

CI AUSTRALIAN EQUITIES FUND QUARTERLY REPORT



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

DECEMBER 2007

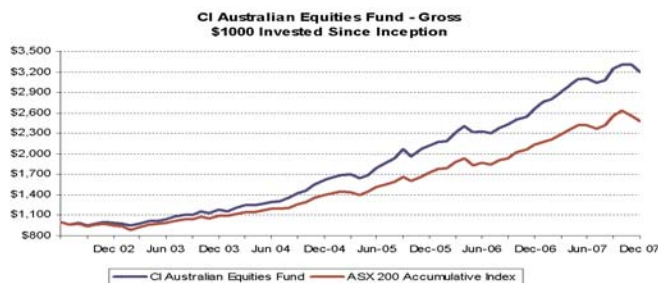
"Nature does not hurry, yet everything is accomplished" Lao Tzu

"The superior man does not waste himself on what is distant, on what is absent. He stands in the here and now, in the real situation" Confucius

PORTFOLIO PERFORMANCE

	PORTFOLIO	BENCHMARK	VALUE ADDED
ROLLING 3 MONTHS	-1.62%	-2.73%	1.11%
FYTD	3.04%	3.00%	0.04%
2007*	33.51%	28.66%	4.85%
2006*	29.29%	23.93%	5.36%
2005*	38.12%	26.35%	11.77%
2004*	24.92%	21.61%	3.31%
2003*	4.23%	-1.49%	5.72%
SINCE INCEPTION*	23.57%	18.02%	5.55%
SINCE INCEPTION^	219.87%	148.58%	71.29%

* 12 months to June except 2003 which is 3 days short of a year as it commenced on the 4th July 2002
Annualised (since 4th July 2002) gross returns
^ Cumulative gross returns (since 4 July 2002)



The ASX200 Accumulation Index rose 16% over 2007, the bulk of the return being made by the end of June. Over the six months to December the market returned 3%, while in the latest quarter the market in fact fell almost 3% and volatility increased. Property prices fell as capitalization rates rose and the Australian listed property market had its worst quarter for 10 years, falling 13%. Over the quarter the portfolio performed ahead of the market. Better performers included RIO (+23%), Worley (+22%) and Oil Search (+14%), while the main underperformers were Brambles (-22%), AGL (-16%), Toll Holdings (-13%) and St George Bank (-11%).

Of particular note this year was the narrowness of the market – very few stocks made up the majority of the market gains. BHP and RIO together contributed 52% of the rise in the index, while the top 10 performers contributed 100% of the gain (compared to a range of between 10% and 60% over the prior five years). The slowing US economy, rising oil price, rising AUD and rising interest cost are all contributing to the increasing risk profile attaching to corporate earnings. The USA in particular looks at risk of recession in 2008, and bond yields there would certainly point you in that direction, the 10 year bond yield having fallen from 4.7% at the start of 2007 to just over 4% as at the end of the year. Interestingly, in the USA, both gold and Treasury Bonds outperformed the S&P 500 by a significant margin over 2007. And while over lesser time periods bonds have not done so well, over the last ten years both bonds and gold have outperformed the S&P500. Australian equities have through that period substantially outperformed both bonds and gold, albeit that the gold price in AUD has been affected by the AUD strength against the USD.

	1 Year	5 Years	10 Years
S&P 500	5.50%	82.88%	77.59%
T Bond	10.05%	32.69%	101.42%
Gold (in USD)	31.59%	140.93%	188.25%
ASX 200 Accum	16.1%	160.00%	263.00%
UBS All Maturities Bond Index	4.0%	23.5%	7.1%

Source: Merrill Lynch, Iress

Of course the issue gaining the most publicity and having the most market impact in 2007 was sub prime lending in the USA. We make the following observations:

- 1) The real cause of the problem is poor lending practices (not only in the US) - lending to those who are unable ultimately to afford to repay, with loan valuation ratios too high for safety, and with too generous terms and conditions;
- 2) Financial markets are transitioning from loose to tighter monetary conditions. Banks are unwilling (or unable) to lend except to the highest rated credit risks. Anecdotally, funding for various asset types in different parts of the globe has "vapourised";
- 3) The rapid growth in the disintermediation model of originate and distribute to faceless investors is over. The benefits of intermediation are likely to re-emerge because the originators of risk are more likely to be diligent and judicious in their risk assessment if they hold the risk for the life of the asset. We believe that this will apply not only to banking assets but also to the equity markets and particularly to the infrastructure, property and utilities sectors;
- 4) The real economy (assets, good and services, and asset values) cannot remain unaffected by what is happening in financial markets;
- 5) Liquidity is today a primary determinant of value;
- 6) Suppliers of capital will increasingly require stronger collateral and more appropriate fiscal terms from all borrowers;
- 7) Interest rates (real and nominal) paid by borrowers are rising and are unlikely to fall in the short term;
- 8) Large refinancing requirements in the short term, no matter how strong the borrower covenant, represent a risk. Conversely strong balance sheets will find opportunities that have not been present for a few years;
- 9) Not all leveraged corporates have the same level of risk. Ultimately the market will differentiate between the better opportunities in property trusts and infrastructure vehicles, and those of lower quality.

VoF OBSERVATIONS ~ INDUSTRY TRENDS & BEHAVIOUR

We have in past reports written on a number of themes we have observed both in Australia and overseas. Despite the angst being caused by the global credit squeeze, these themes we believe remain as valid an investment proposition as ever:

- Increasing efforts at internationalization by companies. In Australia, a large proportion of our top 100 companies now have major offshore operations. Overseas, the likes of Tata in India and the Chinese and

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- other sovereign wealth funds are prime examples of the way global ownership structures in many industries are changing rapidly;
- Energy – rising oil and gas prices and potential oil shortages. The oil price has now for the first time hit \$100. Alternative fuels are making little headway. Note for instance that crop prices have risen to the point where it now costs approximately USD\$1440 to make a ton of biodiesel, compared to \$840/t for the crude based diesel. Subsidies of this size will prove impossible to sustain;
- Ageing infrastructure across the Western world needing billions of dollars for rectification, and massive new infrastructure requirements in the developing world (especially China and India);
- Water shortages are becoming more acute in Australia - we now have desalination plants in operation or planned in most of the capital cities in Australia with the latest announcements being around mobile desalination plant technology. In the USA Midwest water is being drawn from certain aquifers at unsustainable rates, the Colorado and Rio Grande are dry for much of their length. Iran is overpumping its aquifers by 5 billion tons of water per annum. In India's North Gujarat state the water table is falling by 6m per annum and in Tamil Nadu state wells are drying up (UBS Investment Bank);
- The food habits and demands of China change as the country gets wealthier - more water is needed to feed its population. Different food types have varying water requirements – 1kg of beef needs 15t of water, lamb 10t and poultry 6t. Compare this to cereals 1.5t, citrus 1t, palm oil 2t (UNESCO). China's per capita consumption of grain has fallen from 145kg in 1981 to 78kg in 2004 in urban areas, while its consumption of meat has risen from 20kg to 29kg over the same timeframe;
- Soft commodities are in a boom as the demands of feeding the world's growing population and also supplying biofuel feedstock coincide. It would appear that "the USA, European Union and Japan cannot meet their biofuel targets without huge disruptions to global agriculture" (UBS Investment Bank). In addition, the amount of arable land available for global agriculture has reached a peak. Global trade in agricultural products can only increase in future years. Beneficiaries will include Brazil and Argentina;
- Inflation, long dormant, is now on the move. There will be no easy or quick cure – the structural influences of rising food and general commodity prices, labour shortages, rising costs in China where the inflation rate is running at 6.5% compared to 1.5% in 2006, and ongoing global demand will ensure central banks are faced with this problem for some years to come. History tells us that under this scenario in the past interest rates reached 10%!
- The Western world population continues to age, imposing increasingly large demands on government budgets. Even in China, the State Family Planning and Population Commission predicts that by 2050 the proportion of the population 65 or older will reach 24%. Volume growth at 5-10% should be consistently achievable over the long term for healthcare companies, with the caution being prices paid by governments cannot continue to rise;
- Companies continue to focus on what is core to their existence and outsource other operations to those who are more capable of efficiently carrying them out.

As we enter what we believe will be a more difficult period in the market, corporate management assumes even more importance in our thinking about companies. It appears the actions of corporate Australia have not changed despite negative changes in operating conditions of late.

For example:

- There was mergers and acquisitions activity right up to the end of 2007 that appear marginally value adding at best
- Capital is not yet being treated as a scarce resource by companies.
- Executive and Board remuneration is rising unjustifiably sharply
- Companies are still normalizing out most negative aspects in results
- Spin is abounding with only the upsides ever being mentioned in briefings

Some examples of less favourable outcomes are discussed below: Bendigo Bank had the strongest balance sheet amongst the Australian banking sector. Its loan to deposits ratio was by far the lowest, its culture the most conservative and identifiable, and its brand was the strongest. Despite these attractive features Bendigo paid a premium to purchase Adelaide Bank and the combined entities balance sheet now looks similar to all the other banks. Given the structure of Adelaide Bank's balance sheet, patience would almost certainly have yielded a better buy in price.

SP Ausnet agreed to purchase the very highly priced infrastructure assets (the infamous Alinta assets) from its parent despite an obvious change in market pricing for such assets. SP Ausnet continued to pursue this acquisition right up until the point when it became clear that the EGM resolution to approve the purchase would be voted down.

Transfield Services Infrastructure fund outbid Babcock and Brown in buying a portfolio of wind farms despite unit holders having an expectation that this fund is different and will add to its portfolio outside the highly competitive energy sector.

Out of the blue NAB buys a small bank in the mid west of the USA.

AGL shocks the market with prices paid for assets early in 2007. Following the profit downgrade and departure of the MD, the recent review by KPMG reports that "assumptions were at the upper end of probable outcomes and therefore overly optimistic".

Allco buys Rubicon in a related party transaction. Rubicon is the manager of underperforming property trusts whose DNA includes massive use of debt.

Why has behaviour not changed?

A major reason is that many companies appear to have lost their commercial savvy streak. How many companies actually have a capability to evaluate M&A opportunities internally? How many companies have directors who can take a medium term decision, can reject propositions from management, can reject recommendations from advisers and question ratings agencies, can withstand pressure and exercise patience?

Many companies are still using overly optimistic assumptions in their budgeting and investment evaluations.

A real but unsavoury reason for some over optimistic corporate behaviour is that some management teams know that their stock prices and prospects are overrated and therefore while their scrip has value they are compelled to keep dealing, moving and muddying the waters so that they are not exposed.

Finally and most important of all is that many companies undertake strategic M&A as opposed to value M&A. AGL's over-priced acquisitions last year were

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all about strategic positioning rather than value. We are entering a period when strong companies will be able to both buy strategically and at very low prices from weakened companies.

When we travel overseas we find many companies who have faced extremely harsh operating conditions in the recent past and have adjusted their businesses and attitudes to survive. These survivors often perform very well when their internal rationalisations are completed and their operating conditions improve.

CI TRAVELS

In November we traveled to Singapore. Corporates are faced with one big issue similar to that in Australia, namely that it is a small economy and thus to grow companies must go abroad. Like Australia, Singapore has some very successful examples of this trend. Points of interest to emerge from our trip:

- The Singapore government is looking to grow the population from 4.5m today to 8m in 10 years time - a seemingly ambitious target.
- One view expressed to us is that Singapore has exhausted its capacity and competitiveness in shipping, ports and refining and so the emphasis needs to change to utilize its strengths in skilled labour, banking and low tax rates. This inevitably leads to financial services and tourism (thus the two new casino developments, inaugural Formula 1 night race in 2008 etc) and transport logistics given its position central to the rest of Asia.
- Property prices have sky rocketed in Singapore over the past twelve months, very much in synch with most of the region, but also as realization of what the intended population boost will mean.
- The Singapore equity market trades on a PE of 15X FY08, a little lower than Australia, but with a very low level of corporate debt (D/E 12%)
- Singapore Airlines will continue to grow into the region. New capacity over the next 5 years (Airbus 380, Boeing 777) will keep average fleet age down at 6 years (compared to Qantas at 11 years). Discount carrier subsidiary Tiger Airways is a part of their growth plans. Tiger is now cashflow positive and profit break-even. Australia is about to become an important part of the Tiger network. Based in Melbourne, it will fly to most places in Australia. To date the advertised fares are substantially lower than those of its competitors. Jetstar is its most direct competitor, while Qantas will remain at the premium end of domestic air travel. The player most vulnerable to Tiger would appear to be Virgin who is now stuck in the middle and will find it difficult to compete both with Qantas at the premium end and with Tiger at the discount end of the market.
- Parkway Holdings is a very successful private hospital and pathology company expanding throughout Asia as demand increases with increasing wealth. Were it not for the 20+ multiple either Ramsay or Healthscope would already have acquired it. Two major areas of opportunity (where Parkway has only a small presence) are China and India. China has 14,000 public hospitals and 2,000 private hospitals whereas India is the opposite with 16,000 private and 2,000 public facilities. These markets will not have escaped the attention of the two Australian listed hospital operators but any incursion into these areas will be coming from behind the eightball. Of particular note is the growth in medical tourism and the effort underway to make Singapore, and Parkway hospitals, a centre for excellence in the region in certain specialties (eg. cancer).
- The opportunities for Toll Holdings in Asia are huge. Customers are moving to a cross country/regional approach. Trade volumes are rising.

Very few competitors can provide a total outsourcing solution. Technology is not advanced and the market is fragmented. New legislation will assist Toll over time as the smaller less well capitalized players find it increasingly difficult to comply. However Toll will need to be focused/targeted and in doing so, the most logical approach is to follow their existing customer base. Longer term it is likely Toll will use Asia as a base from which to expand into Europe and the USA.

During the last quarter we visited a number of the companies in the portfolio. Some of the opportunities available to smart management teams augur well for the coming years:

Lend Lease

- The company has gone full circle having sold MLC and expanded its property operations to now refocusing and de-risking the business;
- The project pipeline is very large (some \$80B), international and includes a number of high profile projects/sites. This will offer opportunities to the funds management business;
- The company, as an owner operator, retains a technical ability not present in financially driven industry players;
- The balance sheet is conservatively structured;
- The CEO Greg Clarke has done an excellent job in re-positioning the company and the payoff for his team's hard work has arrived. Strong companies with good balance sheets can now cherry pick the quality assets. Lend Lease will be a preferred partner for banks and financiers as others will struggle to match the operational, technical & financial acumen inherent in Lend Lease's integrated model. It would be a SURPRISE to see anything eventuate from their discussions with Mirvac as value is not evident.

Sonic Healthcare

- The dominating force in the Australian private pathology industry, an industry growing at 5% per annum. Scale from large new premises, and the likelihood of increased market share as a result of the current imbroglio between Healthscope and Symbion, both point to a strong 2008 for Sonic in Australia;
- Sonic has now built out a global platform – comprising a strong presence in Germany, the UK and the USA. Germany remains a very fragmented market and we would expect Sonic to make further acquisitions to take advantage of cost synergies. In the UK and USA growth will be organic in the main, supplemented by bolt on acquisitions;
- Sonic now has the size and scale to take advantage of new technology and testing procedures as and when it becomes available;
- The growth in demand for pathology services is a global trend which will continue for many years to come. The risk is not therefore volume but price as governments in most countries fund pathology services.

Healthscope

- Second in size to Ramsay as a listed private hospital operator in Australia, has also entered the pathology arena in Australia and New Zealand via its acquisition of Gribbles. Spending \$100m to expand hospital capacity over the next eighteen months. Demand is unlikely to stop growing provided the private insurance rebate remains in something close to its current form. To change this formula would prove to be politically unpopular given 45% penetration, as well as very costly, for the government.
- The acquisition of Gribbles has taken some time to bed down as management bought the third player in the market using overly optimistic

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assumptions and has had to learn the ropes in a competitive arena. However the logic of putting pathology and hospitals together is undeniable and follows the trend globally and in the public sector in this country.

- Healthscope is currently involved in a battle with Primary Healthcare for the assets of Symbion. Both companies have acquired a stake in Symbion which makes takeover by the other impossible - thus an impasse has been reached. It is to be hoped that logic prevails and the assets are split along sensible lines as soon as possible - this stoush has been going on for too long and undoubtedly will have been detrimental to the core business of each (as well as Symbion operations) as focus has been taken off core operations to manage the takeover. The main beneficiary here will prove to have been Sonic.

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