

CI AUSTRALIAN EQUITIES FUND QUARTERLY REPORT



Cooper Investors Pty Limited AFS Licence Number 221794 ABN 26 100 409 890

DECEMBER 2006

"So when I start to climb, especially when I am on a big wall, whatever difficulties I am so concentrated that there is nothing else existing: there is only a few meters of wall where I am hanging. In this concentration, every thing seems quite logical. The danger is gone. But the concentration is absolute."

"I am only interested in our experiences and not in the mountains - I'm not a naturalist. I'm interested in what's going on in the human beings."

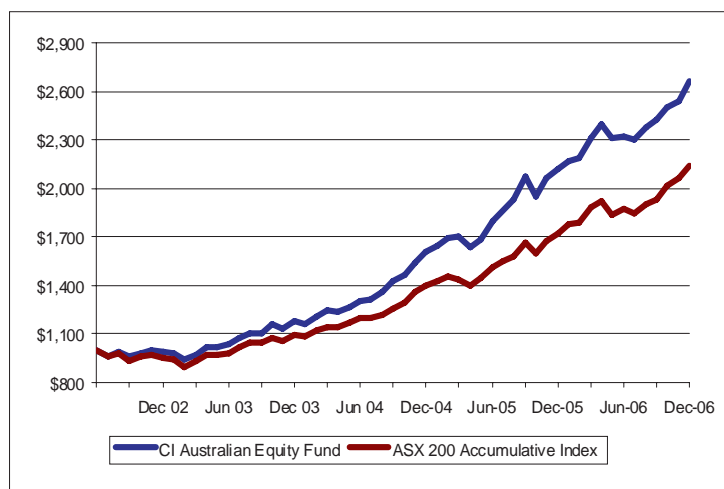
"If you have a highway on Everest, you don't meet the mountain. If everything is prepared and you have a guide who is responsible for your security, you cannot meet the mountain. Meeting Mountains is only possible if you are out there in self sufficiency."

Reinhold Messner ~ World famous mountaineer

PORTFOLIO PERFORMANCE

	PORTFOLIO	BENCHMARK	VALUE ADDED
1 MONTH	4.90%	3.69%	1.21%
ROLLING 3 MONTHS	9.77%	10.94%	-1.17%
ROLLING 6 MONTHS	14.60%	14.16%	0.44%
ROLLING 1 YEAR	25.46%	24.22%	1.24%
ROLLING 2 YEAR	28.67%	23.54%	5.13%
ROLLING 3 YEAR	31.22%	24.99%	6.23%
SINCE INCEPTION*	24.38%	18.47%	5.91%
SINCE INCEPTION^	166.46%	114.15%	52.31%

* Annualised
^ Cumulative (4 July 2002)



Calendar 2006 was the 4th consecutive year of positive market returns with the last 3 years showing in excess of 20% p.a. returns.

During the quarter the portfolio returned 9.77%. Out performers were Fletcher Building, Seven, CSL, QBE and Macquarie Bank. Worst performers over the quarter were Bendigo Bank, BHP and the Coles Group. Furthermore, we did not hold Rinker, Flight Centre, DCA Group and Qantas all of which were subject to proposed takeover announcements during the quarter.

Over the year the best performing sectors were small resources (+57%), the insurance sector (+39%), retailers (+29%), property trusts & media (+26%) whilst telecoms and banks underperformed the market.

In the past 12 months, 8 of the top 10 ASX 200 market performers were small resource companies but notably the big miners (BHP and RIO) underperformed the broader indices and Woodside Petroleum, Oil Search, Santos and Alumina actually fell in absolute % terms.

The good performance of the listed property trusts sector has been exceeded

by the US property industry. The US Reits have outperformed the S&P 500 for the 7th year in a row with a 35% total return vs. 16% in 2006. Cap rates in the USA have declined from a historical 9% to 5.5% today. In many instances asset yields on property have fallen to such a level that IRR can't be increased thru more leverage.

T3 shares have performed exceptionally well since listing. This reflects a modest rise in the headstock, leverage and the substantial discount offered to complete the deal. The telecom industry remains highly competitive both globally and regionally with all local competitors struggling (Optus, Vodafone, and junior teleco's). Overseas trends in mobile and broadband pricing suggest Aussie tariffs remain very high. Despite the huge challenges presented by lower barriers to entry in the telecom industry, the new Telstra leadership team have brought an impressive focus to the company that we have not previously seen. An example of this is far greater control around capex and alignment of capital to the longer term strategic direction. TLS is also likely to continue benefiting from the current disarray of all competitors in the Aussie market.

The media sector was driven by both the prospect of media consolidation and the arrival of Private Equity (PE) deals undertaken by Seven and Publishing and Broadcasting Ltd.

Seven's deal involved the 50% sale of their TV, Magazine and Yahoo7 businesses to KKR in consideration for \$3.2b in cash less the reinjected \$735m of equity into the new vehicle. Seven retains management control. Today Seven has \$2.3b in cash on balance sheet and a market cap of \$2.5b. The \$11 share price compares with a circa \$14 per share valuation. The market price implies that that the controlling shareholder Kerry Stokes will do something value destroying. In recent years management have considerably improved the competitive position of the business and have shown tremendous acumen in putting together the buyout with KKR.

Cost pressures continue to be an issue in the economy driven by labour shortages. Recent examples from our company visits include scientific researchers, doctors, nurses, accountants and actuaries. Services continue to be outsourced to lower cost countries. Some Australian accounting firms outsource compliance work to Malaysian workers. In the resource sector capital cost blow outs are causing project delays and cancellation e.g. PNG gas pipeline. Some industrial sectors have borne the input cost escalation without the benefit of price rises for their products e.g. Amcor has absorbed \$750m p.a. increase in costs in the last few years on a company that has a net profit of \$400m. Qantas has absorbed \$2b in additional fuel costs. The building industry continues to feel the pressures of price rises from material supply companies who are operating within a reasonably concentrated market. Despite the soft housing market quarry prices are expected to rise again by around 10% from April 07. We expect all major suppliers Boral, Rinker and Hanson to participate in these price rises. The cost of housing has also had to bear the add-on expenses for supporting infrastructure in the form of taxes, zoning, transport and water levies. In Sydney, this adds approximately \$140k per block.

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Banking & Finance ~ The banks are fairly to fully priced and face some macro drivers that will dampen profit growth. We are beginning to see a lift in underlying bad debts from a virtually "no bad debt" position. For example, Adelaide Bank's mortgage division delivered negative growth for the 6 months to June 2006 due to delinquencies. Management reiterated their 10% guidance in July in spite of falling market share which is now back to system growth and rising delinquencies. Non accruals rose from 0.06% in June 05 to 0.20% in June 06. In November 06 they downgraded the guidance to 6%-9% due to margins being worse than expected and higher reinvestment costs for long term growth and restructuring costs. ANZ signalled that growth rates were declining due to increased provisioning charges and AIFRS will result in more earnings volatility. They also indicated a softer market in NZ. St George has on the other hand reiterated their growth target of 10% p.a. for 2007 and 2008.

Recently the banking sector has been targeting higher growth markets with minority stakes in Chinese and Asian banks. This is a response to an anticipated slowing in domestic growth. With hindsight the Aussie banks missed the big opportunity to participate in a substantial way in Asia by being too conservative immediately after the Asian crisis when recapitalization opportunities were at their highest.

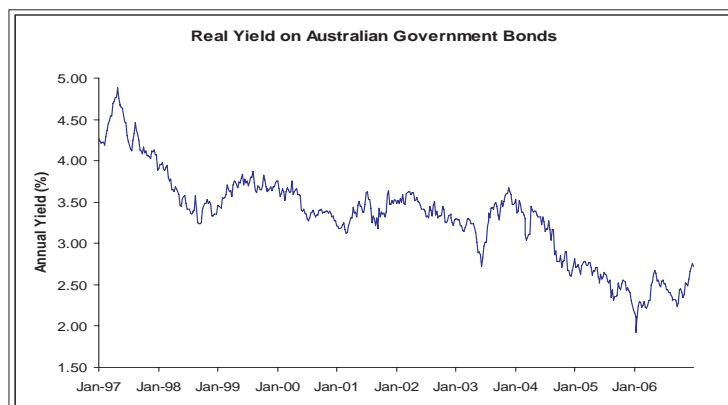
Asian banks where western overseas banks have invested capital make for good investment prospects because the western acquiring company generally would see full financial and credit data. Further, these companies tend to have better access to capital, quality people, quality systems and processes.

One thing we have noticed with financial services in Asia is that insurance companies (AXA, AIG, ManuLife) have been much more successful in establishing organic growth positions than the foreign banks. Banking seems to be able to attract local customer loyalty, making it more difficult for foreigners to gain a foothold through greenfield operations.

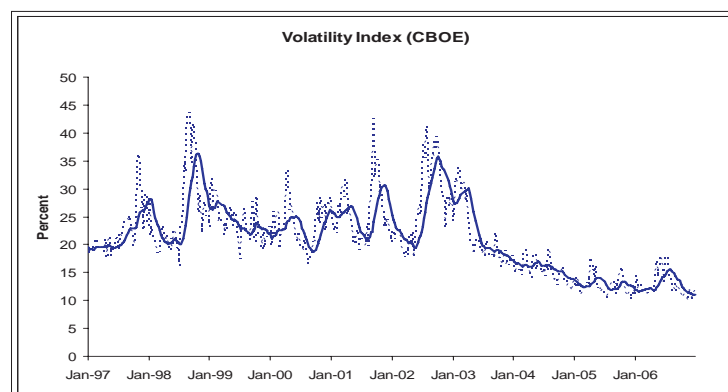
Australia has produced 3 world success stories in structured finance where Macquarie Bank, Babcock and Brown and Allco Finance have excelled in packaging assets into tax and investment efficient vehicles.

The economic success of Australia is predicated on:

- Strong employment ~ at 4.6% unemployment is at a 30 year low.
- GDP in 2006 was below long term trend at 2.6% in 2006 and 2007. Housing remains subdued in Australia overall but below average performance was due to Victoria and NSW whereas Queensland and WA are experiencing above trend conditions.
- Liquidity, low interest rates and credit risk spreads ~ Can it get better? Australian bonds at around 5.8% and 90 day bank bills of 6.4% is consistent with expectations that inflation will fall back into the 2-3% range having risen by 3.5% in 2006. The consumer savings ratio has been falling for 20 years which has fuelled domestic demand. Confidence remains resilient and strong evidenced by the fact that markets have completely digested the impact of Amaranth, a multi strategy hedge fund that reportedly lost US\$6b as a result of a bet on rising energy prices. After an initial slowdown in deal flow and credit availability inflows into the big leveraged funds has rebounded strongly. Furthermore the Wall Street Journal reported that 17 Amaranth traders (from the credit side of the business not the problematical energy division) had found employment at one of the leading Wall Street investment banks. Amaranth's former CEO and co-founder is reportedly planning another fund. A reversing of either liquidity or credit trends would result in substantial asset price contraction.



Source: Reserve Bank



Source: CBOE

- Asia's economic performance ~ the smooth path to industrialization in China and other Asian markets remains singularly the most important external determinant of Australia's continued economic prosperity. With Asia having 50% of the world's population (consumers) and 50% of its growth in many industries there is every reason to believe that Asia can continue to be a driver of Australia's prosperity. "There is a hotbed of entrepreneurial activity compared to the rest of the planet occurring right now in Asia." Craig Barrett Intel CEO. However, we do remember the awe in which many held the Japanese industrial economy in the 1980's and the Asian Tigers in the 1990's.

Other key observations:

- The shift from road to intermodal rail is a long term growth trend due to rails productive efficiency over long haul freight routes.
- We continue to be wary of industries that are exposed to excessive concentration of distribution and retailer power i.e. suppliers to Woolworths and Coles.
- The globalization of Australian based companies continues to be driven by Australia's small population and mature concentrated market. Recent acquisitions have been made by ABC Learning, Toll, QBE, Transfield, Tattersalls, ANZ, Nufarm, Insurance Australia Group across Europe, USA, South America and Asia. The trend is occurring amongst both large and small companies.
- High margins in the Australian explosives industry has attracted (unwelcomed by Orica shareholders) expansionary investment. Dyno will have a new ammonia nitrate plant up and running by 2009. A reminder that high margins attract competition.

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INDUSTRY AND COMPANY VoF TREND OBSERVATIONS

"It is not the strongest of the species that survive, nor the most intelligent, but the one most responsive to change." Charles Darwin

"Example is not the main thing in influencing others. It is the only thing." Albert Schweitzer

"With over a 100m online resumes and growing, employers don't matter anymore employees have the power." Andrew Banks

"I have an intuitive understanding of technical people, whether they are engineers or accountants or market researchers. I don't really resonate with generalists". Peter Drucker

"Your readers are our shop lifters" Macy CEO to Rupert Murdoch

Superannuation Industry ~ Australia's superannuation legislated growth continues to underpin the growth plans of the wealth management and advice industries. Firms such as Perpetual, AXA and AMP, the local stock market and many listed smaller financial services companies will continue to benefit from the demand profile of this industry.

Energy ~ There are some real issues emerging with the green energy alternatives. Some of the problems include: Nuclear reactors are uninsurable and need governments to underwrite their commercial viability; Wind power generators kills an estimated 12-15m birds each year in the USA; Solar requires vast land mass to generate energy and is unreliable; Hydro damming causes upstream problems particularly in areas with water shortage; Biomass requires the cultivation of vast acres of food based agriculture. Ethanol studies in the USA show that producing from corn kernels creates almost as much green house gas (Scientific American) as gasoline production does due to the fact that some stages of the ethanol production are highly energy intensive. Political support for ethanol fuel is driven as much from the economic interests of the farm based states as concern for the environment. The US\$23b farm subsidies paid by the US government to support local agriculture is likely to become increasingly part of the global trade negotiations.

Controversy with Russia continues with the poisoning of Alexander Litvinenko and Shell's pressured sell down of the Sakhalin II project to Gazprom. European and Japanese customers would be highly concerned with the dependency on Russian energy given the increasing influence of the Russian government on energy policy.

Most recently Russia has imposed an export duty of \$180.7 per tonne on oil exports to Belarus from 2007. Previously these were tax-exempt. Russia has been losing out on billions of dollars annually by allowing oil firms to send oil to Belarus's refineries, which were then re-exporting refined products to European markets.

China ~ With the second-largest network of roads in the world after the United States in 2007, China is expected to build or upgrade 300,000 kilometres of roads. USA energy consumption remains 10x China's on a per capita basis.

Asia and China remains the most advantaged cost centre for manufacturing in the world. The cost of labour in US\$ per hour is: Korea 10.71, Singapore 7.63, Hong Kong 5.54, Mexico 2.37, China 0.75, India 0.60 and the cheapest Vietnam 0.58 is shaping up as an alternative to some Chinese manufacturing facilities.

Leveraged Structures ~ Listed company boards are reviewing their responses to potential PE offers. We believe that some companies demonstrate that they have all the capability of PE firms. E.g. the Seven and PBL boards have demonstrated that they are particularly savvy in negotiating with PE by extracting good prices and structuring the deals and they retain management control.

In the building sector, Lafarge Group has also decided to sell their global tile business to PE in what appears to be a difficult USA market. The key lesson from the PE model is to link management performance to actual long term delivered returns. We are attracted to companies that have re-gearing opportunities and companies with some of the disciplines found in PE firms i.e. focused operating management, management incentives that align shareholders and management, M&A capability, capital discipline, e.g. QBE

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