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Rising from the Ashes of Black Swans

While the Australian stock market is down 2% so far this calendar year, Shaw continues to expect the market to recover over the course of the balance of the year, as the short term disasters abate, and the longer term recovery of the (“developed”) global economies continues. While risk management will remain an issue for the markets, on balance the current weakness in the market should be seen as an opportunity for investors.

We highlight ten stocks in this report that we believe are of particular value, and represent a mix of exploration companies with superb resources, larger resource companies with exposure to the ongoing China story, and industrial leaders in their market niches.

Shaw also continues to highlight other opportunities in the market. For clients wanting further information on **AcruX (ACR)**, **carsales.com (CRZ)**, **Exco Resources (EXS)**, **Greenland Minerals & Energy (GGG)**, **Lynas Corp (LYC)**, **Nanosonics (NAN)** and **Starpharma (SPL)** please contact your Shaw advisor. We have a BUY recommendation on each of these stocks.

On a thematic basis, we maintain our focus on the long term potential for the **rare earths** sector, and indeed a number of our preferred resources stocks are based on this theme. The **commodities** boom has several years to run, irrespective of whether China reports 10-11% GDP growth, or 8-9% (our most likely expectation). While **retail** will remain competitive for several years, a cyclical recovery in **consumer spending** would be positive for a few discretionary spending exposed retailers. We believe we are now beyond the worst of the cycle. While lending growth for the **banks** is expected to remain subdued for several years, our preferred stocks in this sector are **National Australia Bank (NAB)** and **Australia & New Zealand Bank (ANZ)**.

The world has had to endure a number of unexpected events over the past few months, and these have had an impact on the equity markets. While the general global economic recovery scenario has not been altered, a number of “**Black Swan**” events have created diversions in this recovery.

In the past 3 or 4 months the equity markets have had to cope with the ongoing European sovereign debt problems (which will drag on the markets for some time to come), various floods and cyclones mainly in QLD, the unfortunate earthquake / tsunami and resulting nuclear disaster in Japan, and rolling unrest in the Middle East and broader theatre.

“A Black Swan event” is defined as an event that is a surprise to the market and has a major impact. These are individually classified as rare “outlier” events. Unfortunately, the world has experienced a number of Black Swan events in rapid succession that both individually and collectively had had a significant impact on world markets.

While these have occurred at a time that the developed world remains vulnerable in its recovery, we do not believe they will derail the broad global economic recovery.

Impacts on the markets have been several, and include:

- The cost and regional impact of the **devastation in QLD**, which briefly delayed coal shipments from QLD, impacted on tourism and general economic activity in parts of QLD, has had a negative impact on insurers and reinsurers, but should result in an economic boost when the rebuilding commences.

- The QLD disaster has precipitated a federal government move to enforced national insurance against natural disasters, with an unknown impact on longer term risk pricing.
- **The Japanese nuclear plant disaster** has skewed base load energy generation from nuclear to gas / coal at the margin. While the longer term impact on the nuclear industry is unclear, there is no scientific reason to cease nuclear power growth plans in geologically stable regions. The recent fall in uranium exposed stocks (miners) has been an over reaction.
- The **rolling Middle East scenario**, while notionally a move toward democracy in this region, leaves a trail of uncertainty. It is not clear whether the replacement ruling regimes will actually be truly democratic, or more importantly better economic managers. It is also unclear how extensive (geographically) the regime changes will become. While the changes are locally very significant, from the point of view of the global equity markets the key is maintaining the flow of oil through whatever changes are coming such that the oil price does not rise significantly above US\$100 / bbl, or become unstable (volatile).
- The **European sovereign debt problems** are continuing, and at the moment contained within Europe. While Germany and France are a reluctant funders of the solution, in reality by either direct funding or indirect guarantees they are overseeing the containment of this problem. Of concern however are the other major indebted countries including Japan, the UK and the USA. We expect that the balance sheets of the developed world are large enough to address these problems, combined with the advent of time (and some regulatory / budgetary solutions to the various structural problems).

These Black Swans have created opportunities for the brave and counter cyclical investors.

First, several **uranium** mining companies in Australia represent good value on the assumption that the growth in nuclear generation will be ongoing. We highlight three listed stocks that have suffered price falls recently:

- **Extract Resources (EXT)** as our first preference (though there is takeover activity on this stock);
- **Paladin Energy (PDN)** especially with expansion potential as our second choice; and
- **Energy Resources of Australia (ERA)** as our third choice, however this company has had some production problems.

There is the view that gas demand will increase as several countries re-evaluate their nuclear power expansion plans. Shaw does not maintain that view at present.

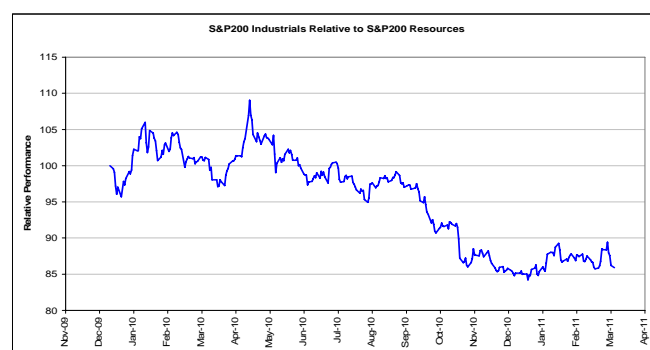
The **QLD floods** have destroyed infrastructure that will need to be replaced as funds are made available. This has obvious positive impacts for companies such as **Leighton (LEI)**, **Macmahon (MAH)**, **Sedgman (SDM)**, **Boom Logistics (BOL)** and **Bradken (BKN)**. Also several tourism related companies have suffered, and we highlight **Webjet (WEB)** as an opportunity for the counter cyclical investor.

The impact of the **oil price** will depend on your view of the end game for the Middle East, and how they get there. As noted, key for the markets is the supply of oil, which will require economically rational governments, a national sense of order, and indeed functioning governments through the transitions. If the view is that there will be volatility on that path, then our major energy companies (**Woodside (WPL)**; **Santos (STO)**; and **Origin Energy (ORG)**) will provide trading and investing opportunities. If the view is that the region will quickly stabilise with new and functioning governments then consumer discretionary stocks will become investment destinations on the thesis that oil prices will decline.

We also highlight that the **A\$ is closing in on its expected peak**. The rapid move of the A\$ from 0.60 in October 2008 to parity created very significant profit headwinds for a number of companies whose profits are exposed to the A\$. We note the obvious – the A\$ will not experience a similar run, and so the headwind to profit growth has now passed. These impacted companies can resume their profit growth trajectory from their current levels. And if the A\$ does fall, this will accelerate their profit growth.

Currently, Australia's economic prognosis remains sound. However, few things last forever, and even the healthiest economy needs to be professionally managed. There are several risks to Australia's economy, including our trade exposure to Japan (as that country suffers nuclear inspired economic volatility), and the impact of incremental tax increases on a number of sectors of the economy and the consumer.

The following chart shows the relative performance of listed Australian Industrial stocks compared to listed Resources stocks. From January 2010 to June 2010 the Industrials performed in line with the Industrials. From about June 2010 to December 2010 the Resources outperformed. More recently, the Industrials have again performed in line with the Resources.



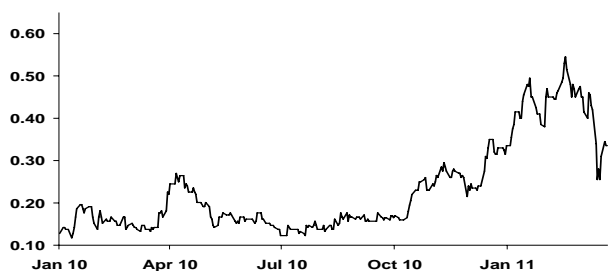
The market is clearly indicating that the strong outlook for commodities is largely priced into the resource stocks. While we continue to see upside for this sector, there are large industrial companies that now represent good long term value. These include **Wesfarmers (WES)**, **Coca-Cola Amatil (CCL)**, **Leighton Holdings (LEI)**, and the previously mentioned banks **National Australia Bank (NAB)** and **Australia & New Zealand Bank (ANZ)**.

[We detail ten of our preferred stocks on pages 3-7](#)

AURA ENERGY (AEE)

Share Price: \$0.34
Target Price: \$0.60
Gearing: NET CASH
VINCENT PISANI BUY

Share Price Chart



Rel Performance * 1m -26% 3m +6% 12m +55%

Is Uranium Over Post Japan...We Think NOT

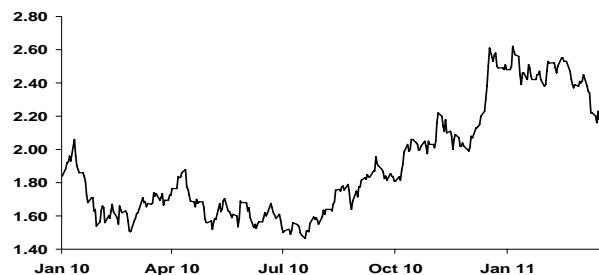
- The tragedy at the Fukushima uranium plant in Japan sent chills all over the world about the future use of uranium as a source of cheap, safe energy. This situation had a devastating effect on global uranium stocks with some down 50-60% from recent highs. With some 55 new reactors under construction (30 in China alone) and over 480 under consideration, it is highly likely that further safety issues will be strengthened and the industry will flourish longer term. With a fall from 55 cents to 32 cents (40%), Aura Energy has definitely moved to the extreme value range of valuation.
- AEE has two very distinct projects, one in Sweden (Häggån) and one in Mauritania (Reguibat). Currently, AEE has 291m lbs of U₃O₈ in its resource base in Sweden. To put this in perspective, the reactor at Fukushima used 5m pounds of uranium in the last 12 months. The deposit lies very close to surface and hence would require limited overburden removal.
- AEE is drilling in Sweden now. Potential exists to materially increase the current inferred resource closer to 500m lbs of U₃O₈ which would rank Aura's deposits in the top three undeveloped uranium resources in the world. Initial studies suggest a near surface, flat lying ore body that would be mined by open cut methods with mining costs of US\$2.50-3.00/tonne. Aura is looking closely at Finland's Talvivaara mine as a possible method uranium extraction for its Häggån deposit.
- Recent drilling has delineated a high grade (+300ppm) uranium exploration discovery at AEE's property in Mauritania called Reguibat. Mineralisation starts either from the ground surface or within one metre of the surface. We are confident that AEE's areas have the ability to hold 50-60m lbs of calcrete uranium mineralisation. When added to the potential upside of AEE's Swedish exploration sites, the company appears to be grossly undervalued.

* Relative Performance is compared to the S&P/ASX 200 Index over 1 month, 3 months and 12 months

ALUMINA (AWC)

Share Price: \$2.39
Target Price: \$2.80
Gearing: 10%
VINCENT PISANI BUY

Share Price Chart



Rel Performance * 1m -1% 3m -6% 12m +40%

Carbon Tax Implication to Alumina Limited

- We have recently upgraded our earnings profile on Alumina Limited to reflect the better outlook for production, costs and prices for 2011 and 2012. After reporting \$37m in 2010, our upgraded number of 2011 and 2012 are \$235m and \$335m respectively.
- Legacy issues that affected the 2010 reporting period are well and truly behind the company now with record alumina production of 15.8Mt expected in 2011.
- Spot alumina prices are now stabilising above US\$400/t vs US\$320/t in June 2010. If prices persist at these levels for another 6 months, our 2011 earnings numbers could be upgraded to above \$300m (+25%)
- Even with record production and alumina prices, the stock has retraced back to \$2.24 in recent weeks from a high of \$2.65. We attribute this to the spectre of a Labor Party Carbon Tax.** With this in mind, we have looked that the implication to profits of AWC if such a tax was introduced from July 2012.
- AWC releases approx. 13.3m tonnes of CO₂ from its aluminium smelters and alumina refineries in Australia each year. This is a 65% reduction over the last 20 years despite major upgrades of these operations. Under a \$10/t Carbon Tax, AWC's profits would fall by \$53.2m or 11.8%. The Federal Govt has said that a Carbon Tax would be capped at \$40/t (2015) and thereafter by CPI increases. Under this scenario, profits of AWC would fall by \$212.8m. We see a limited chance of this tax being introduced and hence maintain a BUY with \$2.80 target.

Forecasts

YE 31 December	2010 (A)	2011 (E)	2012 (E)
Earnings cps	2.1	9.6	13.5
Dividends cps	5.0	8.0	10.0
PE x	85.9	24.8	17.4
Yield %	2.8	3.3	4.2
Franking %	100	100	100

* Relative Performance is compared to the S&P/ASX 200 Index over 1 month, 3 months and 12 months

BHP BILLITON (BHP)

Share Price: \$44.76
Target Price: \$51.00
Gearing: NET CASH
VINCENT PISANI ACCUMULATE

Share Price Chart



Rel Performance * 1m -1% 3m 0% 12m +10%

Project Growth Capex of \$80bn

- BHP recently announced a record half year profit of \$10.7bn, a \$10bn buyback of stock, zero gearing on the balance sheet and more importantly a capex programme of up to \$80bn to drive production growth, efficiency and profits over the next 5 years. BHP categorises its project growth pipeline by 3 categories, "Execution", Feasibility" and "Future Options".
- In the Execution Phase, the major expansion of its iron ore operations in WA from 155Mtpa to 205Mtpa, called RGP5, has a cost of \$4.8bn and we believe will add of \$14.5bn in NPV. This is scheduled to commence in 2012. The second largest project in this phase is its alumina expansion at Worsley, WA. An expansion of production by 1.1 mt has a cost to BHP of \$1.9bn, but adds close to \$8.0bn in NPV. Three other projects in this Phase, namely the Macedon gas development also in WA, the North West Shelf Rankin B new production platform and two new gas/oil fields in Bass Strait (Turrum & Kipper) together will cost BHP over \$4.0bn but add close to \$7.0bn in NPV.
- The Feasibility Phase has coal, potash, gas and iron ore project dominating BHP's potential future capital spend. Caval Range & Daunia are major coal projects in Qld, an expansion of Brazilian iron ore pellet operations at Samarco and a tripling of gas from new acquired Fayetteville operations add almost \$9.5bn in NPV.
- We upgrade our valuation of BHP from \$45 to \$51 per share with an **Accumulate recommendation**.

Forecasts

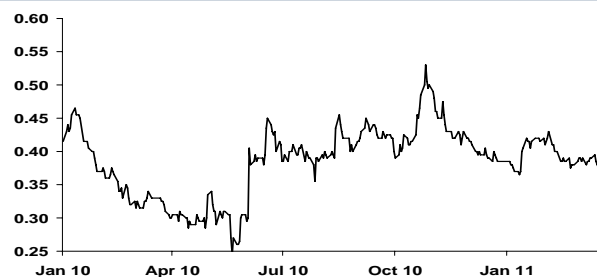
YE 30 June	2010 (A)	2011 (E)	2012 (E)
Earnings cps	227.8	447.6	500.3
Dividends cps	87.0	95.0	100.0
PE x	19.6	10.0	8.9
Yield %	2.0	2.1	2.2
Franking %	100	100	100

* Relative Performance is compared to the S&P/ASX 200 Index over 1 month, 3 months and 12 months

BOOM LOGISTICS (BOL)

Share Price: \$0.38
Target Price: \$0.50
Gearing: 27%
DANNY YOUNIS ACCUMULATE

Share Price Chart



Rel Performance * 1m +3% 3m +0% 12m +29%

Leverage to Improving Outlook

- We see significant earnings upside for BOL. BOL's first half profit (with EBIT up 104%) also delivered a significant increase in margins. Restructuring continues with assets redeployed to high need regions and some depots closed.
- The share price – at a discount to NTA and indicating a low PE - suggests the market still requires some convincing. We believe the outlook is improving and encourage investors to act ahead of the pack. Utilisation is improving; BOL is generating a higher return from its fleet mix; there is a positively trending billed crane wet hire hours; and there is potential price (margin) recovery. This is in addition to vastly improved operational leverage: with increased asset utilisation on the high capital base.
- We remain confident that by drawing a line through BOL's earnings profile in FY08-FY10 and the measures being undertaken to reshape its business model that our FY12 earnings forecast isn't overstretched, and potentially understated.
- BOL has recently extensively strengthened its balance sheet through equity issues, slowdown in capex (\$40-\$50m in FY11) and working capital management. BOL's capex outlook (including divestments) will be keenly watched for both its balance sheet implications and as a sign of management confidence.
- Given the upside earnings risk the investment metrics continue to attract us. BOL trades on a discount FY11 PE vs. average mining services peer group of 14.0x.

Forecasts

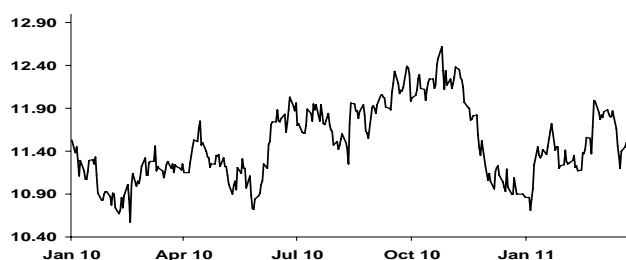
YE 31 July	2010 (A)	2011 (E)	2012 (E)
Earnings cps	1.6	2.9	4.3
Dividends cps	0.0	1.5	2.0
PE x	22.9	13.1	8.7
Yield %	0.0	4.0	5.3
Franking %	100	100	100

* Relative Performance is compared to the S&P/ASX 200 Index over 1 month, 3 months and 12 months

COCA-COLA AMATIL (CCL)

Share Price: \$11.50
Target Price: \$13.20
Gearing: 46%
SCOTT MARSHALL BUY

Share Price Chart



Rel Performance * 1m +3% 3m +8% 12m +8%

Aggressive Asset and Brand Manager

- Statutory profit for the year to December 2010 increased 10.8% to \$497.3M. Profit before significant items increased by 12.8% to \$506.6M.
- This was a very strong result for the group, and highlights CCL's aggressive investment in cost reductions and marketing, which when combined provide a marketing edge on its competitors.
- CCL remains a value focused marketing company, and generates a high (17%) return on capital. With 2011 expected to be the peak capital expenditure year, CCL could generate very strong free cash flow from 2012, especially if Indonesia continues to grow strongly.
- Aggressive cost reductions include via volume scale, new production and warehouse facilities being built, and bringing PET bottle production inhouse (and introducing ultra thin bottle technology).
- The two key markets for CCL are Australia (62% of profit, where the group continues to grow sales strongly in a mature market), and Indonesia (19% of profit, where long term rebuilding of the retail sector as a whole and changes to consumer tastes will be very positive for volume suppliers such as CCL).
- CCL remains a leader in the regional beverages market, aggressively expanding its product range and maintaining its relevance to its key markets via innovative packaging and marketing. This sustains CCL's product price premium and hence high returns on invested capital.

Forecasts

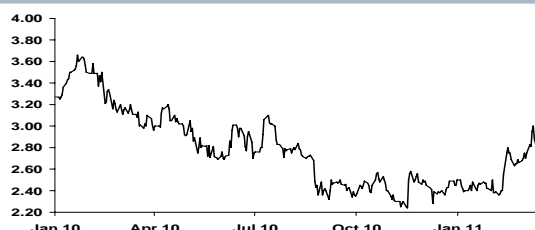
YE 31 December	2010 (A)	2011 (E)	2012 (E)
Earnings cps	71.0	75.9	80.5
Dividends cps	48.5	52.0	55.0
PE x	16.2	15.2	14.3
Yield %	4.2	4.5	4.8
Franking %	100	100	100

* Relative Performance is compared to the S&P/ASX 200 Index over 1 month, 3 months and 12 months

CELLESTIS (CST)

Share Price: \$2.82
Target Price: \$3.75
Gearing: NET CASH
MATTHIJS SMITH BUY

Share Price Chart



Rel Performance * 1m +6% 3m +13% 12m -6%

TB, or Not TB

- Despite the strong A\$, CST generated HY profit of \$5.7M on \$22.5M worth of sales of its unique diagnostic test for tuberculosis (TB). We are forecasting full year sales and profit of \$52.1M and \$11.0M respectively.
- The third generation of CST's diagnostic test, called QFT-TB In-Tube GOLD, is approved in all key markets including US, Europe and Japan. In many of these markets use of the test is being specifically recommended by regulatory bodies for most situations when it is necessary to test for a latent TB infection.
- While most of the cases of active TB disease occur in developing countries, TB remains a major public health issue in developed countries. Infections easily spread in environments where people are in close contact (prisons, hospitals, hospices etc) and, if left untreated, can result in a potentially fatal disease. The WHO estimates around 50M tests for latent TB are performed in the developed countries each year.
- CST's test replaces the 110yr old Mantoux test which is inefficient and unreliable, particularly in populations that have received the BCG vaccine for TB. While changing clinical practice takes time, CST's test is getting good traction in the market with strong support from key opinion leaders, scientific literature and regulatory bodies. We believe the company will have little difficulty in maintaining its historical sales growth of 35%-50% pa with the potential for a major step change as the test becomes adopted as best clinical practice.

Forecasts

YE 30 June	2010 (A)	2011 (E)	2012 (E)
Earnings cps	8.6	11.5	19.2
Dividends cps	5.0	6.5	10.5
PE x	31.3	24.6	14.7
Yield %	1.9	2.3	3.7
Franking %	100	100	100

* Relative Performance is compared to the S&P/ASX 200 Index over 1 month, 3 months and 12 months

OROTONGROUP (ORL)

Share Price: \$7.80
Target Price: \$9.20
Gearing: 15%
DANNY YOUNIS BUY

Share Price Chart



Rel Performance * 1m -9% 3m -4% 12m +23%

Class Act

- Growth options open to ORL remain significant. We see plenty of growth remaining for the Orotong brand (75% of group profit) plus Polo and other opportunities. Key drivers to the top-line include: Entrance into "adjacent" categories which create excitement (nail polish, shoes, knitwear, jewellery, perfume, hair accessories); Strength in accessory sales and growth of the aspirational buyer (helped by the rise in tier 1 luxury brands in Australia); Uplift in online sales with ORL in which ORL is a leader; and Store openings and refurbishments (from 49 stores to 60).
- Asian expansion can be achieved on a significantly lower cost base vs. Australia and the market opportunity is far larger (population size and stronger inclination to buy high margin accessories).
- Over the past two years ORL has demonstrated a solid track record of enviable EPS growth (CAGR from FY07 to FY10 of 35%) and we forecast ORL will maintain this for a few years.
- Shaw values ORL on a higher PE to the stock's current level. ORL's Return on Capital Employed of > 80% places it at the top of the retail sector, emphasising the company's efficient use of its capital.
- ORL is able to rigorously manage and control long term brand development coupled with a stringent focus on cost minimisation and profit growth. We highlight ORL based on the attractive dividend yield, strength of the balance sheet (net debt \$2.3M); proven management; and brand portfolio strength.

Forecasts

YE 31 July	2010 (A)	2011 (E)	2012 (E)
Earnings cps	56.2	58.5	68.0
Dividends cps	48.0	49.0	52.0
PE x	14.2	13.3	11.5
Yield %	6.0	6.3	6.7
Franking %	100	100	100

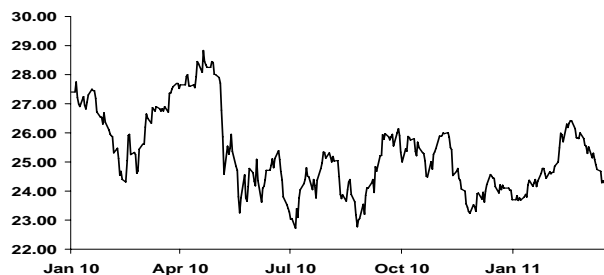
* Relative Performance is compared to the S&P/ASX 200 Index over 1 month, 3 months and 12 months

NATIONAL AUSTRALIA BANK (NAB)

Share Price: \$25.02
Target Price: \$29.00

ANDREW BUTTERELL BUY

Share Price Chart



Rel Performance * 1m -1% 3m +6% 12m -8%

Our Preferred Bank

- NAB is our preferred bank exposure for its leverage to the likelihood of stronger business lending and a potential re-rating as the market becomes more comfortable that strategic blunders are in the past. NAB is undervalued for this outlook, both relative to the other major banks and to its normal PER relative. We maintain our \$29 price target.
- We believe that the outlook for the Australian banks has improved with funding costs falling, albeit slowly, and borrowing requirements in the domestic economy expected to pick up in the second half of the calendar year.
- NAB has the most leverage to business lending of the "Big-4". It has 23.9% market share (Jan 10, 2011, source APRA) an improvement of 223 bps in 12 months. Australian businesses are the lowest geared they have been for 30 years following widespread recapitalisations during the GFC. While business sentiment is very low presently, we expect conditions to improve throughout the course of this year. This provides the potential for earnings growth ahead of peers.
- NAB trades at a sizable PER discount to peers, currently a 15% discount to CBA. Much of this is due to strategic errors committed by previous management and underperforming legacy operations such as NAB's UK assets. The current management and board appear to be both addressing legacy problems and slowly proving to the market that by omission, blunders are in the past. This provides scope for an earnings re-rating.

Forecasts

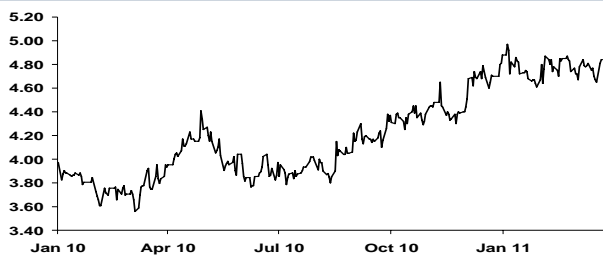
YE 30 September	2010 (A)	2011 (E)	2012 (E)
Earnings cps Cash	214.6	244.7	274.8
Dividend cps	151.7	167.0	184.0
PE x	11.6	10.2	9.1
Yield %	6.1	6.7	7.4
Franking %	100	100	100

* Relative Performance is compared to the S&P/ASX 200 Index over 1 month, 3 months and 12 months

SAI GLOBAL (SAI)

Share Price: \$4.87
Target Price: \$5.46
Gearing: 38%
SCOTT MARSHALL ACCUMULATE

Share Price Chart



Rel Performance * 1m +4% 3m +4% 12m +22%

Strong Growth, International Success

- SAI has three business segments. The Information Services Division provides the information required for companies to comply with global standards, regulations, directives and legislation. The Compliance Division provides business solutions and staff training so that companies comply with their regulatory and legal obligations. The Assurance Division helps organisations manage risk and achieve product certification.
- SAI has grown from its Australian base to now be a globally significant company in this market. The group has managed the consolidation of this industry while maintaining strong profit growth and sound financials.
- SAI's strengths include its aggressive growth via acquisition strategy, its proven management, dominance of content management and distribution in most markets it has entered, and its financial position.
- SAI consistently generates cash flow in excess of its capital expenditure requirements, has acquired or built leading content distribution and training technology, maintains a sound balance sheet (gearing typically 40-45%), and has generated 25% compound average annual growth in profits over the 5 years from 2006 to 2011(e).
- We expect SAI to continue to generate strong profit growth. Combined with the resilient business model ("essential" business services) SAI is a low risk, strong growth company.

Forecasts

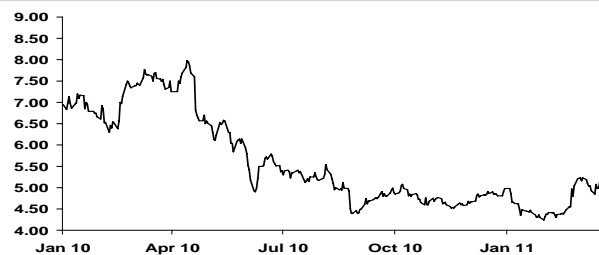
YE 30 June	2010 (A)	2011 (E)	2012 (E)
Earnings cps	20.9	29.1	33.8
Dividends cps	10.9	15.0	17.0
PE x	23.2	16.7	14.4
Yield %	2.2	3.1	3.5
Franking %	100	100	100

* Relative Performance is compared to the S&P/ASX 200 Index over 1 month, 3 months and 12 months

WOTIF.COM HOLDINGS (WTF)

Share Price: \$5.27
Target Price: \$6.00
Gearing: NET CASH
SCOTT MARSHALL BUY

Share Price Chart



Rel Performance * 1m +7% 3m +7% 12m -17%

Cashed Up Growth Company

- We maintain our positive outlook for WTF based on its dominance of the online accommodation sector and growth strategies. While the localised flooding in QLD has affected several key travel destinations directly, and travel intentions more widely, we expect the accommodation market in these affected regions to recover.
- The share price weakened over the second half of calendar 2010 to a level that we believe represents very good value for investors. Shaw has a Buy recommendation at these lower share prices.
- Profit drivers for the group include geographic expansion (WTF has operating relationships and businesses in Canada, China, Indonesia, Hong Kong, Malaysia, New Zealand, Singapore, Thailand, and the United Kingdom), increasing acceptance of online accommodation bookings, maintaining its dominant market share, and growth of adjacent booking capabilities (travel, last minute accommodation, corporate travel, and destination "things to do"), increasing the available online content (currently 16,000 accommodation properties), and increasing the number of international hotel chains utilising WTF's web site.
- WTF continues to manage its competitive advantages and brand awareness. The balance sheet has net cash of \$120M (57 cps), the group has low capital spend requirements, and generates \$80M / yr cash flow.

Forecasts

YE 30 June	2010 (A)	2011 (E)	2012 (E)
Earnings cps	26.7	26.3	31.4
Dividends cps	21.5	22.5	26.0
PE x	19.2	20.0	16.8
Yield %	4.2	4.3	4.9
Franking %	100	100	100

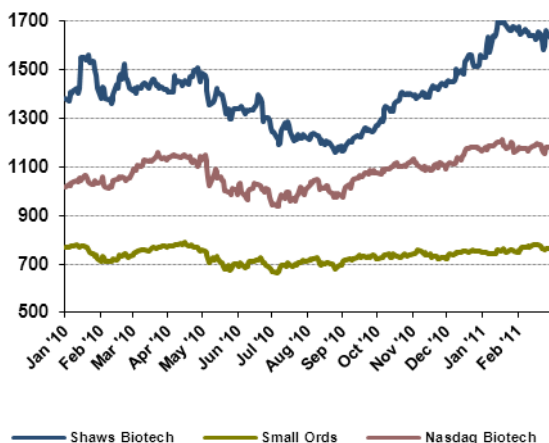
* Relative Performance is compared to the S&P/ASX 200 Index over 1 month, 3 months and 12 months

Biotech - Life in Life Sciences

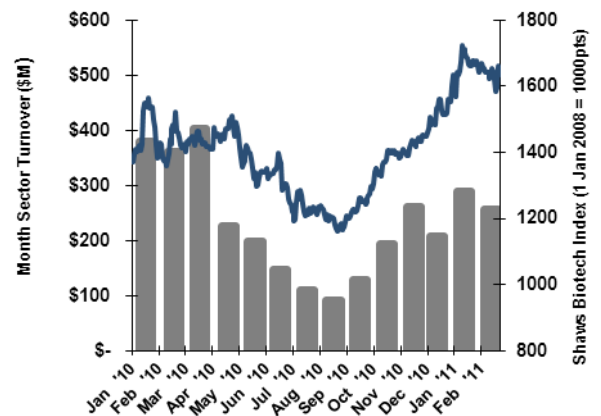
Historically investing in the biotech sector has been only for the brave, the knowledgeable or the foolish. While companies have been promising revolutionary new cures for everything from pale skin to prostate cancer, the reality is that these new products will always take more time and money to develop than was expected. This, combined with all the risks associated with the clinical development of new drugs and therapeutic products, meant that many of the early biotech investments ended up going pear-shaped and leaving investors with a tax loss and a wholesale wariness towards the sector.

While it has been a very turbulent journey, ten years on from when the biotech sector first gained an identity of its own right, we are starting to see the benefits and upside that comes from success. We now have companies that are making profits from selling their products in major markets and even paying dividends. We have seen a number of significant licensing deals with big pharma companies paying hundreds of millions of dollars to license technologies and products developed by some of our Australian biotechnology companies. And just behind these we have other companies who are in the final stages of clinical testing (Phase-3) of their new drugs which puts them 12-18 months away from market launch. As a result, investors are starting to make good money from their biotech investments and the appetite for these stocks has increased dramatically with everybody looking for the next new one.

As a consequence, the sector as a whole has outperformed the ASX Small Ordinaries Index with the Shaw's proprietary Biotech Index (a composite of 25 stocks) increasing by 35% since August last year.



In addition, turnover in the sector has started to increase with the value of trade starting to exceed \$300M per month. To put this in perspective, the average value of trades in biotech stocks in 2008 was \$75M per month.



Thus, at a macro level, the biotech sector is starting to get some real momentum and certainly the interest in the sector from institutional and offshore investors has picked up dramatically. The reason for this is the companies have really started to kick some major goals in realising the benefits from these technologies.

Generating revenues and profits:

A few companies have not only succeeded in developing a product and getting it approved by the various regulators (the FDA in the US, EMEA in Europe and TGA in Australia) but are generating meaningful sales revenue and profits from their products.

Cellestis (CST, MCap \$264M), one of our picks in the sector, is selling a vastly superior diagnostic test for tuberculosis which is now recommended in a number of regulatory guidelines. The company has reported solid sales growth over the past 4 years and we are forecasting FY11 sales of over \$50M with a net profit of \$11M. We believe the company can deliver 35%-50% year-on-year sales growth for several years to come which will translate into significantly improved profits through scale-related margin improvement.

Sirtex (SRX, MCap \$298M) generated revenue of \$34M and NPAT of \$3.6M in 1H FY11 from sales of its radioactive beads which are used to kill cancer growth in the kidney. The product is currently only used in very late stage cancer patients and, to date, the company has only been able to achieve 17% growth in unit sales. However, as secondary liver cancer is a leading cause of death in patient diagnosed with breast and colon cancer, there is a very significant commercial opportunity available once these beads are used more extensively.

Universal Biosensors (UBI, MCap \$195M) is also starting to get revenue from production of its test strips for rapid and accurate measurement of blood glucose in diabetics. Johnson & Johnson's LifeScan is rolling out the OneTouch Verio blood glucose monitor in several markets and UBI has reported that they achieve profitability on volume of strips sold in the December 2010 quarter.

Doing Deals:

Probably the one thing that has really brought the biotech sector to the attention of investors in the last 6 months has been some of the deals that have been done.

In December 2010, one of our biotech picks, **Acrux (ACR, MCap \$595M)** received an US\$87M milestone payment when Eli Lilly took out a license to ACR's male testosterone replacement therapy, Axiron, in March 2010. ACR had already received \$50M when the deal was signed and is entitled to a further US\$195M in milestone payments plus a royalty, which we estimate could equate to \$60M-\$100M pa at peak sales. We believe Eli Lilly is planning to launch Axiron into the US market in the very near future and has put considerable effort and resources into the market launch. Furthermore, as Eli Lilly has had a series of unfavourable clinical trial results on some of its late stage drugs, we would not be surprised if they made a bid for ACR at some stage in the future in order support their profits as some of their key drugs come off patent and subject to competition from generics.

In December 2010, **Mesoblast (MSB, \$2.1B)** announced that they signed a deal with US-based Cephalon (NASDAQ: CEPH) around a number of therapeutic applications for MSB's adult stem cells. Under the deal, MSB received \$130M on signing and CEPH acquired a 19.9% equity stake in MSB by purchasing a combination of new and existing equity. MSB is also entitled to milestone payments totalling \$1.7B which we believe are related to the approval of various products in different markets. The first product that is likely to trigger a milestone payment uses MSB's cells to accelerate the tissue culture expansion of bone-marrow stem cells which is expected to complete clinical testing in 2 yrs time. The market has shown great enthusiasm for this deal taking the stock up over 125% from its pre-deal price. Taking into account other companies around the world developing adult stem cell-based therapies, we consider MSB's current valuation is challenging to rationalise however the stock is clearly being supported by considerable momentum.

We have also speculated that CEPH may make a bid for **Chemgenex (CXS, MCap \$125M)** at \$0.70 per share on the basis that the company announced in October that CEPH had subscribed to a \$15M worth of convertible notes in CXS (converting at \$0.50 per share) and had entered into option agreements with two existing shareholders to acquire up to an additional 19.9% of equity at \$0.70 per share. Given that CEPH is a biotech company and not an investment bank, we believe it has put these instruments in place with a view to a future acquisition. We have also noted that CEPH has been very acquisitive including recently a privately held cancer company called Gemin X Pharmaceuticals for \$225M with future potential milestone payments of up to \$300M.

Near To Market:

Several companies are close to getting their products into the market. One of our recommended biotech stocks **Nanosonics (NAN, MCap \$205M)**, will be launching its ultrasound probe sterilising device in the US. The product has already been launched in Australia and Europe and received approval from the FDA in February 2011. In September 2010 NAN established a distribution agreement with GE Healthcare who is one of the leading suppliers of ultrasound equipment.

We are expecting GE to launch NAN's device into the US in mid-2011 and we anticipate strong sales growth over the next few years.

Furthermore, there has been an ever increasing focus on hospital acquired infections with the US Centres for Disease Controls (CDC) recently announcing a \$10M R&D program to identify approaches for reducing infections in healthcare settings. The potential install base in the US alone is estimated to be 100,000 units. In addition to a profit on the sale of each unit, NAN will receive an ongoing annuity from the sale of the consumable sterilising solution which is used by the machine.

Another of our high conviction biotech stocks, **Starpharma (SPL, MCap \$260M)** is expected to benefit this year from the launch of condoms coated with the company's proprietary anti-viral product VivaGel. SPL has a licensing deal in place with the consumer products giant Reckitt Benckiser who, following the acquisition of SSL last year, now owns the Durex brand of condoms which has over 40% share of the condom market. SPL is entitled to a royalty on each coated condom sold which we believe could generate \$30M-\$50M in revenue at peak sales. SPL has also licensed its dendrimer technology for a special type of polymer to leading companies who are using it to develop new cancer drugs, agrochemicals, dermatological products and water purification systems. In addition SPL has programs using VivaGel for various women's health applications. During 2Q 2011, the company is expected to announce data from its Phase-2 trial using VivaGel to treat a common microbial infection called bacterial vaginosis. If this trial meets the anticipated endpoints, it will confirm this application, which was initially identified in other clinical trials, and open up a significant potential revenue stream for the company.

We also see significant upside in **Pharmaxis (PXS, MCap \$558M)** which is expected to launch its Bronchitol product in the Australian and European market during the second half of the year. Bronchitol is an inhaled product that helps cystic fibrosis (CF) patients to clear mucous from their lungs. This not only enables them to breathe more easily but also breaks the cycle of continuous infection and lung damage that ultimately results in an early death for CF sufferers. Bronchitol has shown stunning data in two Phase-3 clinical trials with a sustained 8% improvement in lung function over a 12-month period during which these patients would have typically lost 1%-2% of lung function. Bronchitol is approved in Australia and we are expecting it to be approved in Europe in 2Q. In combination, these have an addressable market of \$400M and, based on similar product, Bronchitol is likely to be used by up to 60% of CF patients. PXS is expected to submit an application to the FDA in 2Q to get marketing approval in the US. Typically the review process of these applications is 12-15 months and thus we would expect an outcome in 2H 2012. The US has approximately 35,000 CF sufferers and based on the pricing of similar types of products, we estimate the addressable market for Bronchitol in the US is approximately US\$700M per annum.

Outlook:

Clearly 2011 is shaping up to be the year where the biotech sector delivers some great wins to investors. While the sector is risky, like the other discovery and development industries, when it goes well the reward for this risk can be significant. We believe that the biotech sector offers good returns for investors who take a pragmatic and informed approach to their investments. Shaw aims to keep a comprehensive watch on the sector with a view to identifying what we consider the best investment opportunities.

Forecasts and Recommendations

COMPANY		PRICE	PROFIT	PROFIT	PE	PE	DPS	DPS	YIELD	YIELD	FRANK	REC
		(\$ps)	2011	2012	2011	2012	2011	2012	2011	2012	2011	
			(\$M)	(\$M)	(x)	(x)	(cps)	(cps)	(%)	(%)	(%)	
CONSUMER DISCRETIONARY												
DJS	David Jones	\$4.67	188.1	204.7	12.9	11.8	28.0	31.5	6.0%	6.7%	100	Accumulate
JBH	JB Hi Fi	\$18.45	156.0	183.1	13.2	11.3	84.0	98.0	4.6%	5.3%	100	
MYR	Myer Holdings	\$3.17	160.4	166.1	11.5	11.1	22.5	23.0	7.1%	7.3%	100	Accumulate
ORL	Oroton	\$7.80	23.9	27.8	13.3	11.5	49.0	52.0	6.3%	6.7%	100	Buy
RCG	RCG Corporation	\$0.65	9.1	10.6	18.5	15.5	2.4	2.7	3.7%	4.2%	100	Accumulate
RFG	Retail Food Group	\$2.90	27.7	31.8	11.4	9.9	15.0	18.0	5.2%	6.2%	100	Accumulate
TRS	The Reject Shop	\$12.20	20.8	26.1	15.3	12.4	69.0	74.0	5.7%	6.1%	100	Hold
FINANCIALS incl DIVERSIFIED FINANCIALS												
AMP	AMP Ltd	\$5.38	840.0	940.0	13.4	12.0	33.5	37.0	6.2%	6.9%	85	Accumulate
ANZ	ANZ Banking Group	\$23.37	5,914.5	6,536.5	10.6	9.7	144.5	157.3	6.2%	6.7%	100	
ASX	ASX Ltd	\$35.00	360.0	390.0	17.0	15.7	185.0	200.0	5.3%	5.7%	100	Hold
AXA	AXA Asia Pacific Hldgs	\$6.42	710.0	791.9	18.7	16.8	20.0	22.3	3.1%	3.5%	40	Hold
CBA	Commonwealth Bank	\$51.86	6,673.3	7,324.5	12.1	11.1	313.5	342.5	6.0%	6.6%	100	Hold
MQG	Macquarie Group	\$36.32	956.0	1,336.0	13.3	9.8	186.0	225.0	5.1%	6.2%	76	Buy
NAB	National Aust Bank	\$25.02	5,326.0	6,100.0	10.2	9.1	167.0	184.0	6.7%	7.3%	100	Buy
QBE	QBE Insurance	\$17.60	1,840.0	2,052.3	10.6	9.5	132.0	147.2	7.5%	8.4%	20	Buy
WBC	Westpac	\$23.73	6,599.8	7,255.3	11.0	10.1	152.5	167.5	6.4%	7.1%	100	
PROPERTY TRUSTS and PROPERTY MANAGEMENT												
GPT	GPT Group	\$3.07					16.6	18.5	5.4%	6.0%		Hold
MGR	Mirvac Group	\$1.24					8.5	8.5	6.9%	6.9%		Accumulate
SGP	Stockland	\$3.77					23.8	24.1	6.3%	6.4%		Accumulate
WDC	Westfield Group	\$9.46					48.7	51.5	5.1%	5.4%		Accumulate
INDUSTRIALS												
BKN	Bradken	\$7.85	96.5	87.9	13.0	12.4	41.0	43.0	5.2%	5.5%	100	Hold
BOL	Boom Logistics	\$0.38	13.1	19.8	13.1	8.7	1.5	2.0	4.0%	5.3%	100	Accumulate
BXB	Brambles	\$7.06	495.7	628.3	20.7	16.9	26.0	30.0	3.7%	4.2%	14	Reduce
LEI	Leighton Holdings	\$29.50	487.0	603.0	27.1	14.8	135.0	147.0	4.6%	5.0%	100	Buy
QUB	Qube Logistics	\$1.50	0.2	45.0	17.3	17.3	4.0	5.0	2.7%	3.3%	100	Accumulate
SAI	SAI Global	\$4.87	42.9	50.8	16.7	14.4	15.0	17.0	3.1%	3.5%	100	Accumulate
SDM	Sedgman	\$1.76	24.9	31.4	13.5	11.0	7.5	8.5	4.3%	4.8%	100	Hold
SWK	Swick Mining Services	\$0.34	3.7	7.7	21.5	10.5	0.0	0.0	0.0%	0.0%		Accumulate
WTF	Wotif.com Holdings	\$5.27	55.6	66.2	20.0	16.8	22.5	26.0	4.3%	4.9%	100	Buy
TOL	Toll Holdings	\$5.90	397.5	413.0	10.4	10.0	27.7	27.7	4.7%	4.7%	100	Buy
MATERIALS												
CSR	CSR	\$3.34	175.4	190.7	28.9	26.5	8.5	9.0	2.5%	2.7%	100	Hold
ORI	Orica	\$25.72	661.0	765.5	14.1	12.2	100.0	110.0	3.9%	4.3%	35	
TELECOMMUNICATIONS and INFORMATION TECH												
TLS	Telstra	\$2.70	3,120.0	3,760.0	10.8	8.9	28.0	28.0	10.4%	10.4%	100	
CONSUMER STAPLE												
CCL	Coca-Cola Amatil	\$11.50	558.0	591.9	15.2	14.3	52.0	55.0	4.5%	4.8%	100	Buy
FGL	Foster's Group	\$5.69	700.4	746.4	15.7	14.9	28.0	28.0	4.9%	4.9%	100	Hold
MTS	Metcash	\$4.01	251.6	263.0	12.2	11.7	25.9	26.9	6.5%	6.7%	100	Accumulate
PFL	Patties Food	\$1.43	19.3	20.8	10.3	9.5	8.0	8.5	5.6%	5.9%	100	Accumulate
WES	Wesfarmers	\$31.65	2,323.1	2,763.5	17.0	14.1	155.0	180.0	4.9%	5.7%	100	Accumulate
WOW	Woolworths	\$26.10	2,231.6	2,352.0	14.3	13.6	125.0	129.0	4.8%	4.9%	100	Accumulate
BIOTECH & HEALTHCARE												
ACR	AcruX	\$3.65	57.1	14.1	10.2	41.3	0.0	0.0	0.0%	0.0%	100	Buy
COH	Cochlear	\$79.91	171.7	227.7	26.3	19.9	225.0	298.0	2.8%	3.7%	100	Reduce
CSL	CSL	\$34.33	956.9	1,040.4	19.5	18.0	85.0	100.0	2.5%	2.9%	0	Hold
CST	Cellestis	\$2.82	11.0	18.4	24.6	14.7	6.5	10.5	2.3%	3.7%	100	Buy
NAN	Nanosonics	\$0.93	(10.3)	(2.8)	NA	NA	0.0	0.0	0.0%	0.0%	100	Buy
PXS	Pharmaxis	\$2.52	(42.6)	(15.7)	NA	NA	0.0	0.0	0.0%	0.0%	100	Buy
SPL	Starpharma	\$1.14	(8.4)	(4.5)	NA	NA	0.0	0.0	0.0%	0.0%	100	Buy
BASIC MATERIALS												
AWC	Alumina	\$2.39	235.0	335.5	24.8	17.4	8.0	10.0	3.3%	4.2%	100	Buy
BHP	BHP Billiton	\$44.76	24,124.7	26,612.3	10.0	8.9	95.0	100.0	2.1%	2.2%	100	Accumulate
BSL	Bluescope	\$1.99	63.4	327.8	57.3	11.1	5.0	11.0	2.5%	5.5%	100	Hold
LYC	Lynas Corp	\$2.14	-	215.8	NA	17.6	0.0	0.0	0.0%	0.0%	0	Buy
MBN	Mirabela Nickel	\$2.05	13.1	52.4	77.0	19.2	0.0	0.0	0.0%	0.0%	0	
NCM	Newcrest Mining	\$38.76	623.9	514.0	30.0	36.5	15.0	15.0	0.4%	0.4%	30	
OST	OneSteel	\$2.51	332.6	324.4	10.0	10.4	14.0	16.0	5.6%	6.4%	70	Hold
RIO	RIO Tinto	\$82.02	17,300.0	18,000.0	10.1	9.7	116.0	125.0	1.4%	1.5%	100	Buy
ENERGY												
ORG	Origin Energy	\$15.86	531.6	1,015.4	21.2	15.7	52.0	54.0	3.3%	3.4%	100	Hold
STO	Santos	\$15.50	-	-	46.4	25.3	30.0	20.0	1.9%	1.3%	100	Buy
WPL	Woodside Petroleum	\$46.72	-	-	53.3	21.3	105.0	120.0	2.2%	2.6%	100	Hold
UTILITIES AND INFRASTRUCTURE												
AGK	AGL Energy	\$14.11	467.5	499.9	13.8	12.9	62.0	65.0	4.4%	4.6%	55	Buy
HDF	Hastings Diversified	\$1.56	18.4	45.8	43.9	17.8	12.5	13.5	8.0%	8.7%	10	Hold

Sector	Preferred Stocks	Sector	Preferred Stocks
ENERGY		CONSUMER STAPLE	
Energy	Aura Energy	Food, Beverages, Agriculture, Brewers	Coca Cola Amatil Patties Foods Wesfarmers
MATERIALS		HEALTHCARE	
Chemicals and Ag	Orica	Healthcare, Pharmaceuticals & Biotech	Cellestis Nanosonics Pharmaxis Starpharma
Construction Materials		FINANCIALS	
Metals & Mining	Alumina BHP Billiton Peak Resources	Banks	Australia & NZ Bank National Aust Bank
INDUSTRIALS		Diversified Financials	
Capital Goods, Conglomerates	Boom Logistics	Insurance	
Construction & Engineering	Leighton	Property Trusts, Property Mgt	Westfield Stockland
Commercial Services & Supplies	SAI Global	INFORMATION TECH	
Transportation, Marine	Qube Logistics	Software, Hardware	
CONSUMER DISCRETIONARY		TELECOMMUNICATIONS	
Casinos, Gambling		Telecommunications	
Media – Broadcast & Publishing		UTILITIES	
Retailing	OrotonGroup Wotif.com	Utilities	



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Recommendation Definitions

Buy	Can be added to the portfolio immediately.
Accumulate	Can be added to the portfolio immediately although we believe time exists to finesse entry.
Hold	Fair value at current price.
Reduce	Reduce holding at current price although we believe time exists to finesse exit.
Sell	Divest as the stock is fundamentally overpriced, or risk profile outweighs potential reward.

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