a period of investment. FY17 is set to be a year of strong growth with a whole new contract manufacturing arrangement coming on line and a full year benefit from price increases. Importantly, management is confident it has the supply of key organic ingredients over the coming years to meet the strong demand for its product. **Bellamy's remains one of our key picks in the sector.** We think it is attractively priced for its growth profile.

Ways of getting exposure to rising Chinese food demand for Australian 'clean, green, quality, and safe' products include the companies in the following table.

Company	Mkt Cap ($m)	PE (x) 2017	EV/EBITDA (x) 2017	Div Yield 2017	EPS growth 2017	ROE 2017
Capilano Honey	204	15.2	10.7	2.7%	17.4%	25.1%
Comvita	477	21.4	12.9	1.9%	25.6%	16.8%
Bellamy's Australia	1087	17.1	11.3	1.8%	73.9%	49.6%
A2 Milk Company	1055	19.5	12.2	0.6%	95.9%	29.9%
MG Unit Trust	214	11.0	5.0	9.1%	27.8%	4.5%
Bega Cheese	952	26.1	12.8	1.9%	30.5%	10.6%
Freedom Foods	643	37.7	20.9	1.2%	57.0%	6.0%
Vitaco Holdings Ltd.	257	16.7	10.6	3.3%	18.0%	16.8%
Blackmores	2782	23.3	15.2	3.4%	21.1%	54.3%
Treasury Wine Estates	7714	27.2	14.2	2.5%	26.8%	7.6%
Average		**21.5**	**12.6**	**2.8%**	**39.4%**	**22.1%**
Median		**20.5**	**12.5**	**2.2%**	**27.3%**	**16.8%**

Source: Morgans, FactSet

Wrapping up bank reporting season

Major bank reporting season is now over with ANZ, NAB and Westpac having reported 1H16 results and CBA having provided a 3Q16 trading update. As expected, the common theme across all the results was deterioration in the asset quality of institutional exposures with a handful of single name exposures being the culprits. Arrium was one exposure that we believe was impaired by all four major banks. However, with other troubled single name exposures such as Slater & Gordon and Peabody it appears that treatment differed across banks in terms of impairment. In the case of Slater & Gordon, where NAB and Westpac appear to be equally exposed, we believe Westpac impaired its exposure in 1H16 whereas NAB did not. Consequently, we expect that either Westpac will write back its Slater & Gordon impaired exposure in 2H16 or NAB will recognise its Slater & Gordon exposure as impaired. We believe the former is more likely. Asset quality deterioration was also generally evident in the unsecured consumer loan portfolios, with this deterioration particularly stemming from pockets of Western Australia and Queensland.

On the capital front, no capital raisings were announced and no discounted price was offered to dividend reinvestment plans, signaling confidence in common equity tier 1 (CET1) capital positions for the moment. Commentary around the timeframe of increases in regulatory capital requirements was positive with Westpac commenting that APRA is likely to commence implementation of 'Basel 4' in 2018. ANZ cut its dividend as expected, while NAB kept its dividend flat. While our base case is that NAB will keep its dividend flat over our forecast period, there is a relatively high risk of a dividend cut with NAB.

We continue to view Westpac as the major bank with the lowest risk profile. We believe downside risks to earnings and dividends are least for Westpac. **Westpac** continues to remain our preferred major bank and ANZ remains our least preferred major bank. We expect dividend yields offered by the sector to generally remain attractive.

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-june-2016**

Top 100

This month's changes

May has defied the weight of investor apathy and continued its positive run through what is normally a seasonally weaker period. We hold onto the view that the broader macro backdrop for equities remains supportive. We think the downside risks are overplayed, and while we don't discount near-term shocks (Brexit, US interest rates), we think the fundamentals driving earnings remain sound.

June: we add CYBG and remove AMP.

CYBG CYB			
Price	$5.65	PE (x)	15.3
Price Target	$5.81	Yield	1.1%
Upside	2.8%	Gross Yield	1.1%

CYBG is a leading mid-sized UK Retail and SME bank with a long-established customer franchise across its core regions (Scotland, North East England, North West England, Yorkshire and the Humber). It was demerged from NAB in February 2016.

Key reasons to buy

- Removal of the EU referendum on 'Brexit' and inclusion in the FTSE 250 will provide meaningful catalysts for the stock in the short term.
- CYB recently revised down its cost guidance for FY16 and have further stated that cost will be capped at FY16 levels over the medium term. This helps to bring forward its cost-to-income goal of <60% in five years (currently 71.9%).
- It appears to us that CYB already has much of the infrastructure in place to achieve IRB accreditation for its mortgage portfolio, which will reduce CET1 capital required to be held against mortgages thus increasing return on equity.

Orora ORA			
Price	$2.77	PE (x)	19.4
Price Target	$3.00	Yield	3.6%
Upside	8.6%	Gross Yield	4.0%

Orora Limited (ORA) is focused on fibre packaging and beverage packaging in Australia and packaging distribution in North America. ORA has manufacturing plants and 83 distribution sites across seven countries.

Key reasons to buy

- Since demerging from Amcor (AMC) in December 2013 ORA has experienced strong double-digit earnings growth in both the Australasia and North America divisions.
- We estimate ORA derives around 60% of revenue from highly defensive sectors such as food and beverage. Given the volatile market, we think the stock should receive good support.
- ORA has made a number of growth investments in the last two years that should set it up for solid earnings growth over the medium term (forecast 3-year EPS CAGR of 12%).

Sydney Airport SYD			
Price	$7.18	PE (x)	nm
Price Target	$7.85	Yield	4.6%
Upside	9.4%	Gross Yield	4.6%

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 a premier infrastructure asset and prime retail space leveraged to Asian travel growth, as well as commercial property and parking.
- We expect interest costs to fall materially, as out-of-the-money interest rate swaps expire and are replaced at lower interest rates.
- The combination of solid earnings growth and falling interest costs should generate strong distribution growth and potential for capital management initiatives, although over the near term, the potential development of the second Sydney airport at Badgerys Creek will be a key capital allocation decision.

Westpac WBC			
Price	$30.80	PE (x)	12.1
Price Target	$31.00	Yield	6.2%
Upside	0.7%	Gross Yield	8.8%

Westpac (WBC) is Australia's oldest banking and financial services group, with branches and operations throughout Australia, New Zealand and the near pacific region.

Key reasons to buy

- Relatively low risk profile in terms of loan book positioning and low reliance on treasury and markets income.
- Westpac stands to benefit most from re-pricing of investor home loans.
- Relatively low risk of dividend cut as a result of strong regulatory capital position and good organic capital generation capacity.

Source: IRESS, Morgans.
Priced at 31 May 2016.

Ex 100

This month's changes

We add Bellamy's (BAL) back into the high conviction list, as we believe BAL is attractively priced for its growth profile. We also add Kina Securities (KSL).

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-june-2016**

APN Outdoor APO

Price	$6.89	PE (x)	16.7
Price Target	$7.24	Yield	3.6%
Upside	5.1%	Gross Yield	5.1%

APN Outdoor (APO) is a leading outdoor advertising operator in Australia and New Zealand.

Key reasons to buy

- Industry revenue growth running well ahead of current FY16 guidance of 8-11%. We see the potential for further earnings upgrades.
- Rate of static to digital conversion remains the best in the industry, with demand remaining solid, we expect APN to continue to capture market share.
- No major contracts up for renewal this financial year.

Bellamy's Australia BAL

Price	$10.98	PE (x)	17.6
Price Target	$16.65	Yield	1.7%
Upside	51.7%	Gross Yield	2.4%

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

Key reasons to buy

- BAL has a strong brand, well regarded management team and plenty of market share to win in big markets, particularly China. It also warrants corporate appeal.
- We believe that FY16 earnings guidance is conservative, albeit that it is a period of investment during the 2H16. A new manufacturing agreement and a full year of price rises bode well for strong earnings growth in FY17.
- We believe that BAL is attractively price for its growth profile.

Corporate Travel Management CTD

Price	$14.59	PE (x)	27.7
Price Target	$16.00	Yield	1.9%
Upside	9.7%	Gross Yield	2.7%

CTD provides innovative and cost effective solutions to the corporate travel market globally.

Key reasons to buy

- CTD is looking to leverage its technological competitive advantage into new market segments and diversify its revenue streams into B2B and B2C work.
- Improving corporate travel demand, higher airfares, the benefits of scale and a falling AUD should underpin strong double-digit earnings growth for many years to come.
- CTD is also well positioned to report strong earnings growth over the next few years from consolidating large global corporate travel markets (US is worth US$320bn, Europe is US$500bn and Asia is valued at US$650bn) and winning global tenders.

GBST GBT

Price	$5.35	PE (x)	25.1
Price Target	$5.06	Yield	2.1%
Upside	-5.5*%	Gross Yield	3.1%

GBST is a provider of fund administration and financial markets systems growing in popularity with major institutions.

Key reasons to buy

- Recent regulatory changes in the UK have increased the likelihood of GBST winning new clients for its Composer range of fund manager back-office products in the near term.
- A planned merger of one of GBST's major clients with another major pension fund manager offers significant earnings upside potential if the deal comes off.
- Despite heavy investment in new product development, the company generates high levels of free cash flow.

IPH Limited IPH

Price	$6.97	PE (x)	21.2
Price Target	$8.09	Yield	4.1%
Upside	16.1%	Gross Yield	5.5%

IPH is a defensive business with growth potential as the market leader in a fragmented market. Its core competencies are providing intellectual property and trade mark services in the Asia Pacific.

Key reasons to buy

- Since listing IPH has grown its domestic market share to 23.5% and holds the leading market position.
- IPH, through its number one market share both in Australia and Singapore, is able to leverage its efficient operating system to deliver strong EBITDA margins (c46%), which are above industry standards.
- News flow is a key share price catalyst which would include: announcing acquisitions with its cash balance; FX weakness; and further cost outs to drive margin expansion.

Kina Securities KSL

Price	$1.03	PE (x)	7.0
Price Target	$1.37	Yield	10.3%
Upside	33.3%	Gross Yield	10.3%

Kina Securities Limited is a diversified financial services provider in PNG offering its customers end-to-end financial solutions. Kina group has two operating divisions, Kina Bank and Kina Wealth Management.

Key reasons to buy

- We see risk to the upside with the stock trading on only 6x FY16F and offering an 11% dividend yield. Management indicated at the AGM that they will update their capital management strategy at the next result.
- Loan growth has continued to recover post completing the Maybank acquisition and synergies appear on track.
- Management team has been bolstered since listing and has continued to deliver on earnings post listing.

NEXTDC NXT

Price	$3.47	PE (x)	nm
Price Target	$3.33	Yield	0.0%
Upside	-3.9*%	Gross Yield	0.0%

NEXTDC is a Data-Centre-as-a-Service (DCaaS) provider offering a range of services to corporate, government and IT companies.

Key reasons to buy

- In a high barriers to entry business, leveraged to the high growth digital economy and now fully funded, NXT is set up to grow solidly over the next few years.
- NXT is due to announce secondary data centres in Brisbane and Melbourne shortly and we see the potential for NXT to sign large cornerstone deals in the near future which will have the potential to make new facilities EBITDA positive from day 1.
- It is looking increasingly probable that NXT will be included in the ASX200 index in June (changes to be announced 10 June).

RCG Corporation RCG

Price	$1.34	PE (x)	15.6
Price Target	$1.90	Yield	5.0%
Upside	42.4%	Gross Yield	7.1%

RCG is a holding company which owns and operates a number of footwear businesses in the performance, comfort and active lifestyle sectors.

Key reasons to buy

- RCG offers a very strong growth profile with EPS growth of 45% in FY16 and c20% in FY17 and FY18. The key Accent business has substantial store rollout potential, leveraging significant global growth trends in key brands.
- The extension of the Skechers agreement removes a key business risk and allows RCG to accelerate the rollout of these stores.
- Despite management recently upgrading FY16 guidance, we still believe it is conservative. Trading on a PEG of <1x and PE of 17x FY17F, RCG is a key retail stock pick.

Vitaco VIT

Price	$1.81	PE (x)	15.0
Price Target	$3.03	Yield	3.7%
Upside	67.4%	Gross Yield	3.7%

Vitaco manufactures and distributes branded products within the nutrition, health and wellness industry.

Key reasons to buy

- VIT is well diversified across its number of brands, products, channels to market and geographies (Australia, New Zealand, China, Middle East and UK).
- It is leveraged to favourable industry dynamics (healthy eating trends) and generates solid earnings growth.
- VIT is attractively priced for its growth profile, in our view. The global FMCG sector trades on an FY17F PE of about 20x and generates negligible growth and certainly not the EPS growth we believe VIT is capable of achieving in FY17.

Source: IRESS, Morgans. Priced at 31 May 2016.

* We see meaningful imminent catalysts for the stocks which are difficult to reflect in valuations.

Queensland

Brisbane Stockbroking, Corporate Advice, Wealth Management	+61 7 3334 4888
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Brisbane – Tynan Partners	+61 7 3152 0600
Bundaberg	+61 7 4153 1050
Cairns	+61 7 4222 0555
Caloundra	+61 7 5491 5422
Gladstone	+61 7 4972 8000
Gold Coast	+61 7 5581 5777
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Milton	+61 7 3114 8600
Mt Gravatt	+61 7 3245 5466
Noosa	+61 7 5449 9511
Redcliffe	+61 7 3897 3999
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Spring Hill	+61 7 3833 9333
Sunshine Coast	+61 7 5479 2757
Toowoomba	+61 7 4639 1277
Townsville	+61 7 4725 5787

New South Wales

Sydney Stockbroking, Corporate Advice, Wealth Management	+61 2 9043 7900
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Balmain	+61 2 8755 3333
Bowral	+61 2 4851 5555
Chatswood	+61 2 8116 1700
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Hurstville	+61 2 9570 5755
Merimbula	+61 2 6495 2869
Neutral Bay	+61 2 8969 7500
Newcastle	+61 2 4926 4044
Newport	+61 2 9998 4200
Orange	+61 2 6361 9166
Port Macquarie	+61 2 6583 1735
Scone	+61 2 6544 3144
Sydney – Level 7 Currency House	+61 2 8216 5111
Sydney – Level 9	+61 2 8215 5000
Sydney Hunter St	+61 2 9125 1788
Sydney Reynolds Equities	+61 2 9373 4452
Wollongong	+61 2 4227 3022

Victoria

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Brighton	+61 3 9519 3555
Camberwell	+61 3 9813 2945
Domain	+61 3 9066 3200
Farrer House	+61 3 8644 5488
Geelong	+61 3 5222 5128
Richmond	+61 3 9916 4000
South Yarra	+61 3 8762 1400
Southbank	+61 3 9037 9444
Traralgon	+61 3 5176 6055
Warrnambool	+61 3 5559 1500

Australian Capital Territory

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Northern Territory

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