# CI BRUNSWICK FUND
# QUARTERLY REPORT

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

## DECEMBER 2009

***"Try not to become a man of success but rather try to become a man of value." Albert Einstein***

***"Be content with what you have; rejoice in the way things are. When you realize there is nothing lacking, the whole world belongs to you." Lao Tzu***

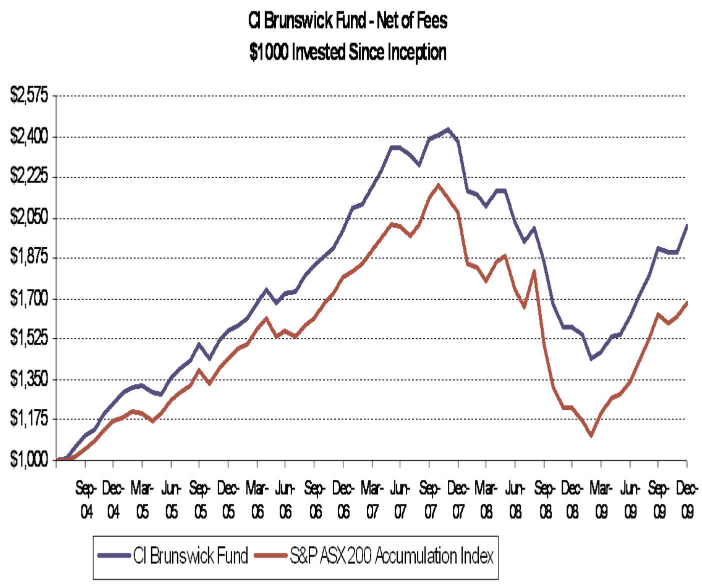
***"An ant on the move does more than a dozing ox." Lao Tzu***

***"If you realize that all things change, there is nothing you will try to hold on to. If you are not afraid of dying, there is nothing you cannot achieve." Lao Tzu***

## Market and Fund Performance

| | **FUND | BENCHMARK | VALUE ADDED |
|---|---|---|---|
| ROLLING 3 MONTHS | 5.29% | 3.39% | 1.90% |
| ROLLING 1 YEAR | 29.22% | 37.03% | -7.81% |
| ROLLING 2 YEAR | -7.12% | -8.15% | 1.03% |
| ROLLING 3 YEAR | 2.32% | -0.70% | 3.02% |
| ROLLING 5 YEAR | 14.10% | 8.36% | 5.74% |
| SINCE INCEPTION* | 18.57% | 10.71% | 7.86% |
| SINCE INCEPTION^ | 155.37% | 75.03% | 80.34% |

*Annualised
^Cumulative (1 July 2004)
** Before fees and expenses




The CI Brunswick Fund returned 5.29% over the quarter compared with the index of 3.39%. Main contributors to the portfolio's performance were BHP, QBE, Wotif, Coca Cola Amatil, Navitas, Healthscope and Austar. Stocks that made negative contributions to performance included Oil Search and Westpac. The Fund has delivered positive returns over the past 12 months albeit less than the ASX 200. Longer term performance remains above market returns. In the last 12 months Australia has returned 35% vs. 31% for developed markets generally. The best performing ASX sectors were resources, transport, insurance and media. REITs and the energy sector showed negative returns over the quarter whilst banks were flat in a rising market. Over the last decade Australia's equity market has been a star performer compared with other developed markets. The ASX 200 delivered 12.7% p.a. for the last 10 years compared with negative returns by the U.S. S&P 500 over the same period.

The strong global recovery in markets has been driven by the stimulatory effects of both monetary and fiscal policy in all countries around the world including China's US$570b stimulus package and their 35% credit expansion. Liquidity has continued to flow into commodity linked currencies such as the AUD and commodity linked stock markets. Australia's currency strength is explained by the economic performance of the Asian region (including Australia) in addition to the US's loose interest rate policy. The US (the world's reserve currency) now has the steepest yield curve in 40 years reflecting the severity of the downturn. The biggest risk question remains when and how do governments withdraw liquidity?

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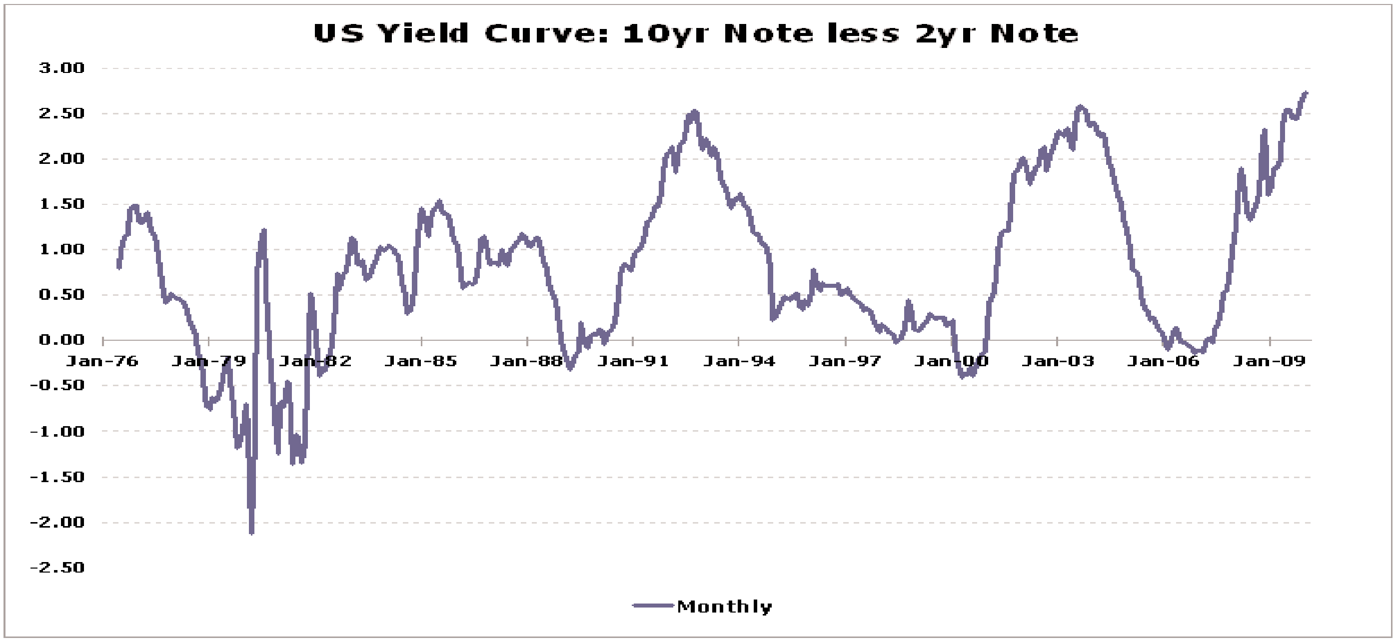


## The Portfolio

Our strategy is to identify stocks with VoF (value latency, operational performance, industry/strategic positioning & focused management) qualities within 4 broad categories:

1. Stocks with above market dividend yields backed by strong balance sheets and businesses ~ dividends have historically made up over 50% of total returns and we believe this is going to be a key theme over next decade.
2. Growth industries and companies e.g. education; internet based travel business models; resources and engineering services.
3. Asian geographic exposure ~ Australia's prospects are inextricably linked to the Asian region.
4. Consolidations ~ particularly in OECD countries where economies are mature and face global competition. Firms will need to drive value from consolidation.

The portfolio attributes compared with the broader market are summarized below.

| | **Portfolio** | **ASX 200** |
|---|---|---|
| PE x | 15.1 | 14.8 |
| Yield % | 4.3 | 4.2 |
| Roe % | 15.0 | 13.0 |
| Debt/equity % | 43 | 49 |
| Stock numbers | 37 | 200 |

Over the quarter we increased our position in Trust Power (the NZ power utility) and reduced positions in a couple of stocks due to their strong share price appreciation. The Fund participated in capital raisings for Amcor and Oil Search. Oil Search has now fully funded its share of the PNG upstream LNG project. Amcor's raising was to fund the acquisition of the Alcan packaging assets from Rio Tnto which has been given regulatory approval. The acquisition of the Alcan packaging assets should provide Amcor with operational synergies estimated to be between A$200m to A$250m per annum in the first three years of ownership.

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Major sector exposures of the portfolio are:

| Sector | Portfolio Weight | Stock examples |
|---|---|---|
| Energy & materials | 17% | (Oil Search, Bhp, Alumina) |
| Industrials | 12% | (Brambles,Toll) |
| Consumer sectors | 25% | (Glorious Sun, Austar, Metcash) |
| Healthcare | 18% | (Healthscope, Cochlear, Csl) |
| Financials | 19% | (Standard Chartered, Westpac) |
| Utilities/Teleco/Infrastructure | 6% | (Trust Power, Australian Infrastructure) |
| Cash & equivalents | 7% | (Bank deposits) |

**Stock comments:**

**Alcoa Inc -** Alcoa and Ma'aden (Saudi Arabian mining company) announced the development of a fully integrated, world-class aluminum industry in the Kingdom of Saudi Arabia. AWAC (40% owned by Alumina Ltd) will be the supplier of alumina to the project's smelter with the JV expecting first production in late 2014. As a cross reference to our valuation work we have estimated the value of Alumina's producing assets by applying the greenfield cost estimates being used for the Saudi Project. Using this methodology CI estimates the replacement cost of Alumina's assets to be $3.30 net of debt which compares with the current share price of $1.80. Aluminum stock levels are high but peak in 2010 with global demand expected to exceed production growth over the next 3 years.

**Coca-Cola Amatil** - A strong positive contributor to the Fund was our position in Coca-Cola Amatil (CCL). CCL is one of the largest bottlers of non-alcoholic beverages in the Asia-Pacific region and is one of the six major Coca-Cola bottlers in the world. More recently CCL has formed a 50/50 joint venture with SABMiller which manufacturers and markets a range of premium beers in Australia and New Zealand. CCL has delivered consistent growth in earnings and improvement in returns. A hallmark of their performance has been the continued growth of their mature brands such as Coke, supplemented by introducing new categories and extending existing categories. CCL have demonstrated clearly that by extending their reach into bottled water, sports and energy drinks they can deliver both operational and earnings growth. Nonetheless, it is CCL's reach into the burgeoning Indonesian market which has the potential to deliver significant growth. The latent potential in the Indonesian economy has taken many years to emerge but, more recently, the macroeconomic transformation underway has started to deliver a more stable and consistent level of growth. Against this backdrop and a population of circa 240m, there has been a meaningful rise in foreign capital invested in Indonesia. A corollary of this has been the growing presence of international supermarket chains which has provided an ideal distribution platform for CCL's portfolio of beverages. Subsequently, CCL is stepping up their investment in production facilities in Indonesia to more fully participate in this growing market.

**Brambles** - It is worth noting the reasons behind the disappointing performance of Brambles over the quarter. From a business trading perspective Brambles is similar to many of the global industrial businesses we spoke to, namely while the destocking process has now ended there remains only a tepid pickup in business activity and organic volumes are still lower than pre GFC levels. In addition, there were a number of company specific issues which beset Brambles during the last quarter, e.g. both the CEO and CFO resigned. They were replaced by Tom Gorman (formerly President of CHEP Europe) and Greg Hayes and we believe that they should collectively bring greater focus to operational matters. Indeed it was evident under Tom Gorman's stewardship of CHEP's European business that there was a concerted effort in improving its engagement with its key customers. Also during the quarter the company announced a significant restructuring of its USA pallet business. This restructuring initiative called "Better Everyday Program" required a quantum increase in capital expenditure to lift the quality of the US pallet pool to new standard specifications and set minimum standards of repair. The ongoing net cost of this program is US$50m per annum and an additional fast-track spend of US$110m over three years. In the short term it is clear that this is hefty investment which will add significant cost. It should however ultimately strengthen Brambles' competitive offering in the market place by ensuring their pallets keep pace with changes in manufacturing processes; principally the greater use of automation & smaller packaging sizes used by their customer base.

**Fisher & Paykel** - We recently visited Fisher & Paykel Healthcare (FPH) a medical device company head quartered in Auckland, NZ. FPH was a division of Fisher & Paykel Appliance and was spun out 10 years ago as a separate listed company. FPH's technology is centred on pumping air into the body whilst heating cooling & controlling moisture using semi permeable membrane tubing that lets air and moisture out of tubing but not in. There are 5 broad product applications: 1) obstructive sleep apnea, 2) neonatal care, 3) invasive and non invasive (hospital patient) humidification, 4) surgery (open and laparoscopic, and 5) chronic obstructive pulmonary disease. FPH exports to home care organisations, hospitals and medical device distributors in 110 countries from its NZ manufacturing plant and a new plant in Mexico (from 2010). FPH has grown its revenue @ 16% p.a. in constant currency since 2001 and the product pipeline supports a repeat of this growth rate over the next 10 years.

## Company trips/visits ~ CI trips to China - November 2009

The key insights from our meetings in China covered the following areas.

**The Economy**

- We should believe the statistics published on the Chinese economy which show continued high growth and expectations of around 8% growth in 2010.
- The second and third tier provinces have been growing faster than the first tier provinces.
- Urbanisation is at the heart of the growth story, already 183 cities with more than 1m population.
- There is an oversupply in many products such as steel, cement, shipping and some other commodities, but the stronger companies are continuing to add capacity.
- Planning in many industries to shut down or consolidate the small, weaker, dirty operators and increase the size and strength of the leading operators, e.g. Baosteel, Shanghai ports.
- There are plans for "asset injections" into some of the stronger State Owned Enterprises (SOE's). These will not be Board decisions.
- Spending on infrastructure and real estate particularly strong.
- Bank lending has grown 35% year to date, compared with the "normal" loan growth of 2x GDP or around 18%.
- Competition is cut-throat and good business models get copied very quickly.
- Business environment is very dynamic, it was recommended that you need to visit China quarterly to keep up with changes.
- Quite hard to see how the economy moves quickly from investment spending to consumption spending.

**Politics**

- The central government cannot control the provinces.
- "Things are back on track" with the Australian relationship.
- China views Australia as having attractive investment characteristics however their level of investment to date is very low.
- Plenty of censorship, often the internet freezes and TV shows go blank for a while.
- If you stuff up in China you might get executed rather than getting a payout or a cushy job, that tends to focus the mind.
- A lot of mentions of environmental issues (closing dirty plants, targeting less coal reliance) but it felt like jobs and economic growth will not be jeopardised for environmental concerns unless it starts hurting the bottom line.

**Companies**

- The SOEs have been generally positive for the development of China and investment into SOE structures should not be ruled out from a philosophical perspective.

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- Clearly you would want to invest in the favoured SOE's that feel like "good" companies in any other market.
- If an SOE has two years of losses there are negative regulatory consequences.
- There will definitely be more acquisitions by Chinese companies in Australia, they will be in companies with strategic importance rather than cheap companies.
- The Nasdaq listed Chinese companies we saw were the "best' companies.
- Foreign companies struggle in China, i.e. EBay failed, Google is not the largest search engine.
- English widely used - most of our meetings did not need an interpreter which is different from three years ago.

**Commodities**

- Chinese produced coal is becoming more expensive and there is likely to be a shortage for at least a few years until new mines are fully functional.
- Coal production costs are going up quicker than prices.
- Will import if cheaper than domestic production.
- Closing small mines and steel mills but plenty of new capacity coming on stream.
- Iron ore prices expected to rise by 20% for 2010.
- China trying to consolidate the buyers of commodities but this will take a long time.
- Government policy to diversify energy source away from coal therefore China will be big buyers of gas, uranium, wind and clean coal technology. Any meaningful change in energy source from coal will take years.
- The scale of the country and its industry is staggering, everything is huge.

We believe that investment portfolios should have solid exposure to commodities and services that China needs but does not already control such as iron ore and high quality coal. Equally obvious is that it is tough in industries where China dominates such as steel, ships and other heavy industry.

## Market Observations & Outlook

**Australia's economic performance** - Australia finished 2009 on a high. We avoided a technical recession. Australian companies were able to raise close to $100 billion in ordinary equity. Unemployment remained below 6% and the share market was up by 35%.

**Banking regulation and the Basel Proposals** - Major change is likely to be a strengthening of tier 1 capital with the stipulation it must be made up of ordinary equity and retained earnings and not a myriad of hybrid securities.

**Impact of reduction in leverage** - Deleveraging reduces the availability of debt. The sheer weight of deleveraging and increased propensity to save over the next decade is expected to provide headwinds for debt dependent asset values and some credit fuelled consumer sectors.

**Wealth Management costs must fall** – In Australia, regulatory changes are expected to favour the big integrated brand managers who can deliver low cost, simplified products with trusted brands and advice, e.g. the big four banks and the industry funds.

**Energy costs must rise** - The Australian Energy Regulator faces a tough balancing act to ensure utilities receive an adequate return on their investment to fund the required doubling of capital expenditure to upgrade, maintain and expand our electricity and gas infrastructure.

**Climate change** - Ultimately it will be the big nations of the world that determine the outcome and Australia will follow rather than lead.

**Investment and trade opportunities closer to home** - ASEAN has a GDP of US$1.5 billion and a population of about 580 million. It is a large and growing opportunity for Australia. GDP per capita in the most populous member nation and our closest neighbour, Indonesia, is forecast to grow strongly over the next 20 years from current levels of about US$3,980 and urbanisation is forecast to rise from 50% to 69% over the same period.

It is estimated that 160m people in the ASEAN region have no access to electricity. The region has only 1% of the world's proven energy reserves but accounts for 4.4% of the world's energy demand. Despite global initiatives to contain carbon emissions, coal is the fastest growing power source in the ASEAN region.

Australian companies with operations linked to the region include Leighton, Oil Search, Worley, Downer, Coca-Cola Amatil, BHP and ANZ.