

Westpac Office Trust

Re-initiation of coverage

Event

WOT has announced a resolution proposal to cease trading instalment receipts and commence trading full units in the Trust. The deadline for lodgment of Proxy Forms is Tuesday, 8 September 2009, with the meeting to consider the resolutions to follow on Thursday, 10 September 2009. If approved, instalment receipts will cease trading on the ASX on Friday, 11 September 2009 and full units will commence trading on Monday 14 September 2009. Furthermore, investors will have the option to repay instalment debt early and receive fully paid units; sell all or part of their current holdings; or continue to hold the instalment receipts for an extended term. There will be no constraints on investors selling out of their instalment receipt holdings through their broker.

Implications

The proposal to restructure has been assessed by the Independent Expert (IE) to be in the best interests of unitholders. Should the proposal be approved, this will allow the Trust to resume a disciplined growth strategy in a buyers market. However, the Trust's balance sheet has above-average leverage relative to that of its peers and may prove to be an achilles heel in the near term. Aegis estimates the sale of \$100M of assets could reduce gearing from 63% to below 60%. Aegis estimates that over FY10 (including income growth), cap rates need to soften a further 100bps before lending covenants come under threat. More importantly, interest cover is 1.8x earnings compared to covenant of 1.5x, an adequate buffer considering the strength of tenant covenant. We attach a low probability for such an outcome. Finally, an FY10F implied distribution yield of 8.6% at current prices represents a solid yield in the context of current market conditions. Based on our DCF and NAV valuations, we value WOT at \$0.76 per fully paid unit (equivalent to \$0.26 per IR).

Investment Opinion

The research on this company has been commissioned and as such Aegis has received a fee for its initiation and ongoing research coverage.

No part of either the fee received by Aegis or the compensation paid to its analysts involved in preparing this report was, is or will be directly or indirectly, related to the valuation, earnings forecast or views expressed in this report.

The DPS and DPS yield shown in 'Earnings summary' below reflects what investors receive under the instalment receipt structure. If the resolution to trade as fully paid units on the ASX is approved, DPS and DPS yield will be shown on a fully paid unit.

Earnings Summary

Yr to Jun	NPAT Rep \$M	NPAT ¹ Adj \$M	EPS ¹ c	EPS chg %	PER x	PER rel All Ords x	PER rel Sector x	DPS c	Yield %	Franking %	Deferred Tax %
2008A	(4.5)	31.9	6.6	28.1	3.5	0.2	0.2	4.0	17.0	0	100
2009F	12.1	33.2	6.9	4.0	3.4	0.2	0.2	3.4	14.5	0	100
2010F	34.0	34.0	7.1	2.5	3.3	0.2	0.3	3.4	14.5	0	100
2011F	34.9	34.9	7.2	2.6	3.2	0.3	0.3	3.6	15.2	0	100

¹ NPAT and EPS are adjusted by removing non-recurring items. All the above statistics are derived from normalised earnings.

Key Information

Share Price	\$0.24
Valuation	\$0.26

Price Performance



Market Statistics

Market Cap (M)	\$113
Shares (M)	482.2
% of All Ords	0.00
% of Sector	0.02
12 Month Range	\$0.22 - \$0.42
Company Risk	★ ★ ★ ☆ ☆
Share Price Risk	★ ★ ☆ ☆ ☆
Ethical rating	★ ★ ★ ★ ★

	Performance against indices (%)		
	3 Months	6 Months	12 Months
WOT	(16.1)	(13.0)	(42.7)
Sector	23.3	42.5	(6.1)
Market	16.8	34.0	(13.1)

Key Assumptions

Beta:	1.2
Market risk premium (%):	6.0
Risk free rate (%):	6.3
WACC (%):	10.2
Forecast cashflow (years):	10
Residual value % of total valuation:	58.9
Nominal terminal growth rate (%):	3.0

Westpac Office Trust

Valuation: \$0.26

Company risk ¹: ★★☆☆☆

Share Price risk ¹: ★★☆☆☆

Ethical rating ²: ★★★★★

Year end Jun. All figures in A\$M

Profit & loss summary					Ratio analysis				
	2008A	2009F	2010F	2011F		2008A	2009F	2010F	2011F
Operating revenue	86.9	94.3	98.5	100.9	Revenue growth (%)	53.7	8.5	4.5	2.4
Invest & other income	4.3	(2.1)	(3.0)	(3.1)	EBITDA growth (%)	75.2	1.2	0.9	2.3
EBITDA	80.9	81.8	82.5	84.5	EPS growth (%)	28.1	4.0	2.5	2.6
Depreciation/Amort	0.0	0.0	0.0	0.0	EBITDA/Sales margin (%)	93.1	86.8	83.8	83.8
EBIT	80.9	81.8	82.5	84.5	EBIT/Sales margin (%)	93.1	86.8	83.8	83.8
Net Interest	(49.0)	(48.6)	(48.5)	(49.5)	Tax rate (%)	0.0	0.0	0.0	0.0
Pre-tax profit	31.9	33.2	34.0	34.9	Net debt/equity (%)	115.7	170.5	165.4	160.2
Tax expense	0.0	0.0	0.0	0.0	Net debt/net debt + equity (%)	53.6	63.0	62.3	61.6
Minorities/Assoc./Prefs	0.0	0.0	0.0	0.0	Net interest cover (x)	1.7	1.7	1.7	1.7
NPAT	31.9	33.2	34.0	34.9	Payout ratio (%)	109.4	96.5	94.2	94.2
Non recurring items	(36.4)	(21.1)	0.0	0.0	Capex to deprec'n (%)	0.0	0.0	0.0	0.0
Reported profit	(4.5)	12.1	34.0	34.9	NTA per share (\$)	1.26	0.86	0.90	0.94
NPAT add Goodwill & Pref	0.0	0.0	0.0	0.0	ROA (%)	5.9	6.4	6.8	6.9
Adjusted profit	31.9	33.2	34.0	34.9	ROE (%)	5.0	7.1	8.0	7.9
Cashflow summary					Multiple analysis				
	2008A	2009F	2010F	2011F		2008A	2009F	2010F	2011F
EBITDA	80.9	81.8	82.5	84.5	Market cap (M)	113			
Working capital changes	(2.2)	(0.1)	(0.1)	(0.0)	Net debt (\$M)	711.4			
Interest and tax	(51.0)	(55.3)	(48.5)	(49.5)	Peripheral assets (\$M)	(0.0)			
Other operating items	(1.6)	6.1	0.0	0.0	Enterprise value (\$M)	824.7			
Operating cashflow	26.1	32.5	34.0	34.9	EV/EBIT (x)	10.2	10.1	10.0	9.8
Required capex	0.0	(5.3)	(10.0)	(10.0)	EV/EBITDA (x)	10.2	10.1	10.0	9.8
Maintainable cashflow	26.1	27.2	24.0	24.9	EV/EBITDA All Ind (x)	7.3	7.2	6.7	6.1
Dividends	(34.8)	(16.6)	(16.5)	(16.4)	EV/EBITDA rel All Ind (x)	1.4	1.4	1.5	1.6
Acq/Disp	(146.0)	0.0	0.0	0.0	P/E (x)	3.5	3.4	3.3	3.2
Other investing items	(22.5)	(14.3)	(15.6)	(15.6)	P/E rel All Ind (x)	0.2	0.2	0.3	0.3
Free cashflow	(177.1)	(3.7)	(8.1)	(7.1)	P/E rel All Ind ex banks (x)	0.2	0.2	0.2	0.3
Equity	1.4	0.0	0.0	0.0	P/E sector (x)	17.6	15.6	12.1	10.7
Debt inc/(red'n)	170.2	(6.2)	8.1	7.1	P/E rel sector (x)	0.2	0.2	0.3	0.3
Balance sheet					Assumptions				
	2008A	2009F	2010F	2011F		2008A	2009F	2010F	2011F
Cash & deposits	45.8	25.0	16.0	9.9	GDP growth (%)	3.58	0.50	0.00	1.40
Inventories	0.0	0.0	0.0	0.0	Interest Rates (%)	7.38	4.88	2.30	2.49
Trade debtors	3.5	1.2	1.3	1.3	Inflation (%)	3.40	3.65	2.50	2.50
Other curr assets	44.4	0.5	0.5	0.5					
Total current assets	93.7	26.8	17.8	11.8					
Prop., plant & equip.	0.0	0.0	0.0	0.0					
Non-curr intangibles	0.0	0.0	0.0	0.0					
Non-curr investments	1,260.6	1,172.4	1,182.4	1,192.4					
Other non-curr assets	20.4	7.8	23.4	39.0					
Total assets	1,374.8	1,207.0	1,223.6	1,243.2					
Trade creditors	15.4	12.9	12.9	12.9					
Curr borrowings	243.8	5.3	5.3	735.8					
Other curr liabilities	6.2	33.5	33.5	33.5					
Total current liab.	265.4	51.7	51.7	782.2					
Borrowings	503.3	730.4	729.5	0.0					
Other non-curr liabilities	0.0	7.8	7.8	7.8					
Total liabilities	768.7	790.0	789.1	790.1					
Minorities/Convertibles	0.0	0.0	0.0	0.0					
Shareholders equity	606.1	417.0	434.5	453.1					

Notes To Accounts

The DPS and DPS yield shown in our Earnings summary on Page1 reflects what investors receive under the instalment receipt structure. If the resolution to trade as fully paid units on the ASX is approved, DPS and DPS yield will be shown on a fully paid unit.

Notes:1. The risk ratings are on a 12 month perspective, where five stars denotes low risk and one star denotes high risk. Company risk takes into account expected financial, strategic and execution risks associated with the company. Share price risk is a measure of the expected volatility of the price and other trading factors.

2. The Ethical rating rates a company on an ethical investment basis where five stars denote very good and one star a poor rating. The score is based on four key factors: areas of operating, environmental, corporate governance and social factors. For more information see www.aegis.com.au.

Westpac Office Trust

Background to WOT

The Trust is a Sydney-centric commercial office property trust, designed to deliver sustainable and predictable distributions to investors. The cashflows underpinning distributions are derived from a quality tenant base with fixed rent increases and having an above-average lease expiry profile.

The property portfolio consists of eight assets, in seven of which the Trust holds a 100% interest. The flagship asset, Westpac Place, is the anchor of the portfolio and represents 62% of the portfolio by value (as at 30 June 2009).

Structure

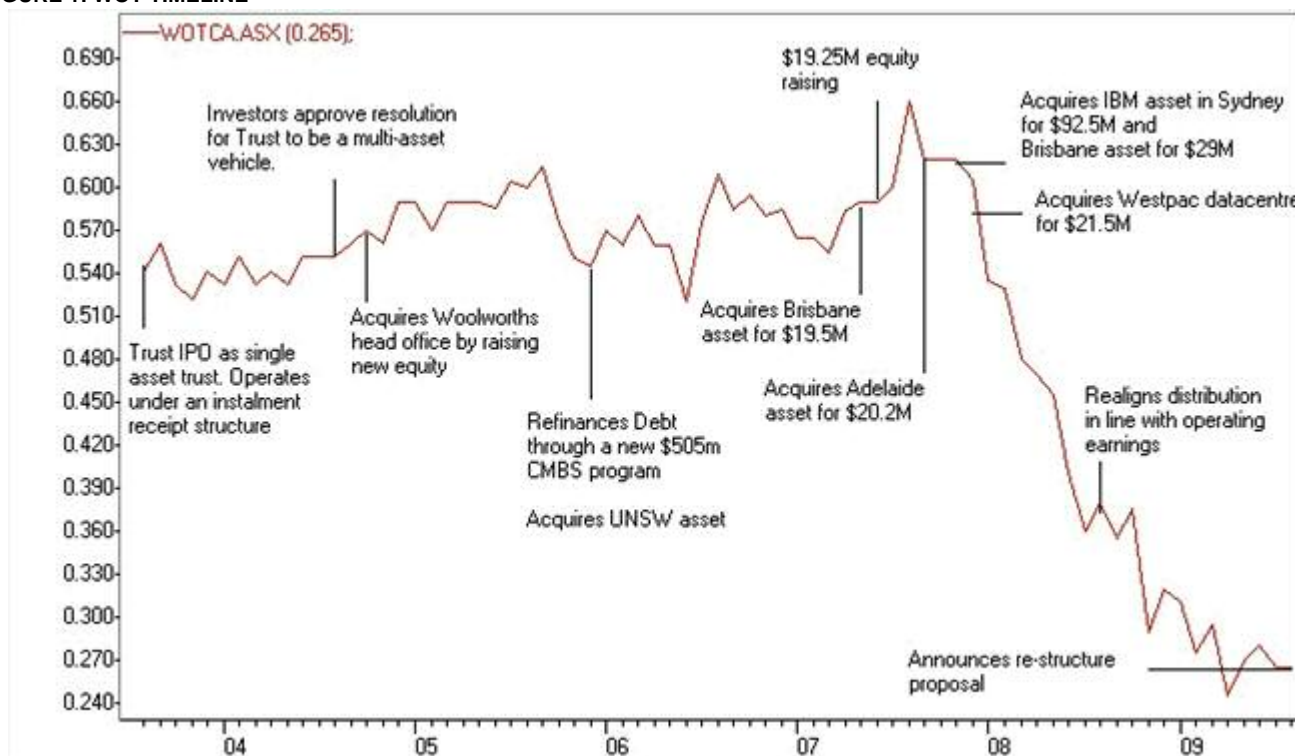
WOT is a structured investment vehicle, which listed on the ASX in August 2003 as a partly paid instalment receipt (issue price of \$1.00 partly paid up to \$0.50), as described in Figure 1.

Westpac Securities Limited has contributed the amount equal to the second call (\$241M) as instalment debt on which it receives interest (fixed rate of 6.5% and funded by distributions). This amount was originally expected to be repaid from the proceeds of the final call on investors of \$0.50 in November 2011. Consequently, each instalment receipt will convert to one fully paid unit in the Trust.

The instalment receipt structure was appropriate when the Trust was established as a single asset vehicle to hold Westpac Place, the parent entity's head office in Sydney. However, with the Trust moving to a multi-asset vehicle, the IR structure has proved to be an impediment due to changes in market regulation (in light of the issues surrounding Bris Connections), lack of flexibility and appeal to a broader class of investors.

Despite the ramifications from the global financial crisis (GFC) that we are familiar with and the pressures on asset de-valuation, we believe the opportunity to re-invent the Trust structure and market positioning is a prudent step to recapture value. To provide a quick recap of the history of the Trust, Figure 1 timelines the history of the Trust.

FIGURE 1: WOT TIMELINE



Source: IRESS/Aegis Equities

The Proposal

WOT management has put forward a proposal for investors to consider and vote on the following two resolutions:

1. Commence trading the ordinary units of the Trust on the ASX and cease trading the existing instalment receipts and
2. Approval for an extension of and amendments to the Business Development Agreement between the Trust and Westpac. The current agreement, which expires in July 2010, provides the Trust with support from Westpac in securing new properties.

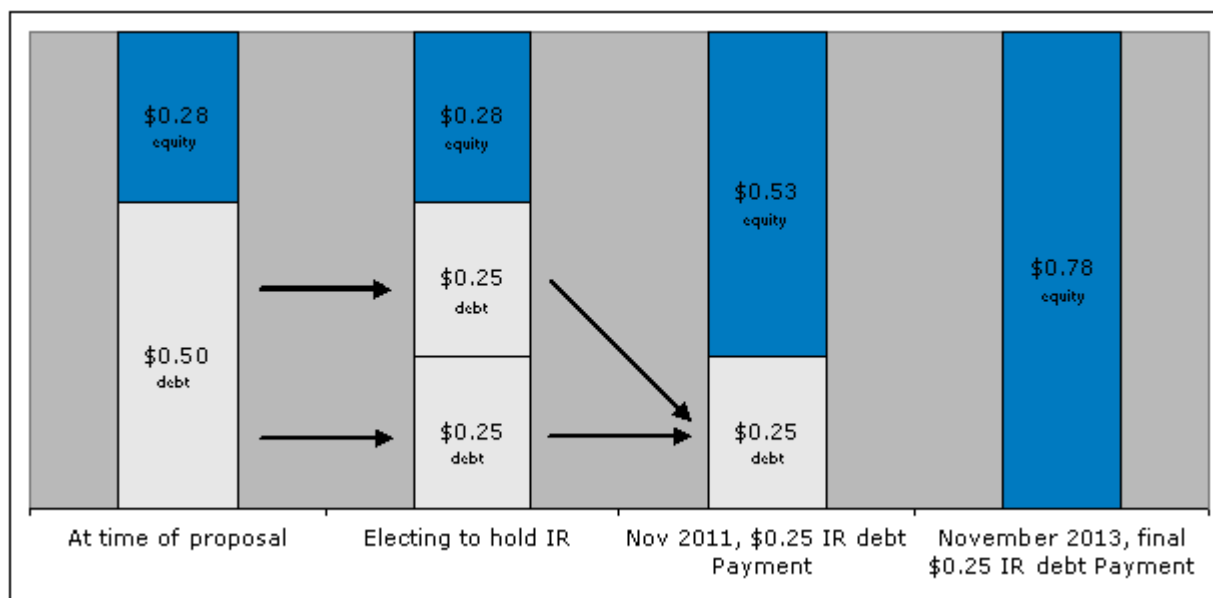
For more details on the proposal, please refer to the Explanatory Memorandum (EM) and the Independent Expert's report, which recommends investors vote in favour of the proposal and that it is in the best interests of unitholders. We, however, summarise the proposal briefly below.

Should the proposal be approved by a majority of investors (50% minimum), the Trust will trade on the ASX as fully paid units. Current holders of WOT instalment receipts (IRs) will have three options which are outlined below:

1. **Continue to hold the IRs:**
Under the current IR structure, investors are required to pay the remaining debt amount of \$0.50 per unit in November 2011. However, the proposal requires unitholders to pay \$0.25 in November 2011 and defer the remaining \$0.25 payment until November 2013. We note the interest rate will remain fixed at 6.5% until November 2011 but will revert to the floating rate (plus a margin) for investors choosing to pay the remaining \$0.25 in November 2013. When unitholders make the final payment, the IR debt is retired and fully paid units are issued;
2. **Sell your instalment receipts:**
Investors can sell some or all of their IRs. Investors are not required to repay the Instalment Debt to convert their Instalment Receipts to units prior to the trade. This will be achieved through a broker who will sell the whole underlying security and the settlement proceeds will retire all IR debt and remaining proceeds will be paid to the investor; *and*
3. **Pay the instalment debt:**
Investors will have the flexibility to pay the IR debt anytime before November 2011, an option that is not available under the current structure. After payment of IR debt, the fully paid units will be traded on the ASX, with investors receiving the full distribution on units without the deduction of their instalment debt interest.

In Figure 2 below, we have illustrated the scenario of an existing investor electing to continue holding the IRs until November 2013.

FIGURE 2: EXAMPLE OF INVESTOR HOLDING THE IR



Source: Aegis Equities

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Aegis notes the approval of the proposal should achieve the following:

1. Enable management to appeal to a larger investor base and potentially attract institutional investors that have hitherto been deterred to invest in the Trust due to its structure;
2. The Trust's portfolio of prime quality assets fits well with the current theme of investors seeking greater exposure to Australian domiciled assets; and
3. Reduces investors concerns on the final \$0.50 call in November 2011 and provides a wide range of options for investors; and
4. There is the potential for the Trust to be included in the S&P/ASX 300 A-REIT index as liquidity improves which should have positive implications for the trading price.

We note that the market capitalisation of the Trust will dramatically increase from around \$135M to around \$375M based on current trading price. This could potentially result in WOT gaining increased status in the A-REIT sector.

Trust Investment Mandate

WOT has well-defined investment criteria of investing in prime commercial assets that are substantially leased to major corporations and located in major capital cities. A major consideration for any acquisition is the strength of the underlying property metrics and sustainable cashflow. We believe this discipline in the mandate has proved to be a strong feature in the context of recent market events.

Property Portfolio

The Trust owns and manages a portfolio of eight commercial office property buildings and has a strong orientation to the Sydney office market. The key features of the property portfolio are as follows:

1. The income component of the Trust is arguably its strongest attribute.
2. The Trust exhibits 96% rental income from investment-grade tenants, with Westpac, Woolworths and IBM making up approximately 90% of income.
3. WOT has an average five-year fixed portfolio rental growth profile of 2.5% per annum (after RVA adjustment). Moreover, 98% of total rental growth is from fixed rental increases. We note, this could potentially result in a material over-rented position in the future if market rents do not recover over the medium term.
4. As at 31 December 2008, the occupancy rate of the Trust was 100% (including a rental guarantee of Cannon Hill 2, ~ 1.3% of total portfolio income).
5. The weighted average lease expiry is 9.7 years, with only 7% of leases expiring before 2014. This is an important feature, given the perceived risks in the current environment of rising incentives and declining market rents in the short to medium term.

The Trust's portfolio metrics outperform those of its peers on most measures and, as such, suggest that the portfolio is well protected from cyclical risks in the short to medium term.

TABLE 2: PORTFOLIO METRICS

Building	Tenant	Valuation 30/06/2009 (\$M)	Cap Rate 30/06/2009	WALE (Dec 2008)	Fixed Lease Increases
Westpac Place	Westpac	730.0	6.88%	9.5	4.0% pa
Woolworths NSO	Woolworths	234.0	7.75%	11.8	2.75% pa
Pennant Hills	IBM	93.0	8.50%	5.7	6.0% Biannually
Kensington	UNSW	36.0	7.75%	23.0	3.0% pa
Cannon Hill 2	Honeywell	25.8	8.25%	4.9	3.4% pa
Cannon Hill 1	Westpac	18.3	8.25%	5.9	3.5% pa
North Ryde	Westpac	17.5	9.10%	5.8	2.5% pa
Bedford Park	Westpac	18.0	8.75%	10.8	3.5% pa
Total		\$1,172.6	7.32%	9.7 yrs	3.5% pa

Source: Company/Aegis Equities

Key Financial Issues

Earnings Outlook

- As we have commented throughout the document, WOT has a high-quality earnings stream derived from major tenants such as Westpac, Woolworths and IBM. As such, earnings visibility is high and generally should increase in line with the fixed-rent profile of the assets. The average five-year portfolio rental growth profile is 2.5% per annum (after RVA adjustment).

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Distributions

- The Trust has a policy of paying distributions from operating cashflows after adjusting for operating capex and re-leasing costs. This is consistent with market practice in recent months and does not include any synthetically derived profits (gains from derivative instruments). Management has guided to FY10 distributions of 6.65 cents per fully paid unit, which is similar to the distributions made in FY09. The distribution guidance takes into account the earnings impact of the restructure costs. Beyond this, we expect distribution growth to be broadly in line with the underlying rent growth. Based on an implied price for a fully paid unit, the FY10 distribution yield is estimated at 8.6%.

Balance sheet leverage

- The balance sheet gearing of around 62% is well above that of its peers, which, on average, are geared around 32%. WOT's peers have scrambled to raise new equity at highly discounted prices to reduce balance sheet gearing as asset prices have tumbled and risked a breach of debt covenants.
- However, WOT has yet to undertake a dilutive capital raising. Our analysis indicates that the 7% headroom available for the Trust against its covenant of 70% provides a modest cushion against deteriorating real estate fundamentals. We estimate asset values need to decline by another \$110M (or 100bps softening in cap rates) for the Trust to sail close to its covenant.
- This remains a key risk under current market conditions. Management commentary suggests that we may be approaching a trough in asset devaluation and, as such, the Trust may remain within covenants.
- More important, interest cover was 1.83x earnings compared to covenant of 1.5x. For the Trust to be in breach of this covenant, one of the Trust's major tenants (Westpac, Woolworths or IBM) need to default on rent payments. We attach a low probability for such an outcome.
- Table 3 below summarises WOT's funding sources and liquidity capacity as at 30 June 2009. The **weighted average interest rate is 6.0%** (excluding margins) and is 100% hedged until FY11.

TABLE 3: WOT LIQUIDITY

	Facility Limit (\$M)	Drawn (\$M)	Undrawn (\$M)	Expiry	Covenant Limits	Current level
CMBS	505	505	0	16-Nov-11	none	n/a
Westpac Term Debt	251	231	20	30-Jun-11	70%	60%
Westpac Working capital	15	5	10	16-Nov-11	70%	60%
Total	771	741	30			

Source: Company/Aegis Equities

NTA

Table 4 below shows that WOT currently trades at a discount of 28% to NTA, which is a smaller discount in comparison to its peers. WOT benefits from a 100% domestic exposure and exhibits a lease profile superior to that of its peers. However, it remains highly leveraged relative to its peers.

We note the significance of sensitivity to NTA for higher leveraged vehicles to movements in asset values. Even a small change in property value can often have significant impacts on the Trust's NTA. As such, Aegis believes there remains the risk for further property devaluation and, therefore, the implied discount to NTA could be much smaller.

TABLE 4: DISCOUNT-TO-NTA COMPARISON, GEARING & FORECAST DISTRIBUTION

Comparable A-REITs	NTA (30 Jun 09)	Trading Price (25 Aug 09)	Discount to NTA	Gearing	Gearing date	Aegis FY10F yield
Macquarie Office Trust ¹	\$0.49	\$0.24	-51%	58%	Jun-09	11.7%
ING Office Fund ¹	\$0.80	\$0.50	-38%	39%	Jun-09	7.9%
Dexus Property Trust ¹	\$1.01	\$0.69	-32%	31%	Jun-09	7.4%
Commonwealth Property Office Fund	\$1.15	\$0.78	-32%	28%	Jun-09	6.8%
WOTCA ²	\$0.36	\$0.28	-28%	60%	Dec-08	14.5%

Source: Company/Aegis Equities

¹Gearing stated on a look-through basis, NTA inclusive of tax deferred liability.

²Aegis FY10F yield based on the implied price of a fully paid unit.

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Valuation

- Aegis undertakes a detailed DCF and NAV analysis to ascertain an appropriate valuation for A-REITs. Based on our DCF assumptions outlined below, we value WOT at \$0.76 per fully paid unit or \$0.26 per IR. Our valuation assumes that the proposal is approved by investors and the one-off costs are expensed in FY10.
- The DCF valuation includes a beta of 1.2 and a WACC of 10.2%. WOT's beta has been weighted for stock-specific factors, including the Trust's size (based on its market capitalisation), liquidity and its underlying asset base.
- As a cross check, we show our NAV analysis below. We note that assumed costs of the transaction are as per the Independent Expert report and a base management fee multiple of 5x has been applied.

TABLE 5: NET ASSET VALUE SENSITIVITY

	NTA		NAV	
	1H09A	FY09F	+25bps cap rate expansion	+50bps cap rate expansion
Westpac Place cap rate	6.4%	6.9%	7.0%	7.2%
Other Assets WACR	7.7%	8.1%	8.5%	8.9%
Total market weighted average cap rate	6.9%	7.3%	7.6%	7.8%
Investment Property Value	1,226.6	1,172.4	1,167.7	1,130.4
Other Assets	29.4	26.8	26.8	26.8
Total Assets	1,256.0	1,199.2	1,194.5	1,157.1
Total Borrowings	739.0	735.8	735.8	735.8
Other Liabilities	87.4	54.3	54.3	54.3
Total Liabilities	826.4	790.0	790.0	796.1
Equity	429.6	409.1	404.4	361.0
Assumed cost of transaction	-	-	6.1	6.1
Management Fee	-	-	22.7	22.7
Net Equity	429.6	409.1	375.7	332.2
Value per whole unit	0.89	0.85	0.78	0.69
Change in % from 31 Dec 2008	-	-4.8%	-12.6%	-22.7%
LVR (debt/prop val)	60%	63%	63%	65%

Source: Company/Aegis Equities

Investment Summary

- WOT owns and manages a high-quality commercial office portfolio of eight assets that generates a sustainable and predictable income stream. This in turn underpins our view of the Trust providing distributions with modest growth over the medium to long term.
- The portfolio metrics rate favourably against its peers.
- The proposal to restructure has been assessed by the Independent Expert to be in the best interests of unitholders and that it improves flexibility. Should the proposal be approved, this will allow the Trust to resume a disciplined growth strategy in a buyers market.
- However, the Trust's balance sheet has an above-average leverage relative to that of its peers and may prove to be Achilles heel in the near term.
- The Trust has the option of selling smaller assets in the portfolio. Aegis estimates the sale of \$100M of assets could reduce gearing to below 60%. Nonetheless, this remains high and may require the Trust to raise new equity to fund acquisitions.

Investment Summary contd.

- Asset devaluation pressures continue to pound the sector, although there are signs emerging that the rate of decline has slowed. Aegis estimates that over FY10 (including income growth), cap rates need to soften a further 100bps before lending covenants come under threat.
- The more important covenant breach to consider is the interest cover covenant of 1.5x earnings. Aegis attaches a low probability for this breach to occur as it would require Westpac Bank, Woolworths or IBM to default on rent payments.
- Finally, an FY10F distribution yield of 8.6% at current prices represents a solid yield in the context of current market conditions.

TABLE 6: EVENTS AND DATES TIMETABLE

Important Events	Important dates
Deadline for lodgement of Proxy Forms	5:00pm (Sydney time) on Tuesday, 8 September 2009
Meeting to consider the resolutions	11:00am (Sydney time) on Thursday, 10 September 2009
If the Proposal is approved	
Instalment Receipts cease trading on the ASX	Friday, 11 September 2009
Units commence trading on the ASX	Monday, 14 September 2009
Investors to repay \$0.25 of the Instalment Debt	1 November 2011
Investors to repay remaining \$0.25 of the Instalment Debt	1 November 2013

Source: Company/Aegis Equities



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