

# Health of the Market Report November 2009

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## Health of the Market Report November 2009

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## Lincoln Health of the Market Report November 2009

### Executive Summary

**While Lincoln has identified a stabilisation in the overall health of the market, it continues to caution investors on exposing themselves to potential downside.**

**Purpose:** Lincoln Indicators releases its semi-annual *Health of the Market (HOTM)* report to provide investors with independent, timely analysis of the financial health of all 1,800 plus listed Australian companies.

**Methodology<sup>1</sup>:** Developed by Dr Merv Lincoln, Lincoln's unique research and investment methodology applies models and accounting ratios to measure a company's level of risk and [financial health](#) based on its financial report. Lincoln has been monitoring the health of Australian listed companies for over 20 years with semi-annual reports published for the last five years.

**Key findings:** The latest *Health of the Market (HOTM)* report (data as at 6 November 2009) shows:

- The effects of the global recession were clearly still felt by many companies, particularly those in the Materials and Energy sectors. However, a number rose to the challenge and managed to produce impressive results despite the difficult operating environment. Overall, the health of the Australian sharemarket remained relatively stable during the six months to June 2009. Cost cutting measures, prudent debt management, capital raisings and cash preservation helped most companies survive the crisis.
- The proportion of companies on the Australian Securities Exchange (ASX) that continue to display a 'Marginal' or 'Distressed' Financial Health position has increased slightly from 62% to 63%, while the number of companies exposed to a manageable level of financial risk remained unchanged at 25%.
- There was no change in the overall sector rankings with Financials, Consumer Discretionary and Telecommunication Services the healthiest of the sectors while Materials, Energy and Health Care remained the least healthy.

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<sup>1</sup> Methodology background information: *HOTM Report Page 37*

### Unique sector by sector analysis:

Sector	Market cap \$	% of total market
Financials	481,085m	35.55%
Consumer Staples	90,395m	6.68%
Consumer Discretionary	77,406m	5.72%
Industrials	97,105m	7.17%
Telecommunications	47,415m	3.50%
Materials	355,200m	26.25%
Energy	124,909m	9.23%
Utilities	18,008m	1.33%
Health Care	49,554m	3.66%
IT	12,317m	0.91%

Health rating	Jun 2009
Strong	22%
Satisfactory	3%
Early Warning	12%
Marginal	47%
Distressed	16%

**The outlook:** All indications are that the pace of economic decline has eased, resulting in investors being more positive about the future. World markets have rebounded strongly from recent lows, and signals from major economies like the US have started to improve. Demand from China has returned and commodity prices have bounced from their lows. This definitely augurs well for the profitability of Australian listed companies in the coming months.

While we have been strong supporters of the return to positive sentiment, we feel many potential disasters were avoided as many unhealthy businesses, particularly a large number in the mining and energy sectors, have taken the opportunity of the recent bounce to raise much needed capital. But not all companies were successful in weathering the financial storm, including two agribusiness firms that Lincoln identified as being exposed to unacceptable levels of financial risk prior to their failure in the first half of 2009: Timbercorp Limited (TIM) succumbed to high gearing levels and pressures caused by negative operating cash flow and Great Southern Limited's (GTP) lack of profitability made it difficult to meet its obligations.

Despite the capital raisings resolving cash balance issues, there are many companies that continue to remain unprofitable enterprises and exposed to unacceptable levels of financial risk, recording no operating cash flow, with some maintaining unacceptable levels of gearing.

Significant risk therefore exists for investors who invest blindly in companies that are not fundamentally sound. We cannot stress enough the importance of choosing companies that are financially healthy, are well managed, have strong balance sheets and efficient operations that would enable them to thrive under varying market conditions. This is Lincoln's Golden Rule Number one for successful investing,

Investment opportunities still abound despite the steep run-up in share prices over the past few months. We recommend focusing on undervalued stocks that exhibit strong fundamentals and are operating in sectors that have promising prospects, particularly those that will benefit immediately from the recovery of the global economy.

## Lincoln Health of the Market Report – November 2009

**The financial health of Australian listed companies remained relatively stable over the last six months as the effects of the global recession were still felt in a number of sectors. Companies positioned themselves well to withstand the ongoing effects of the downturn adopting measures such as cost reductions, capital raisings and cash preservation to help tide them over until the recovery. But with the release of mixed global economic data, there is still some uncertainty, and Lincoln reiterates the importance of remaining cautious and vigilant when investing in the sharemarket as a majority of companies continue to be exposed to unacceptable levels of financial risk.**

Lincoln's unique sector-by-sector analysis of the Australian sharemarket confirms that the deterioration in the overall ['health of the market'](#) has slowed down in the six months to June 2009. However, the number of companies exhibiting unacceptable results remains at historically high levels.

Analysis of the broader market shows 22% of all companies on the Australian sharemarket are in a 'Strong' Financial Health position, with 3% in a 'Satisfactory' position. Overall, the percentage of Australian listed companies exposed to manageable levels of financial risk remained unchanged at 25%. Companies which are either 'Distressed' or 'Marginal' increased to 63% while those in an 'Early Warning' position declined by 1%.

Volatility persisted in global sharemarkets during the six months ending 30 June 2009. The All Ordinaries index continued to fall in the first three months of the period reaching a five year low of 3,052.50 in March before rebounding strongly to close the period 7.9% higher at 3,947.80 on 30 June 2009. Since then the market has powered on to higher levels as confidence returned to the market.

As the world prepared to face what was possibly the worst global recession in 70 years, governments and individual companies did their share to cushion the impact on the economy and to protect shareholder value. Major economies implemented co-ordinated interest rate cuts and provided stimulus packages. Many ASX listed companies conducted capital raising exercises, asset sales and cost cutting measures to strengthen their balance sheets and maximise profitability.

Their efforts have appeared to pay off as economies did not plunge as deeply as initially feared. Latest data in fact point to a recovery in the near term. In Australia, the economy has shown signs of improvement prompting the Reserve Bank of Australia (RBA) to increase interest rates and the Federal Government to wind down the stimulus packages. On the corporate front, many companies have come out of the crisis leaner, more efficient and much stronger.

### Key points

- The deterioration in the overall [Financial Health](#) of Australian listed companies has halted with the number of 'Strong' and 'Satisfactory' companies unchanged at 25%. 'Distressed' companies increased from 15% to 16%.
- 63% of ASX listed companies have a Financial Health rating of either 'Marginal' or 'Distressed'.
- Predictions of facing the worst global recession in 70 years drove Australian shares to their lowest levels in five years during this period but subsequently rebounded.
- Potential disasters were narrowly avoided as many unhealthy businesses took the opportunity to capitalise off the rebound in the market to raise much needed capital.
- Financials, Consumer Discretionary and Telecommunication Services, are the healthiest sectors.
- Materials, Energy and Health Care are the least healthy sectors.
- The Consumer Discretionary and Information Technology sectors are the most improved.



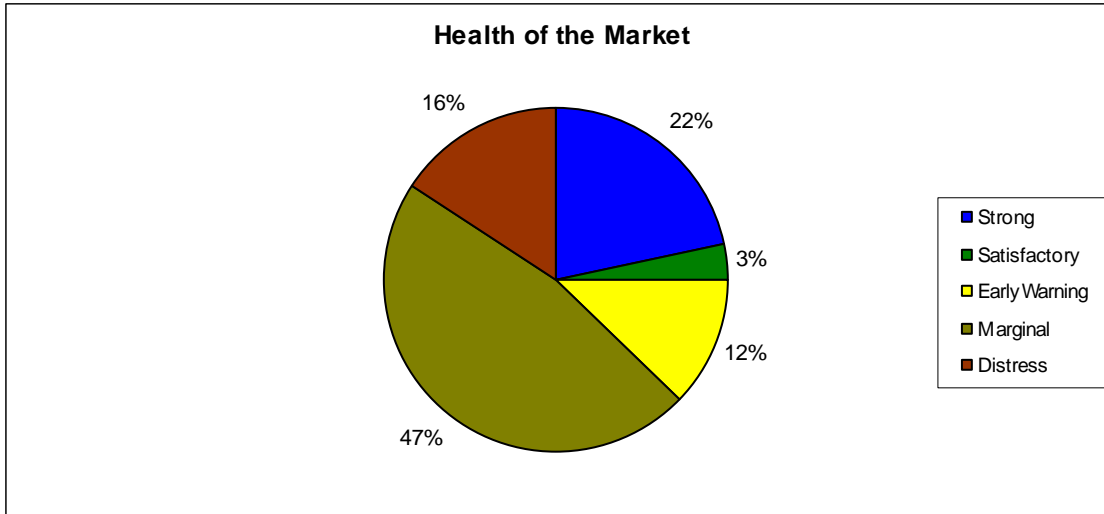
What remains a concern to us is that 63% of companies continue to exhibit 'Marginal or 'Distressed' Financial Health. Another 12% are in an 'Early Warning' position. This means a total of 75% of the companies listed on the ASX are exposed to unacceptable levels of financial risk. In fact, many potential disasters were narrowly avoided as many unhealthy businesses have taken the market's recent return to a healthier risk appetite to raise much needed capital to maintain existing operations. This is a poignant reminder to investors that a thorough and careful review must be made prior to making any investment decision.

Opportunities however still exist despite the generally poor financial health of the market. Quality companies emerged as the financial crisis served as an acid test that saw the 'survival of the fittest'. These are the companies that are financially healthy, profitable, with good operating cash flows, possess a sound balance sheet and can grow even under a challenging environment. Lincoln continues to highlight that these are the companies that should form the cornerstone of an investor's portfolio in order to minimise risk and maximise long-term growth.

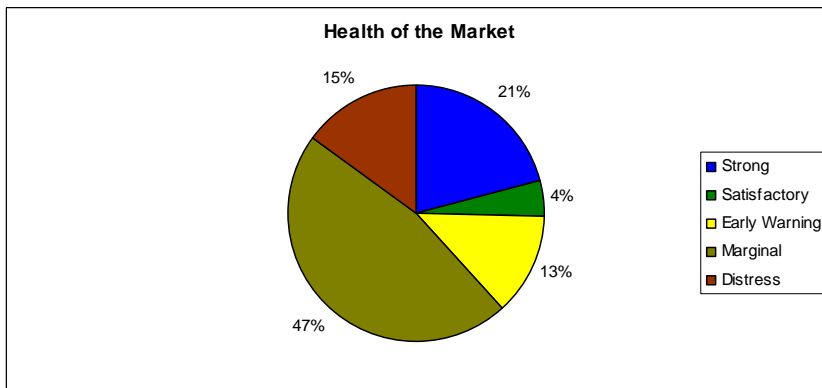
For background information on [Lincoln's Financial Health rating methodology](#), please refer to Appendix 1 on page 37.

Health Rating	Jun 2009	Dec 2008
Strong	22%	21%
Satisfactory	3%	4%
Early Warning	12%	13%
Marginal	47%	47%
Distressed	16%	15%

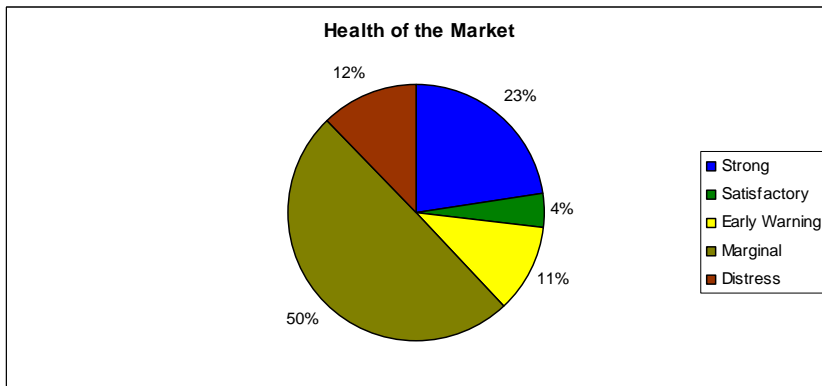
### Health of the Market – Jun 09



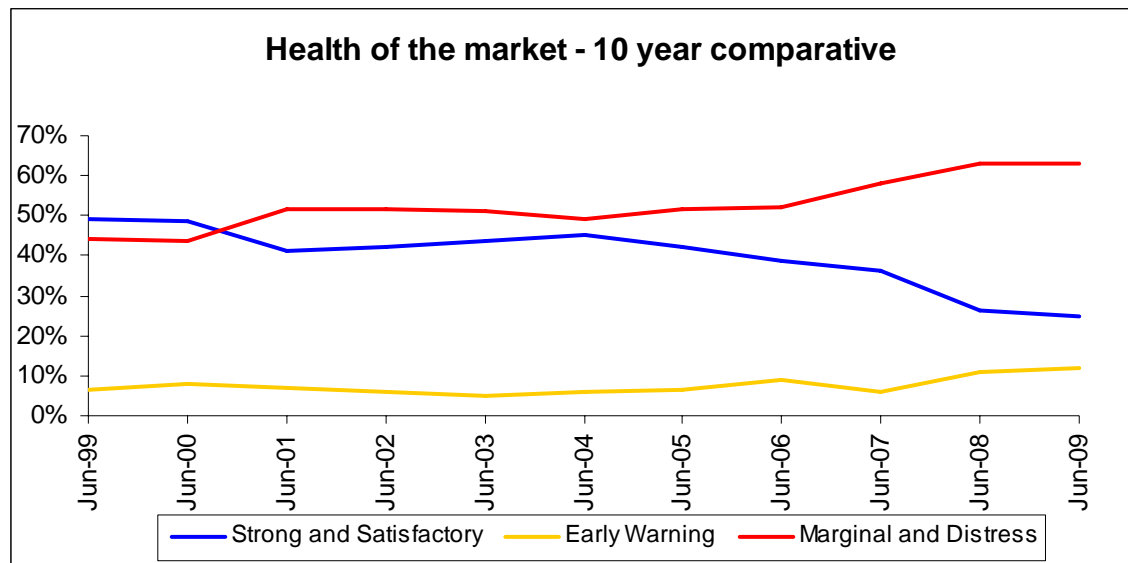
### Health of the Market – Dec 08



### Health of the Market – Jun 08



## Health of the Market – 10 year comparative data



### Recovering from the bottom

From a financial health perspective the first six months of 2009 was an interesting one, with the ASX reaching the bottom in early March as the crisis of confidence really took hold. Whilst the stream of negative economic news continued throughout the period, the rate of deterioration decelerated. Although Australia was one of the last developed countries to be hit by the predicted global recession, we have fortunately been the first one out. This is a testament to both the resilience of our heavily regulated banking sector, commodity restocking in China and decisive policies by both the RBA and the Federal government. Interestingly, we are the only major economy that has raised interest rates (twice so far) in 2009. Although this will 'drag' our performance, it is a strong indicator of the RBA's confidence in our economy's prospects.

### Australian market overview

The period 1 January 2009 to 30 June 2009 was a period of changing sentiment for equity markets. The All Ordinaries Index fell 15% to a 'bottom' on 6 March 2009 during this period (a 54.6% decline from its peak on 1 November 2007) but rebounded strongly, ending the half year up 7.9%. The rebound from the lows has been as swift as the rate of decline. Despite a mild contraction recently, this performance trend continued, and has seen the market recover approximately 48% from its 6 March 2009 low to 6 November 2009.

### Australian economy

With evidence of the domestic economy growing from strength to strength, the Federal Government has started to wind down the stimulus packages which were previously in place. Whilst the period 1 January 2009 to 30 June 2009 saw both the second stimulus package and the extension of the first home buyers grant, these initiatives will not recommence in the current environment, particularly since GDP rose 0.6% seasonally adjusted in the June quarter in what was originally envisaged to be a recessionary environment.

Of particular interest is the RBA decision to leave interest rates stable at 3% earlier in the year and subsequently raise interest rates by a total of 50 basis points to 3.5% in October and November 2009. To put into perspective the boldness of the interest rate rise, consider that the central banks of the world's developed nations are holding interest rates at near 0%. This has sent a clear message that the RBA believes that the future of our economy is bright and that it feels the need to start applying the brakes to our economy to control inflation.



Naturally, being the only country to raise our interest rates, demand for the Australian dollar has escalated significantly. Overseas money has been pouring in, to benefit from the relatively high interest rate environment. This rise was meteoric and has prompted talks of US dollar parity reminiscent of the highs in 2007 preceding the financial crisis. This high currency environment is also supported by improving commodity prices which form the majority of our exports.

Ironically, the strong Australian dollar will place competitive pressures on our exporters. Nonetheless, we expect the economy to continue to strengthen. As previously mentioned, GDP figures were up 0.6% (seasonally adjusted) supported by exports, household and capital expenditure during the period. Both are indicators of improving business and consumer confidence during this period. Looking forward we expect this performance to continue to improve.

Finally, with business sentiment recovering it is unsurprising that the unemployment rate for October 2009 remained relatively stable at 5.8% seasonally adjusted. While unemployment actually increased in from 5.7% to 5.8% in October, it is worth noting that the number of people employed has actually increased over the month.

### **Company outlook**

The majority of companies listed on the ASX have managed themselves well through the financial crisis which was characterised by record levels of capital raisings to strengthen company capital structures. According to figures available from the ASX, \$39.8 billion was raised on the Australian equity market in the first half of 2009. This took the total amount for the 2009 financial year to \$90 billion. With more coming from capital raised overseas (eg. Rio Tinto Limited), the flood of money has gone a long way to supporting the balance sheets of companies.

Moreover, the financial crisis has been a great 'wake up call' to companies. Many hard decisions surrounding restructuring, cost reductions, asset sales, reduced production and dividend cutting had to be made during this time to weather the storm. As a result, many companies have proved their mettle and have come out of the financial crisis stronger than before.

Although most companies continue to be exposed to unacceptable levels of financial risk with only 25% in an acceptable position, it is worth noting that the composition has changed, with the number of 'Strong' companies increasing by 1% and the number of 'Distressed' companies similarly increasing by 1%. Well managed companies will weather the crisis and subsequently recover strongly with the market. Their opposites will be pushed to the edge and too busy fighting for survival to benefit from the improving environment.

The sharemarket is a leading indicator of economic events and will continue to move in line with future expectations. While the market has already risen strongly since the bottom, we are still a long way from previous highs and the market has historically always surpassed previous peaks. This is reflected by the global economy where the economic situation is far from resolved and the opportunity appears to be ripe for recovery and subsequent improvement. Rather than be scared by the overall health of the market, investors should be excited, as now is an opportune time to re-assess their portfolio and look to position it for future long-term growth.

A number of quality companies have performed very well during the period, with many high profile companies performing well from a Financial Health perspective. These include: Westpac Banking Corporation (WBC), Commonwealth Bank of Australia (CBA), JB Hi Fi Limited (JBH), BHP Billiton Limited (BHP), David Jones Limited (DJS), Leighton Holdings Limited (LEI), Felix Resources Limited (FLX) and many more. This is evidence of quality companies not just outperforming in bad economic times, but also recovering ahead of the market from a bottom.

## Sector by sector analysis

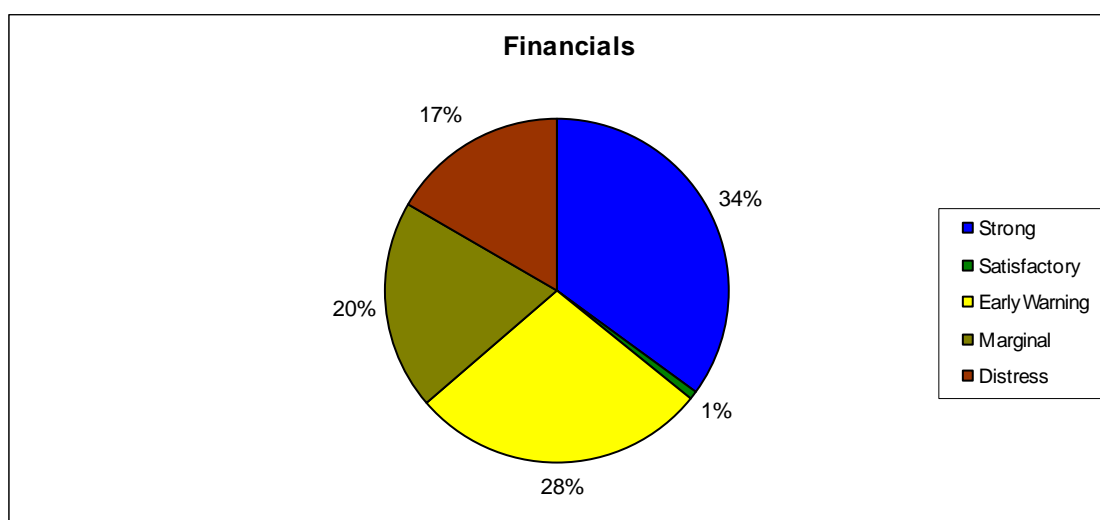
### Financials

The largest sector in terms of market capitalisation is the Financials group, cumulatively representing approximately 35.55% of the current market. It is comprised of Banks, Insurance, Diversified Financials and Real Estate.

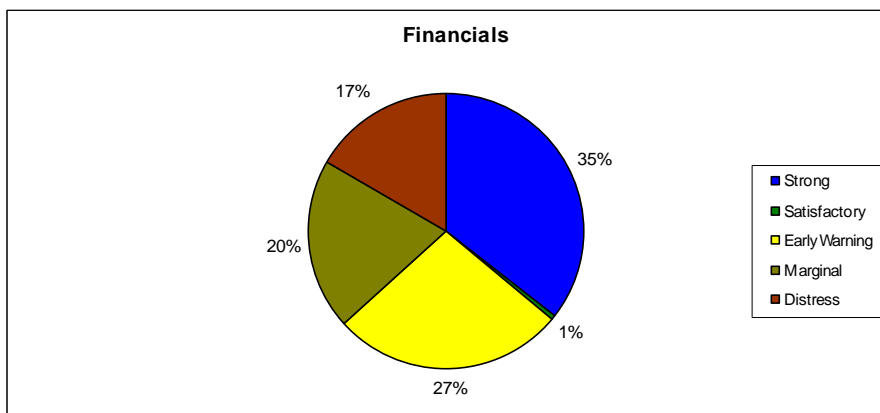
Traditionally, the Financial sector possesses 'Strong' Financial Health. However, the economic downturn has taken its toll on the sector. Weak equity returns, coupled with losses on derivative instruments and the high cost of debt in the first half impacted annual earnings results.

Currently, 35% (down 1%) of the companies in this sector exhibit 'Strong' or 'Satisfactory' Financial Health. The mild deterioration is reflective of recent domestic investment performance partially offsetting the weak financial environment.

#### Financials Jun 09



#### Financials Dec 08



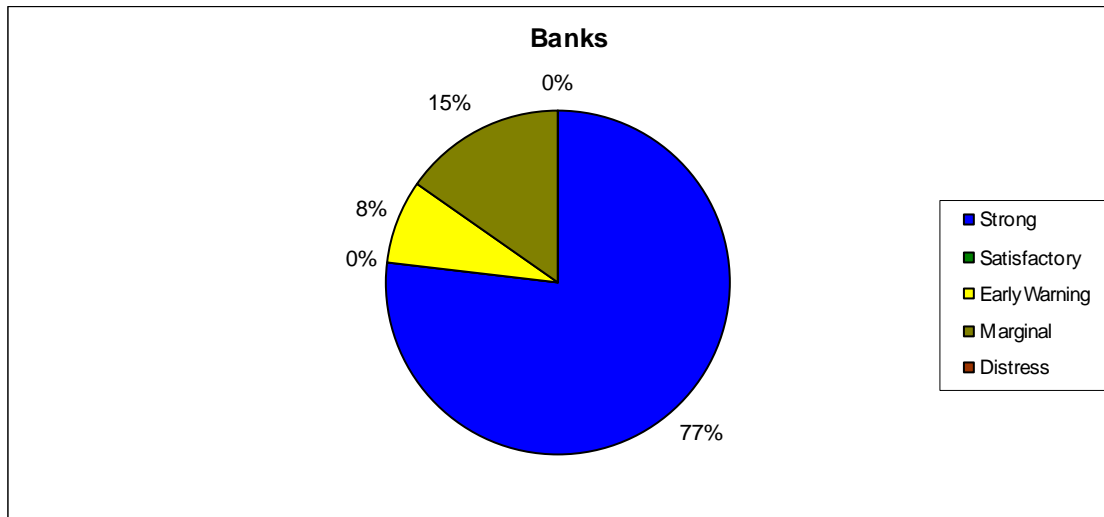
Quick stats on sector	Financials
Sector market capitalisation (\$mil)	\$481,085 million
% of total market	35.55%
Number of companies	265
Highest cap company	Commonwealth Bank of Australia (CBA) \$78,814 million
Lowest cap company	Sabina Corporation Limited (SAP) \$621,918

## Banks and Insurance

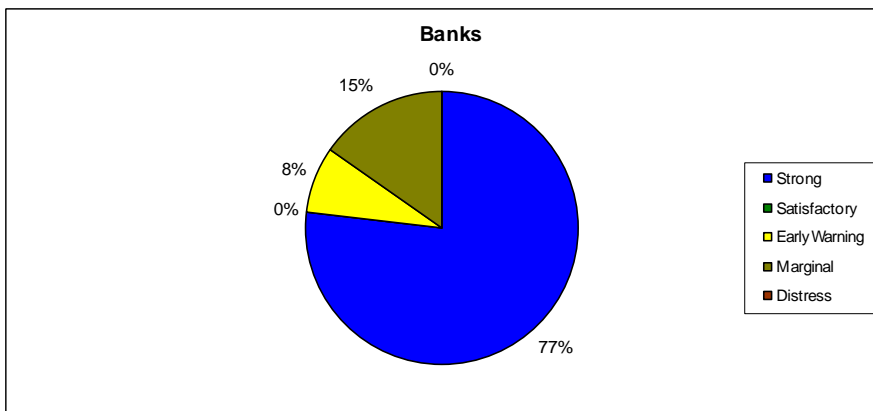
Banks and Insurance companies contribute significantly to the sector's overall health and market capitalisation and are historically considered the strongest companies in the sector. The strong health is largely due to the highly regulated environment (by the Australian Prudential Regulatory Authority (APRA)) these companies operate within.

The virtues of this regulatory environment are perhaps best exemplified by global recognition of our banks' resilience during the global financial crisis. This confidence was reflected by both share price recovery ahead of our broader market and strong credit ratings. Furthermore, our banks and insurance companies have been able to produce strong profit results unlike the majority of their peers.

### Banks Jun 09

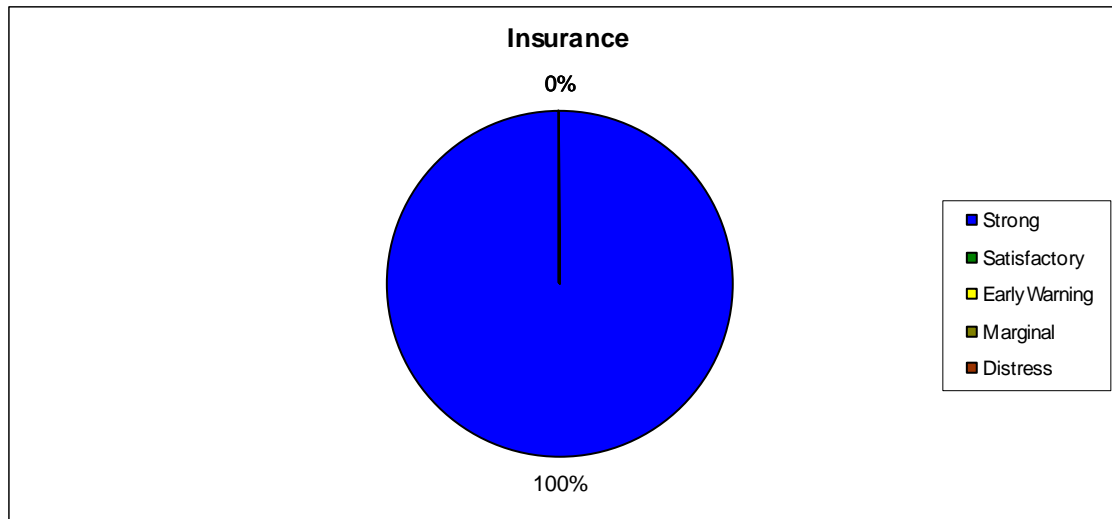


### Banks Dec 08

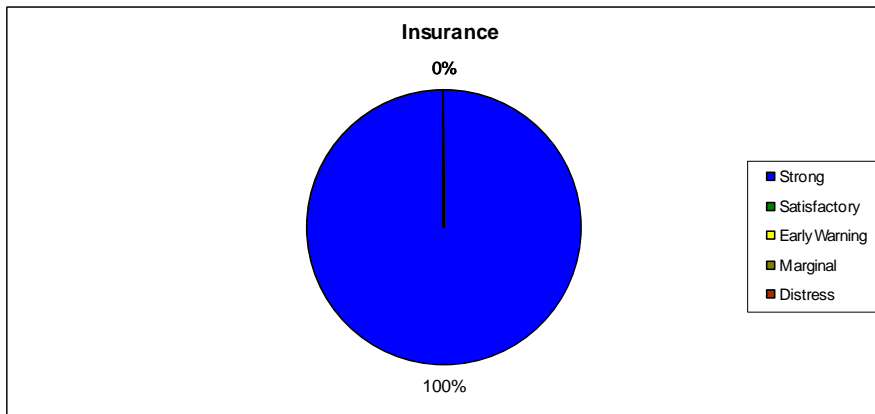


Quick stats on sector	Banks
Sector market capitalisation (\$mil)	\$276,796 million
% of total market	20.45%
Number of companies	13
Highest cap company	Commonwealth Bank of Australia (CBA) \$78,814 million
Lowest cap company	CL Asset Holdings Limited (CLS) \$4.551 million

### Insurance Jun 09



### Insurance Dec 08



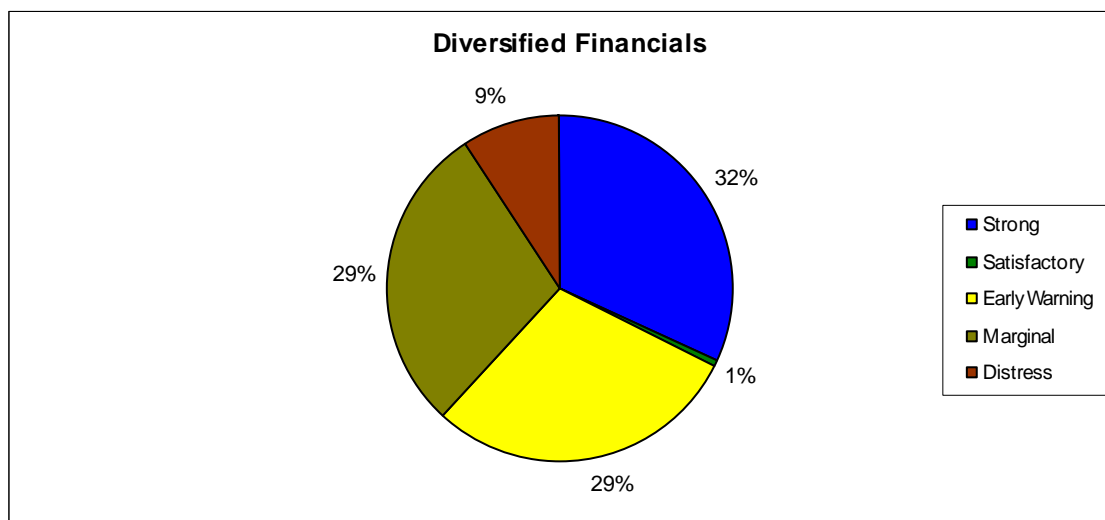
Quick stats on sector	Insurance
Sector market capitalisation (\$mil)	\$63,219 million
% of total market	4.67%
Number of companies	10
Highest cap company	QBE Insurance Group Ltd (QBE) \$21,778 million
Lowest cap company	Calliden Group Limited (CIX) \$76.278 million

## Diversified Financials

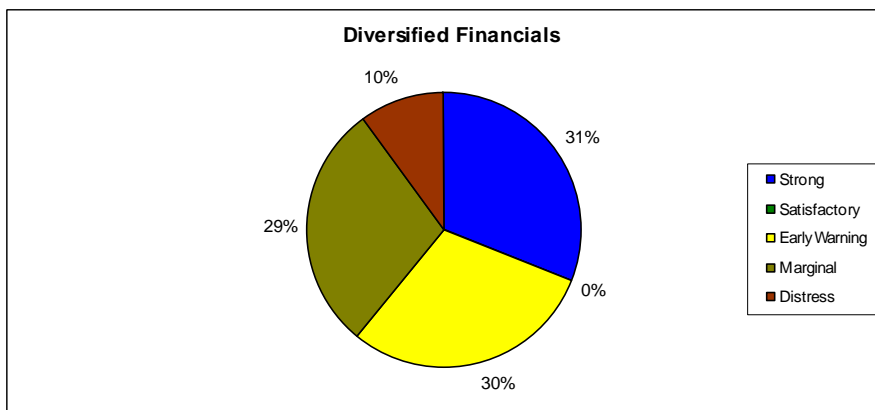
The Diversified Financials sector which has previously been devastated by a series of failures including **Babcock and Brown Limited (BNB)** has thankfully recovered mildly in the last six months. In this period, the number of companies in this sector in a 'Strong' or 'Satisfactory' Financial Health position has improved by 2% from 31% to 33%.

The share price of a number of listed companies in this sector has started to recover with the improving market sentiment and stronger investment performance. The largest company in this sector continues to be **Macquarie Group Limited (MQG)**, which has engaged in deleveraging and risk management activities typical of companies in this sector. As a result, investor sentiment is improving and share price subsequently benefiting from this.

### Diversified Financials Jun 09



### Diversified Financials Dec 08

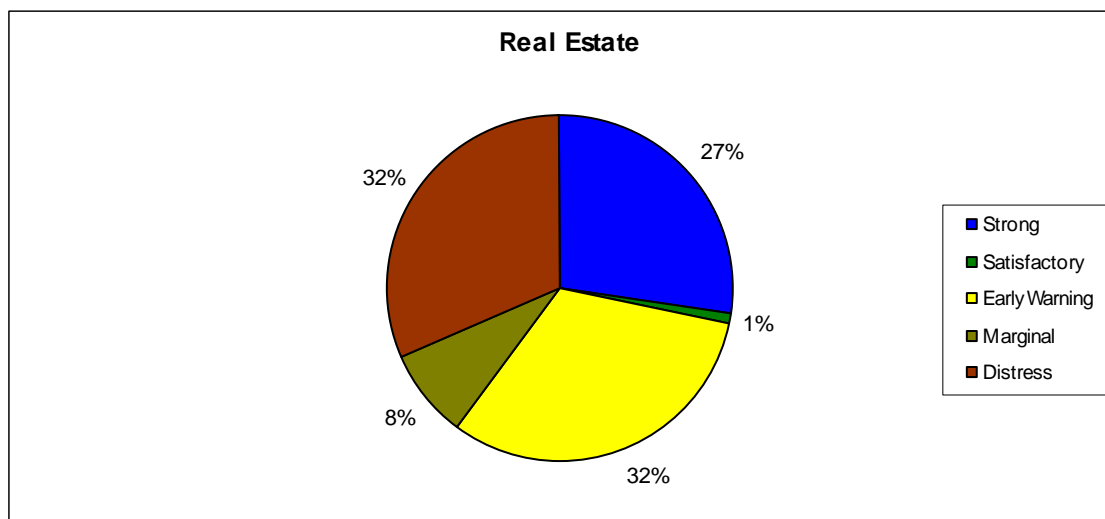


Quick stats on sector	Diversified Financials
Sector market capitalisation (\$mil)	\$59,901 million
% of total market	4.43%
Number of companies	147
Highest cap company	Macquarie Group Limited (MQG) \$15,999 million
Lowest cap company	Equities and Freeholds Limited (EQF) \$710,400

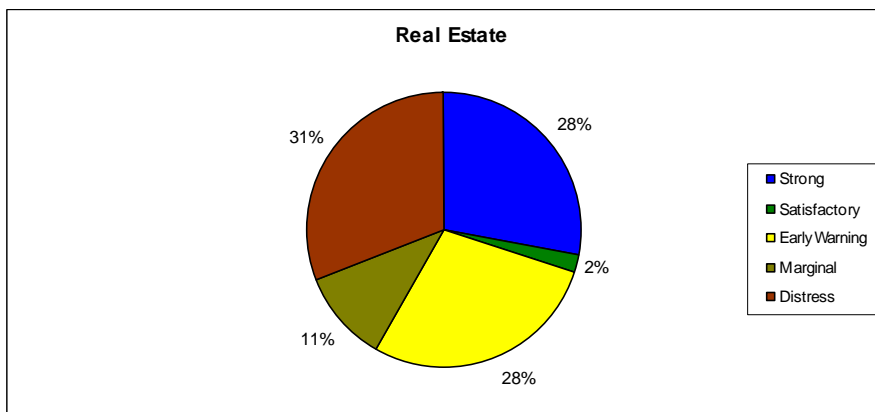
## Real Estate

Like the Diversified Financials, the Real Estate sector has been one of the hardest hit by the economic downturn and we are pleased to see the situation stabilising. It experienced a very mild deterioration in its health where 28% (down 2%) of all Real Estate companies are in a 'Strong' or 'Satisfactory' position. Although significant losses have been realised across the sector, it is important to note that many of these companies have reorganised their capital structures to both reduce leverage and better absorb future shocks. Weakness in this sector is reflected by companies which weakened with the economic environment due to failure to adequately restructure the respective businesses.

### Real Estate Jun 09



### Real Estate Dec 08

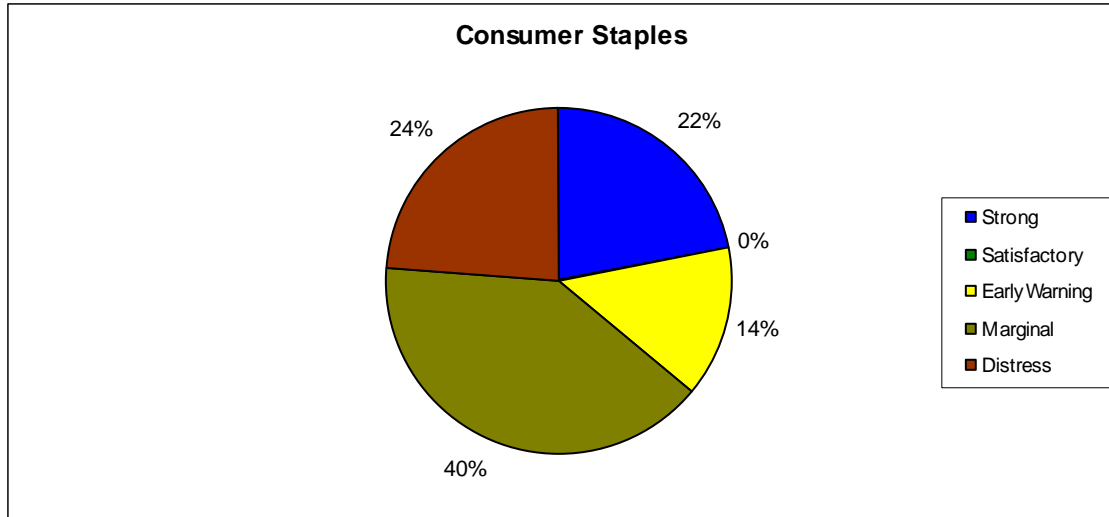


Quick stats on sector	Real Estate
Sector market capitalisation (\$mil)	\$81,169 million
% of total market	6.00%
Number of companies	95
Highest cap company	Westfield Group (WDC) \$27,693 million
Lowest cap company	Sabina Corporation Limited (SAP) \$621,918

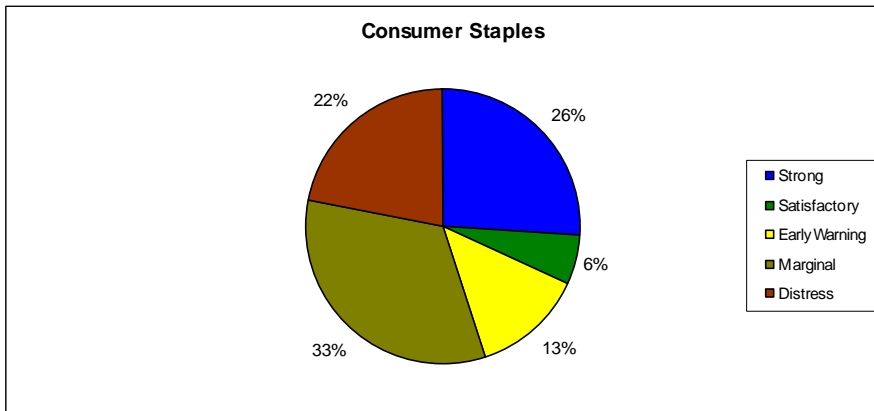
## Consumer Staples

The Consumer Staples sector consists of the Food and Staples Retailing Sector and the Food Beverage and Tobacco industry groups and is one of the largest sectors by capitalisation, currently accounting for approximately 6.68% of the market. This sector is generally considered to be a 'defensive' sector and demand for its products is expected to be inelastic to changing economic conditions. However, on closer analysis, with the exception of the dominant players in this sector, investors still need to be wary. The sector has weakened in the current environment with the number of 'Strong' or 'Satisfactory' financially healthy companies falling from 32% to 22%. This change seems to be largely led by weak demand and prices for agricultural products.

### Consumer Staples Jun 09



### Consumer Staples Dec 08

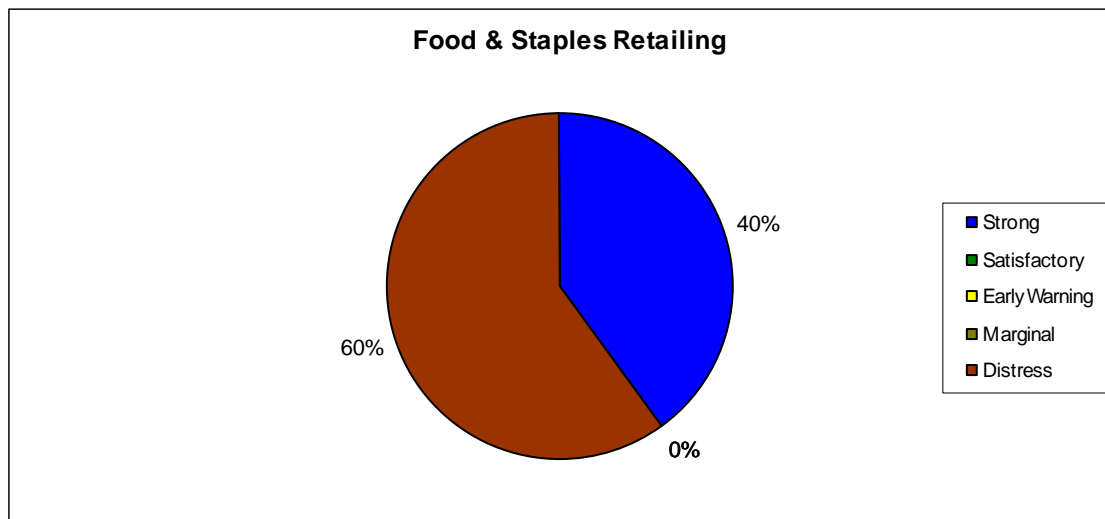


Quick stats on sector	Consumer Staples
Sector market capitalisation (\$mil)	\$90,395 million
% of total market	6.68%
Number of companies	50
Highest cap company	Woolworths Limited (WOW) \$34,576 million
Lowest cap company	Health Corporation Limited (HEA) \$577,017

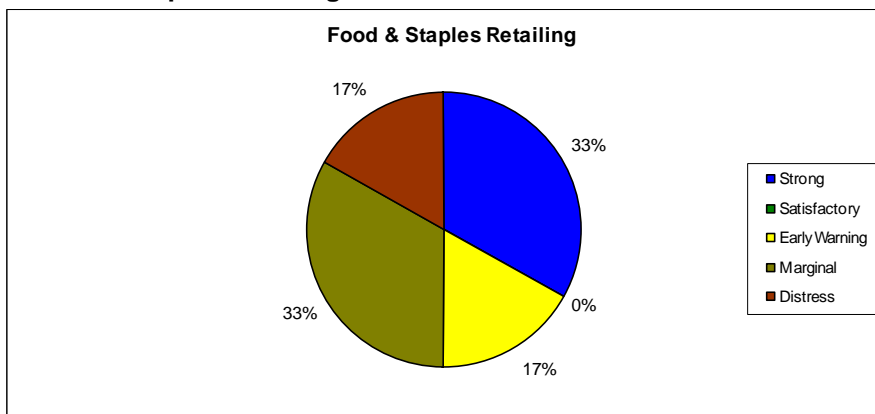
## Food and Staples Retailing

The Food and Staples Retailing is one of the smaller industry groups in the Australian market (by number of companies). It is comprised of just eight companies but it includes two retailing giants **Woolworths Limited (WOW)** and **Wesfarmers Limited (WES)**. Both companies continue to maintain 'Strong' Financial Health due to strong overall performances possibly at the expense of others in the sector which have suffered from declining profits.

### Food and Staples Retailing Jun 09



### Food and Staples Retailing Dec 08



Quick stats on sector	Food & Staples Retailing
Sector market capitalisation (\$mil)	\$65,991 million
% of total market	4.88%
Number of companies	7
Highest cap company	Woolworths Limited (WOW) \$34,576 million
Lowest cap company	Health Corporation Limited (HEA) \$577,017

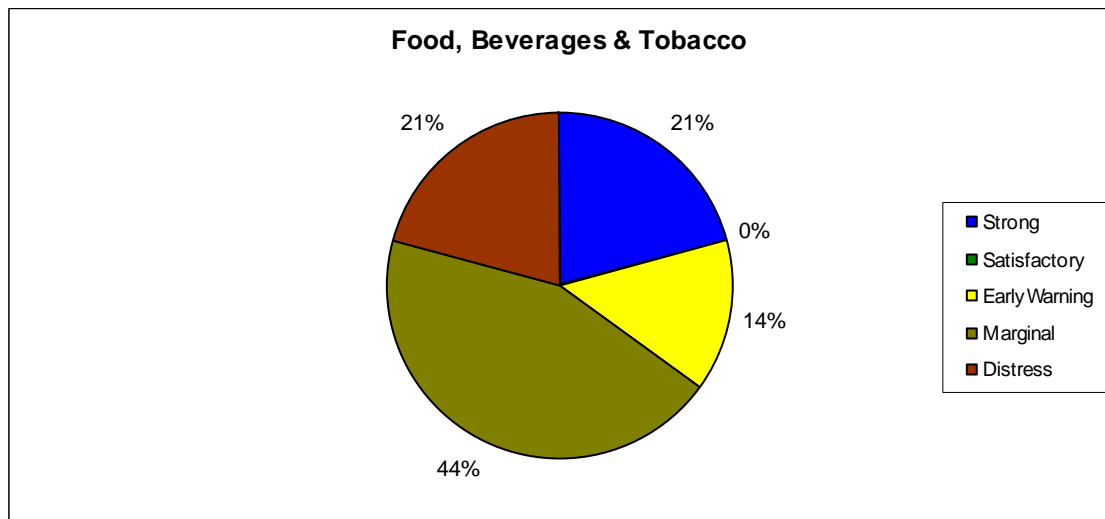


## Food, Beverages & Tobacco

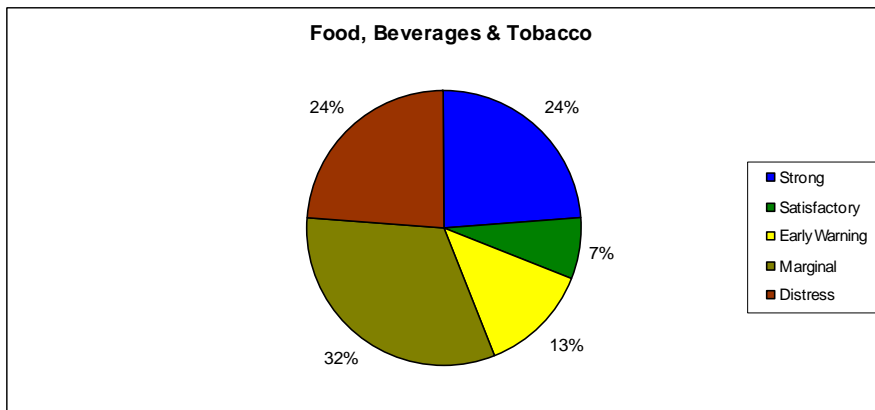
Like Food and Staples Retailing, the Food, Beverages & Tobacco industry is dominated by a few large companies like **Foster's Group Limited (FGL)** and **Coca-Cola Amatil Limited (CCL)** which account for the majority of the sector's market capitalisation. Similarly, both companies and other large cap companies such as **Goodman Fielder Limited (GFF)** in the sector are in 'Strong' position of Financial Health.

Notably, in the recent period, one of the large caps in this sector, **Lion Nathan Limited (LNN)** has been taken over by its majority shareholder Kirin. The Financial Health of the smaller companies has deteriorated during the period. 21% of the sector is in 'Satisfactory' or 'Strong' Financial Health compared to 31% in the previous period.

### Food, Beverages & Tobacco Jun 09



### Food, Beverages & Tobacco Dec 08

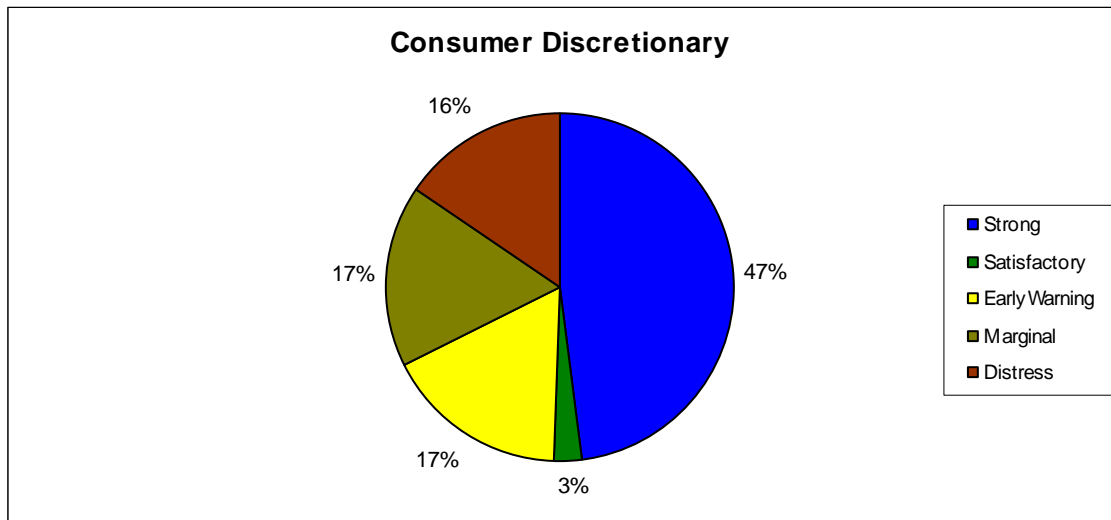


Quick stats on sector	Food Beverage & Tobacco
Sector market capitalisation (\$mil)	\$24,404 million
% of total market	1.80%
Number of companies	43
Highest cap company	Fosters Group Limited (FGL) \$10,362 million
Lowest cap company	Montec International Limited (MTI) \$1.858 million

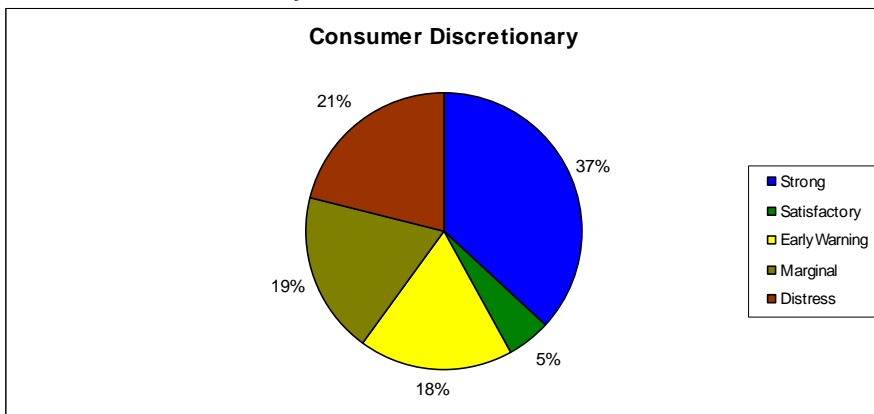
## Consumer Discretionary

The last half year has been characterised by improving consumer confidence after we hit the bottom of the market. Unsurprisingly, this has favoured the Consumer Discretionary sector which suffered during the financial crisis. The Consumer Discretionary sector is one of the broader industry sectors of the ASX encompassing the Media, Consumer Services, Consumer Durables & Apparel, Automobiles & Components and Retailing industry groups. Generally speaking, this sector is sensitive to economic conditions and is benefiting from the improving sentiment. Perhaps this is best reflected by a 8% improvement in the number of 'Strong' and 'Satisfactory' companies to 50%.

### Consumer Discretionary Jun 09



### Consumer Discretionary Dec 08

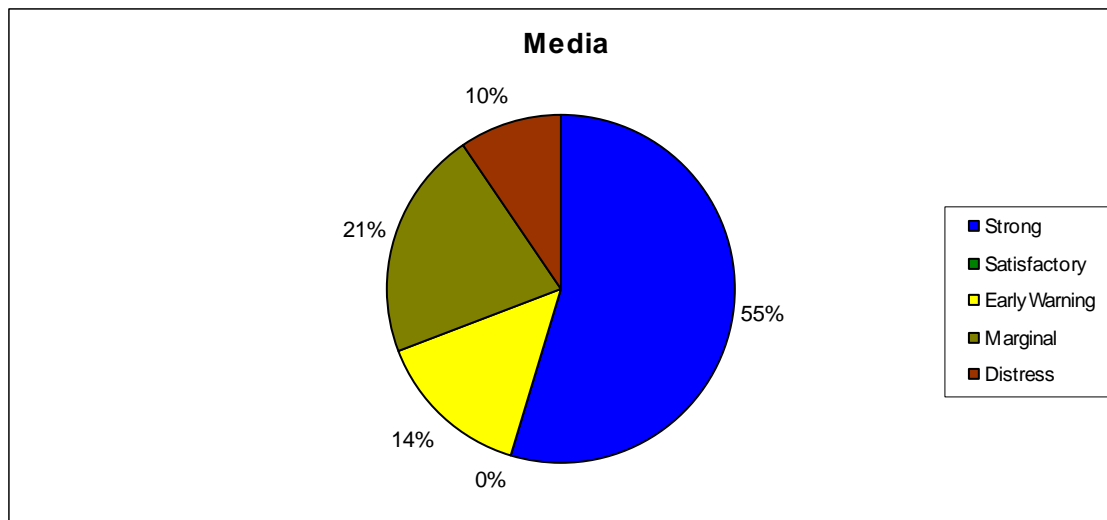


Quick stats on sector	Consumer Discretionary
Sector market capitalisation (\$mil)	\$77,406 million
% of total market	5.72%
Number of companies	154
Highest cap company	News Corporation (NWS) \$12,098 million
Lowest cap company	Viagold Capital Limited (VIA) \$886,130

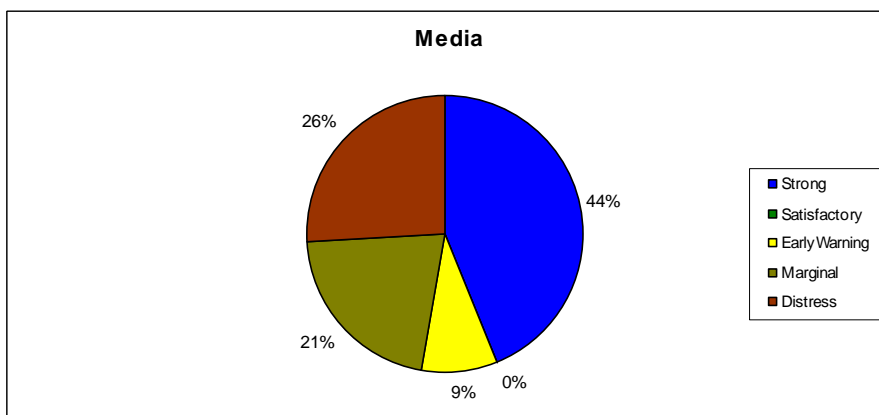
## Media

**News Corporation (NWS)** continues to dominate this sector, constituting 39% of the total market capitalisation of the sector. The sector has improved significantly from 44% of companies in a 'Strong' position to 55%. This is attributable to a recovery in advertising revenue was hit hard in the previous period. A notable trend is the improvement in the health of companies with online and advertising exposure.

### Media Jun 09



### Media Dec 08

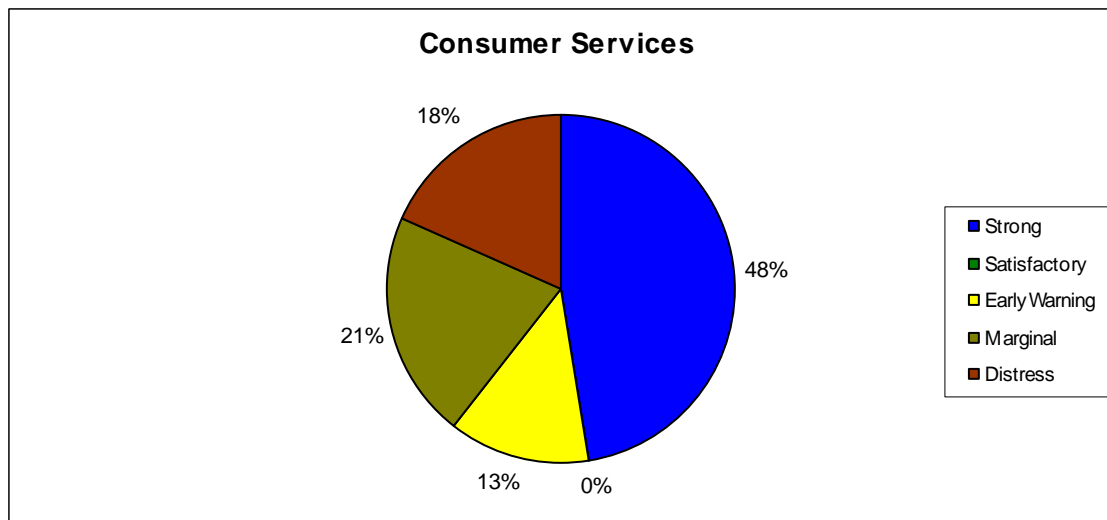


Quick stats on sector	Media
Sector market capitalisation (\$mil)	\$31,156 million
% of total market	2.30%
Number of companies	42
Highest cap company	News Corporation (NWS) \$12,098 million
Lowest cap company	Palamedia Limited (PMX) \$1.120 million

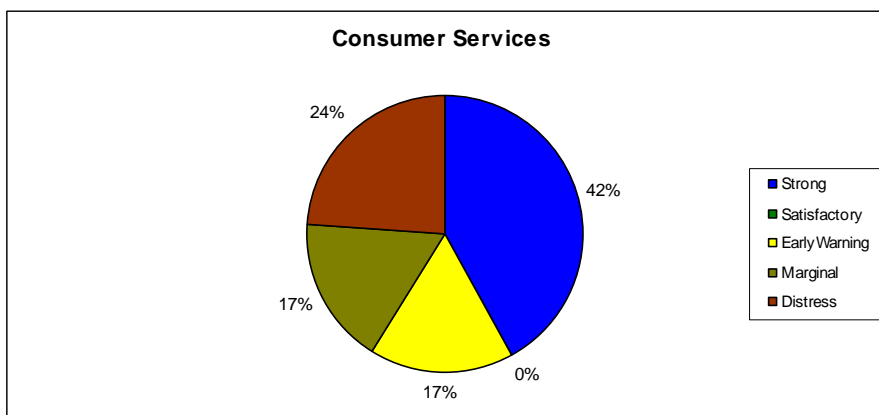
## Consumer Services

The Consumer Services sector has traditionally been characterised by companies with gambling exposure which are traditionally resilient to economic conditions. However, most of the smaller companies in the sector exhibit more cyclical earnings. The sectors' largest participant **Crown Limited (CWN)** and the number of companies with 'Strong' Financial Health have risen from 42% to 48% of participants that remain within acceptable financial risk levels.

### Consumer Services Jun 09



### Consumer Services Dec 08

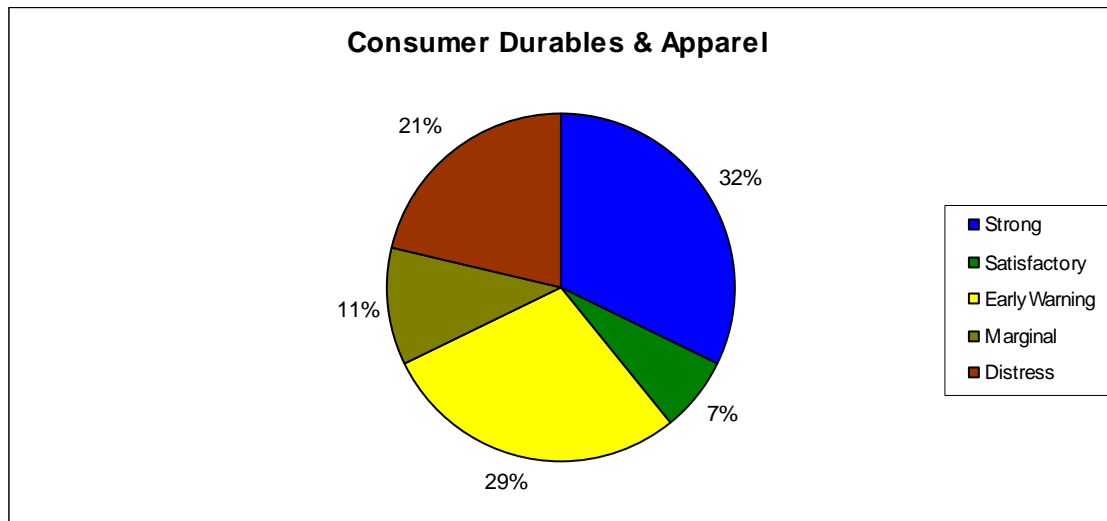


Quick stats on sector	Consumer Services
Sector market capitalisation (\$mil)	\$22,521 million
% of total market	1.66%
Number of companies	38
Highest cap company	Crown Limited (CWN) \$6,164 million
Lowest cap company	Viagold Capital Limited (VIA) \$886,130

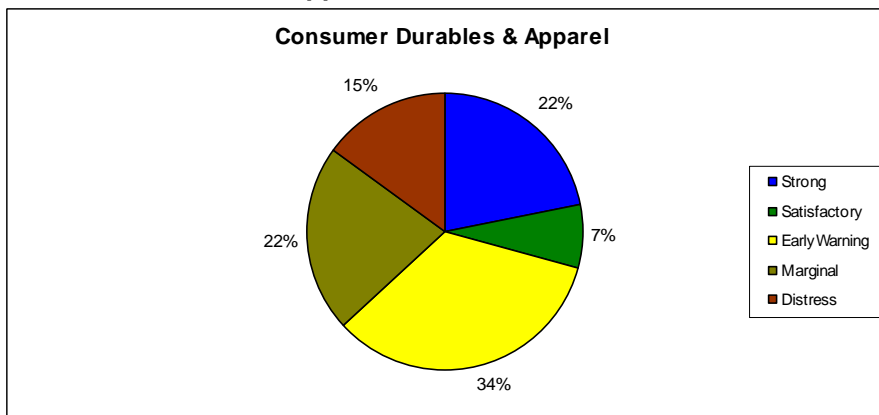
## Consumer Durables & Apparel

The small Consumer Durables & Apparel industry group has traditionally been a volatile sector locally. It often experiences quite large swings in Financial Health. Currently 39% of companies are in either a 'Strong' or 'Satisfactory' position, compared to 29% in the previous six month period. The high Australian dollar has benefited a number of companies in this sector whilst producing headwinds to its multinational market leader **Billabong International Limited (BBG)** which nonetheless retained its 'Strong' health rating.

### Consumer Durables & Apparel Jun 09



### Consumer Durables & Apparel Dec 08

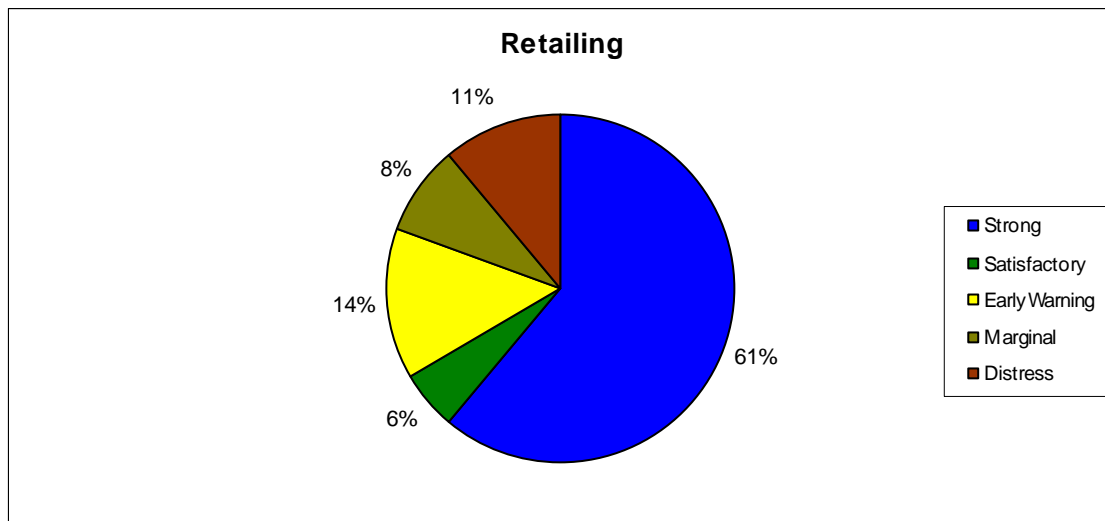


Quick stats on sector	Consumer Durables & Apparel
Sector market capitalisation (\$mil)	\$4,693 million
% of total market	0.35%
Number of companies	28
Highest cap company	Billabong International Limited (BBG) \$2,546 million
Lowest cap company	Photo-Me Australia Limited (PTO) \$1.008 million

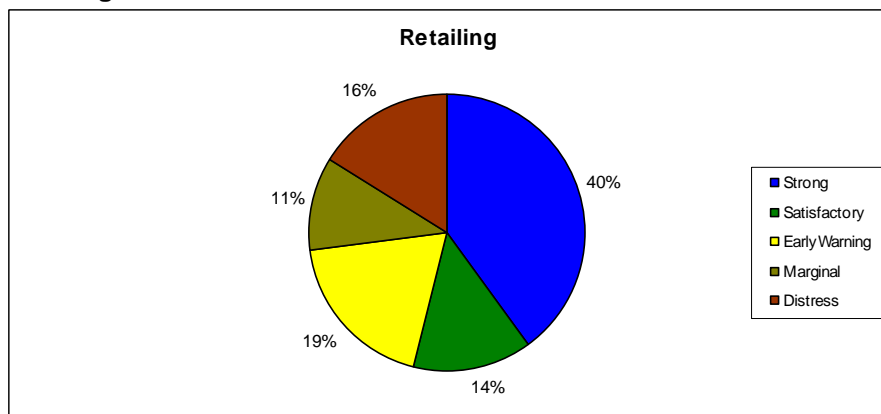
## Retailing

The Retailing sector has performed admirably over the past six months, benefiting from favourable exchange rates, recovering consumer sentiment and government stimulus packages. There were standout performers like **JB Hi Fi Limited (JBH)** and **Wotif.com Holdings Limited (WTF)** which delivered impressive earnings growth by capitalising on the importance of affordability during the crisis. Cash flow levels in particular continue to be impressive and have resulted in an improvement of 13% to an admirable 67% of companies in this sector in either a 'Strong' or 'Satisfactory' position. Restructuring in the sector in response to economic weakness in the previous period has contributed to this result. Notably, the recent float of department store **Myer Holdings Limited (MYR)** appears to have capitalised on the sector's improving sentiment.

### Retailing Jun 09



### Retailing Dec 08

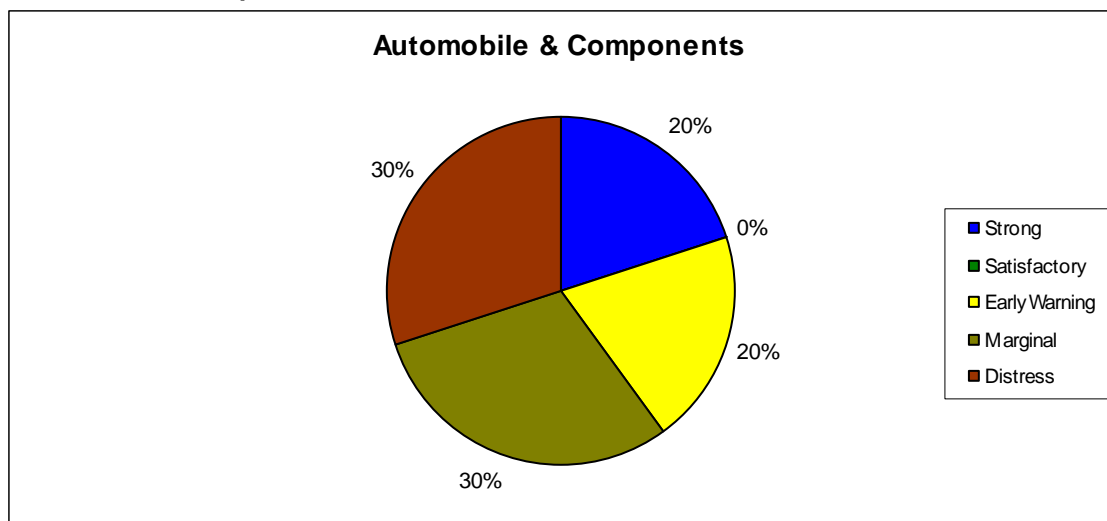


Quick stats on sector	Retailing
Sector market capitalisation (\$mil)	\$18,384 million
% of total market	1.36%
Number of companies	36
Highest cap company	Harvey Norman Holdings Ltd (HVN) \$3,134 million
Lowest cap company	TVN Corporation Limited (TVN) \$1.925 million

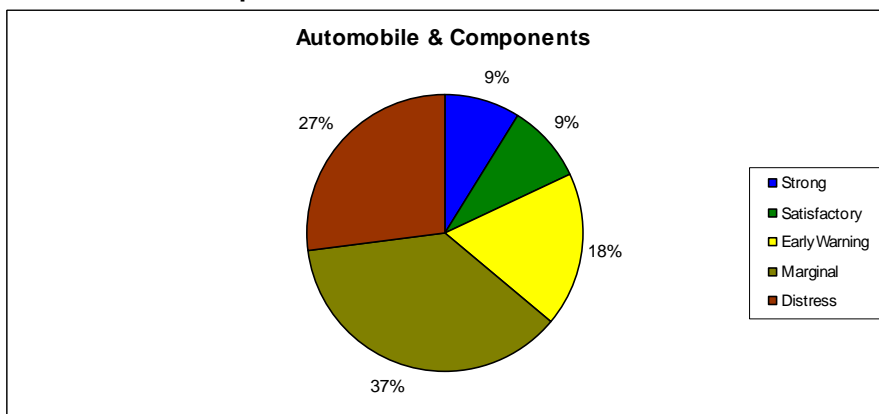
## Automobile & Components

The Automobile and Components industry group is one of the smallest sectors that we cover in this report. This sector has strengthened in line with the global automotive industry, with acceptable Financial Health rising 2% to 20%. This recovery is below our expectations for the sector due to generally poor performance despite favourable economic conditions. However, it is worth noting that the number of 'Strong' companies increased from 9% to 20%.

### Automobile & Components Jun 09



### Automobile & Components Dec 08

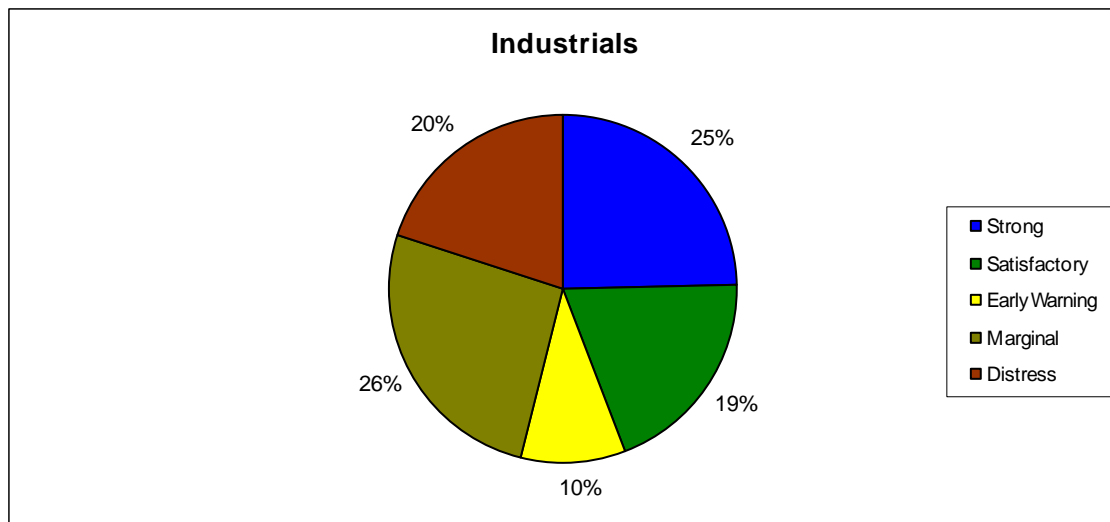


Quick stats on sector	Automobile & Components
Sector market capitalisation (\$mil)	\$652 million
% of total market	0.05%
Number of companies	10
Highest cap company	Fleetwood Corporation Ltd (FWD) \$385 million
Lowest cap company	Berklee Limited (BER) \$10.821 million

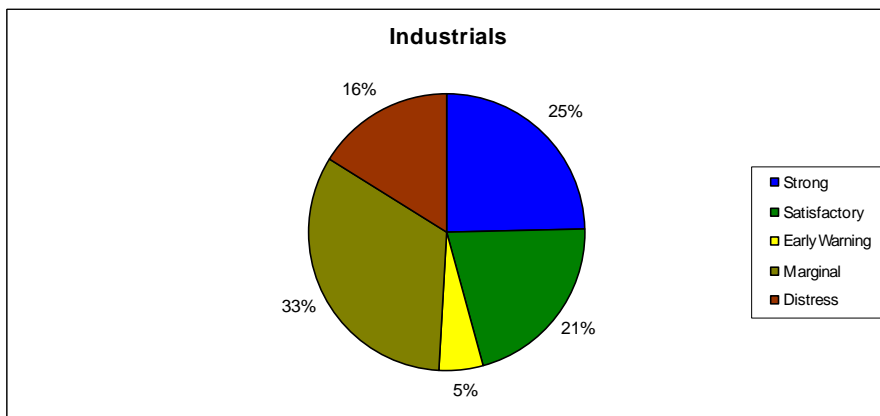
## Industrials

The Industrials sector is comprised of the Transportation, Capital Goods and Commercial Services and Supplies industry groups. This sector has weakened marginally over the last six months with the number of companies exhibiting an acceptable level of risk declining to 44% (down 2%) and the number of 'Distressed' companies rising to 20% from 16%. This has been a result of the economic crisis which led to lower demand and rising costs.

### Industrials Jun 09



### Industrials Dec 08



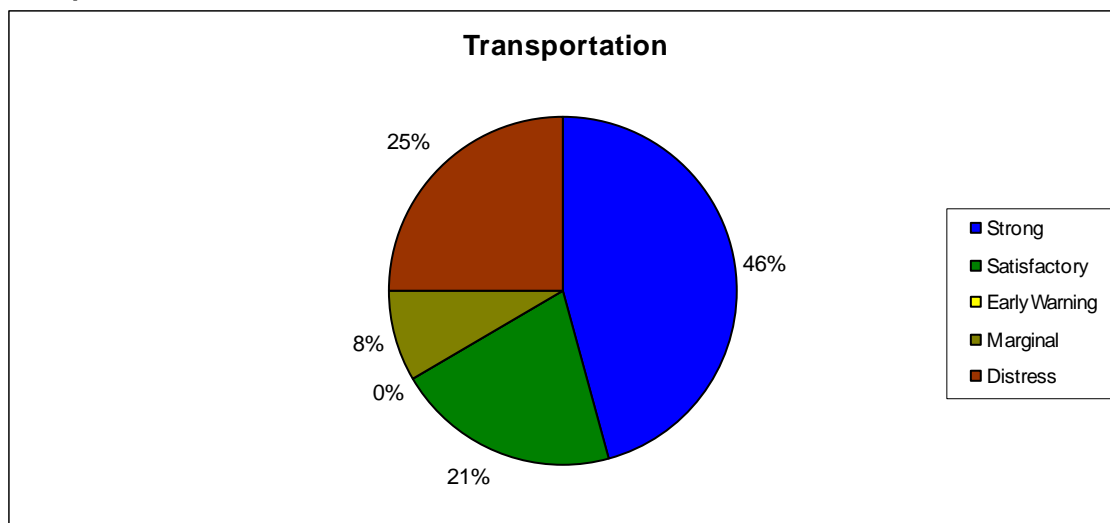
Quick stats on sector	Industrials
Sector market capitalisation (\$mil)	\$97,105 million
% of total market	7.17%
Number of companies	186
Highest cap company	Leighton Holdings Limited (LEI) \$10,132 million
Lowest cap company	HiTech Group Australia Limited (HIT) \$837,000



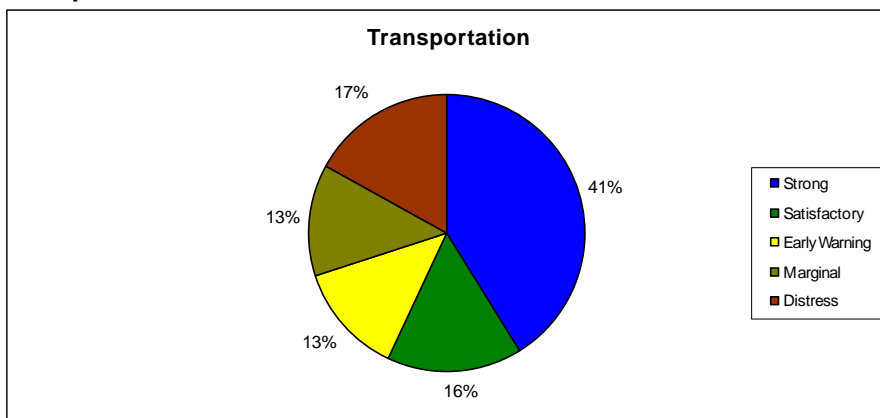
## Transportation

The Transportation industry group showed a marked improvement in financial for the period despite weak consumer sentiment. Companies with either a 'Strong' or 'Satisfactory' rating increased to 67% from only 57% in the previous period. The number of 'Distress' companies however also increased to 25% (up 8%). Both the largest companies in this sector **Qantas Airways Limited (QAN)** and **Toll Holdings Limited (TOL)** remain exposed to manageable levels of financial risk.

### Transportation Jun 09



### Transportation Dec 08



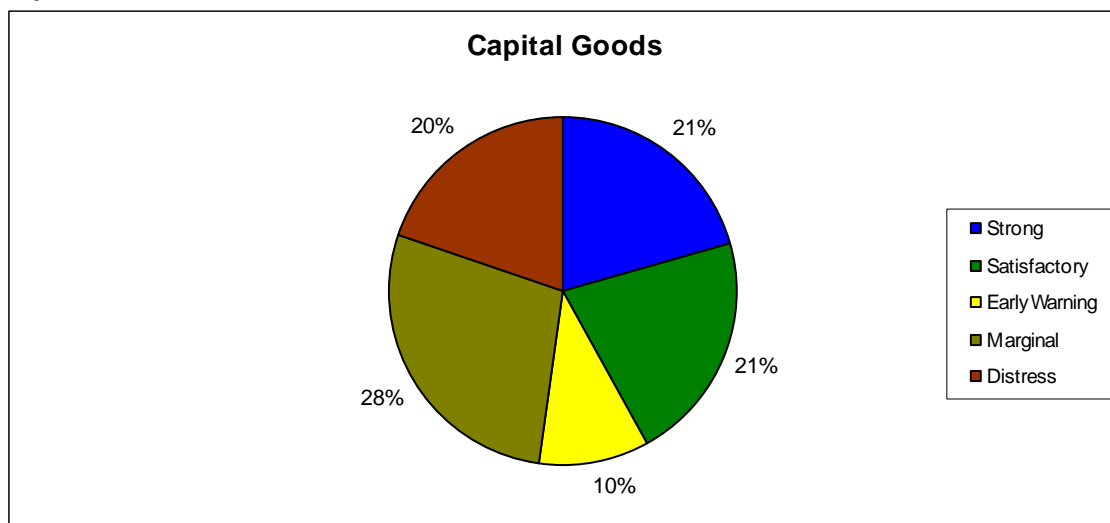
Quick stats on sector	Transportation
Sector market capitalisation (\$mil)	\$37,754 million
% of total market	2.79%
Number of companies	24
Highest cap company	Qantas Airways Limited (QAN) \$6,025 million
Lowest cap company	Richfield International Limited (RIS) \$4.551 million

## Capital Goods

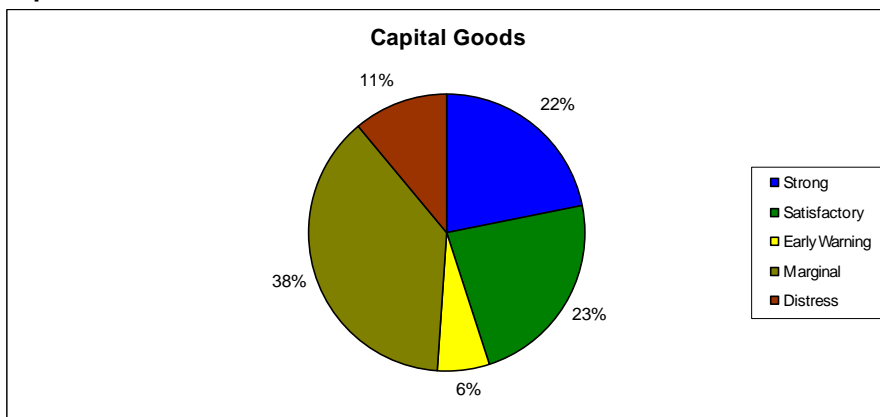
The scope of the Capital Goods industry group is very broad as it consists of seven sub industries including Construction and Engineering Services and Trading Companies & Distributors.

**Leighton Holdings Limited (LEI)**, the largest company in this group accounted for 31.71% of the total market capitalisation and has retained its 'Satisfactory' rating as it posted higher than expected profits and maintained a high level of 'Work in Hand'. The number of companies in a sound Financial Health position with either a 'Strong' or 'Satisfactory' rating has fallen to 42% from 45% in the previous period. The number of 'Distressed' companies increased to 20% from only 11%.

### Capital Goods Jun 09



### Capital Goods Dec 08

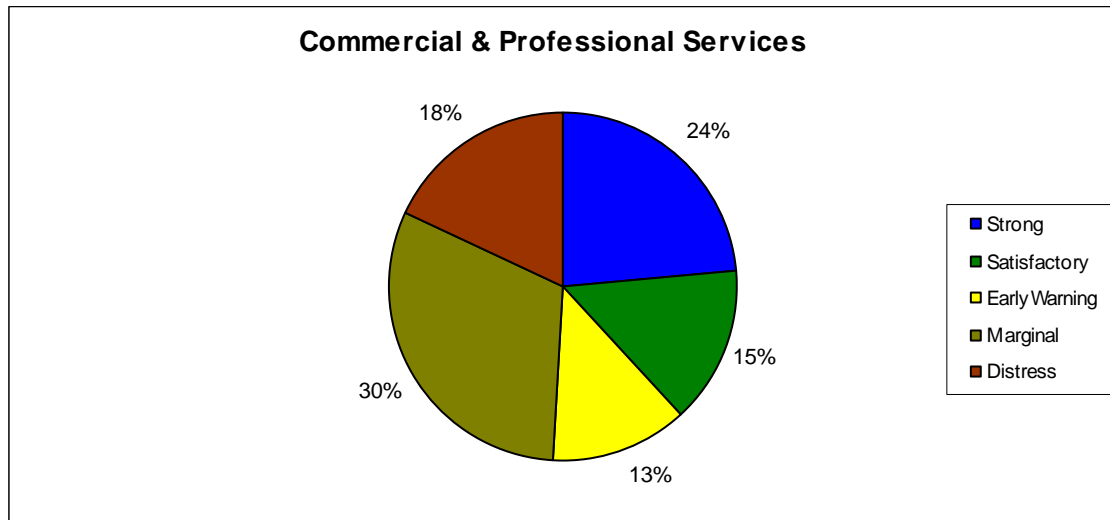


Quick stats on sector	Capital Goods
Sector market capitalisation (\$mil)	\$31,954 million
% of total market	2.36%
Number of companies	107
Highest cap company	Leighton Holdings Limited (LEI) \$10,132 million
Lowest cap company	Multistack International Limited (MSI) \$896,032

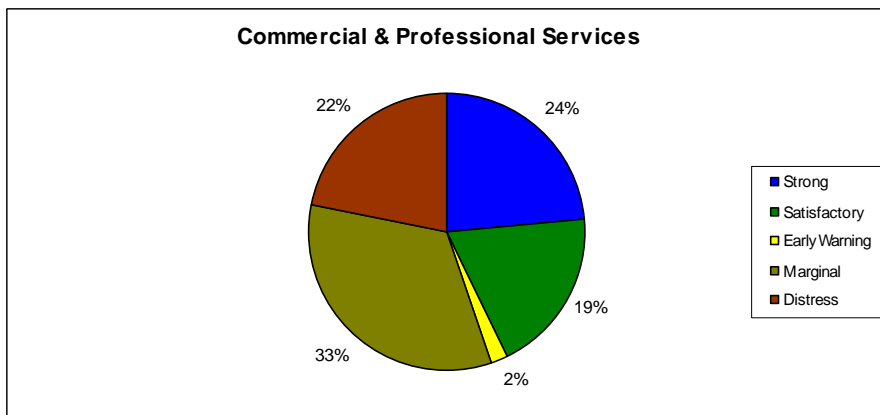
## Commercial & Professional Services

The Commercial Services & Supplies industry group has 39% (down 4%) of companies in a sound position of Financial Health. The sector is dominated by **Brambles Limited (BXB)** which makes up 36.95% of the total market capitalisation. It is worth noting that weakness in this sector is a result of the poor performance of many small cap companies operating within the sector.

### Commercial & Professional Services Jun 09



### Commercial & Professional Services Dec 08

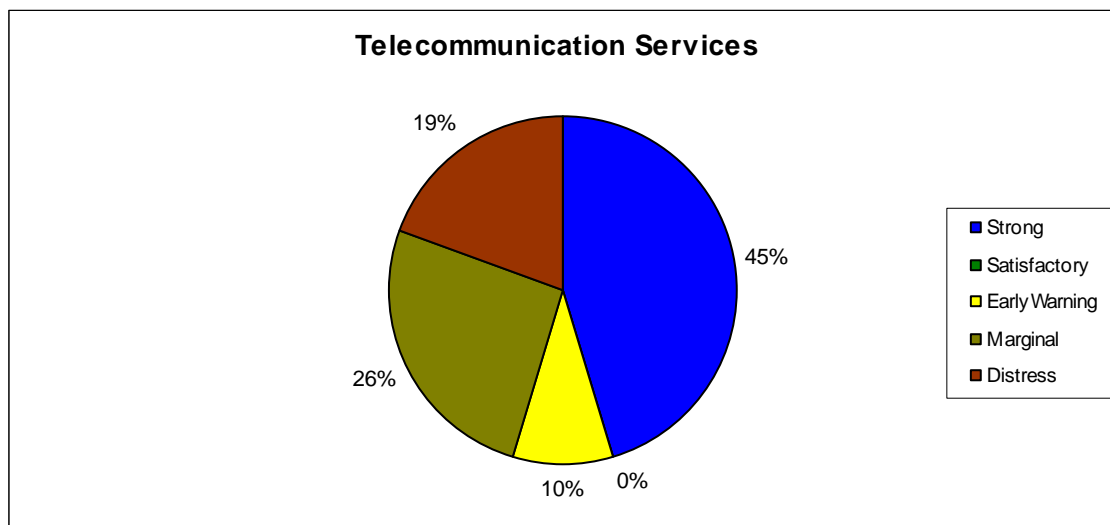


Quick stats on sector	Commercial & Professional Services
Sector market capitalisation (\$mil)	\$27,397 million
% of total market	2.02%
Number of companies	55
Highest cap company	Brambles Limited (BXB) \$10,124 million
Lowest cap company	HiTech Group Australia Limited (HIT) \$837,000

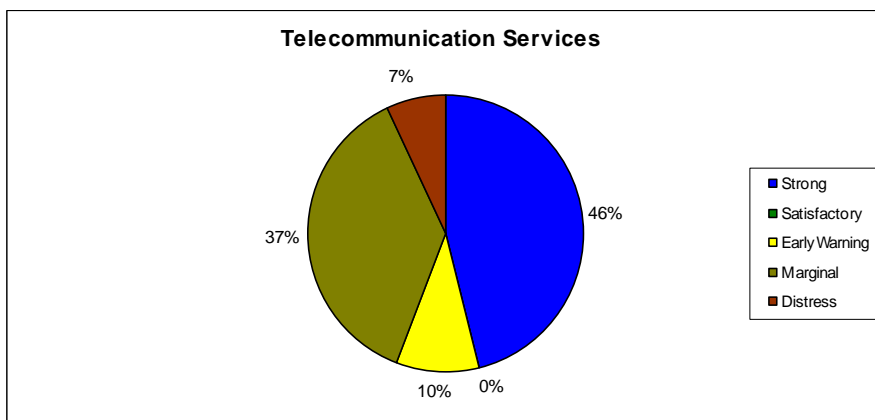
## Telecommunication Services

The Telecommunication Services sector historically has produced almost an even split of companies with acceptable and poor Financial Health. This was maintained during the past six months as 45% of companies had 'Strong' Financial Health (down 1%). Companies with poor Financial Health accounted for 55%. While this represents a very small change from the last period, it is worth noting that the number of companies that deteriorated to 'Distress' increased significantly from 7% to 19%. This may have been due to the large capital investments necessary to keep up with the rapidly changing technology in the industry as well as declining margins brought about by the higher level of competition. **Telstra Corporation Limited (TLS)** remained the largest company in the sector accounting for 84.76% of the group's market capitalisation. The rest of the participants in the sector are smaller telecommunications suppliers.

### Telecommunication Services Jun 09



### Telecommunication Services Dec 08



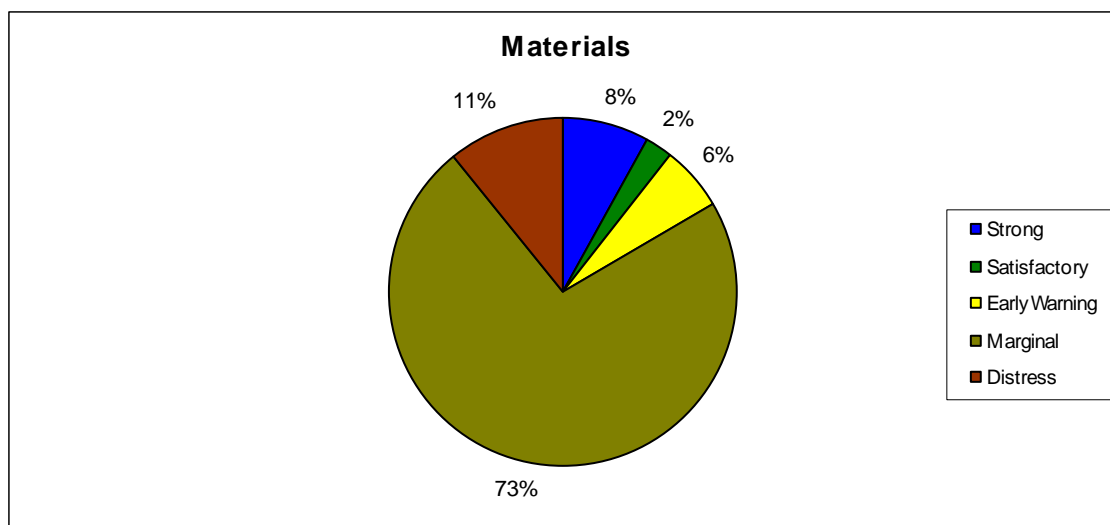
Quick stats on sector	Telecommunication Services
Sector market capitalisation (\$mil)	\$47,415 million
% of total market	3.50%
Number of companies	31
Highest cap company	Telstra Corporation Limited (TLS) \$40,191 million
Lowest cap company	Wintech Group Limited (WTG) \$943,475

## Materials

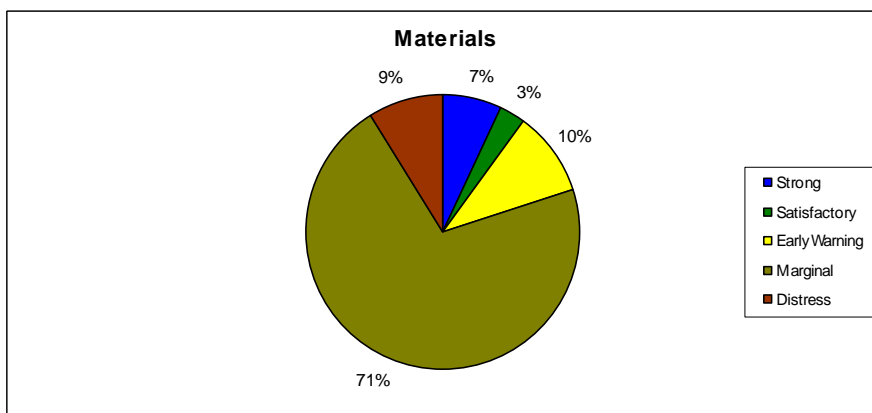
The Materials sector is the second largest sector in the Australian sharemarket in terms of market capitalisation but it is composed of the greatest number of companies. However, the majority are small cap explorers and largely speculative in nature. As many have not commenced production, they are loss-making entities exhibiting poor Financial Health. That said, the recent return to favour of equity markets have seen many junior explorers raise cash via capital raisings during the period. Despite this, only 10% of the companies in this sector exhibit either 'Strong' or 'Satisfactory' Financial Health.

**BHP Billiton Limited (BHP)** and **Rio Tinto Limited (RIO)** are the two largest companies, constituting 45.74% of the sector. Both are multinational diversified companies and continue to retain an acceptable level of Financial Health despite lower demand for their products and weaker commodity prices during the period.

### Materials Jun 09



### Materials Dec 08



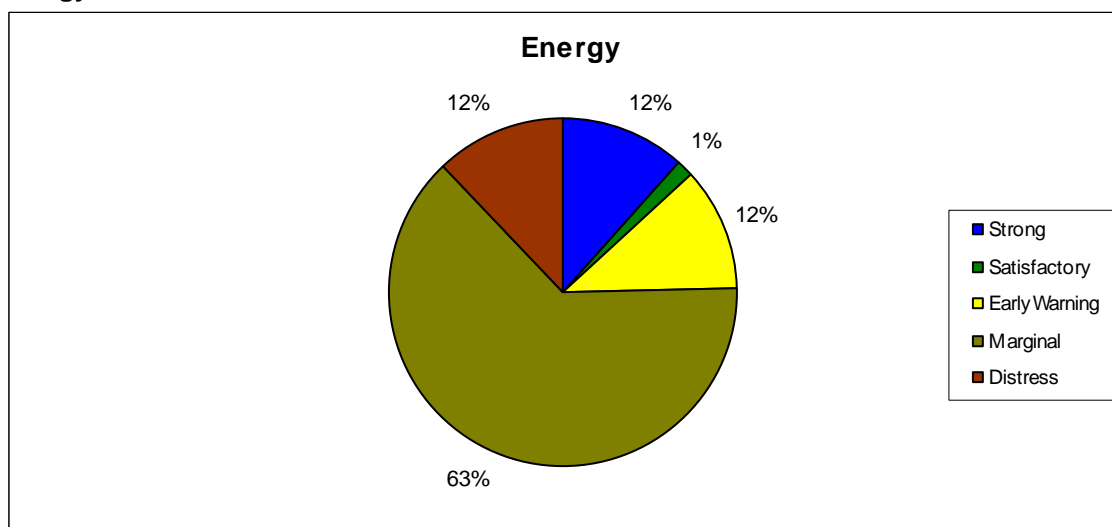
Quick stats on sector	Materials
Sector market capitalisation (\$mil)	\$355,200 million
% of total market	26.25%
Number of companies	616
Highest cap company	BHP Billiton Limited (BHP) \$123,974 million
Lowest cap company	Eagle Nickel Limited (ENL) \$502,250

## Energy

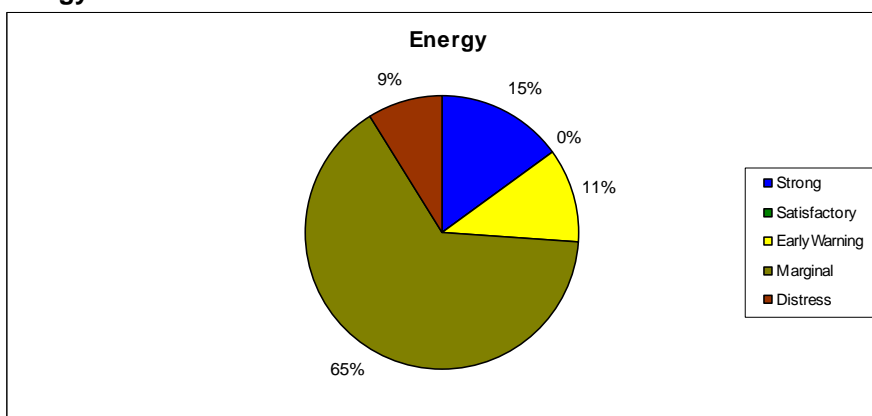
The Energy sector suffered from the rapid decline in oil and gas prices during the financial crisis resulting in lower profitability. Furthermore, there are still many junior oil and gas exploration companies in the sector which have not commenced production and are therefore still loss-making operations. Coupled with coal seam gas companies which have yet to prove their commercial viability, deterioration in the overall Financial Health of the sector is unavoidable. The number of companies possessing sound Financial Health has fallen further from 15% to 13% and those with a 'Distressed' rating increased from 9% to 12%.

The biggest companies in the sector in terms of market capitalisation are **Woodside Petroleum Limited (WPL)** which accounts for 27.12% of the sector and **Origin Energy Limited (ORG)** which constitutes 11.10%. Both managed to retain their 'Strong' Financial Health rating.

### Energy Jun 09



### Energy Dec 08

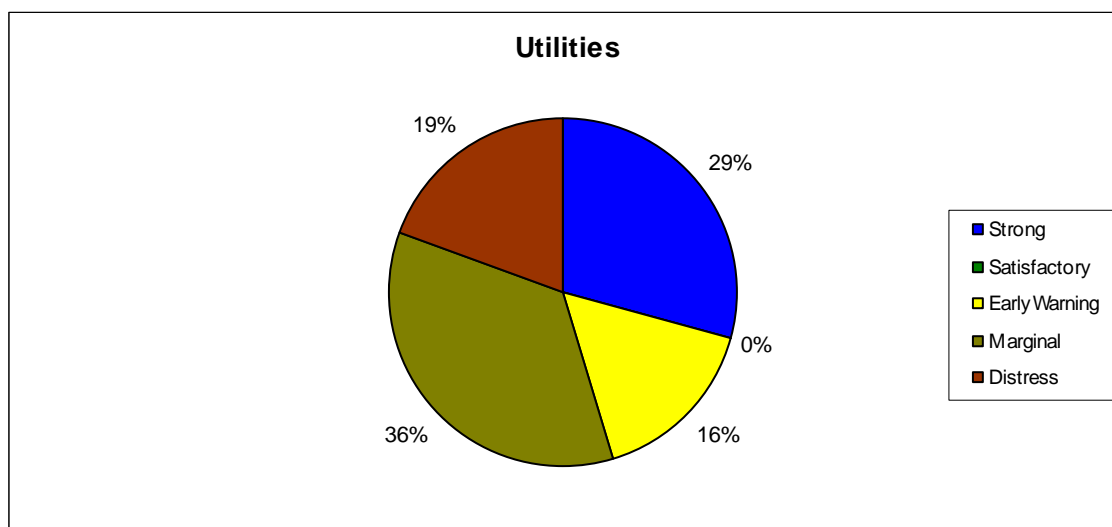


Quick stats on sector	Energy
Sector market capitalisation (\$mil)	\$124,909 million
% of total market	9.23%
Number of companies	214
Highest cap company	Woodside Petroleum Limited (WPL) \$33,875 million
Lowest cap company	Fall River Resources Limited (FRV) \$848,205

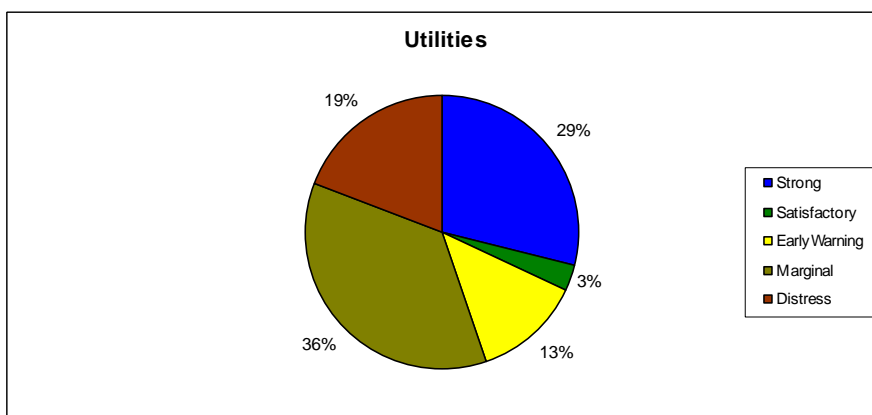
## Utilities

Traditionally regarded as a 'safe' sector particularly during times of economic uncertainty owing to its defensive nature, the Utilities sector had very little changed this year. Companies with 'Strong' Financial Health still accounted for 29% of the sector and those with 'Marginal' and 'Distressed' ratings stayed at 36% and 19% respectively. The only change evident was in companies with 'Satisfactory' Financial Health that moved to an 'Early Warning' position. **AGL Energy Ltd (AGK)** continued to dominate with 34.27% of the sector by market capitalisation. New challenges await the sector going forward due to growing concerns about climate change and the need for renewable energy.

### Utilities Jun 09



### Utilities Dec 08

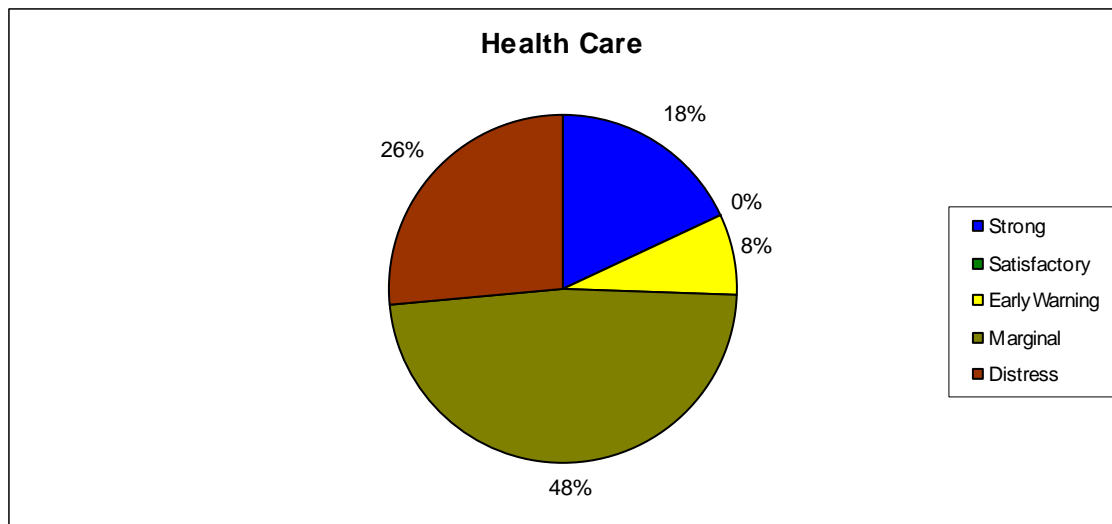


Quick stats on sector	Utilities
Sector market capitalisation (\$mil)	\$18,008 million
% of total market	1.33%
Number of companies	31
Highest cap company	AGL Energy Limited (AGK) \$6,172 million
Lowest cap company	KUTH Energy Limited (KEN) \$9.062 million

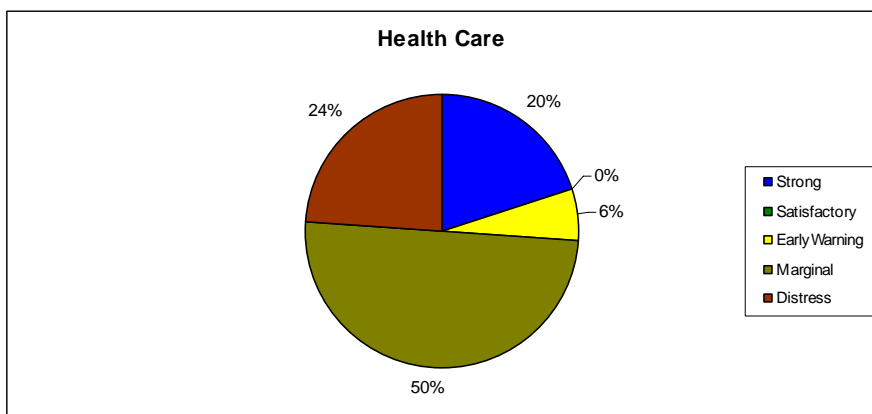
## Health Care

The Health Care sector has not changed much with overall Financial Health remaining largely poor due to the Pharmaceutical & Biotechnology industry group which has many companies that are still in the development stage and have therefore yet to make profits. Only 18% (down 2%) of the companies in this sector are in a sound position of Financial Health with a 'Strong' or 'Satisfactory' rating. **CSL Limited (CSL)** remains the largest company in the sector increasing its share in the total market capitalisation to over 80%.

### Health Care Jun 09



### Health Care Dec 08



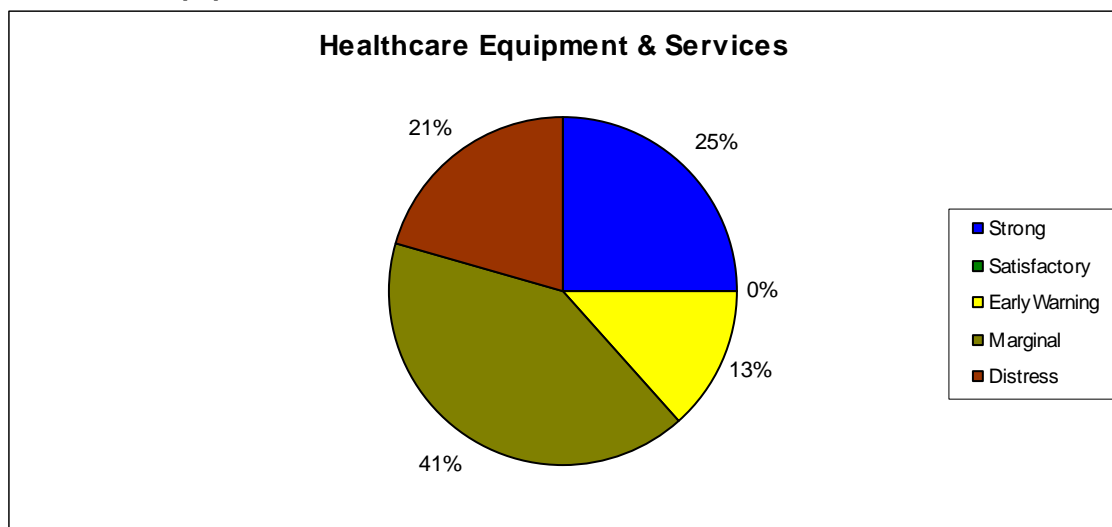
Quick stats on sector	Health Care
Sector market capitalisation (\$mil)	\$49,554 million
% of total market	3.66%
Number of companies	144
Highest cap company	CSL Limited (CSL) \$18,485 million
Lowest cap company	Rockeby Biomed Limited (RBY) \$897,324



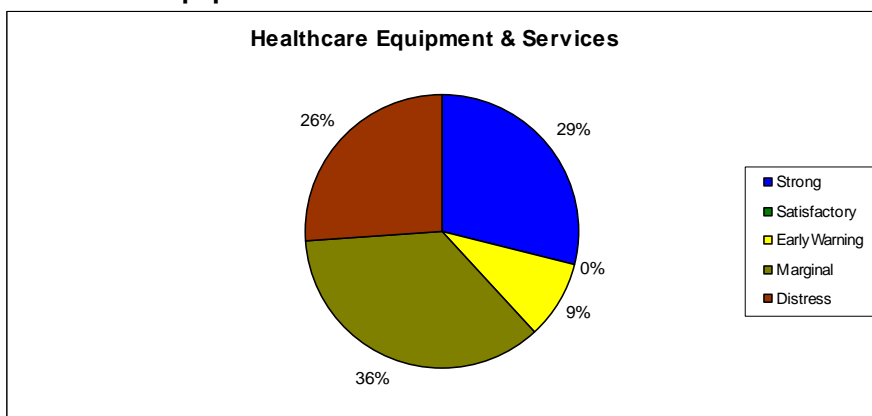
## Health Care Equipment & Services

The Health Care Equipment & Services industry group is highly fragmented with the market being divided among 68 companies. There is a mix of established and relatively new players in the group with the few established ones performing well in the past year despite a difficult operating environment due to their defensive nature. Majority of the companies however are still in the 'start up' stage whereby new health care technology is still being researched and developed. These are generally highly speculative, are loss-making operations, and in poor Financial Health. **Sonic Healthcare Limited (SHL)** remains the largest in the group constituting 17.45% of the sector by market capitalisation. The result for the Healthcare Equipment & Services industry group was mixed. Whilst the number of 'Strong' companies fell, accounting for only 25% (down 4%) of the total, an improvement can be noted with the decline in the share of 'Distressed' companies to 21% (down 5%) and the shift to 'Marginal' and 'Early Warning'.

### Health Care Equipment & Services Jun 09



### Health Care Equipment & Services Dec 08



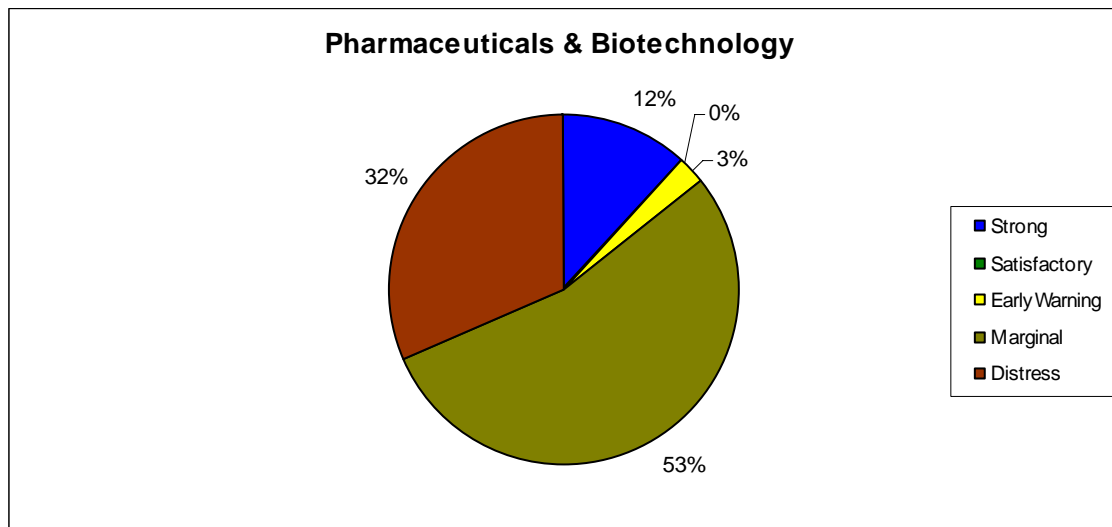
Quick stats on sector	Health Care Equipment & Services
Sector market capitalisation (\$mil)	\$26,603 million
% of total market	1.97%
Number of companies	68
Highest cap company	Sonic Healthcare Limited (SHL) \$4,642 million
Lowest cap company	Anteo Diagnostics Limited (ADO) \$2.193 million

## Pharmaceutical & Biotechnology

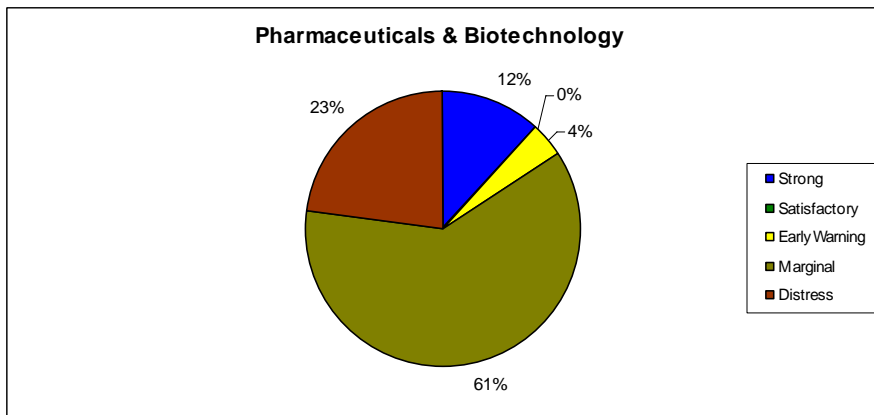
The Pharmaceutical & Biotechnology industry group continues to be dominated by **CSL Limited (CSL)** which accounts for more than 80% of the sector by market capitalisation. The remainder of the group consists mostly of small caps that are still in the early stages of research and development and are therefore currently loss-making entities.

The sector was expected to perform well even amidst the economic crisis given the defensive nature of its business. However, this was not evident in the latest results which showed that 32% (up by 9%) of companies in this sector are in a 'Distressed' position. Only 12% (unchanged) are in a 'Strong' position. The strengthening of the Australian dollar became a concern for many companies as this could impact US earnings negatively.

### Pharmaceuticals & Biotechnology Jun 09



### Pharmaceuticals & Biotechnology Dec 08



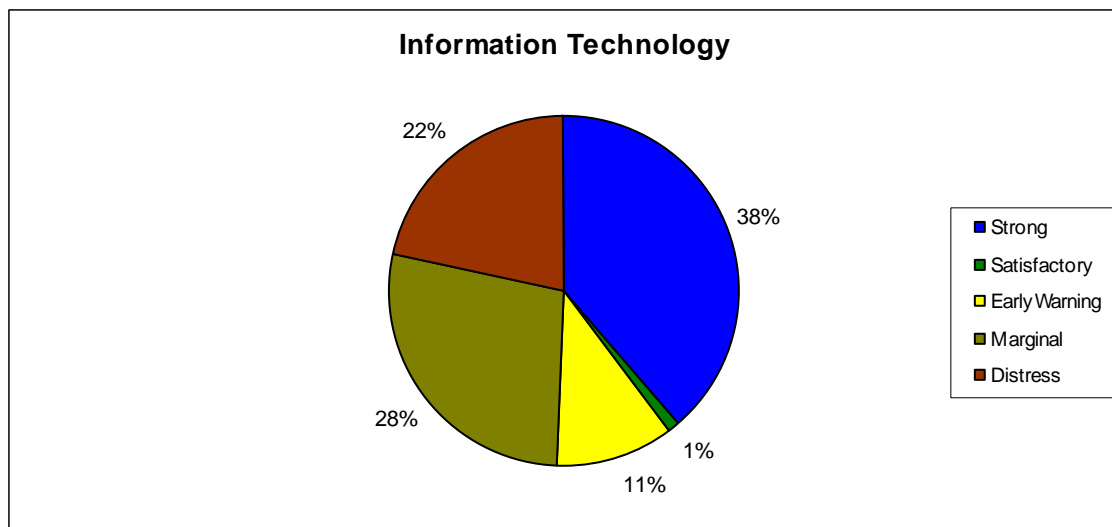
Quick stats on sector	Pharmaceuticals & Biotechnology
Sector market capitalisation (\$mil)	\$22,951 million
% of total market	1.70%
Number of companies	76
Highest cap company	CSL Limited (CSL) \$18,485 million
Lowest cap company	Rockeby Biomed Limited (RBY) \$897,324

## Information Technology

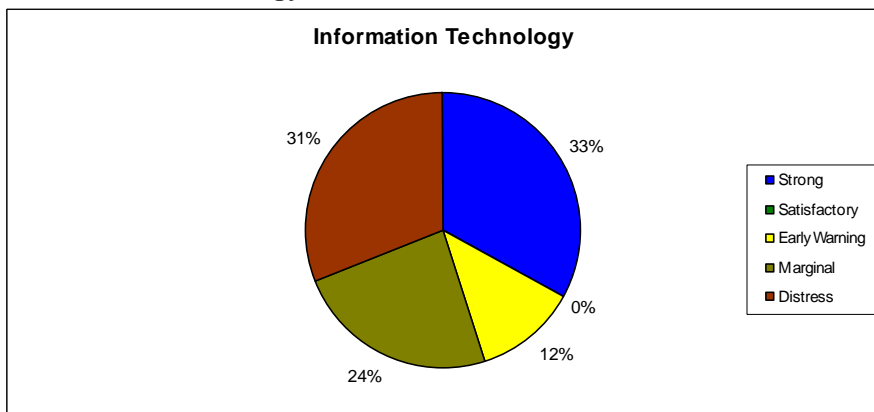
The Information Technology sector is made up of three industry groups: Software Services, Technology Hardware & Equipment and Semiconductors & Semiconductors Equipment. This sector was affected by the global economic slowdown last year as companies either cut or postponed IT spending in an effort to conserve cash and stay afloat during the crisis.

Demand seems to have picked up lately as confidence has returned following the release of promising economic figures. This has resulted in better than expected earnings and an improvement in overall Financial Health. This year, 39% (up 6%) of companies in this sector are in a 'Strong' or 'Satisfactory' position.

### Information Technology Jun 09



### Information Technology Dec 08

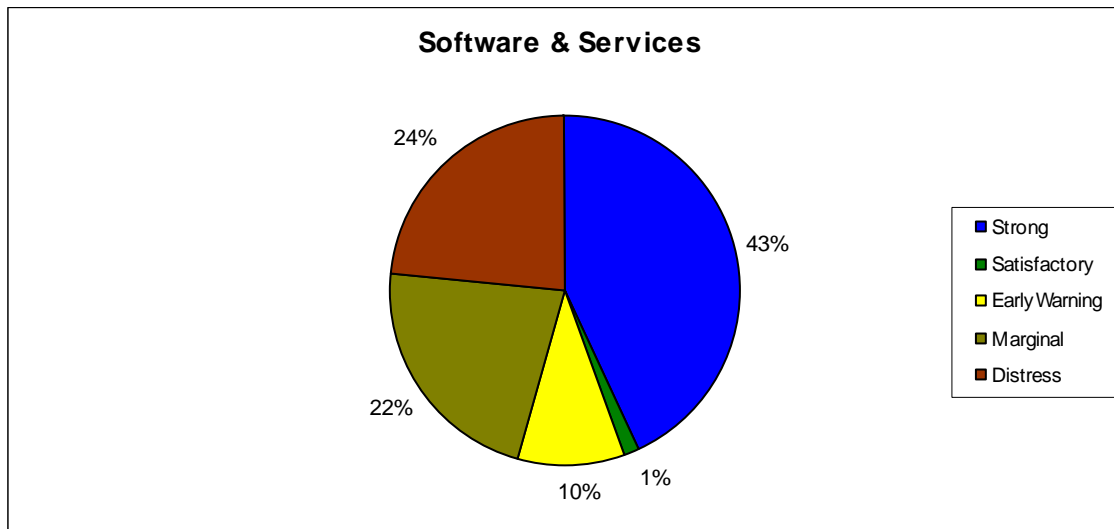


Quick stats on sector	Information Technology
Sector market capitalisation (\$mil)	\$12,317 million
% of total market	0.91%
Number of companies	98
Highest cap company	Computershare Limited (CPU) \$4,367 million
Lowest cap company	APA Financial Services Limited (APP) \$877,120

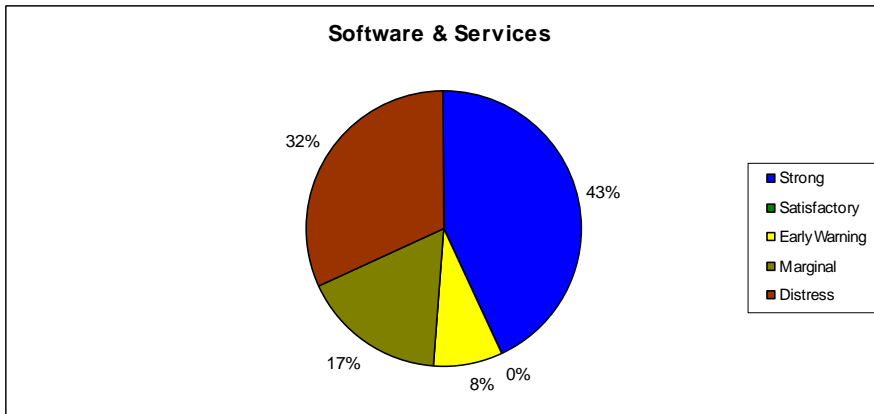
## Software and Services

The companies under the Software and Services sector account for almost 96% of the market capitalisation of the Information Technology industry. Overall this sector has improved, with companies like **Computershare Limited (CPU)**, **Iress Market Technology Limited (IRE)** and **Reckon Limited (RKN)** exhibiting strong fundamentals. The number of companies possessing sound Financial Health increased slightly to 44% (up 1%) and the number of companies with 'Distressed' Financial Health falling to 24% (down 8%).

### Software and Services Jun 09



### Software and Services Dec 08

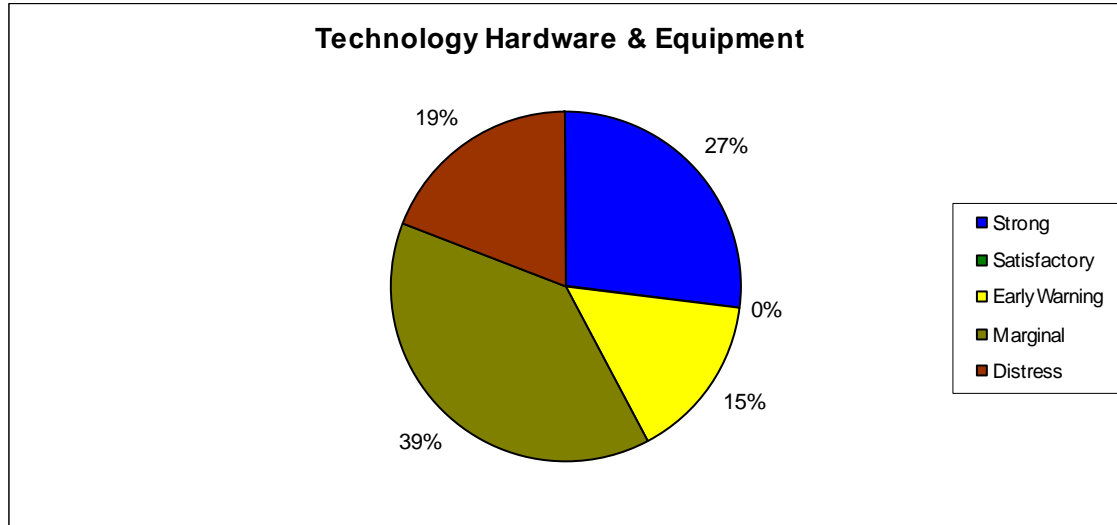


Quick stats on sector	Software and Services
Sector market capitalisation (\$mil)	\$11,795 million
% of total market	0.87%
Number of companies	72
Highest cap company	Computershare Limited (CPU) \$4,367 million
Lowest cap company	APA Financial Services Limited (APP) \$877,120

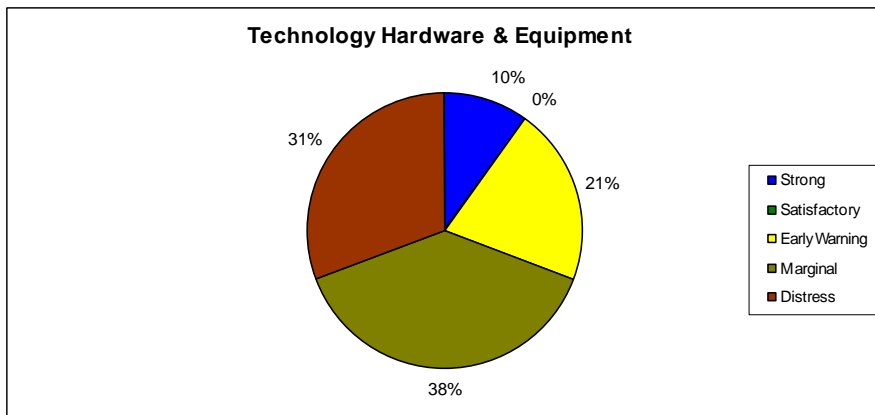
## Technology Hardware & Equipment

Accounting for a very small segment of the market, this industry group consists of small cap companies which have generally exhibited poor Financial Health in the past. This year however, there has been a significant improvement with 27% (up 17%) of companies now having a 'Strong' Financial Health rating and only 58% (down 11%) having 'Marginal' or 'Distressed' ratings.

### Technology Hardware & Equipment Jun 09



### Technology Hardware & Equipment Dec 08



Quick stats on sector	Technology Hardware & Equipment
Sector market capitalisation (\$mil)	\$522 million
% of total market	0.04%
Number of companies	26
Highest cap company	Codan Limited (CDA) \$149 million
Lowest cap company	4C Security Solutions Limited (FCS) \$1.432 million

[See pages 37-39 for: Appendix 1 - Lincoln ratings and ratios – Background information](#)

## Important Information

Lincoln Indicators Pty Ltd ACN 006 715 573 (Lincoln) AFSL 237740.

This information is current as at 6 November 2009.

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## Lincoln ratings and ratios - Background information

Dr Merv Lincoln's [methodology](#) develops models from accounting ratios and characterises the financial standing of a company using a single figure on a scale of risk from 0.01 to 1, with the company's level of risk increasing as the measure moves up the scale towards 1. On the scale of risk, for ease of interpretation, the following benchmarks are used:

<b>LEVEL OF RISK</b>	<b>FINANCIAL STANDING</b>
0.01 - 0.10	Strong
0.11 - 0.30	Satisfactory
0.31 - 0.50	Early Warning
0.51 - 0.80	Marginal
0.81 - 1.00	Distress

If a company has a 'Strong' or 'Satisfactory' financial standing it will be interpreted as having sufficient cash flow and a balance sheet robust enough to finance growth, withstand significant business shocks or prolonged economic downturns.

If a company is in the zone of 'Early Warning', it is neither satisfactory nor particularly unhealthy. The company will need to address certain issues in regards to its business operations in order to achieve a healthy financial position.

A 'Marginal' financial standing indicates unsatisfactory risk above desired levels and it is preferable that management focus on getting the company into better shape. The company will have difficulties funding future growth through existing business facilities and its ability to withstand significant shocks or prolonged downturns in the economy is questionable.

If the company is in 'Distress' it is exhibiting similar financial characteristics of failing companies. It will be difficult for this company to recover should there be negative developments, and any recovery will generally be slow as it tends to take longer to get out of a difficult situation than it does to get into one.

In Dr Lincoln's initial study, models were constructed using companies; both those that had failed and those that had survived during the period 1969 to 1978. Using a sample of failed and non-failed companies, a set of financial ratios was selected which yielded a linear function of ratios making the best distinction between the two groups. It was necessary to acknowledge that the financial characteristics of industries differ and models were constructed for different industry groups.

Recognising the changes in the economic landscape, accounting methods and reporting standards, Lincoln undertook further research in 2007 to refine its unique methodology. Under the guidance and supervision of esteemed academic Associate Professor Neville Norman of the University of Melbourne, the model was revisited and new ratios were tested using multi-level modelling with the aim of improving its predictive power.

The model currently has a predictive accuracy of 95% where companies flagged in poor shape actually failed.

## The ratios

From a population of over 60 ratios, 12 ratios make up the Lincoln model. These ratios, when combined and weighted, separate the high risk companies from the low risk companies.

### **CATAI: Current Assets to Total Tangible Assets**

This ratio measures the efficiency in the management of stock and/or debtors, and the backstop of fixed assets that may be available as a source of funds, either by way of sale or mortgage. Lower risk firms have a lower value for CATAI because they turn their stock over faster and/or collect their debtors quicker, and/or have a backstop of long-term assets that may be available as a source of funds, either by way of sale or mortgage. Higher risk companies have a higher value for CATAI.

### **CBTA: Cash Balance to Total Assets**

Cash balance is defined as a company's total cash in the bank as it appears on the balance sheet. Lower risk firms have a higher value for CBTA because they have more cash that can be used to pay for commitments that it has with suppliers, a bank or any other party that has rendered a product or service. Higher risk companies have a lower value for CBTA which means its ability to meet its commitments is significantly hampered.

### **CBTL: Cash Balance to Total Liabilities**

This ratio shows a company's cash balance in relation to its total liabilities. Lower risk firms have a higher value for CBTL because they have more cash that can be used to pay for commitments that it has with suppliers, a bank or any other party that has rendered a product or service. Higher risk companies have a higher value for CBTL which means its ability to meet its commitments is significantly hampered.

### **CLTL: Current Liabilities to Total Liabilities**

A factor determining a company's financial standing is the extent of more pressing debt commitments. Higher risk companies have more of their borrowings short term than is normal for the industry. The higher the value of this ratio, the greater the risk because the more that borrowings are short term, the more susceptible a company is to financial difficulties in the event of a downturn in trading.

### **CTCCL: Change in Total Cash Flow to Current Liabilities**

Total cash flow refers to the net cash flow from a company's operating, investing and financing activities. If a company produces a negative change in cash flow over the year, then this development puts a significant strain on the business to meet its short-term commitments. A reduction in the amount of cash in the bank is an increased risk, particularly if a third party needs to be paid in the short term.

### **OCFTA: Operating Cash Flow to Total Tangible Assets**

Operating cash flow pertains to the cash generated from the operations of a company, generally defined as revenues less all operating expenses, plus depreciation. It is a better measure of a company's profitability than net income because it deducts only the actual cash expenses and therefore shows the strength of its operations. Consistent negative operating cash flow implies a business is going backwards in relation to its ordinary operations. A negative operating cash flow is a drain on the businesses assets, which can not only be used to support ongoing business, but is also vital for it to be a going concern. This ratio shows what percentage of assets is supported by the cash flow.

### **OCFCL: Operating Cash Flow to Current Liabilities**

This ratio is significant because it shows the ability of a company to meet short-term commitments from internally generated cash flow. The higher the value of this ratio, the lower the level of risk because it implies that the company has more cash from its operations to cover short-term liabilities. A lower value for OCFCL denotes higher risk.



**PDACL (formerly CFBCL): Profit before Depreciation and Amortisation to Current Liabilities**

Profit before depreciation and amortisation is defined as net operating profit before tax plus non cash charges. This is a powerful ratio because it depicts the margin of safety to meet short-term commitments from cash flow generated from trading operations. Lower risk companies have a higher margin of safety, whereas higher risk companies have a lower margin of safety.

**QACA: Quick Assets (Current Assets - Stock) to Current Assets**

The “immediate liquidity” of a firm is measured by this relationship. Implied in this ratio is the relationship between stock and more liquid assets. The higher the value of this ratio, the lower the level of risk because the company has more claims to immediate liquidity than is norm for the industry. The lower the value for QACA, the higher the risk.

**QLCL: Quick Liabilities (Current Liabilities - Short-term Bank Finance) to Current Liabilities**

This ratio describes the relationship between trade and short-term bank finance. The lower the value of this ratio, the higher the level of risk, because there is a limit to the amount of short-term funds available from a bank. The closer a company gets to that limit, the less likely additional funds will be available, should they be required.

**RPTAI: Retained Profits to Total Tangible Assets**

The extent of funding from profit retention is a factor determining a company’s financial standing. Lower risk companies have a higher proportion of their funds being sourced from profit retention. A high value would indicate a mature company with a history of good profits and a conservative dividend payout ratio.

**TLTAI: Total Liabilities to Total Tangible Assets**

This is the gearing ratio: the relationship between liabilities and equity. The higher the value of this ratio, the higher the level of risk because the more a company borrows, the more susceptible it is to financial difficulties in the event of a downturn in trading.

## Important Information

Lincoln Indicators Pty Ltd ACN 006 715 573 (Lincoln) AFSL 237740.

This information is current as at 6 November 2009.

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