

# Morningstar® Preferred Stock List

## Key Benefits

- Provides a good starting point from which to build a direct equity portfolio.
- Helps identify stocks that are higher quality or lower risk using our economic moat, stewardship, fair value uncertainty ratings in addition to our recommendations

The Morningstar Preferred Stock List is a screened subset of our coverage universe that we believe provides a good starting point from which to build a direct equity portfolio. In fact, our internal investment committee uses the same system to find compelling investment opportunities for our five model equity portfolios: Core, Income, Growth, Sustainable, and Small Cap.

The goal of the Morningstar Preferred Stock List, or PSL, is to identify stocks that are higher quality or lower risk using our economic moat, stewardship, and fair value uncertainty ratings, along with our buy, accumulate, hold, reduce and sell recommendations. We think it is important for clients to understand how to use all our proprietary data points in their investment decision-making process, rather than view any one characteristic in isolation. For more detail on our ratings and research process, please refer to the Morningstar Equity Research Methodology on page 5 or contact our equity analyst team.

The number of stocks on the PSL varies over time depending on prevailing market prices but tends to average about 100 stocks. We view this as a great head start for prospective direct equity investors as it balances the need for investment ideas that suit a variety of portfolio styles while remaining restrictive enough to prevent excessive exposure to high risk situations. For clients with specific needs regarding the size or quality of this list, we can discuss customisation – please speak with your sales representative.

## The Morningstar PSL applies five simple filters:

1. Start with the 230 Australia & New Zealand stock universe covered by our team of 20 analysts and strategists using our globally-consistent equity research framework. We intentionally focus our coverage universe on higher quality companies, so this is a powerful initial filter in finding portfolio candidates. If we don't cover the stock, it is often lower quality or too small to meet most client requirements.
2. Remove stocks that are rated 'Very High' or 'Extreme' fair value uncertainty rating by our coverage analyst. This step serves to limit exposure to hard-to-predict cash flows and often highly volatile share prices when viewed through the economic cycle.
3. Remove stocks with a 'Sell' recommendation. This rating indicates our analyst believes the market has priced in an unrealistically optimistic outlook, implying that future share price returns are likely to be undesirable.
4. Remove stocks with both a 'No Moat' rating and a 'Reduce' recommendation. We prefer to keep a shorter leash on companies without sustainable competitive advantages, often removing them from our model portfolios when they appear somewhat overvalued rather than waiting for the material overvaluation indicated by our 'Sell' rating.
5. Remove stocks that receive both a 'No Moat' and 'Poor Stewardship' rating. We prefer to limit exposure to firms with questionable strategies, particularly if their current business lacks competitive advantages, as an additional measure to avoid capital destruction.

The PSL provides guidance to a general audience and must be considered in the context of an individual's investment goals, risk tolerance, tax situation, time horizon, income needs, and complete investment portfolio, among other factors. There are several important steps beyond the Morningstar PSL that must be performed effectively to build a direct equity portfolio, such as number of holdings, position weighting, turnover, benchmark, etc. These elements are not considered here and are the responsibility of the end user. Investors can also consider subscribing to our model portfolios or separately managed accounts.

# Morningstar Preferred Stock List (Australia & New Zealand)

## 2 December 2014



Ticker	Investment Name	Economic Moat	Stewardship Rating	Fair Valuation Uncertainty	Morningstar Recommendation
🚫 securities with this symbol passed the previous monthly PSL review, but based on updated data do not currently meet the PSL criteria					
<b>Basic Materials</b>					
ABC	Adelaide Brighton Limited	Narrow	Standard	High	Hold
AWC	Alumina Ltd	None	Standard	High	Accumulate
BHP	BHP Billiton Ltd	Narrow	Standard	Medium	Accumulate
BKW	Brickworks Ltd	None	Standard	High	Hold
DLX	DuluxGroup Ltd	Narrow	Standard	Medium	Hold
ILU	Iluka Resources Ltd	Narrow	Exemplary	High	Accumulate
IPL	Incitec Pivot Ltd	Narrow	Standard	Medium	Accumulate
JHX	James Hardie Industries PLC DR	Narrow	Standard	High	Hold
NHC	New Hope Corp Ltd	None	Standard	High	Accumulate
NPX	Nuplex Industries Ltd	None	Standard	High	Hold
ORI	Orica Ltd	Narrow	Standard	Medium	Accumulate
RIO	Rio Tinto Ltd	Narrow	Standard	High	Hold
SFR	Sandfire Resources NL	None	Standard	High	Hold
SGM	Sims Metal Management Ltd	None	Standard	High	Hold
<b>Communication Services</b>					
CNU	Chorus Ltd	None	Standard	High	Hold
IIN	iiNET Ltd	Narrow	Standard	Medium	Hold
MTU	M2 Group Ltd	None	Standard	High	Hold
SGT	Singapore Telecommunications Limited DR	Narrow	Standard	Medium	Reduce
SKT	Sky Network Television Ltd	Wide	Standard	High	Hold
SPK	Spark New Zealand Ltd	Narrow	Standard	Medium	Hold
TLS	Telstra Corp Ltd	Narrow	Standard	Medium	Reduce
TPM	TPG Telecom Ltd	Narrow	Standard	Medium	Reduce
<b>Consumer Cyclical</b>					
AGI	Ainsworth Game Technology Ltd	Narrow	Standard	High	Buy
AMC	Arcor Ltd	Narrow	Standard	Medium	Reduce
ARP	ARB Corp Ltd	Narrow	Standard	Medium	Hold
AHE	Automotive Holdings Group Ltd	Narrow	Standard	High	Hold
CWN	Crown Resorts Ltd	Narrow	Standard	High	Accumulate
FLT	Flight Centre Travel Group Ltd	Narrow	Standard	High	Hold
GWA	GWA Group Ltd	Narrow	Standard	High	Reduce
IVC	InvoCare Ltd	Narrow	Standard	Medium	Reduce
KMD	Kathmandu Holdings Ltd	None	Standard	High	Hold
MYR	Myer Holdings Ltd	None	Standard	High	Accumulate
NWS	News Corp DR	None	Standard	High	Hold
NEC	Nine Entertainment Co. Holdings Ltd	Narrow	Standard	High	Hold
PMV	Premier Investments Ltd	None	Exemplary	High	Hold
SKC	Skycity Entertainment Group Ltd	Narrow	Standard	High	Hold
SGH	Slater & Gordon Ltd	Narrow	Exemplary	Medium	Hold
SGN	STW Communications Group Ltd	None	Standard	Medium	Accumulate
SUL	Super Retail Group Ltd	None	Exemplary	High	Hold
TAH	Tabcorp Holdings Ltd	Narrow	Standard	Medium	Reduce
TTS	Tatts Group Ltd	Narrow	Standard	Medium	Reduce
<b>Consumer Defensive</b>					
AHY	Asaleo Care Ltd	Narrow	Standard	Medium	Hold
BKL	Blackmores Ltd	Narrow	Standard	Medium	Hold
CCL	Coca-Cola Amatil Ltd	Narrow	Standard	Medium	Hold
GEM	G8 Education Ltd	None	Exemplary	Medium	Accumulate
GNC	Graincorp Ltd Class A	None	Standard	High	Hold
MTS	Metcash Ltd	None	Standard	Medium	Hold
NVT	Navitas Ltd	None	Standard	High	Hold
TRS	Reject Shop Ltd	None	Standard	High	Accumulate
WES	Wesfarmers Ltd	Wide	Exemplary	Medium	Hold
WOW	Woolworths Ltd	Wide	Standard	Low	Accumulate
<b>Energy</b>					
AWE	AWE Ltd	None	Standard	High	Buy
ORG	Origin Energy Ltd	None	Standard	Medium	Accumulate
STO	Santos Ltd	Narrow	Standard	High	Buy
WOR	WorleyParsons Ltd	Narrow	Exemplary	High	Accumulate
<b>Financial Services</b>					
AMP	AMP Ltd	Narrow	Standard	Medium	Hold
ASX	ASX Ltd	Wide	Standard	Medium	Hold
ANZ	Australia and New Zealand Banking Group Ltd	Wide	Exemplary	Medium	Accumulate
BOQ	Bank of Queensland Ltd	None	Standard	Medium	Hold
BEN	Bendigo And Adelaide Bank Ltd	None	Standard	Medium	Hold
BTT	BT Investment Management Ltd.	Narrow	Standard	Medium	Hold

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Ticker	Investment Name	Economic Moat	Stewardship Rating	Fair Valuation Uncertainty	Morningstar Recommendation
securities with this symbol passed the previous monthly PSL review, but based on updated data do not currently meet the PSL criteria					
CGF	Challenger Ltd	None	Standard	High	Hold
CBA	Commonwealth Bank of Australia	Wide	Exemplary	Medium	Hold
FXL	FlexiGroup Ltd	None	Standard	High	Accumulate
FSF	Fonterra Shareholders Fund	None	Standard	High	Hold
GMA	Genworth Mortgage Insurance Australia Ltd	None	Standard	High	Hold
HGG	Henderson Group PLC DR	Narrow	Standard	Medium	Accumulate
IAG	Insurance Australia Group Ltd	None	Standard	Medium	Accumulate
IFL	IOOF Holdings Ltd	Narrow	Standard	Medium	Hold
MQG	Macquarie Group Ltd	None	Standard	Medium	Hold
MFG	Magellan Financial Group Ltd	Narrow	Standard	High	Hold
NAB	National Australia Bank Ltd	Wide	Standard	Medium	Accumulate
NHF	NIB Holdings Ltd	Narrow	Standard	Medium	Hold
PPT	Perpetual Ltd	Narrow	Standard	Medium	Hold
PTM	Platinum Asset Management Ltd	Narrow	Exemplary	Medium	Accumulate
QBE	QBE Insurance Group Ltd	Narrow	Standard	High	Accumulate
SUN	Suncorp Group Ltd	None	Standard	Medium	Hold
TWR	Tower Ltd	None	Standard	High	Hold
TRG	Treasury Group Ltd	None	Standard	High	Hold
WBC	Westpac Banking Corp	Wide	Exemplary	Medium	Hold
<b>Healthcare</b>					
ANN	Ansell Ltd	Narrow	Standard	Medium	Hold
COH	Cochlear Ltd	Narrow	Exemplary	Medium	Hold
CSL	CSL Ltd	Narrow	Standard	Medium	Hold
EBO	Ebos Group Ltd	Narrow	Standard	High	Hold
FPH	Fisher & Paykel Healthcare Corp Ltd	Narrow	Standard	Medium	Hold
GXL	Greencross Ltd	None	Standard	High	Hold
HSO	Healthscope Ltd	Narrow	Standard	Medium	Reduce
MYX	Mayne Pharma Group Ltd	None	Standard	High	Accumulate
MVF	Monash IVF Group Ltd	None	Standard	Medium	Accumulate
PRY	Primary Health Care Ltd	None	Standard	Medium	Hold
RHC	Ramsay Health Care Ltd	Narrow	Exemplary	Medium	Hold
RMD	ResMed Inc DR	Narrow	Standard	Medium	Hold
SIP	Sigma Pharmaceuticals Ltd	Narrow	Standard	High	Hold
SHL	Sonic Healthcare Ltd	Narrow	Standard	Medium	Hold
VRT	Virtus Health Ltd	None	Standard	Medium	Accumulate
<b>Industrials</b>					
ALQ	ALS Ltd	Narrow	Standard	High	Hold
AIO	Asciano Ltd	Narrow	Standard	Medium	Hold
AIA	Auckland International Airport Ltd	Wide	Standard	Medium	Reduce
AZJ	Aurizon Holdings Ltd	Narrow	Standard	Medium	Hold
BKN	Bradken Ltd	None	Standard	High	Accumulate
BXB	Brambles Ltd	Wide	Standard	Medium	Hold
CDD	Cardno Ltd	None	Standard	High	Accumulate
DOW	Downer EDI Ltd	None	Standard	High	Hold
LEI	Leighton Holdings Ltd	Narrow	Standard	High	Hold
MMS	McMillan Shakespeare Ltd	None	Standard	High	Hold
MRM	Mermaid Marine Australia Ltd	None	Standard	High	Accumulate
MND	Monadelphous Group Ltd	Narrow	Standard	High	Accumulate
NWH	NRW Holdings Ltd	None	Standard	High	Accumulate
OFX	Ozforex Group Ltd	None	Standard	High	Accumulate
QUB	Qube Holdings Ltd	Narrow	Standard	Medium	Hold
REC	Recall Holdings Ltd	Narrow	Standard	Medium	Reduce
SVW	Seven Group Holdings Ltd	None	Standard	High	Accumulate
SKE	Skilled Group Ltd	None	Standard	High	Accumulate
SPO	Spotless Group Holdings Ltd	Narrow	Standard	Medium	Reduce
SYD	Sydney Airport	Narrow	Standard	Medium	Reduce
TOL	Toll Holdings Ltd	None	Standard	Medium	Hold
TOX	Tox Free Solutions Ltd	None	Standard	High	Accumulate
TPI	Transpacific Industries Group Ltd	None	Standard	High	Hold
TCL	Transurban Group	Narrow	Standard	Medium	Reduce
VED	Veda Group Ltd	Wide	Standard	Medium	Hold
SOL	Washington H Soul Pattinson & Co Ltd	None	Standard	High	Hold
<b>Real Estate</b>					
ABP	Abacus Property Group	None	Standard	Medium	Hold
LEP	ALE Property Group	None	Exemplary	Medium	Hold
AOG	AVEO Group	None	Standard	Medium	Accumulate
BWP	BWP Trust	Narrow	Standard	Medium	Reduce
CHC	Charter Hall Group	Narrow	Standard	Medium	Hold
COR	Charter Hall Retail REIT	None	Standard	Medium	Hold

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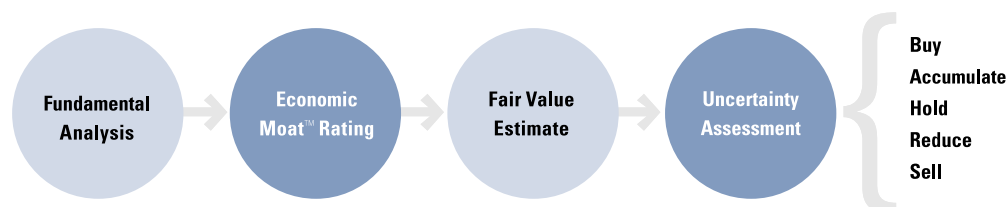
Ticker	Investment Name	Economic Moat	Stewardship Rating	Fair Valuation Uncertainty	Morningstar Recommendation
securities with this symbol passed the previous monthly PSL review, but based on updated data do not currently meet the PSL criteria					
DXS	Dexus Property Group	Narrow	Standard	Medium	Hold
FDC	Federation Centres	Narrow	Standard	Medium	Hold
GMG	Goodman Group	Narrow	Standard	Medium	Accumulate
GPT	GPT Group	Narrow	Standard	Medium	Hold
HPI	Hotel Property Investments	None	Standard	Medium	Hold
IOF	Investa Office Fund	Narrow	Standard	Medium	Hold
MGR	Mirvac Group	None	Standard	Medium	Hold
NVN	Novion Property Group	Narrow	Standard	Medium	Hold
SCG	Scentre Group	Narrow	Standard	Medium	Hold
SCP	Shopping Centres Australasia Property Group	None	Standard	Medium	Hold
SGP	Stockland Corp Ltd	Narrow	Standard	Medium	Hold
WFD	Westfield Corp	Narrow	Standard	Medium	Hold
<b>Technology</b>					
ALL	Aristocrat Leisure Ltd	Narrow	Standard	High	Reduce
BRG	Breville Group Ltd	Narrow	Exemplary	High	Hold
CRZ	Carsales.com Ltd	Narrow	Standard	Medium	Hold
CPU	Computershare Ltd	Narrow	Standard	Medium	Accumulate
DWS	DWS Ltd	None	Standard	High	Hold
IRE	IRESS Ltd	Narrow	Standard	Medium	Reduce
REA	REA Group Ltd	Narrow	Standard	High	Hold
RKN	Reckon Ltd	None	Standard	Medium	Accumulate
SEK	Seek Ltd	Narrow	Standard	High	Reduce
SMX	SMS Management & Technology Ltd	None	Standard	High	Hold
TNE	Technology One Ltd	Narrow	Exemplary	Medium	Reduce
TME	Trade Me Group Ltd	Wide	Standard	Medium	Hold
<b>Utilities</b>					
AGL	AGL Energy Ltd	Narrow	Standard	Medium	Accumulate
APA	APA Group	Narrow	Exemplary	Medium	Reduce
GNE	Genesis Energy Ltd	Narrow	Standard	High	Hold
IFZ	Infratil Ltd	None	Standard	Medium	Hold
MEZCA	Meridian Energy Ltd	Narrow	Standard	High	Hold
MYT	Mighty River Power Ltd	Narrow	Standard	High	Hold

# Morningstar® Equity Research Methodology

## Fundamental Analysis

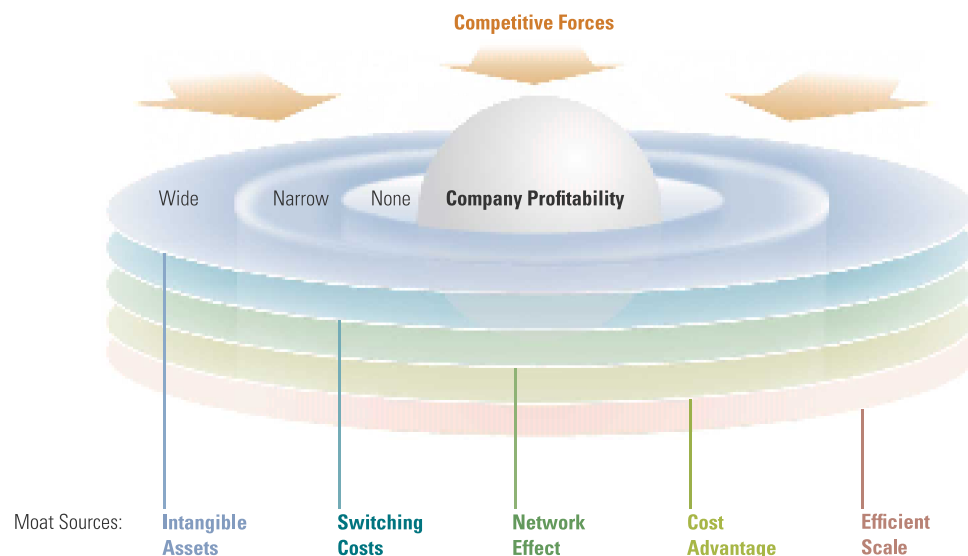
At Morningstar, we believe buying shares of superior businesses and allowing them to compound over time is the surest way to create wealth in the stock market. The long term fundamentals of businesses, such as cash flow, competition, economic cycles, and stewardship, are our primary focus because history has shown that market sentiment is fleeting, momentum can quickly reverse, and the herd is sometimes a dangerous crowd. Occasionally, this approach causes our recommendations to appear out of step, but willingness to be contrarian is an important source of outperformance and a benefit of Morningstar's independence. The brief definitions that follow help illustrate our methodology. Extensive methodology documents are available on our website.

## Morningstar Research Process for Company Analysis



## Economic Moat

The economic moat concept is a cornerstone of Morningstar's investment philosophy and is used to distinguish high quality companies. An economic moat is a structural feature that allows a firm to sustain excess returns over a long period of time. Without a moat, profits are more susceptible to competition. Companies with a narrow moat are likely to achieve normalised excess returns beyond ten years while wide moat companies are likely to sustain excess returns beyond 20 years. The longer a firm generates economic profits, the higher its intrinsic value. We believe low quality, no moat companies will see their returns gravitate toward the firm's cost of capital more quickly than companies with moats. We have identified five sources of economic moats: intangible assets, switching costs, network effect, cost advantage, and efficient scale.



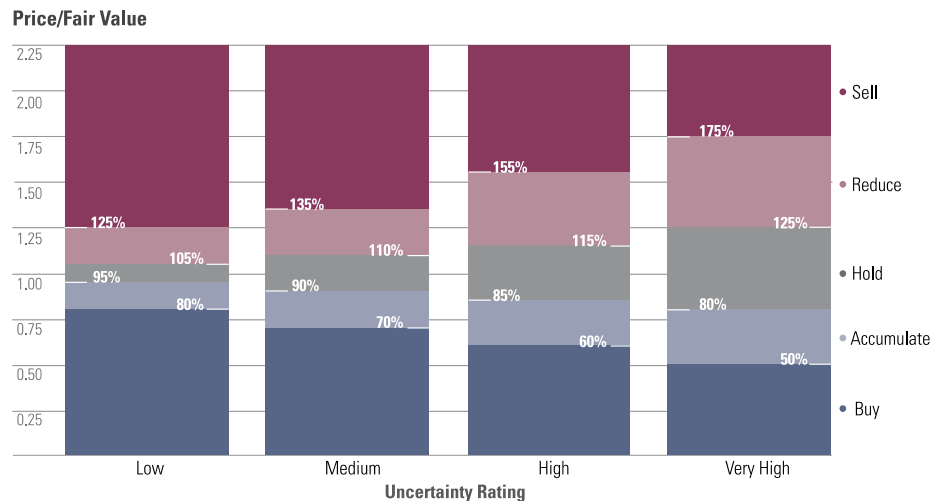
## Fair Value Estimate

Our fair value estimate is primarily based on Morningstar's proprietary three-stage discounted cash flow model. We also use a variety of supplementary fundamental methods to triangulate a company's worth such as sum-of-the-parts, multiples, and yields, among others. We're looking well beyond next quarter to determine the cash-generating ability of a company's assets because history has shown that the market price of a security will migrate towards the firm's intrinsic value over time. Economic moats are not only an important sorting mechanism for quality in our framework, but the designation directly contributes to our estimate of a company's intrinsic value through sustained excess returns on invested capital.

## Uncertainty Rating

The Morningstar Uncertainty Rating demonstrates our assessment of a firm's cash flow predictability, or valuation risk. From this rating, we determine appropriate margins of safety: The higher the uncertainty, the wider the margin of safety around our fair value estimate before our recommendations are triggered.

Our uncertainty ratings are low, medium, high, very high, and extreme. With each uncertainty rating is a corresponding set of price to fair value ratios that drive our recommendations: Lower price/fair values (<1.0) lead to positive recommendations while higher price/ fair values (>1.0) lead to negative recommendations. Our price/fair values have proven highly predictive of future stock returns. In very rare cases, the fair value estimate for a firm is so unpredictable that a margin of safety cannot be properly estimated. For these firms, we use a rating of extreme which indicates that nearly all investors should avoid speculating on that company's shares. Risk and volatility-averse investors should generally avoid very high and extreme uncertainty companies.



### Recommendations

Our recommendations are based on the current share price relative to Morningstar's Fair Value Estimate after adjusting for an appropriate margin of safety. These recommendations are guideposts to a broad audience and individuals must consider their own specific investment goals, risk tolerance, tax situation, time horizon, income needs, and complete investment portfolio, among other factors.

Depending on the portfolio strategy being employed, the ratings below can indicate different actions for different investors. For example, income investors might be best served holding a fairly valued investment with a reliable dividend stream instead of rotating into a buy recommendation with questionable income characteristics. Nonetheless, our recommendations serve as valuable starting points for equity portfolio strategies.

Recommendations displayed in Morningstar's Australian and New Zealand equity research products: Buy, Accumulate, Hold, Reduce and Sell. Equivalent ratings used in Morningstar's global products are ★★★★★, ★★★★, ★★★, ★★ and ★.

**Buy (significantly undervalued, ★★★★★):** Our buy recommendations indicate that we believe appreciation beyond a fair risk-adjusted return is highly likely over a multi-year timeframe. Scenario analysis developed by our analysts indicates that the current market price represents an excessively pessimistic outlook, limiting downside risk and maximising upside potential. This rating encourages investors to consider an overweight position in the security relative to the appropriate benchmark.

**Accumulate (modestly undervalued, ★★★★):** Our accumulate recommendation indicates that we believe appreciation beyond a fair risk-adjusted return is likely. This rating encourages investors to own the firm's shares, possibly overweight relative to the appropriate benchmark after fully considering the security's fit with their targeted portfolio and more attractively-priced alternatives, such as our buy recommendations.

**Hold (fairly valued, ★★★):** Our hold recommendation indicates that we believe investors are likely to receive a fair risk-adjusted return (approximately cost of equity). Concentrated portfolios might consider reducing or exiting these positions if more attractively-priced alternatives are available.

**Reduce (modestly overvalued, ★★):** Our reduce recommendation indicates that we believe investors are likely to receive a less than fair risk-adjusted return and should consider directing their capital elsewhere. Securities with a reduce recommendation should generally be underweight and exited completely in most strategies, assuming less expensive alternatives are available.

**Sell (significantly overvalued, ★):** Our sell recommendation indicates that we believe there is a high probability of undesirable risk-adjusted returns from the current market price over a multi-year timeframe. Scenario analysis by our analysts indicates that the market is pricing in an excessively optimistic outlook, limiting upside potential and leaving the investor exposed to substantial loss. This rating encourages investors to strongly consider exiting portfolio positions in the security in nearly all strategies.