

AUSTRALIAN

RESEARCH

MANAGED INVESTMENTS ANALYSIS

Citigroup Optimiser III

June 2006

Capital protected exposure to the best of the three
market-linked investment profiles

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For Advisers Only

Australian Managed Investments

Structured Products - Equity

Citigroup Optimiser III

Capital protected exposure to the best of the three market-linked investment profiles

Offer Overview

Citigroup Optimiser III (*Optimiser III*) is a three-and-a-half-year investment, with a 1% annual coupon, opportunity for capital growth, and capital protection at maturity. It offers participation in three investment profiles consisting of global equities, bonds, currencies and commodities. Return will be a fixed portion of the best performing investment profile return. At maturity, Optimiser III may deliver either cash or a delivery asset consisting of ASX-listed shares.

Investment Strategy

The performance of Optimiser III will be based on the fixed portion (the participation rate – see Section 5 - *Structure*) of the best investment profile return from the following three profiles:

- Equities-biased (60% international equities + 20% bonds/currencies + 20% commodities);
- Balanced (33.3% international equities + 33.3% bonds/currencies + 33.3% commodities); and
- Commodities-biased (20% international equities + 20% bonds/currencies + 60% commodities).

Investment View

Aegis has issued an **Approved** rating. According to our analysis, the risk / return profile of Optimiser III is attractive, however final returns will be highly dependent on the market direction in the next three and a half years and the participation rate. While the current participation rate generates acceptable returns, it may vary significantly before being set on the issue date.

A particular strength of the product is the benefit of receiving a portion of the return of the best performing investment profile, subject to the final participation rate to be fixed. It is suitable for investors who do not have a particular view on asset allocation. It is expected that over the life of the product, income distribution will be low but steady, with a focus predominantly on capital growth.

Not Recommended Approved Recommended



Offer Details

Offer Period	12-Jun-06: 31-Jul-06
Listing Date	n/a
Maturity (years)	3-Feb-2010 (3.5 years)
Min. Investment	A\$5,000
Liquidity	Monthly
Distributions	Semi-annually
Unit Price	A\$1.00

Risk/Return Profile



Advisor/Broker Fees, incl. GST (%)

Up-front	2.0
Trailing, p.a.	Up to 0.33

Note: All advisor/broker fees are paid by CGMA at no additional cost to investors.

Indices	Return % p.a.			Risk		Correlation (5-year)				
	1 Yr (%)	3 Yr (%)	5 Yr (%)	Std. Dev. (%)	Sharpe Ratio	Simulation	Cash	Property	Equities	Intl. Equities
Simulation ¹	58.0	28.4	16.1	8.5	1.3	1.0				
Cash ²	5.8	5.6	5.3	0.1	0.0	0.4	1.0			
Property ³	17.7	16.8	16.3	7.5	1.5	0.0	0.1	1.0		
Equities ⁴	37.9	25.7	14.1	10.3	0.9	0.4	0.2	0.4	1.0	
Intl. Equities ⁵	24.7	21.4	5.7	13.8	0.0	0.3	0.1	0.2	0.7	1.0

1. Simulation based on reference assets with respective weight; 2. 90-day BBSW; 3. ASX 200 Property Index; 4. ASX 200 Index; 5. MSCI AC World Index.

Est. market cap: A\$10M

Units on issue: 10M

Status: Unlisted, Close-ended

SWOT Summary

Strengths

- Performance will be determined by the best performing investment profile at maturity, without the need to make specific asset allocation decisions.
- Exposure to a well-diversified asset portfolio consisting of international equities, bonds, currencies and commodities.

Weaknesses

- The past performance of the three investment profiles (and of the best performing investment profile) appears to be largely driven by the longer term direction of the investment markets. Hence, a three-and-a-half-year-term investment may not be able to fully participate in the upside of a bullish market whilst being exposed to short- to medium-term volatility.
- Optimiser III may underperform equity markets during periods of strong equity market performance.

Opportunities

- Exposure to a range of asset classes, including international equities, bonds, currencies and commodities.
- Investors can benefit from potential capital growth in the best investment profile taking advantage of the best performing asset class.
- May outperform equity markets during periods of flat to moderate equity market performance.

Threats

- A participation rate of close to 70% significantly reduces any upside potential of the product.
- In case of an early maturity event, Optimiser III will be terminated early and the amount received by investors may be less than the initial investment amount.

Exit

Investors should consider Optimiser III to be a three-and-a-half-year investment, with the exit from the product being either the delivery of ASX-listed shares in BHP Billiton Limited (*BHP*) or sales proceeds. This product offers monthly redemptions, but will not be listed on any exchange. Exit before maturity will invalidate capital protection.

Product Fees

	Product
Base Fees (% of total assets)	
Up-front	0.00
Exit*	0.00
Ongoing	0.00

Performance Fees
There are no performance fees.

Indirect Fees
Whilst there are no direct fees, investors should note that the issuer is expected to profit from its ability to manage the underlying risk associated with the investment of the Optimiser funds.

* The issuer may charge the investor any break costs associated with early exit.

Portfolio Profile

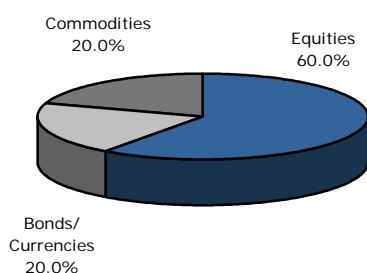
Number of Asset Classes	4
Number of Markets	10
Number of Equity Indices	4
Number of Commodities	4
Max. Exposure to Any One Asset Class, %	60
Min. Exposure to Any One Asset Class, %	20

Operations

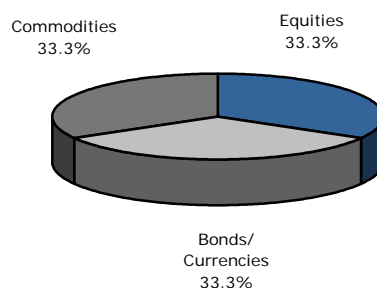
Issuer	Citigroup Global Markets Australia Pty Ltd
Registrar	Australia Derivative Registries
Phone	1300 30 70 70
Website	www.citiwarrants.com.au

Product Diversification – Investment Profiles

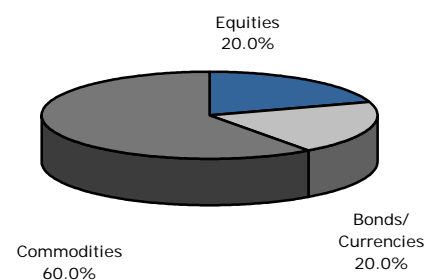
Equities-biased



Balanced



Commodities-biased



2. Product/Investment Detail

Product Information

Optimiser III is an offer to investors seeking a diversified exposure to asset classes, including international equities, bonds, currencies and commodities, over a three-and-a-half-year period with the benefit of capital protection. The product offers potential for medium-term capital growth in the best performing investment profile and a coupon of 1% per annum. The three investment profiles are Equities-biased, Balanced and Commodities-biased, which will be discussed in Section 5 – *Structure*.

The product is capital-protected by Citigroup Inc. (*Citigroup*) if held to maturity. Capital protection will provide unitholders on the maturity date a minimum of the initial investment amount, subject to costs and taxes, including brokerage costs of the delivery asset (at the date of the Product Disclosure Statement (*PDS*), Citigroup Global Markets Australia Pty Ltd (*CGMA*), the issuer of Optimiser III, is not aware of any costs or taxes).

The issuer will provide monthly liquidity to unitholders who wish to redeem their investments. Depending on the performance of the investment profiles, investors should note that redemptions prior to the maturity date would attract costs, losses or expenses in relation to early maturity as described in the *Liquidity* section below. Redemption prior to the maturity date will invalidate the capital protection.

On a half-yearly basis, a 1% per annum coupon based on the investment amount will be distributed to unitholders and will be payable semi-annually in arrears.

Optimiser III is structured as a deferred purchase agreement wherein an investor may elect to either accept the physical delivery of the delivery asset (shares in BHP Billiton Ltd, an ASX-listed company) on the maturity date (3 February 2010) or receive sale proceeds by taking advantage of the Agency Sale Arrangement.

Investment Overview

Optimiser III offers potential for capital growth, income and capital protection over a three-and-a-half-year term. Aegis believes it is suitable for investors seeking a diversified exposure to broad asset classes within an overall balanced portfolio.

A particular strength of the product is the benefit of receiving a portion of the return of the best performing investment profile. This will appeal to investors who do not have a particular sector view on equities, bonds or commodities.

Depending on the general market direction, potential return can be high. However, it remains to be seen whether the equities market and the commodities market sustain a strong upward momentum in the next three and a half years. This is a critical success factor for Optimiser III.

Also of importance is the participation rate, which will dictate the overall return of Optimiser III to the investor. At the date of the PDS, it is estimated to be 80%. A higher or lower rate, to be fixed on the issue date, will impact the final investment value of Optimiser III. Investors should request for an indicative participation rate from CGMA before investing in Optimiser III. Aegis believes that the risk of the participation rate changing by around 5% (up or down) is relatively high, and investors should be comfortable with this risk before investing.

In terms of fees, the product does not charge investors up-front or ongoing fees. However, the issuer is expected to profit from its ability to manage the underlying risk associated with the investment of the Optimiser funds and its responsibilities as the issuer of Optimiser III.

Overall, Aegis believes this product is well structured to provide exposure to a diversified portfolio of asset classes, with the benefit of receiving a portion of the best performing investment profile return along with capital protection. The return of the product will depend primarily on the performance of the underlying market in the next few years.

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3. SWOT Analysis

Strengths

- Optimiser III offers exposure to a well-diversified asset portfolio consisting of international equities, bonds, currencies and commodities. The product seeks medium-term capital growth and guarantees a 1% coupon per annum.
- The performance of Optimiser III will be determined by the best performing investment profile at maturity, which means that investors will benefit from the highest return of the three investment profiles without the need to make specific asset class selection decisions.
- Capital protection provided at maturity (if held to maturity) mitigates any downside risk.
- There are no up-front or ongoing management fees payable by investors. However, the issuer is expected to profit from its ability to manage the underlying risk associated with the investment of the Optimiser funds.
- The product has a three-and-a-half-year investment term, a relatively shorter term compared with that of other structured products offerings. This may provide flexibility to investors who are seeking shorter term investments.
- At the election of investors, the delivery asset of ASX-listed shares in BHP will be delivered at maturity.

Weaknesses

- The past performance of the three investment profiles (and of the best performing investment profile) appears to be largely driven by the longer term direction of the investment markets. Hence, a three-and-a-half-year-term investment may not be able to fully participate in the upside of a bullish market whilst being exposed to short- to medium-term volatility.
- The early redemption of units invalidates an investor's capital protection as well as attracts costs, losses or expenses. Further, early redemptions will not benefit from the best performing investment profile return.
- The deferred purchase agreement requires that at maturity, units in Optimiser III be exchanged with the delivery asset. For investors who wish to receive cash, the delivery asset will need to be sold. The sale of the delivery asset may also be subject to costs, taxes and brokerage expenses (none at the time of the PDS). Therefore, despite capital protection, the net sale proceeds may be less than the initial investment amount.
- Optimiser III may underperform equity markets during periods of strong equity market performance.

Opportunities

- Exposure to a structured investment that invests across a range of asset classes, including international equities, bonds, currencies and commodities.
- Investors can benefit from potential capital growth in the best performing investment profile taking advantage of the best performing asset class.
- Outperforms equity markets during periods of flat to moderate equity market performance.

Threats

- Participation rate remains as one of the key success factors for Optimiser III. A participation rate of close to 70% significantly reduces upside potential of the product.
- Under the terms of the PDS, capital protection is an unsecured obligation of the issuer. Hence, it is subject to the creditworthiness of CGMA. CGMA, as at the date of the PDS, has credit ratings of AA- (S&P) and Aa1 (Moody's). Aegis considers the counterparty risk to be low.
- In case of an early maturity event, Optimiser III will be terminated early and the amount received by investors may be less than the initial investment amount.

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4. Management & Corporate Governance

Directors

The directors of CGMA are not involved directly in this product; however, they are involved in determining CGMA's overall strategy and policies for Optimiser III.

Aegis considers the board of CGMA to be highly experienced and to have excellent depth.

Management Team

The role of the management team of CGMA is limited to the ongoing maintenance of the product. As the derivative structures are entered into on day one and the ongoing maintenance of Optimiser III is effectively fixed, there will be very little management involvement. As such, Aegis puts more weight on the investment strategy and process.

As this structure is fixed upon formation, key person risk/depth at CGMA is not as much of an issue for this type of product.

Management is not financially aligned with the performance of Optimiser III, as CGMA is expected to profit from its ability to manage the underlying risk associated with the investment of the Optimiser funds.

Risk Management

Investment risk in Optimiser III primarily stems from counterparty and market risks. CGMA is an Australian-regulated institution that must report to the Australian Securities & Investments Commission (ASIC) and the Australian Prudential Regulation Authority (APRA). These organisations require that CGMA maintain a minimum standard of procedures and disclosures.

On the basis of the information provided, Aegis understands that Optimiser III has been reviewed and approved by CGMA's internal business units and is comfortable with the risk management and sign-off processes in place.

Counterparty Risk

Broadly defined, *counterparty risk* is the risk that CGMA will fail to perform its obligations to the investor at the time of settlement. Under Optimiser III, an investor's exposure to counterparty default could potentially equal the full value of any cash flows and securities the investor is to receive at maturity.

The obligations of Optimiser III are unsecured contractual obligations of CGMA and will rank equally with the issuer's other unsecured obligations and debt other than liabilities mandatorily preferred by law. CGMA, as at the date of the PDS, has credit ratings of AA- (S&P) and Aa1 (Moody's). Aegis considers the counterparty risk to be low.

Market Risk

The inherent risk of Optimiser III stems largely from the market risk, specifically the volatility of share price movements, interest rate, commodity prices and currency movements. The product construction methodology for Optimiser III lowers the relative market risk by including a broad range of reference assets diversified by geography and asset class.

Additionally, the capital protection feature further lowers the risk of capital loss, although very low returns are not protected by this feature.

Given the product structure, Aegis considers the market risk associated with Optimiser III to be moderate.

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Information Flow

The product is relatively simple, and, as such, is quite transparent about the underlying basket and respective weightings and pay-offs to investors. Within the product pricing are fees, and while Aegis makes estimates as to the level of fees, the actual fees are not transparent.

Monthly performance update on Optimiser III will be made available on CGMA's website.

Related Parties

Aegis notes that Optimiser III is constructed, managed and distributed by CGMA or its affiliated entities. These entities may receive a fee directly or indirectly for the services performed for the product.

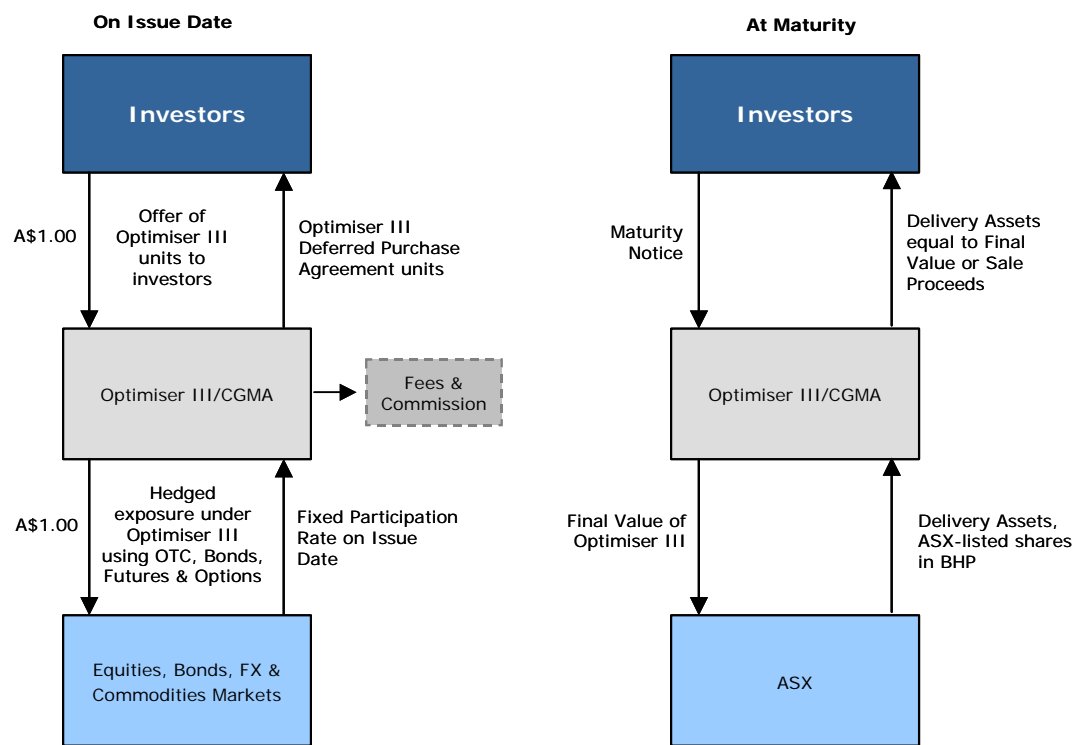
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5. Structure

The structure of Optimiser III consists of a number of components. Aegis has reviewed the structure and understands that it has been designed for the benefit of investors.

Figure 1 below shows the structure of Optimiser III.

Figure 1. Optimiser III Investment Structure



Source: CGMA/Aegis Equities Research

On the issue date, investors pay A\$1.00 per unit in Optimiser III to gain exposure to the three investment profiles. At this time, the participation rate (which determines the portion of return that investors will receive from the best performing investment profile at maturity) will be fixed and may range between 70% and 100%, with a minimum of 70% (at the date of the PDS, the participation rate was 80%). Investments in equities, bonds, currencies and commodities markets are hedged by CGMA. Fees and commission may be payable by CGMA to financial advisers at no additional cost to investors.

During the three-and-a-half-year investment term, investors will receive a 1% per annum coupon of the investment amount, payable semi-annually in arrears.

Approximately 20 business days before the maturity date, CGMA will notify investors of the upcoming maturity through a maturity notice, allowing investors to elect to receive the delivery asset or sale proceeds from the delivery asset equal to the final value of Optimiser III units, less costs, taxes and brokerage. At the time of the PDS, CGMA is not aware of any associated costs. The final value at maturity is the greater of A\$1.00 per unit and the value of Optimiser III.

Optimiser III will gain exposure to the performance of three investment profiles, which comprise a range of market indices in international equities, bonds, currencies and commodities. The three investment profiles are

- Equities-biased;
- Balanced; and
- Commodities-biased.

Figure 2 below outlines the weightings of the three investment profiles.

Figure 2. Investment Profiles and Asset Allocation

Investment Profile	Equities Allocation (%)	Bond/Currencies Allocation (%)	Commodities Allocation (%)	Total (%)
Equities-biased	60	20	20	100
Balanced	33.3	33.3	33.3	100
Commodities-biased	20	20	60	100

Source: CGMA

The underlying asset allocation will be equally weighted across a basket of reference assets. Also refer to Section 6 – *Investment Process* for the underlying reference assets.

Figure 3. Sub-allocation of Investment Profiles

Asset Class	Reference Asset	Investment Profile		
		Equities-biased (%)	Balanced (%)	Commodities-biased (%)
Equities Allocation	EURO STOXX 50	15	8.33	5
	Hang Seng	15	8.33	5
	Nikkei 225	15	8.33	5
	S&P 500	15	8.33	5
Bond/Currencies Allocation	Citigroup World Government Bond Index	10	16.67	10
	Australian Dollar Exchange Rate	10	16.67	10
Commodities Allocation	Aluminium	5	8.33	15
	Gold	5	8.33	15
	Crude Oil	5	8.33	15
	Zinc	5	8.33	15
	100	100	100	100

Source: CGMA

At maturity, Optimiser III will provide investors with the best performance over the three investment profiles adjusted for the participation rate.

Participation Rate and Final Value

The participation rate is the degree to which investors will participate in the performance of the best performing investment profile. It is dependent on a number of market-driven variables that may change from time to time. The key factors influencing the participation rate include the following:

- Australian dollar interest rates;
- Volatility of reference assets;
- Correlation between the reference assets; and
- Forward price of commodities relative to spot.

Figure 4 below provides an outline of the impact of change in these factors on the participation rate.

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Figure 4. Factors Influencing the Participation Rate

Factor	Change in Factor	Effect on Participation Rate
Australian dollar interest rates	Increase	Increase
Volatility of reference assets	Increase	Decrease
Correlations between the reference assets	Increase	Decrease
Forward price of commodities relative to spot	Increase	Decrease

Source: CGMA

On the basis of the information provided, Aegis has conducted a preliminary sensitivity analysis on the participation rate given a change in each of these individual factors, assuming all other variables are constant.

Aegis believes the volatility of the reference assets and the correlation between the reference assets are unlikely to make a significant difference to the participation rate.

To change the participation rate by 10%, either

1. Australian dollar interest rates would have to move by over 30 basis points or
2. The forward price of all commodities (referenced in Optimiser III) relative to spot would have to change by over 6%.

Aegis believes that the risk of the participation rate changing by around 5% (up or down) is relatively high, and investors should be comfortable with this risk before investing.

Note that the participation rate will be fixed on the issue date. So the risk of change of the participation rate from the indicative rate as at the time of the PDS is between the date the investor applies and the issue date of the units.

As at the middle of May, indications are that the participation rate would be higher than the 80% indication given in the PDS. Investors may request for an indicative participation rate from CGMA before investing in Optimiser III.

The participation rate will be used to calculate the final value that investors will receive from their investment in Optimiser III at maturity. At the time of the PDS, the participation rate was 80%. The participation rate is expected to be fixed on the issue date, with a minimum of 70% and a maximum of 100%, and will remain fixed throughout the investment term. Therefore, the higher the participation rate, the greater the return investors will receive from the best performing investment profile. Mathematically, the participation rate will impact the final value in the following way:

Final value per unit = A\$1.00 [1 + (Participation Rate × Best Performing Investment Profile Return)]

Given that CGMA offers investors the benefit of capital protection, the final value or final investment value at maturity will be the greater of

- (a) A\$1.00 per unit or
- (b) A\$1.00 [1 + (Participation Rate × Best Performing Investment Profile Return)].

Below, we provide an example of how the final investment value is determined.

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Assumptions:

Figure 5. Investment Profiles Returns and Participation Rate Assumptions

Participation Rate: 80%

Investment Profile	Investment Profile Return			
	Scenario 1 (%)	Scenario 2 (%)	Scenario 3 (%)	Scenario 4 (%)
Equities-biased	31.36	21.55	19.47	-1.93
Balanced	24.91	21.76	18.67	-4.68
Commodities-biased	23.08	19.31	20.39	-8.85
Best Performing Investment Profile Return	31.36	21.76	20.39	-1.93

Source: CGMA

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Scenario 1:

At maturity, the Equities-biased profile outperforms other investment profiles

Best performing investment profile: Equities-biased Profile

Final value per unit is greater of (a) and (b):

(a) A\$1.00
 (b) $A\$1.00 \times [1 + (80\% \times 31.36\%)] = A\1.25

Final value per unit: A\$1.25

Scenario 2:

At maturity, the Balanced profile outperforms other investment profiles

Best performing investment profile: Balanced Profile

Final value per unit is greater of (a) and (b):

(a) A\$1.00
 (b) $A\$1.00 \times [1 + (80\% \times 21.76\%)] = A\1.17

Final value per unit: A\$1.17

Scenario 3:

At maturity, the Commodities-biased profile outperforms other investment profiles

Best performing investment profile: Commodities-biased Profile

Final value per unit is greater of (a) and (b):

(a) A\$1.00
 (b) $A\$1.00 \times [1 + (80\% \times 20.39\%)] = A\1.16

Final value per unit: A\$1.16

Scenario 4:

At maturity, the Equities-biased profile outperforms other investment profiles

Best performing investment profile: Equities-biased Profile

Final value per unit is greater of (a) and (b):

(a) A\$1.00
 (b) $A\$1.00 \times [1 + (80\% \times -0.1.93\%)] = A\0.98

Final value per unit: A\$1.00

These examples are provided for illustrative purpose only and do not indicate the likely performance of any of the three investment profiles or of Optimiser III.

Capital Protection

Optimiser III is capital-protected by CGMA. Investors pay the initial investment amount at inception and receive a 1% per annum coupon of the initial investment amount payable semi-annually in arrears (seven times over the investment term) and an amount equal to A\$1.00 per unit plus the return of the best performing investment profile at maturity, subject to the participation rate.

Capital protection will be provided to investors in Optimiser III only if they hold their investment until the maturity date. Capital protection will not apply to those investors who exit the investment prior to or post the maturity date. Investors should note that the obligation of the issuer to repay their initial investment amount does not apply if Optimiser III is terminated prior to the maturity date, that is, when an early maturity event occurs. An early maturity event is generally beyond the issuer's control and may include events such as, but not limited to, the suspension of a reference asset index (see Section 9 – *Terms and Conditions* of the PDS).

At maturity, CGMA will deliver to the investor, based on the final investment value, either

- ASX-listed shares in BHP, that is, the delivery asset; or
- Sale proceeds from the delivery asset valued at the closing price (that is, the closing price of the delivery asset reported by the ASX on the trading day immediately following the maturity date).

Investors should note that the conversion of the final investment value at maturity into the delivery asset may be subject to costs and taxes, including brokerage (none as at the date of the PDS). Hence, the value of the delivery asset or sale proceeds from the delivery asset received by the investor may be less than the final investment value. This may mean that the minimum amount paid to the investor may be close to or less than the initial investment amount after deducting such costs.

Capital Returns and Distributions

Optimiser III seeks to generate predominantly capital growth with limited income. The product will pay a coupon of 1% per annum based on the issue price of A\$1.00 per unit, payable semi-annually in arrears.

Investors are not entitled to receive any other dividends or distributions with respect to Optimiser III, reference assets or delivery assets during the term of the investment.

Leverage

Optimiser III does not borrow or employ direct leverage in its investments. CGMA may have an indirect exposure to reference assets via derivatives such as swaps, futures and options contracts to hedge their exposure under Optimiser III.

Liquidity

The issuer offers monthly liquidity to investors who wish to terminate their investment prior to the maturity date. Request for early termination will be required in writing. An indicative unit price for Optimiser III can be obtained from www.citiwarrants.com.au. Investors should note that the issuer may, in its absolute discretion, accept or reject any early termination request. Upon acceptance of an early termination request, the issuer will either apply the normal maturity process or pay a refund.

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If the normal maturity process is applied, the investor will receive the early maturity value, which is equal to the fair economic value of Optimiser III, as determined by the issuer, less any costs, losses or expenses that it incurs in relation to the early maturity, including costs and taxes, break costs, administrative costs plus other associated costs. The fair economic value is the theoretical value of the underlying components of Optimiser III, including the mark-to-market value of any hedges. Depending on the value of the underlying reference indices at any time, it may be higher or lower than the issue price. Investors should note that early redemptions will not benefit from the best performing investment profile return.

The refund received by investors will equate an amount determined by the issuer in its absolute discretion and may adjust for any costs, losses or expenses as mentioned above in relation to the early maturity value.

Investors should note that the issuer provides capital protection only if investors hold their investments in Optimiser III until the maturity date. Early maturity may result in an amount less than the initial investment.

At Maturity

Optimiser III is structured as a deferred purchase agreement. Under the agreement, an investor in Optimiser III agrees to either

- Accept the physical delivery of the delivery asset at maturity (ASX-listed shares in BHP); or
- Sell the delivery assets under the Agency Sale Arrangement and receive sale proceeds at the maturity date.

Approximately 20 business days before the maturity date, the issuer will notify investors of the upcoming maturity by sending them a maturity notice, advising them of the above two options. If investors do not choose either option, Optimiser III will automatically default to the physical delivery of ASX-listed shares in BHP. It should be noted that costs and taxes, including brokerage, may be deducted from the final value before delivery.

If an investor elects the Agency Sale Arrangement option on the maturity notice and return the notice to the issuer by the closing time (5:00 p.m. Sydney time on the trading day, immediately before the maturity date), the issuer will pay the investor sale proceeds, which will equal the number of delivery assets sold multiplied by the closing price, less costs and taxes.

Investors should note if there are associated costs to the delivery asset (none at the time of the PDS) or sale proceeds of the delivery asset, these costs may have implications for the capital protection. Refer to the section on *Capital Protection* above.

Taxation

The taxation consequences for an investor in Optimiser III will depend on individual circumstances and the method and timing of the disposal of units in Optimiser III or the securities in the delivery asset. We refer investors to Section 6 – *Tax Considerations* in the PDS and provide the following as a summary only. Investors should seek their own taxation advice about owning or dealing in these units.

- **Coupons.** CGMA expects that the income derived from Optimiser III will be treated as income for tax purposes. According to the taxation opinion provided in the PDS, an investor holding an investment in Optimiser III will not be subject to the Foreign Investment Fund (*FIF*) attribution.
- **Receipt of Delivery Asset or Sale Proceeds at the Maturity Date.** At maturity, where the value of the redemption proceeds exceeds the investors' cost base, a capital gains tax (*CGT*) event will occur for the withdrawing investors. At maturity, investors of Optimiser III have the choice of receiving the delivery asset or sales proceeds, or a combination of the two (a decision based upon investor withdrawals). When the value of the sale proceeds upon the disposal of the delivery asset exceeds the original investment amount, a *CGT* event will occur for the withdrawing investors. A *CGT* event should not be triggered for investors upon delivery until they dispose of their units, prompting the issuer to dispose of the corresponding portion of the delivery asset.

Commissions

- **Placement Fee.** 2% (including GST) of the investment amount, payable by the issuer to financial advisers at no additional cost to investors. The issuer may also pay advisers, out of its own funds, an additional volume-based up-front fee of up to 0.50% of the investment amount.
- **Trailing Commission.** 0.33% (including GST) per annum based on the initial investment amount, payable by the issuer to financial advisers at no additional cost to investors.

Fees

Our review of Optimiser III reveals that there are no direct up-front or ongoing fees payable by investors. However, CGMA is expected to profit from its ability to manage the underlying risk associated with the investment of the Optimiser funds. Indirect costs may be embedded in the structure as reflected by the participation rate to be determined at the issue date. Aegis does not have detailed information about the level of indirect fees and whether they are appropriate. Our discussions with the issuer lead us to believe that the indirect fees are similar to those in other structured products.

Up-front Fees

There are no up-front fees payable by investors.

Ongoing Fees

There are no ongoing fees payable by investors.

Other Fees

- **Early Exit (Break Costs).** In the event that Optimiser III terminates early, the issuer may charge the investor any break costs associated with early termination. The issuer will notify investors of such break costs in the early termination notice.
- **Indirect Fees.** Whilst there are no direct fees, investors should note that the issuer is expected to profit from its ability to manage the underlying risk associated with the investment of the Optimiser funds.

Investors should note that the issuer reserves the right to pass on to investors any unforeseen costs and taxes. As at the date of the PDS, the issuer is not aware of any such costs and taxes.

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6. Investment Process

Reference Assets

Optimiser III will gain exposure to the performance of three investment profiles, which comprise a range of market indices in international equities, bonds, currencies and commodities. The three investment profiles are

- Equities-biased;
- Balanced; and
- Commodities-biased.

Below are the relevant reference assets for equities, bonds, currencies and commodities constituents.

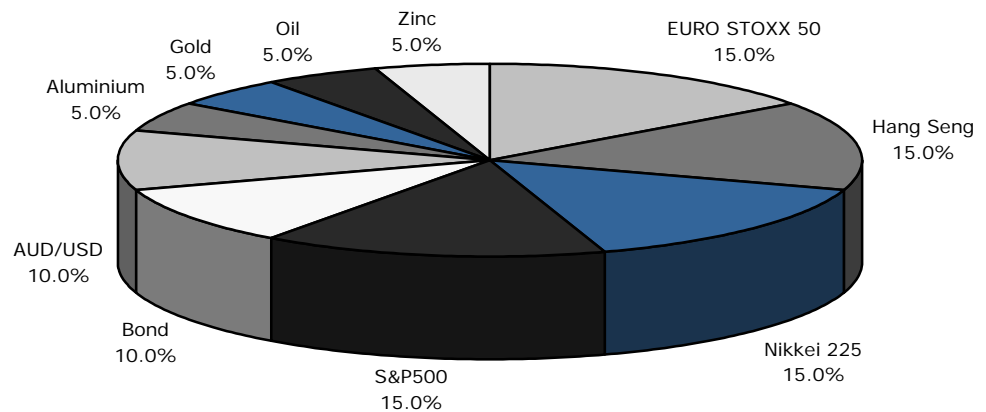
Figure 6. Reference Assets of Optimiser III

Equities	Bonds/Currencies	Commodities
EURO STOXX 50	Citigroup World Government Bond Index	Aluminium
Hang Seng	Australian Dollar Exchange Rate	Gold
Nikkei 225		Crude Oil
S&P 500		Zinc

Source: Citigroup

The allocation of the reference assets for the three investment profiles is intended to be fixed at inception until maturity. Figures 7-9 below provide the allocation of the investment profiles.

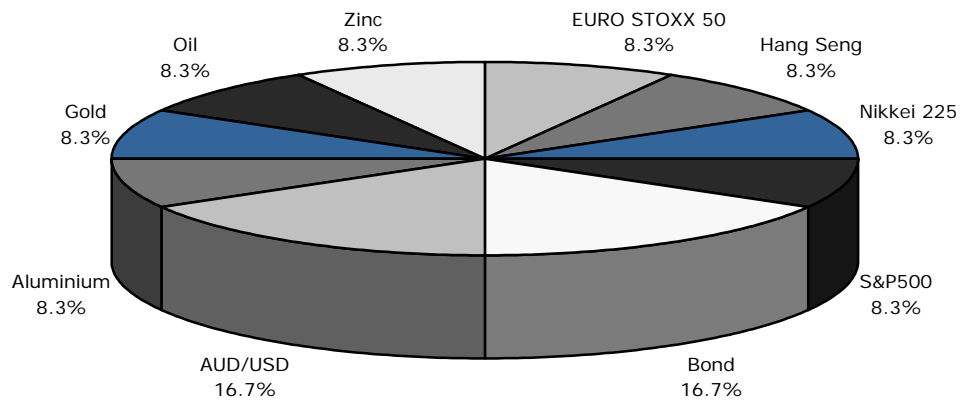
Figure 7. Equities-biased Investment Profile Allocation



Source: CGMA/Aegis Equities Research

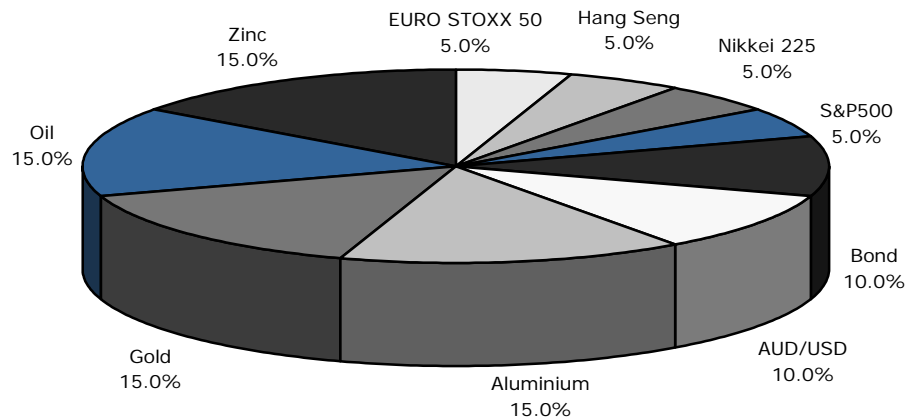
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Figure 8. Balanced Investment Profile Allocation



Source: CGMA/Aegis Equities Research

Figure 9. Commodities-biased Investment Profile Allocation



Source: CGMA/Aegis Equities Research

Reference assets are intended to be fixed for the investment term unless any of the reference assets is closed or suspended. In such a case, the relevant reference asset may be changed partially or completely at the issuer's discretion so as to leave the investor and the Citigroup in the same position after the change as they were before the change unless it is not possible to do so, in which case it may be determined to be an early maturity event.

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7. Performance Analytics

The expected risk/return profile of Optimiser III looks to be relatively attractive, with the product providing expected returns about 1%-1.5% lower than Aegis would expect from a well-diversified equities portfolio, but with a much lower volatility of returns.

However, we note that our analysis and simulations rely on long-term returns, whereas Optimiser III has a relatively short duration, and so market timing will be more of an issue for this product than other longer, structured products. Also, while the volatility of returns is expected to be lower in the long term, over shorter periods there will likely be periods where the volatility is significantly higher than Aegis would expect from a well-diversified equities portfolio.

Furthermore, we note that commodities have had a particularly strong performance over the last few years. Traditionally they have short periods of out-performance followed by long periods of under performance, and the performance of commodities over the next three and a half years will play an important role in the performance outcomes for Optimiser III.

Asset Class Returns

Structured products by their nature have extremely different return profiles from product to product, and, as such, generalisations cannot be made.

The underlying indices that Optimiser III relies upon do have a long track record though, and the table below shows the returns and risks from an investment in the underlying components.

Figure 10. Past Performance of Underlying Components as at 31 May 2006

	1 Year (%)	3 Years (%)	5 Years (%)	10 Years (%)
EURO STOXX 50	14.5	13.2	(4.6)	7.5
Hang Seng	14.4	18.7	3.8	3.5
Nikkei 225	37.2	22.4	3.1	(3.4)
S&P 500	6.6	9.6	0.2	(4.2)
Bonds	2.2	5.3	7.3	na
AUD/USD	0.5	5.3	8.4	(0.5)
Aluminium	51.4	22.3	11.9	na
Gold	56.9	21.4	19.7	5.3
Oil	37.2	34.1	20.2	13.7
Zinc	212.3	71.9	33.7	14.4

Source: Bloomberg/Aegis Equities Research

There are two important trends to note over the last five years that are atypical of longer term performance:

1. International equity markets were in the grip of a protracted bear market between 2001 and 2005 and
2. Commodities have generally had a price boom over the last three years, the performance was generally poor for most commodities prior to 2001.

For our simulations and in assessing this product, we used long-term returns of

- 4%-6% above the long-term bond rate in the respective countries for the equity markets;
- Close to inflation for commodities;
- Close to current bond market levels for bonds; and
- 0% for the Australian dollar.

With all of the components, we assume long-term volatility to mirror the volatility seen over the last 10 years.

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Figure 11. Correlation Analysis of Reference Assets (July 1997–September 2005)

	EURO				AUD/USD						
	STOXX 50	Hang Seng	Nikkei 225	S&P500	Bonds	Aluminium	Gold	Oil	Zinc		
EURO											
STOXX 50	1.00	0.54	0.49	0.80	(0.35)	0.16	0.21	(0.11)	(0.05)	0.18	
Hang Seng		1.00	0.41	0.62	(0.15)	0.44	0.39	0.12	0.12	0.20	
Nikkei 225			1.00	0.48	(0.21)	0.32	0.39	0.18	0.23	0.21	
S&P500				1.00	(0.26)	0.39	0.33	(0.01)	(0.01)	0.15	
Bonds					1.00	0.05	(0.25)	0.07	0.04	(0.30)	
AUD/USD						1.00	0.40	0.43	0.16	0.27	
Aluminium							1.00	0.21	0.23	0.48	
Gold								1.00	0.20	0.27	
Oil									1.00	0.16	
Zinc										1.00	

Source: Aegis Equities Research

As expected, the individual reference assets do not show signs of a strong correlation amongst themselves. In some cases, there is negative correlation, further demonstrating the diversification benefit of the asset allocations of the three investment profiles.

Expected/Simulated Returns

To evaluate the return on Optimiser III, Aegis built a Monte Carlo model that assesses the likelihood of various outcomes.

We generally compared the return generated by Optimiser III to a well-diversified equities portfolio (the 'benchmark') with risk/return characteristics similar to the Australian market to provide an indication of the appropriateness of the strategy.

We found that over the long term, Optimiser III is likely to return around 1%-1.5% less than the benchmark at the 80% participation level; however, Optimiser III has a lower volatility and so the risk/return trade-off appears attractive.

At the 90% participation rate, Optimiser III is likely to return similar returns as does our benchmark in addition to lower volatility. At the 70% participation rate, Optimiser III is likely to return around 1.5% to 2% less than the benchmark, again with significantly lower volatility.

Model Parameters

The model simulates the returns of the various markets using Stochastic processes, which assume that the returns on the various indices follow a log-normally distributed process with constant drift and volatility.

The price of a given index I_1 at time period t is given by:

$$I_1(t) = I_1(t-1)(1+x)$$

Where:

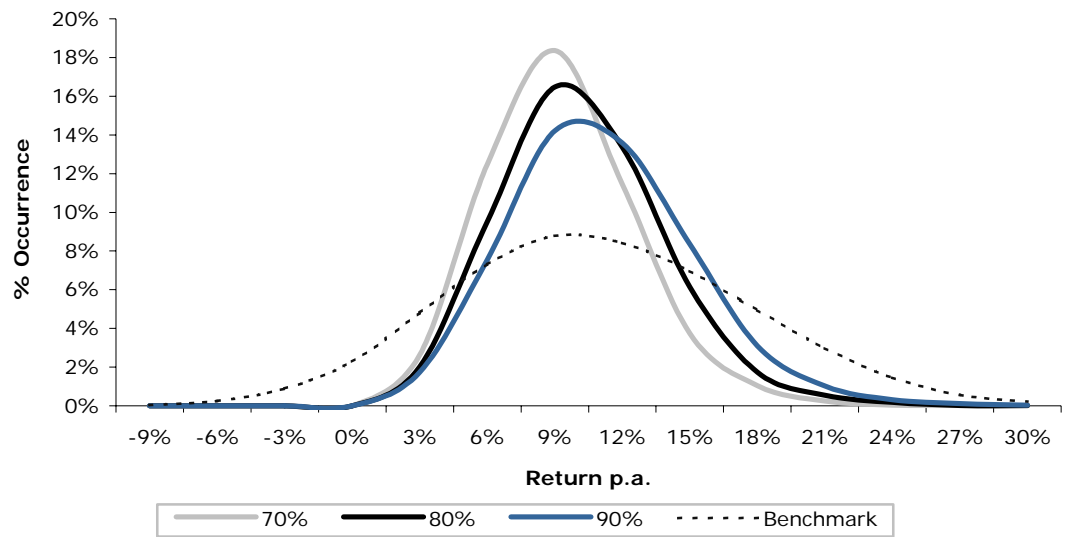
x is a random variable, which is log-normally distributed with a mean of (8% - index dividend yield) and a standard deviation equal to the standard deviation displayed by the respective indices over the last 20 years.

Aegis ran over 100,000 simulations to evaluate the various impacts of changing assumptions.

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Results

Figure 12. Distribution of Expected Returns



Source: Aegis Equities Research

As you can see from the above chart, based on the above assumptions we expect this product to return 8.6% per annum with an 80% participation level. In contrast, the simulated benchmark has a much wider range of outcomes (although it does have a higher average outcome).

Return Sensitivity

As part of the simulation exercise, Aegis examined the effect of increasing/decreasing expected volatilities and returns.

Predictably, we found that changes in the underlying volatility assumptions affected Optimiser III returns significantly, with a 10% change in volatility leading to a 0.4% change in the expected return from Optimiser III.

Naturally, increases/decreases in the long-term expected returns affect Optimiser III returns in the same direction; however, the Optimiser III return increase/decrease is generally less due to the participation rate.

Expected Volatility

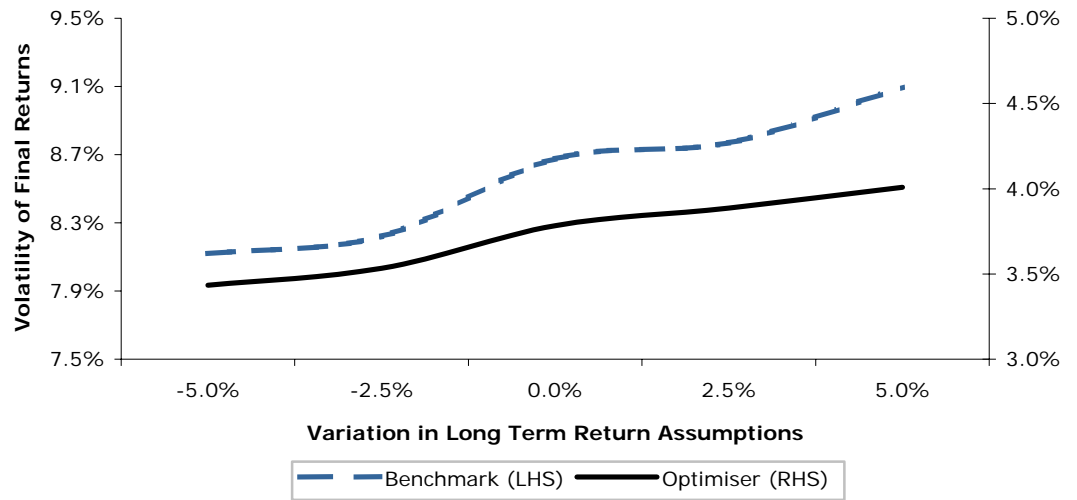
The figure below shows the standard deviation of returns for our benchmark and for Optimiser III based on different long-term expected returns.

We expect the volatility in Optimiser III to be significantly less than the volatility of our benchmark over the long term, and it appears to change in a similar manner.

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Figure 13. Volatility of Optimiser III for Different Long-term Expected Returns



Source: Aegis Equities Research

Volatility Sensitivity

As part of the simulation exercise, Aegis examined the effect of increasing our expected volatilities on the underlying indices by 10%.

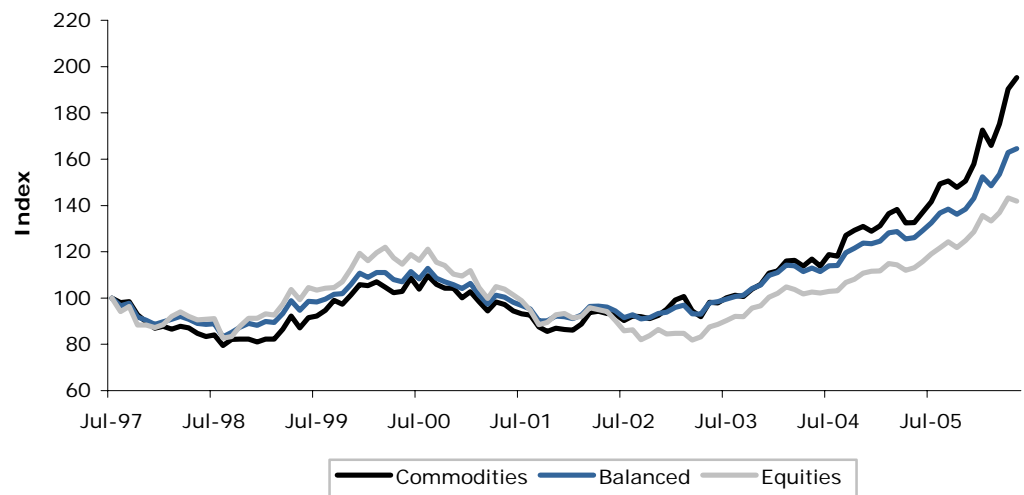
Predictably, we found that this generally improved the value of Optimiser III relative to our benchmark as the Optimiser III volatility increased by less than the volatility of our benchmark and returns improved.

Prior Performance

Figure 14 below provides a reconstructed performance history to show the relative performance of the three investment profiles over the period July 1997 to May 2006.

The performance history of the three investment profiles, which comprise global equities, bonds, currencies and commodities, clearly exhibits a fair degree of volatility, trend and cycle over the long term. It is apparent that the three investment profiles have had similar performance prior to 2002. Since that time, the Commodities-biased investment profile has outperformed the other profiles due to commodity strength and rising oil prices for the last few years.

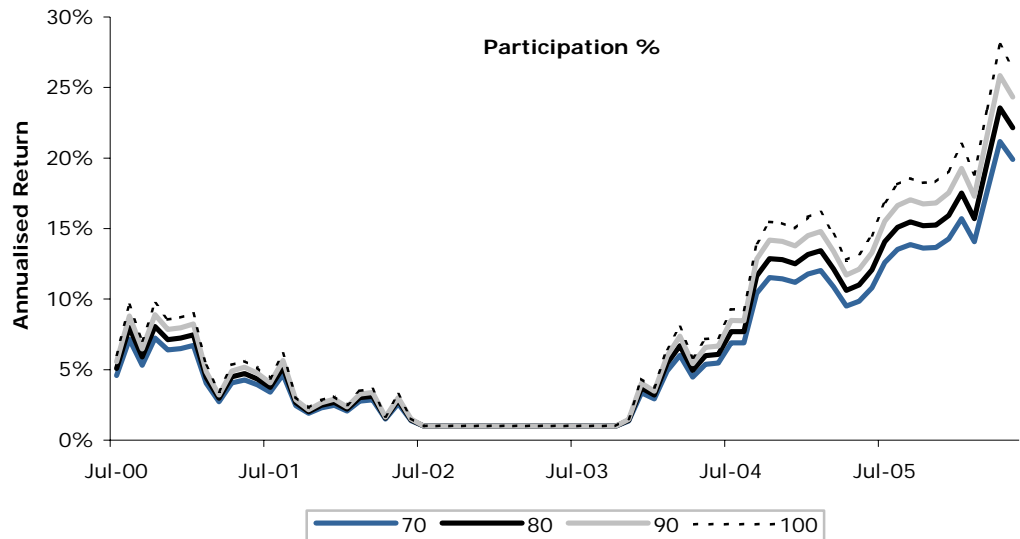
Figure 14. Performance of the Three Investment Profiles (July 1997-May 2006)



Source: Aegis Equities Research

Next, we overlay additional guidelines assuming the best performing investment profile over a period of three and a half years adjusted for different participation rate scenarios. Three and a half years have been selected to closely replicate the assumptions for Optimiser III. Figure 15 below represents the monthly rolling three-and-a-half-year annualised performance of the best performing investment profile over the same period, with participation rates of 70%, 80%, 90% and 100%. At the date of the PDS, participation rate was 80% and is unlikely to result in a 70% (minimum) or 100% (maximum) participation rate.

Figure 15. Monthly Rolling Three-and-a-Half-Year Return (annualised) of Best Performing Investment Profile Adjusted for Participation Rate (70%, 80%, 90% and 100%)



Source: Aegis Equities Research

Due to the bullish nature of the equities market and the commodities market in the past 18 months, the investment return generated from the best performing profile, assuming an 80% participation rate, has been 23.6% per annum. The out-performance has been largely the result of a buoyant market.

Based on the performance history of the reconstructed performance, we believe the success of Optimiser III will be highly dependent on the outlook and direction of various markets over the next 24 to 42 months. While we do not attempt to anticipate or predict the direction of all of these markets, it is nonetheless an important determinant for Optimiser III.

While over the longer term, we expect Optimiser III to generate an attractive return relative to the risk, we note that three and a half years is a short time frame and is unlikely to incorporate a full cycle in all of these markets. Because of this, Optimiser III is more dependent on short term market performance in each of the underlying assets than a longer duration product.

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8. Risks

We refer investors to Section 5 of the PDS and provide the following as a summary only.

- **Early Maturity Risk:** In certain circumstances, Optimiser III may be terminated early where an investor requests early maturity or an early maturity event occurs. Investors will always be given 30 days' notice of any proposed early maturity by the issuer unless it is otherwise impracticable to do so. The issuer guarantees to provide capital protection only for investments held for the full term of Optimiser III. Prior to the maturity date, investors will receive the fair economic value of Optimiser III or the refund (as determined by the issuer); this amount may be less than the initial investment amount. In determining the fair economic value or the refund, the issuer may deduct break costs or taxes in relation to the early maturity.
- **General Market Risk:** During the term of the investment, the value of Optimiser III will be affected by a number of market variables that change daily, such as the performance of the reference assets; interest rates; volatility and the trading liquidity of the futures contracts; FX contracts and/or indices; time remaining to maturity; prevailing and anticipated economic conditions; technological, legal or political conditions; and other interrelated factors that affect the performance of markets generally. There is no guarantee that any or all of the reference assets will have increased in value at the maturity date and so there is a risk that investors in Optimiser III will only receive the issue price plus the coupons. Further, the value of reference assets may fluctuate over the life of Optimiser III such that an increase in the value of reference assets in the early part of the term of Optimiser III may be offset by a corresponding decrease in the value of reference assets later in the term and investors would only receive the issue price plus the coupons.
- **Performance of Obligations by the Issuer:** The value of Optimiser III depends on the ability of the issuer to perform its obligations under the terms. These obligations are unsecured contractual obligations of the issuer and will rank equally with the issuer's other unsecured obligations and debt other than liabilities mandatorily preferred by law. The issuer is a wholly owned subsidiary of Citigroup Inc., a diversified global financial services holding company whose businesses provide a broad range of financial services to consumer and corporate customers, with more than 200M customer accounts doing business in more than 100 countries.
- **Liquidity Risk:** It is at the issuer's absolute discretion to permit early maturity once a month. However, Optimiser III obtains exposure to the reference assets using over-the-counter (*OTC*) transactions. These *OTC* transactions must be unwound to allow for early maturity and, consequently, Optimiser III may be illiquid.
- **Event Risk:** There may be adjustments to the terms of Optimiser III due to adjustment events such as (but not limited to) mergers and disposals, price source disruption, trading suspension, material change in the calculation and/or composition of reference assets and changes in the *Corporations Act* or taxation laws as set out in the terms.
- **Exercise of Discretion by the Issuer:** Investors should note that a number of provisions of the terms confer discretions on the issuer and its associates, which could affect the value of Optimiser III. These include the power to nominate adjustment events and early maturity events to substitute the reference assets and/or the delivery assets, to adjust or modify the method of any calculation as set out or used in the terms and to make adjustments to the terms of Optimiser III as contemplated in the terms.
- **Tax Risk:** We recommend that investors seek independent tax advice before making an investment in Optimiser III. The issuer is not in the business of providing tax advice and therefore cannot be relied upon to advise upon, nor take any responsibility for, the taxation implications in respect of an investment in Optimiser III.

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- **Factors Affecting the Reference Assets:** The value of the reference assets will vary over time. The individual performance of each reference asset will have a direct effect on the value of Optimiser III units and on the final value at maturity. An investor in Optimiser III should be familiar with stocks, bonds, commodities, foreign exchange contracts and investments in the financial markets generally. In particular, investors should be familiar with the financial markets where the reference assets are based, economic, political and other aspects relevant to investments in the countries where the reference assets are issued or traded and where the relevant commodities are sourced or consumed. Investors should understand that economic, financial and political developments in those countries, among other things, may have a material effect on investments in those countries.
- **Interest Rates:** Fluctuations in interest rates can indirectly affect the value of Optimiser III units during the term of investment. If long-term interest rates increase, then all other things being equal, the relative value of Optimiser III is expected to fall because an investor could have obtained a better investment return by investing in other financial products, such as variable interest rate deposits. Conversely, if long-term interest rates decrease, then all other things being equal, the relative value of Optimiser III is expected to increase. In addition, interest rates movements that affect the asset class return of the bonds/currencies asset class will directly impact the value of Optimiser III. The level of the Citigroup World Government Bond Index (the *Citi WGBI*) would generally be expected to fall if the yield of an included country's government fixed-rate issues increases and vice-versa. As the asset class return will be derived in part by the performance of the Citi WGBI, changes in the level of the Citi WGBI will have a direct impact on the final value of Optimiser III.
- **Investment Decisions:** The PDS is intended to provide investors and their professional advisers information they would reasonably require and reasonably expect to find for the purpose of making an informed assessment of the capacity of the issuer to fulfil its obligations under Optimiser III and the risks, rights and obligations associated with Optimiser III. It is impossible in a document of this type to take into account the investment objectives, financial situation and particular needs of each investor. Accordingly, nothing in the PDS should be construed as a recommendation by the issuer or any associate of the issuer or any other person concerning investment in Optimiser III. Readers should not rely on the PDS other than in respect of those matters referred to above, and should not rely on it as the sole basis for any investment decision in relation to Optimiser III, or any other security.
- **Performance of Optimiser III is likely to be different from the performance of the Reference Assets:** Investors should be aware that the return they receive from investing in Optimiser III may be less than or greater than the return they would have achieved by investing directly in each of the reference assets themselves.
- **Capital Protection:** Capital protection under the terms is an unsecured obligation of the issuer. Capital protection will not apply if there is an early maturity event or if the investor does not hold the investment until the maturity date.
- **Potential Conflicts of Interest:** The issuer and other Citigroup companies may conduct transactions as principal and as agent in various financial instruments, including the delivery assets and the reference assets. These trading activities may affect (positively or negatively) the price at which the delivery assets trade or the level of the reference assets at any point in time.
- **No Proprietary Interest in the Reference Assets:** The issuer and the investors will not have any proprietary interest in or entitlement to any obligation or asset relating to any reference asset.
- **Change of Law Risk:** Changes to laws or their interpretation in Australia and other international jurisdictions, including taxation and corporate regulatory laws, could have a negative impact on the return of investors.
- **Counterparty Risk:** The obligations of Optimiser III are unsecured contractual obligations of CGMA and will rank equally with the issuer's other unsecured obligations and debt other than liabilities mandatorily preferred by law. CGMA, as at the date of the PDS, has credit ratings of AA- (S&P) and Aa1 (Moody's).

Appendix A – Ratings Process

Aegis has developed a framework for rating investment product offerings in Australia. Our review process gives consideration to a broad number of qualitative and quantitative factors. Essentially, the evaluation process includes the following key factors: product management and underlying portfolio construction; investment management, team stability, experience and performance; fees, risks and likely outcomes.

Our rating is based on the following scale:

80 –100 Recommended

60 –79 Approved

0 –59 Not Recommended

A 'Recommended' rating indicates that Aegis believes this is a superior grade product that has exceeded the minimum requirements of our review process across a number of key evaluation parameters.

An 'Approved' rating indicates that Aegis believes this is a suitable product that has met the aggregate requirements of our review process across a number of key evaluation parameters. The product may provide unique diversification opportunities but may not stand apart from its peers.

A 'Not Recommended' rating indicates that Aegis believes that despite the product's merits and attributes, it has failed to meet the minimum aggregate requirements of our review process across a number of key evaluation parameters. However, this does not mean that the product is without merit.

This report has been commissioned, and, as such, Aegis has received a fee for its publication. However, under no circumstances has Aegis been influenced, either directly or indirectly, in making statements and/or recommendations contained in this report.

The Product Disclosure Statement (PDS) dated 22 May 2006 has not been lodged with the Australian Securities and Investments Commission (ASIC) and is not required by the Corporations Act 2001 to be lodged with ASIC. The offer of the securities is made in the PDS, and anyone wishing to acquire the securities should complete the application form in the PDS.

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Appendix B – Entities Involved

Citigroup Global Markets Australia Pty Limited

The issuer of Optimiser III is CGMA, which is a wholly owned subsidiary of Citigroup Inc. and a member of Citigroup. The group has been in the Asia Pacific region for more than 100 years and today provides more services in more markets for more clients than any other financial institution does. The group counts as valued clients 10M customers across 18 countries and territories.

Citigroup Inc.

Citigroup (together with its subsidiaries) is a diversified global financial services holding company whose businesses provide a broad range of financial services to consumers and corporate customers, with more than 200M customer accounts doing business in more than 100 countries. Major brand names under the Citigroup's trademark red umbrella include Citibank, CitiFinancial, Primerica, Smith Barney and Banamex.

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