

CI AUSTRALIAN EQUITIES FUND QUARTERLY REPORT



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

SEPTEMBER 2009

"What the caterpillar calls the end, the rest of the world calls a butterfly." Lao Tzu.

"Pessimism never won any battle." Dwight D. Eisenhower.

"Positive thinking won't let you do anything but it will let you do everything better than negative thinking will." Zig Ziglar.

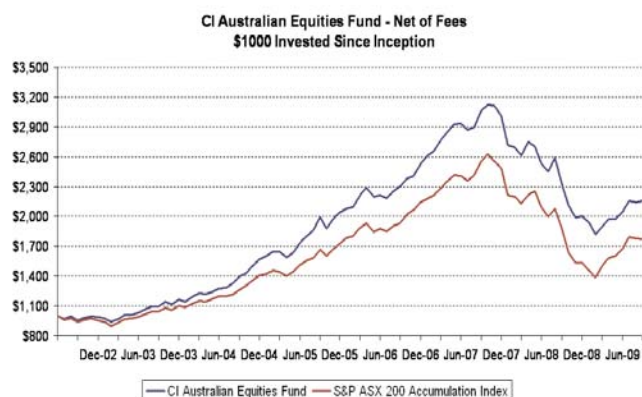
Fund Performance

	**FUND	BENCHMARK	VALUE ADDED
ROLLING 3 MONTHS	17.54%	21.50%	-3.96%
ROLLING 1 YEAR	4.44%	8.34%	-3.90%
ROLLING 2 YEAR	-10.49%	-10.91%	0.42%
ROLLING 3 YEAR	2.38%	1.66%	0.72%
ROLLING 5 YEAR	12.75%	9.99%	2.76%
ROLLING 7 YEAR	15.35%	11.67%	3.68%
SINCE INCEPTION*	14.13%	10.25%	3.88%
SINCE INCEPTION^	160.48%	102.80%	57.68%

* Annualised

^ Cumulative (4 July 2002)

** Before fees and expenses



In a quite remarkable third quarter of the calendar year, the ASX 200 Accumulation Index rose 21.5%, hot on the heels of a rise of 11.3% in the preceding quarter. The market has now risen 54% from its low point in March 2009. Many stocks have more than doubled from their 12 month lows, including CBA, NAB, Rio Tinto and Macquarie Bank.

The Fund did not keep pace with the market over the quarter, returning 17.54%. Stocks in the portfolio which made a strong positive contribution to performance included ANZ, Austar, Brambles and CBA and stocks in the portfolio which detracted from the portfolio's relative performance included Healthscope, Ramsay Healthcare, AGL and Transurban.

Reasons for the Fund's under-performance relative to the Benchmark include:

1) The portfolio is underweight banks (18%) compared with the ASX 200 weighting of 26%. Banks returned 34% for the quarter, materially out-performing as concerns over financial market dislocation and asset deflation abated. In our view, contributory factors to the GFC were the inadequacy of regulation and controls over the banking sector. Our underweight bank position was framed around our view that Australian banks would experience higher bad debts, lower loan growth, fewer cost-saving opportunities, increased capital requirements (imposed by regulators) and consumer pressure on fees. Australian banks have proved to be much more resilient than our expectations due to the favourable oligopolistic industry structure and behavior and the government's fiscal and monetary policy response to the GFC. The major banks were provided another short term "free kick" via reduced competition and further market share gains. On current forecasts the bad debt charges are 1/3rd of what they were in the early 1990's.

Our long term view remains to be underweight banks. On fiscal 2010 earnings the banks are trading at 20 year high relative price earnings ratios. We continue to identify stocks and sectors which we believe offer better long term prospects than a number of the banks.

2) The Fund is over-weight healthcare stocks. A number of these stocks have under-performed in the market rally due to their stable demand profile and earnings, concerns over regulatory risks and the negative impact of the rising Australian dollar on overseas generated earnings. Our investments cover a wide range of different types of healthcare stocks - private hospitals in Australia and the UK (Healthscope, Ramsay), global plasma fractionation (CSL), cochlear implants (Cochlear), pathology (Sonic), sleep apnea devices, respiratory and acute medical equipment (Fisher & Paykel Healthcare). We like these businesses because of their market position, leading world class products and favourable long term demographic trends. We believe the strength of these companies can ameliorate the regulatory and other risks associated with being largely dependent on government funding. More importantly, many of

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the products mentioned above provide positive cost benefit outcomes for government over the long term.

Across a number of health industry areas, the government is looking to reform funding mechanisms whilst allowing the private sector to deliver services to the market. In addition, we believe that there will be more private funding of healthcare generally. Interestingly, the NHS in the UK is moving toward more outsourcing which is an acknowledgement that the private sector has a role in improving service and productivity.

3) The Fund was overweight general industrial stocks/consumer stocks such as Metcash and Coca Cola Amatil. While appreciating in value, these stocks have also under-performed the general market. These are quality growing companies with strong financial and market positions, but they have not participated in the rally to the same extent because of their "defensive" attributes.

4) A number of other sectors, where CI has limited exposure based on our long term view, also out-performed during the quarter. Examples include REIT's, Discretionary Retail and Investment Banking.

We remain confident that the portfolio is comprised of quality companies which are good long term investments based on their financial indicators, industry/operating trends and focused management.

The Portfolio

As at 30 September 2009, the portfolio consisted of 34 stocks and it had a beta of .83 and a tracking error of 4.9%. Major sector exposures were as follows:

Banks	18%	(Westpac, Commonwealth)
Insurance	8%	(QBE, Insurance Australia Group)
Healthcare	16%	(CSL, Sonic, Cochlear, Fisher & Paykel Healthcare, Healthscope)
Metals and Mining	19%	(RIO, BHP, Alumina)
Consumer	13%	(Coke, Woolworths, Metcash, Austar)
Industrials	12%	(Brambles, Toll)
Energy	6%	(Oil Search, Origin)
Reits	nil	
Cash	4%	

Three of our largest positions in the Fund are Alumina, Healthscope and Oil Search. We thought

it would be helpful to reiterate why we remain confident in each of these stocks.

Alumina – The portfolio's largest overweight position is Alumina. During the quarter we spent a day visiting their Western Australian operations. Alumina owns 40% of the AWAC (Alcoa Worldwide Alumina and Chemicals) partnership which comprises a number of alumina mines and refineries, as well as two aluminium smelters.

The W.A. operations produce over half of AWAC's alumina production and represent around 11% of the world's annual alumina production. They are very efficient and are in the bottom cost quartile of alumina production. The principal advantages these operations have are the quality of the deposits, the proximity of the operations to Perth and ports and the long term gas supply contract with the North West Shelf project.

The price that AWAC receives for its alumina is based on a linkage with the aluminium price. Therefore, as the aluminum price has been weak, the revenues for AWAC have fallen. The main costs in producing alumina are mining costs (labour and fuel) and caustic soda and energy (gas) used in the refining process. AWAC faced a severe margin squeeze because the input costs did not fall as much as the aluminium price, and in particular the price of caustic soda continued to rise until earlier this year. Consequently AWAC had a number of quarters where they were only around break even in profit.

The quality of the operations we visited is very high and we were impressed by the calibre of the people. As AWAC is a very low cost producer we feel that it is a matter of time until profitability is resumed as either further high cost production is closed or demand for aluminium increases and lifts the aluminium and alumina price. As profitability is only marginal at present, we believe that there are good prospects of leverage to better margins in the future.

The visit highlighted both the quality of the assets and their irreplaceable nature. At the point we increased the weight in Alumina, we felt the replacement cost of the operations was more than double the share price, the balance sheet was stable and our expectation was that as the alumina margins improve the share price should increase based on higher earnings expectations. In recent months the price of aluminium has started to rise and the price of caustic soda has fallen so earnings forecasts are now starting to rise.

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Healthscope – Healthscope is one of the largest private operators of hospitals and pathology clinics in Australia. The company owns or manages 44 hospitals in Australia and 44 laboratories in Australia, New Zealand and SE Asia. In Australia the company has grown over the last ten years, mainly by acquisition. Due to the now largely consolidated nature of both the hospital and the pathology markets, acquisitive growth is likely to slow into the future. Private hospitals contribute 75% of the company's profits.

Demographics (mainly the ageing population) driving increasing demand for hospital services, market share gains (predominantly from smaller operators) and outsourcing by the public sector should continue to ensure a robust business going forward. Approximately 45% of Australia's population has health insurance (up 2% from this time last year despite the change to the MLS in the 2008 federal budget), and we would not anticipate a large impact if the 2009 budget initiatives (means test the rebate along with an increased Medicare levy) are implemented. Today 57% of all Australian surgery is undertaken in private hospitals, underscoring the task facing public hospitals were the government to change our current dual public/private system.

Healthscope is undertaking expansions at ten of its hospitals which should provide attractive returns over the next three years. In addition, we believe Healthscope will be able to continue to grow its pathology business as underlying volumes grow at 5-6% per annum, albeit at a slower rate than would have been the case in the absence of the recent government mandated fee cut.

Healthscope trades at a sub market PE multiple of 13.7x and a fully franked dividend yield of 4.7%.

Oil Search - We expect late 2009 to be a critical time for our investment in Oil Search (OSH). The final decision on whether to proceed with the upstream Liquefied Natural Gas (LNG) project in PNG is expected by late 2009. OSH owns 30% of the US\$12b project which is expected to deliver first gas in 2013/14.

The project proposes to utilise uncommercialised gas from Juha, Angore and Hides and associated fields in the Southern Highlands and Western Provinces of PNG. The two initial LNG trains will export around 6.3 mtpa of LNG which is a form of gas that will be liquefied through a cooling process plant 20 km from Port Moresby and then shipped to Japan and other Asian markets. The LNG will be

used as a clean fuel in industry, electricity generation, home heating and cooking.

CI finds this project attractive because:

- The resource has a high liquids content compared with other projects in the Asia Pacific region, e.g. Queensland coal seam methane. The high liquid rich attribute delivers superior projected internal rates of % return and earlier payback of capital.
- The project will have a 30 year cash flow stream which will support the development of further growth options. The first two trains account for around 60% of the known gas resource which leaves a further 300m barrels of oil equivalent (boe) for commercialisation. The process of assessment for a possible train 3 & 4 development is expected to commence after the sanctioning of trains 1 & 2. Trains 3 & 4 offer the potential for significant expansion of % returns on capital by leveraging already sunk infrastructure associated with trains 1 & 2.
- OSH is debt free with \$430m of net cash on its balance sheet. With a US\$390m drawdown facility and a recent \$900m equity raising OSH have fully funded their equity share of the project.
- The project has strong backing from the PNG government because of its importance to their economic growth and development. The project's first phase capital cost of circa US\$12b is more than PNG's current GDP of US\$8b (US\$1300/capita) and will triple its exports base.
- In the lead up to construction the project has the benefit of OSH's experienced management team lead by its long standing CEO, Peter Botton. OSH provides local credibility and experience in community issues and government relations to the project operator, Exxon. Exxon is one of the market leaders in terms of planning, project management and "on time on budget" project delivery. Together they can deliver a world class project for the benefit of all stakeholders.

Observations from Trips/Company Visits

As part of CI's investment process, we enhance our knowledge through a program of industry and company visits. In the past year, the investment team has made over 700 one-on-one company or industry meetings in person or by phone in more than 20 countries. The Aussie equities team made two major trips during the quarter.

United States - In August we spent two weeks in the United States and visited a number of companies such as IBM, Colgate Palmolive,

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Johnson & Johnson, Hudson City Bank, Procter & Gamble, Exxon, Chevron, Hewlett Packard, Wells Fargo and Visa which provided insights into Australian comparison companies.

Key themes included energy, consumer goods manufacturing, and finance. Some of the salient comments that are relevant to our thinking about companies in the portfolio included:

- insurance premiums have a long term growth rate of 2-3%. This has not changed in the US in 70 years.
- Visa has more power than issuing banks in determining revenues from credit cards.
- There is a major debate in the U.S. on whether large trading volumes on exchanges increase or dampen volatility.
- Current bill on carbon will not pass congress.
- Wind and solar generation to grow strongly but old dirty power stations will not be retired quickly. New nuclear build is unlikely in the US.
- Politics has become more pro development as the economy has weakened.
- All commodities have proven to be linked, gold is the only metal that has moved differently and the oil price is probably the major driver of commodities cycles.
- Tier 1 suppliers/consumer goods manufacturers do have power over the retailers.
- Simplicity and back to basics are a common trend: less stock, fewer management layers, fewer derivatives.
- Demographics and emerging economies story unchanged.
- Very positive commentary on PNG/LNG project by Exxon/Chevron.

Western Australia – Given the global view that Australia has avoided the worst of the GFC because of its resources bias, in July we visited a number of iron ore companies in Western Australia. Our key take outs were:

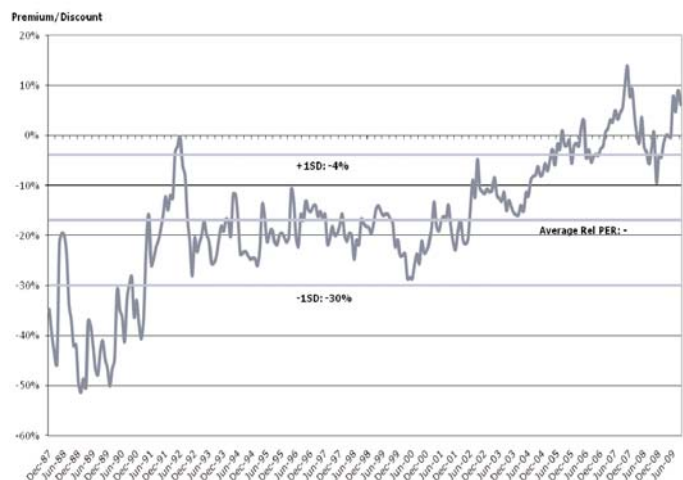
- Chinese iron ore import demand has surprised on the upside as prices have fallen. Lower prices for iron ore have seen Chinese mills switch from low quality domestic ore to imported ore from Australia and Brazil.
- The BHP bid for RIO in 2008, the subsequent aborted Chinalco deal with RIO and now the new RIO/BHP joint venture has spurred further action by the Chinese to gain control of alternate supplies of iron ore.
- We see this move as confirmation of the “stronger for longer” scenario for volume demand out of China and a positive for the diversified miners (BHP and RIO) in the portfolio.

Market Outlook

Although there are some tentative signs of stabilization emerging, we are yet to see any concrete earnings recovery in the industrial western world. The Australian market is now trading at close to record high PE ratios compared with the rest of the world and well above its long term average. We will need to see earnings growth into the second half of the current fiscal year to drive the market substantially higher. In the short term the big question remains what happens when governments withdraw stimulus packages and monetary settings normalise both in the West and BRIC economies, especially China.

While we remain cautious in the short term, in the long run we expect equities to deliver real positive returns as Australia reclaims its title as the “lucky country” (see chart below). Australia’s relative advantage can be summed up as follows: 1) proximity to Asia, the world’s growth engine with 27% of world GDP and 60% of the world’s population; 2) population growth; 3) abundant mineral, energy, agricultural and other natural resources 4) a superior starting balance sheet position without the encumbrances of pension, medical, defense & security liabilities faced by many other countries; 5) public and private world class institutions that regulate, supervise and monitor our finance sectors; and 6) tax advantages with our superannuation and franking credit system

MSCI Australia/MSCI World - Relative PER (12mth forward)



Source: Thomson Financial, GSJBW Research Estimates

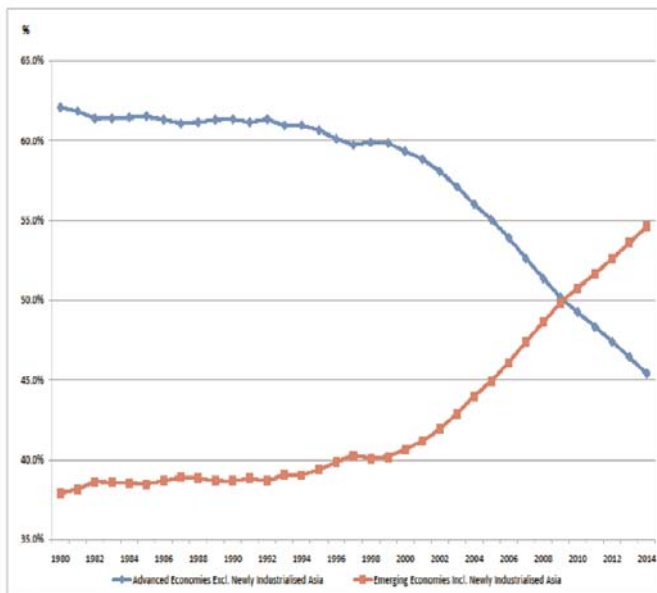
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From an equity market perspective it is easy to underestimate the importance of our regional status as part of the Asia Pacific region, combined with our mineral and other natural resource wealth. Warren Buffett recently stated “The 19th century belonged to England, the 20th century to the US and the 21st century to China. Invest accordingly.” We would substitute Asia for China and include Australia in the mix. The magnitude and speed of this shift in wealth creation is highlighted in Chart below. In 2010 the GDP of emerging economies and, most notably, newly industrialized Asia is forecast to pass the GDP of advanced economies. Equally noteworthy is the forecast move of newly industrialized economies to over 50% of global GDP in 2010.



Source: Evans and Partners

Just over one hundred years ago our agricultural and mineral wealth took us to the top of the world standard of living table. With the right policy settings we can regain this position. Poor government policy, most notably protectionism, eroded our competitiveness for much of the 20th century and sadly saw our ranking fall to a low of 18th in the 1980s. History reminds us the nature of governments is to interfere more rather than less with the workings of the economy, particularly after a major economic shock such as the GFC. It would be tragic to see the benefits of reforms over the last two decades removed by new regulations that do little to foster, and possibly hinder, the long term competitiveness of our economy. Examples of regulatory reviews that are cause for concern include-

- Telecommunications – Telstra and the NBN. The Australian public deserves far more rigorous economic/cost benefit analysis of a \$43B proposal than has been presented to date.
- The Henry tax review in Australia – there will almost certainly be changes to our tax system and we would anticipate the overall tax burden to rise (possibly substantially).
- The never ending reviews (currently the Cooper review) of and changes to superannuation which is undermining confidence in one of the best retirement savings systems in the world.
- Workplace legislation which is now giving rise to greater union activity in a number of sectors in Australia.
- FIRB changes and Australian government interference in bids by foreign companies for Australian companies and assets.
- Emissions trading and renewable energy legislation and its increasing complexity and uncertainties.

We are concerned about the volume and complexity of new regulation and will continue to monitor the impact on industries and companies in the portfolio.

Renewable Energy/the CPRS

Renewable energy and the CPRS (Carbon Pollution Reduction Scheme) are hot topics at the moment. We make the following observations:

- If the requirement to have 20% of our energy consumed from renewable sources by 2020 is to come to fruition, given technology today, the bulk of the new forms of energy required will come mainly from wind. This would entail up to \$25 billion of capital expenditure on wind alone and substantially more on gas (as a back up given that wind does not blow all the time) and on transmission infrastructure. Investors will want to make an adequate return on this capital. In addition, this form of energy is more expensive (by a factor of 3 times) to put in place than traditional coal fired power, implying that we are likely to face rising electricity prices as the years go by. AGL and Origin, as integrated energy suppliers, are the best placed to profit in this environment, although it is not riskless as well known oil and gas executive and legendary entrepreneur T.Boone Pickens has found in the USA – he is now the owner of 687 unwanted wind turbines costing \$2 – 3m each after a wind project was cancelled due to funding and transmission problems.

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- The government seems keen to legislate for our own CPRS environment in advance of the Copenhagen conference in December. There are two issues worthy of consideration. 1) What is the cost and competitive disadvantage to export industries? 2) What is the likelihood of the CPRS pushing the emission offshore, not in curbing overall global emissions? In the long run, the determination to reduce emissions will reduce the value of a number of our commodity and industrial companies.
- Even in the absence of wind and other new forms of renewable energy, the price of electricity in Australia seems destined to rise as gas would be the major source of energy. Gas prices in Western Australia have risen dramatically over the last 5 years as domestic buyers have had to compete with LNG exports. If the coal seam gas players are successful in converting coal seam gas to LNG in Queensland a similar phenomenon could happen there.
- The privatization of parts of the NSW energy industry will increase consolidation in the industry further entrenching the positions of AGL and Origin in an expanding market.

Reporting Season - A thank you

CI and other fund managers enjoy a privileged position in being able to meet with CEOs and senior management teams to discuss the latest results and the medium to long term strategy and outlook for the company. Assessing the quality of management teams is a core component of the CI investment philosophy and we appreciate the valuable time CEOs and CFOs provide to us. We had a number of very productive and enjoyable meetings this reporting season and thank all concerned.

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