

CI GLOBAL EQUITIES FUND QUARTERLY REPORT



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

DECEMBER 2008

"There is no means of avoiding the final collapse of a boom brought about by excessive credit expansion. The alternative is only whether the crisis should come sooner as a result of the voluntary abandonment of further credit expansion, or later as a final and total collapse of the currency system involved." Ludwig Von Mises (Austrian Economist 1881 - 1973)

"And I sincerely believe, with you, that banking establishments are more dangerous than standing armies; and that the principle of spending money to be paid by posterity, under the name of funding, is but swindling futurity on a large scale." Thomas Jefferson in a letter to John Taylor (28 May 1816)

"You make money by identifying stocks and industries with real value latency that with focused management can be realised through time" CI belief

"Modern finance is an antiseptic discipline; it eschews anecdotes and examples, which are messy and possibly misleading – but nonetheless real. It favours abstraction, which is perfect but theoretical. Rather than evaluate financial assets case by case, financial models rely on the notion of randomness, which has huge implications for diversification. It means 2 investments are safer than 1 and 3 safer than 2" Roger Lowenstein

"On financial instruments, our standards are incomprehensible..." International Accounting Standards Board Chairman David Tweedie

PORTFOLIO PERFORMANCE - GROSS

	PORTFOLIO	BENCHMARK	VALUE ADDED
ROLLING 3 MONTHS	-21.44%	-20.78%	-0.66%
ROLLING 6 MONTHS	-32.72%	-30.69%	-2.03%
ROLLING 1 YEAR	-37.27%	-39.53%	2.26%
ROLLING 2 YEAR	-14.90%	-19.48%	4.58%
ROLLING 3 YEAR	-3.26%	-8.94%	5.68%
SINCE INCEPTION*	5.13%	-2.23%	7.36%
SINCE INCEPTION [^]	22.66%	-8.82%	31.48%

* Annualised
^ Cumulative (1 December 2004)

CI Global Equities Fund - Net of Fees
\$1000 Invested Since Inception



UNHEDGED PORTFOLIO PERFORMANCE - GROSS

	PORTFOLIO	BENCHMARK	VALUE ADDED
1 MONTH	-1.44%	-3.21%	1.77%
ROLLING 3 MONTHS	-10.08%	-12.17%	2.09%
SINCE INCEPTION*	-14.37%	-16.09%	1.72%
SINCE INCEPTION [^]	-14.37%	-16.09%	1.72%

* Annualised
^ Cumulative (1 September 2008)

The CI Global Equities Fund returned -21.44% for the last quarter of the calendar year, down slightly against the MSCI All Countries World Net Dividends in Local Currency which returned -20.78%. Our newly opened unhedged version of the fund, the CI Global Equities Fund (Unhedged) returned -10.08%, outperforming its benchmark, the MSCI AC World Net Dividends in AUD, by 2.09%.

There are 36 stocks within the portfolio and our cash position is 4.9%. The top 10 positions in descending order are FPL Group 5.4%, Standard Chartered 4.8%, Reckitt Benckiser 4.7%, Roche 4.5%, QBE 4.4%, Tesco 4.4%, BG Group 4.3%, Procter & Gamble 4%, Covidien 4%, Johnson & Johnson 3.9%. Our smallest position is the Singapore bank DBS Group with 0.7%. We are overweight Consumer Staples, Health Care, Utilities and Telecommunications. Our biggest underweights are Information Technology, Consumer Discretionary and Financials. Major change of note to the portfolio is the positions we have taken up across the Telco industry which Allan will discuss further below. We have also trimmed certain other positions, notably Energy and Materials, to reflect the economic outlook and nibbled at a few opportunities that have arisen as a result of the market turmoil.

This quarter CI portfolio managers visited Europe, in particular, the UK, France, Spain, Germany and Switzerland. We saw 10 companies held by the Fund, amongst others, and reaffirmed our positions in 9 of them. The big talking points of the trip were the bankruptcy of Lehman Brothers and the effect it had on the global credit markets in the following week. The immediate and devastating effect on manufacturing was particularly of note also, especially the car industry, which has been well documented elsewhere.

Although there were no nasty surprises with respect to companies, the difference in atmosphere between countries was particularly tangible. The most pessimism was in the UK, the vulnerability of the economy has been exposed by the relatively large reliance on the financial industry, and of course the collapsing housing bubble that has been underway for some time. It seems many perceive the UK as more similar to Iceland in terms of economic exposure and current predicament than the USA. The economic problems in Spain have been a test for the euro's stability for well over a year now. From outside of Spain many others regard this as the basket case of Western Europe, certainly the problems were starkly highlighted by aggregate electricity demand dropping a huge 2.9% in November year-on-year. One thing that was clear though was the coherency and consistency of the government's infrastructure plans, in particular the planning duration well into next decade. This bodes well for our position in Red Electrica which is discussed below.

If UK and Spain were characterised by acceptance of fate, the outlook in France, Germany and Switzerland was a little more positive, generally due to

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the avoidance of the Anglo-Saxon housing and credit parties of this decade. While of course manufacturing and consumer demand will fall, France and Germany in particular enjoy a more diversified economy both by industry and also region. One comment that was repeated everywhere was that this is the worst downturn seen in working lifetime memory, without exception. With this in mind it is difficult to be overly optimistic for the equity markets for the next few months, short term bounces from oversold positions notwithstanding. Another impression gained was on the banking sector, for the time being funding issues seem to have been resolved, which means that valuations now can focus on non-performing loans, as they do in times of downturn. However again, if the global economy is destined for the course that many we met are saying, then the banks will have replaced one problem with another, albeit a far more run of the mill banking issue. We are still cautious on banks for the time being.

Red Electrica

Given the recent visit it is time to speak a little about a stock we have held in the portfolio for a number of years. Red Electrica operates in the European electricity industry. It is Spain's Transmission & System Operator, (TSO) a title that was granted to it by the government 2 years ago under Spain's compliance with EU electricity unbundling regulation. This means that Red Electrica is the sole operator of the entire Spanish electricity transmission network and wholly responsible for the continuity and safety of the electricity supply. This includes ownership, operation and maintenance of the transmission network, operation of the load balancing of the grid and also extending and upgrading the network as mandated in the 2008-2016 National Infrastructure Plan.

One of the most attractive aspects to Red Electrica is the remuneration model. Red Electrica receives a CPI adjusted return on their assets in existence prior to 2008 but on all investments subsequent to this they enjoy a post-tax financial return of the 10-year bond yield plus 375 basis points. The remuneration on new investment is particularly attractive as it is neither based on electricity volumes or CPI. Red Electrica is also able to outperform on 2 fronts, by beating their operating expenditure targets and also on capex investment costs. They can retain 100% of their operating expenses outperformance and 50% of their capex. Similarly capex over spend burden is shared 50% by the government.

As part of the 2016 Plan Red Electrica has a targeted capex program of around €600m per year, which annually increases the returns available. The investment opportunities in the plan arise for several reasons. First, necessary upgrading of transmission line from 110kv or 220kv to 440kv to allow for higher capacity. Secondly, extension of the grid for new generating sources, in particular renewables such as wind that are often generated large distances from consumers. Thirdly, new interconnections with the Balearic Islands or other countries such as Morocco. All of these provide Red Electrica with a stable transparent program for growth out to 2016.

Red Electrica is a classic owner operator, a simple straightforward company that is at the top of their industry operationally in terms of efficiency and performance. They have a mandate to provide one service and they have been very successful at doing this. They are an excellent example of a long term transparent model for utility assets that has arisen due to good planning and foresight on the part of the government. They currently sit on an earnings multiple of 14x with a dividend yield of around 4%, and with a clear path to growth that is unaffected by economic woes elsewhere they are a sound defensive long term position for the portfolio.

Allan Says... "Phone home"

Over the last quarter the CI Global Equities Fund has increased its weighting in the telecommunications "Telco" sector. From previously having minor exposure to this industry we have built up our Telco position over the last 3 to 6 months. Given the uncertain economic environment we like the large and relatively stable cash flows in the large cap Telco sector with their huge customer bases and recurring revenues streams. We have used the pullback in the market as an opportunity to take stakes in Vodafone Group, France Telecom and NTT Corp to add to our existing holding in MTN Group. While this industry will face headwinds in a contracting GDP environment the huge cash flows, large dividends, low valuations and reasonably sound balance sheets should provide strong support to weather a downturn.

Our preference for large cap market leaders stems from several reasons:

- The major players in Europe have moved more towards sweating their assets, i.e. maximising the profits generated from a company's assets as opposed to the traditional Telco strategy of targeting new customers. With mobile penetration close to or above 100% in the developed markets there is a common trend of cost cutting and maximising the value out of the current subscriber base and networks which bodes well for the market leaders. With market saturation the costs of attracting new subs increases and the service providers have realized that they generate better returns by focusing on their existing customers.
- The focus on sweating the assets along with the completion of the 3G rollout has resulted in a reduction in capital intensity (capex/sales). Free cash flow is on the up as capital intensity eases from above 15% to below 13% of sales for some service providers. In several mature markets service providers are able to run at below 10%. In addition to helping lower the cost base a new idea of sharing the costs has emerged as seen recently by Vodafone signing agreements with Bharti in India and France Telecom in the UK to share base stations.
- Large players with strong balance sheets have the financial capability to seek out opportunities in today's environment. With difficulties in gaining access to capital, a strong balance sheet and credit rating are vital to take advantage of any opportunities whether organic or by acquisitions. There is already evidence of this in the US where debt ridden Sprint is continually losing share to the other wireless majors.
- Consolidation is a positive to the industry in helping stabilize pricing. Prices of calls have been on the decline as more competition has entered the market and the industry has matured. Consolidation assists in slowing the pace or even stopping price declines.
- Confidence in management has been somewhat restored as acquisitions have rationalised and no more crazy \$100bn deals are seen. M&A is still happening helping the market consolidate but the days of 50 or 100x multiples paid for acquisitions are no more.
- Internet and data provide new revenue streams in the face of declines in traditional voice revenues. Access to new products and services such as smart phones which offer advanced capabilities beyond a typical mobile phone, IPTV (internet protocol TV) where TV is delivered through computer network technologies and VoIP (Voice over Internet Protocol) whereby voice communications are delivered over the internet help accelerate revenue growth.
- Telcos are trading at historically low valuations with shareholder friendly dividend policies. Having suffered a gradual de-rating since the tech boom the Global Telco sector trades at a forward PE of 11 xs, below that of the market and with a dividend yield above 5%.

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France Telecom (FT) is the French incumbent with 70% fixed line and 47% mobile market share in France. FT has replicated its integrated model in other European countries such as Poland, Spain and UK to be an integrated pan European player with a small but growing presence in Africa. In total FT have over 170m customers in more than 20 countries with 2/3rds under the Orange brand. FT is hugely cash generative and will generate more than 7.8bn Euros (AUD \$16bn) of free cash flow in 2008 – as large as BHP at the top of the commodity cycle and its 7% dividend yield is comfortably supported.

NTT corp is a holding company with 100% control over the Japanese fixed line incumbent and 60% control of the mobile incumbent NTT Docomo. NTT is completing the rollout of fibre to the home and following this should see its capital intensity eventually move from 20% to 15% of sales, doubling its free cash flow. NTT is currently trading below its book value and on an EV/EBITDA multiple of 3x.

With over 250m proportionate subscribers Vodafone is the largest mobile Telco in the world by revenues. After a decade of acquisitions and divestitures Vodafone is now taking a path of re-focusing its current operations. With a new CEO and tighter strategy Vodafone is seeking to make the most of its huge customer base and maximize free cash flow. Vodafone has a nice mix of mature cash generating markets in Europe and emerging growth markets such as India, Middle East and Africa. Vodafone is trading at historical low multiples of a single digit PE and 6% dividend yield.

Operating in 22 countries MTN group is the number one Telco in Africa with a growing presence in the Middle East. MTN has quickly ramped up its customer base to above 80m subs while overall penetration is only at 36% for its covered areas. MTN has a strong balance sheet with net debt/EBITDA below 0.5 times to support its attractive growth profile.

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