

# CI BRUNSWICK FUND QUARTERLY REPORT



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

## SEPTEMBER 2006

*"...In a garden one must always replenish for the future. Plants must perform or they are gone; design ideas that don't work must be redone".  
Dame Elizabeth Murdoch aged 97.*

*Bill Clinton on Nelson Mandela "Years ago I asked him this about the day of his release: 'You were a great man, you invited your jailers to your inauguration... but tell me the truth. Weren't you really angry all over again?' And he said, 'Yes, I was angry. And I was a little afraid. But when I felt that anger well up inside of me I realized that if I hated them after I got outside that gate, then they would still have me.' And he smiled and said, 'I wanted to be free so I let it go.' It was an astonishing moment in my life. It changed me."*

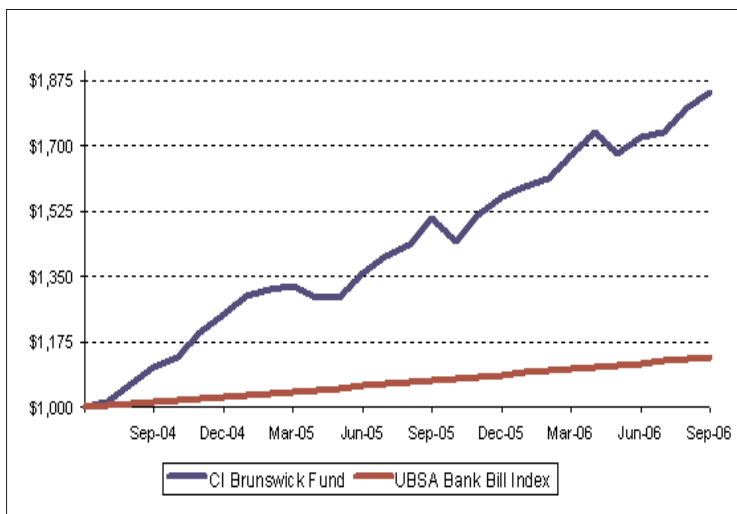
*"China will most likely be saving more than the US for years to come. But, as the next generation takes control in China, this will change. Today's children will not view their own life stories from the perspective of the difficulties China has experienced. As this change unfolds, the enormous willingness to save, and to tolerate high saving government policies, will fade." Robert Shiller, Professor of Economics at Yale University*

*"The abandonment of the gold standard made it possible for welfare statists to use the banking system as a means to an unlimited credit expansion. In the absence of the gold standard, there is no way to protect savings from confiscation through inflation." Alan Greenspan "Gold and Economic Freedom," 1966*

### PORTFOLIO PERFORMANCE

PORTFOLIO	
ROLLING 1 YEAR	22.37%
ROLLING 2 YEAR	28.99%
SINCE INCEPTION*	31.20%
SINCE INCEPTION^	84.24%

\* Annualised net of fees  
^ Cumulative (1 July 2004)



The September quarter continued the recent trend of high volatility in financial markets. Bonds rallied strongly, oil and gas prices fell sharply and stock markets rose quite strongly. In Australia there was a sharp fall in resource and cyclical stocks and rises in the more stable sectors such as financials and property.

The portfolio performed strongly over the quarter with a return of 6.95%. Over the year to September the portfolio rose by 22.37%.

The portfolio did not change significantly during the quarter. In broad terms the net exposure to stocks is around 85%, this includes about 94% in long positions and 9% in short positions.

The largest contributors to the portfolio return were property and infrastructure stocks while the resources exposures dropped in price.

Overall we see high expectations priced into many stock prices however

this is compensated somewhat by rising profit expectations in many stocks and a very high level of liquidity in financial markets.

A major theme in the portfolio is the exposure to Australian listed stocks that have growing overseas businesses. These stocks include Macquarie Bank, Brambles, AXA and QBE. What we are hoping to capture in these stocks is above average growth opportunities delivered by management teams we know and can observe and with the benefits of the Australian franking system.

The portfolio has a large holding in Transurban. There are a number of characteristics within Transurban that we are attracted to.

Firstly the stock has a current yield of 7.4% which we expect to grow steadily for the foreseeable future based on the Australian assets. Whilst this yield represents partly the pull forward of future free cash flows, the cash flows from the Australian roads are so predictable that we feel little risk is being taken by paying high distributions now.

The Transurban assets are internally managed which is in contrast to most other infrastructure based companies. In this structure there is no fee leakage away from shareholders but more importantly Transurban has developed leading edge skills in traffic forecasting, delivering large toll road projects and operating and managing toll roads. This means the potential future value generated from these skills will stay within Transurban rather than an external management company.

Thirdly the assets have different growth profiles. Citylink and M2 are well established roads with predictable revenue growth and these two assets provide the cash flow for the distribution profile. Westlink M7 is a major new road in Western Sydney that is in ramp up and will provide cash flow growth in the future. Transurban also has a growing presence in the US having already purchased the Pocahontas Parkway in Virginia. Transurban is also the preferred developer for the I-95 HOT lane project and has exclusive negotiating rights for another HOT lane project in Washington. We expect that returns from these projects will be higher than new opportunities in Australia.

In the US Transurban is creating an investment vehicle that will be managed by Transurban and include both Transurban and external capital. Given that Transurban stated at it's recent AGM that "it is difficult to overstate the opportunities in the toll road business in the US" we feel it is possible that quite a lot of value can be created for shareholders.

Overall Transurban offers an attractive mix of high and growing yield, a skilled internal management team and significant offshore opportunities.

We have an extensive overseas travel program which is aimed at visiting

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the overseas operations of Australian companies, visiting competitors and also identifying overseas listed companies that may be attractive investment opportunities. We are particularly interested in the rapidly developing Asian economies.

One observation that is very clear at present is that Australian stocks are generally more expensive than their international counterparts. The most obvious example is in the banking sector where Australian prices are some 20% higher than comparables in the UK. While it is arguable that the prospects in Australia are better than some other regions and it is arguable that the flow of funds is also higher in Australia the differences in value are getting harder to reconcile.

### Global Industry Visits

***"The fact is that the world has an abundance of oil and there is little question scientifically that abundant energy resources exist. According to the US Geological Survey, the earth currently has more than 3 trillion barrels of conventional recoverable oil resources. So far, we have produced 1 trillion of that." Mark Nolan Exxon Mobil Australia CEO.***

***"If It bleeds it leads" Media saying***

***"Every year India is adding the entire energy/electricity capacity of Australia..." Leightons, Wal King.***

We traveled to Asia and USA during the past quarter... We visited 32 companies and 7 USA cities over 10 days, focusing on industries in which Australian companies operate such as healthcare, childcare, building and construction. Some of the themes to emerge included:

- Housing starts, having peaked at 2 million, will inevitably fall below the low of 1.8 million assumed by the NAHB. Builders are tightening their belts, consumers are more highly leveraged, Sunbelt states may feel the heat short term due to more investment and second homes.
- Healthcare in the USA is very complex - different states have different regulations; there are a multiplicity of different payers and reimbursement/rebate arrangements, the nature of the system means most operators have bad debt issues (which is not the case in Australia). Healthcare is 15% of USA GDP (compared to 8-9% in Australia and the UK) and there is pressure from government to contain its spend in this area.
- While we were in the USA the private equity bid for HCA, the largest private hospital operator emerged. While nursing wages rise at a similar rate to Australia, and underlying volume growth is also similar, good private hospital operators run at 50% occupancy rates (compared to 75%+ in Australia), and 60% of admissions come from the emergency room. Funding comes in the main from the government in its different guises and managed care organisations. Bad debts run at 10% of revenue (80-90% of self pay results in a bad debt!). Hospitals are under more pressure from the growth in day surgeries are already present, and to be profitable they need scale/volume which is more difficult to achieve). Compared to Australia the for profit private sector remains fragmented, and operators can still grow by acquiring poorly managed not for profit hospitals and turning them around.
- There is a need for infrastructure investment in many areas. Airports are visibly an opportunity - we have yet to see an airport in as poor a condition as LAX (given its stature as the major Western USA gateway),

and almost every other airport we passed through looked run down and, compared to Australia and the UK, under tenanted from a retail perspective. Macquarie Bank has already built a position as the second largest regional airport operator in the USA, and would be hoping to take advantage of opportunities such as the upcoming privatisation of Chicago Midway airport. In addition it would appear that there will be greenfield roads opportunities at acceptable rates of return.

- The energy thematic will continue - while there is no shortage of oil reserves globally there is equally no doubt that in future more oil will have to come from higher cost/more difficult reserves (eg. Canadian oil shale) and more geopolitically risky countries, implying higher capital requirements and higher ongoing operating expense. OPEC has gone from 15m barrels/day spare capacity in 1980s to 1-2m barrels today, NOCs are asking service providers to undertake more technically difficult work, and two Middle Eastern countries at least are looking at heavy oil projects thereby signalling that light, sweet crude is running out.

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