

# Ausbil Dexia Limited

## Australian Emerging Leaders Fund

### Investment Report September Quarter 2011

AUSBIL DEXIA LIMITED  
AFSL 229722  
ABN 26 076 316 473  
ACN 076 316 473  
A Member of the Dexia Group

Neither Ausbil Dexia Limited nor any member of the Dexia Group guarantee the performance of The Ausbil Investment Trusts, the repayment of capital or any particular rate of return.

**Money does not perform. People do.**



# Executive Summary

## Review

Portfolio performance for the September quarter 2011 was -16.77% versus the benchmark return of -13.83%.

The Australian equity market, as measured by the Emerging Leaders composite benchmark<sup>1</sup>, posted a decline of 13.8% for the September quarter on the back of concerns of a deteriorating global economic outlook. Bearish comments from the FOMC, downward global growth revisions by the IMF and concerns regarding the sustainability of the Chinese economic trajectory all weighed.

## Portfolio

At a sectoral level, the Portfolio benefited from its relative positioning in the Telecommunications, Consumer Discretionary and Healthcare sectors. Conversely the positions in the Utilities, Energy and Materials sectors detracted from performance.

At a stock level, the Active positions in Treasury Wine Estate and REA Group and the nil holding in holding Lynas, Cochlear and Paladin Energy were the largest contributors to relative performance. The nil holding in Macarthur Coal and Connecteast Group and the overweight Matrix Composites & Engineering and Oz Minerals were the largest detractors to Portfolio performance during the September quarter.

## Outlook

The ongoing absence of a firm and executable plan to bolster growth in the US and clean up the sovereign debt concerns plaguing Europe remains a key headwind to a market struggling to regain confidence. Appropriate economic leadership is unlikely to emerge quickly and we should therefore anticipate a continuation of the overhang in the short term. Notwithstanding this, valuations have retreated to extreme levels and are now reflective of the expectation of dire economic settings going forward. In numbers we see the market (represented by the S&P/ASX Midcap 50 index) trading on an FY12 PE of 10.0 times and yielding 5.8%, with FY13 sitting at 8.6 times and 6.4%. Even allowing for earnings downgrades in the prospective year, valuations appear to be very reasonable. The S&P/ASX Small Caps are trading at less extreme valuations with an FY12 PE multiple of 12.5 times and a dividend yield of 3.9%. Unlike the largely recapitalised large cap market segment we continue to bear witness to some residual equity recapitalisations at the smaller end of the market, making it important to distinguish the quality from the more structurally challenged. Notwithstanding this element, cheap valuations such as those currently on offer have already induced corporate activity across the market capitalisation spectrum and are likely to continue to do so, with the added prospect of corporate buybacks as an additional indicator of value.

## Market Review

The Australian equity market, as measured by the Emerging Leaders composite benchmark<sup>1</sup>, posted a decline of 13.8% for the September quarter on the back of concerns of a deteriorating global economic outlook. Bearish comments from the FOMC, downward global growth revisions by the IMF and concerns regarding the sustainability of the Chinese economic trajectory all weighed.

In company news, the August earnings season delivered a mixed picture of the current trading conditions and a high level of uncertainty about the outlook; however some companies also announced share buy-backs during the September quarter. The Australian Government announced details of the carbon price scheme while major acquisition activity took place regardless of the highly volatile markets as BHP Billiton announced a \$14.3bn takeover offer for Petrohawk Energy, a US shale gas company; and SABMiller's agreed a deal to take out Fosters Group.

In economic news the Reserve Bank of Australia maintained the cash rate target at 4.75%, unchanged since November 2010 thanks to the increased global uncertainty and a softening domestic economy. News from Europe represented a major concern for investors during the quarter as European Leaders discussed a larger and more flexible stabilization mechanism for the eurozone while markets weighed both the sovereign and regional bank risks. The US congress approved raising the national borrowing capacity and whilst this avoided a breach US Treasury limits it failed to prevent Standard & Poors from downgrading the US debt from AAA to AA+. China lifted its key lending rate and extended the scope of reserve requirements during the quarter. Domestic economic data released during September indicated that GDP rose 1.2% for the quarter which exceeded expectations.

In commodities, most markets were down as a result of a lowered risk appetite. Oil suffered from a weakening growth outlook after news of a likely Libyan return of supply to the markets combined with a softening demand. Gold and Base Metals were both highly volatile with spot gold up 7.4%, and base metals sharply down (-23%) in line with the heightened risk aversion.

The smaller companies, represented by the S&P/ASX Small Ordinaries (-11.8%), underperformed the large cap stocks (-11.2%), represented by the S&P/ASX 50 Leaders Index.

At a sector level, Telecommunications (+4.9%), Utilities (-1.6%) and Consumer Staples (-6.3%) were the best performing sectors with major moves by Singapore Telecommunications (+14.4%), Energy World Corporation (+3.0%) and Telecom NZ (+13.0%)

The Energy sector (-23.7%) and the Materials sector (-17.8%) underperformed on the back of generally weaker commodity prices. The Consumer Discretionary sector (-15.2%) also underperformed the market over the quarter. At a stock level, Karoon Gas (-45.5%), Cindalbie Metals (-40.9%) and Aurora Oil and Gas (-36.0%) were all noteworthy underperformers.

<sup>1</sup> The composite benchmark is 70% S&P/ASX Midcap 50 Accumulation Index and 30% S&P/ASX Small Ordinaries Accumulation Index.

## Where to after an average August 2011 reporting season ?

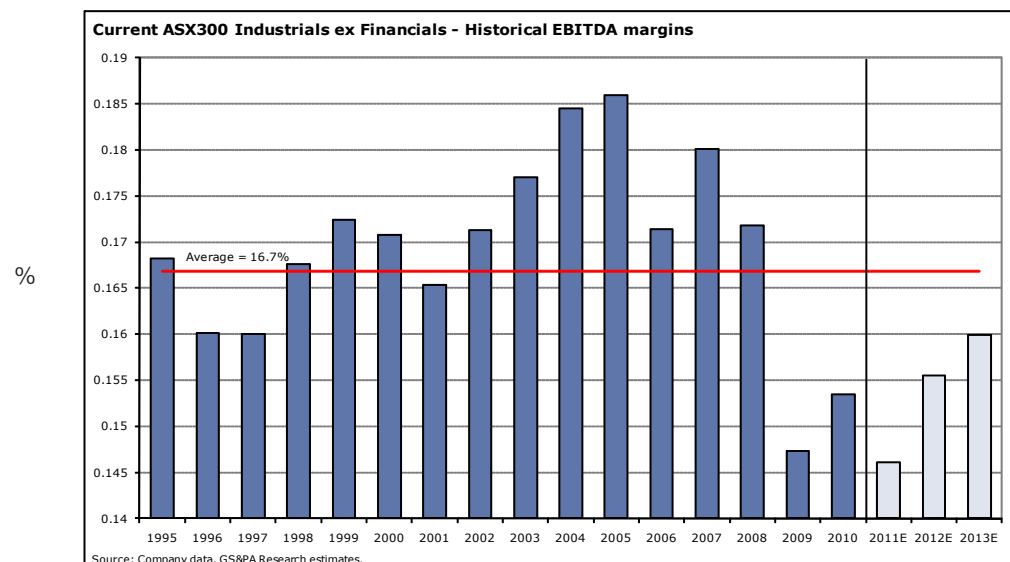
The recent profit reporting season was overshadowed by the sovereign debt issues in Europe. However, the profit results were largely in line with expectations. The key themes we observed included a lack of company guidance, business restructuring and capital management initiatives. Even though business conditions are challenging, valuations suggest share prices reflect the majority of negativity.

The increased global uncertainty and subsequent low levels of confidence as a result of European sovereign debt concerns did not escape Australian company boardrooms. Generally, there was a lack of company guidance on the operating outlook. This in turn has seen the market lower earnings expectations for the 2012FY and we expect additional, but not significant, downgrades to follow. The sectors to experience the largest downgrades were gold, steel, information technology, metals & mining, discretionary retail and general insurance sectors.

A number of companies across various industries announced restructuring plans or intentions to undertake strategic reviews of their businesses to address costs and inefficiencies. Inevitably this will lead to job losses which will add to weaker employment figures.

Lastly there was a notable increase in announced capital management initiatives such as share buy-backs and special dividends across a variety of industries. This indicates the financial strength of listed businesses with strong balance sheets and solid cash flows. Following from the GFC in 2008, most companies are less geared, having recapitalised their balance sheets.

However, the operating environment remains challenging for the industrials sector. The chart below illustrates that EBITDA margins have fallen to their lowest levels in 15 years. This highlights the prospect that EBITDA margins may improve for a number of cyclical industrials in future. But investors should be cautious about companies facing structural headwinds with weak business models representing potential 'value traps'.



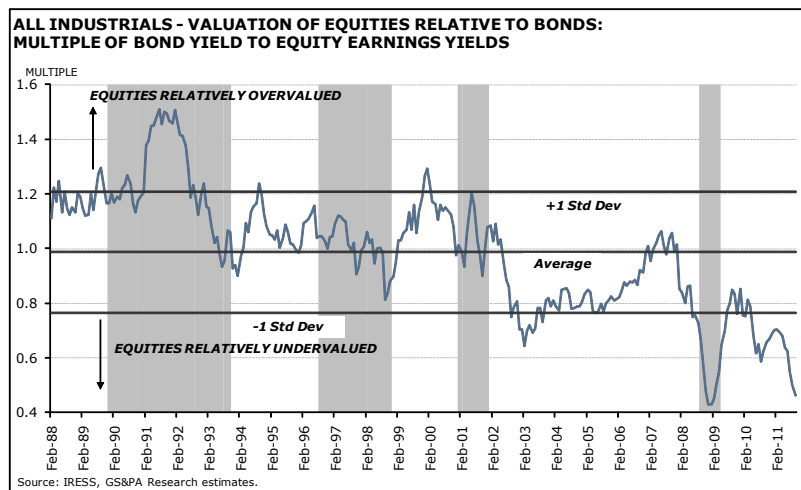
# Australian Equities

From a market valuation perspective, the Australian equity market has historically (since the 1980's) traded on a forward P/E multiple of ~14.5x. Within this context, the market PE multiple of 10.4x (for the 2012 FY forecast) represents good value. The weaker global economic outlook and subsequent weakness in business and consumer sentiment justifies a discount to the historical P/E average of 14.5x, but the current discount seems excessive.

SEPT 2011	PE FY 2012 (E)	EPS GROWTH FY 2012 (E)
MARKET	10.4x	+14.7%
FINANCIALS	8.9x	+7.9%
- REITS	10.6x	+3.4%
INDUSTRIALS	12.4x	+12.0%
RESOURCES	10.1x	+28.7%

Source: Ausbil calculation based on consensus broker earnings forecasts as at 15th September 2011.

Another market valuation measure we monitor is the bond yield relative to the equity yield. The chart below highlights that this ratio is approaching 3 standard deviations below long term averages suggesting that equities are cheap versus bonds. This dispersion could indicate that investors are concerned about the sustainability of dividend yields, however, at almost 3 standard deviations below the historical average, the market has priced in an outcome which seems unlikely in our view.



There is no doubt that the Australian equity market represents good value, however, a positive catalyst to re-rate the market higher is lacking. Potential catalysts could be a reduction in the official cash rate, a weaker AUD, a change in consumer sentiment supported by the high domestic savings rate or a resolution to the European debt problem. In addition, it may be a corporate re-rating via merger and acquisition activity that provides the spark.

In summary, the August profit reporting season was in line with market expectations. A key observation was that companies are well capitalised and the number of capital management initiatives surprised the market. The tough operating environment is evident, whereby company EBITDA margins are the lowest in 15 years. The Australian equity market valuations relative to bonds and historical P/E suggests the macroeconomic negativity is priced into share prices. Equity market valuations are compelling across a number of sectors, however investors will require patience to benefit as a positive catalyst is required to re-rate the market higher.

## Strategy and Outlook

### Strategy

September witnessed a continuation of volatile market conditions that culminated in a significant drop for the month. This further reinforcement of the recent downward trajectory was driven largely by the ongoing lack of leadership in Europe and anaemic US economic data and resulted investors looking for safety in a move that penalised cyclical sectors more than defensive ones. China's position is becoming increasingly important – as well as being the major creditor to governments globally, the Chinese contribution to falling global growth expectations has increased to fill the growing void left by the OECD shortfall. The Portfolio continues to have exposure to the Mining and Capital Goods sectors although the former has been trimmed back in recent weeks. Underweight tilts to the Utilities and other defensives remain in place and whilst the same can be said of the Healthcare sector positioning, valuations are beginning to look more appealing in some instances.

### Outlook

The ongoing absence of a firm and executable plan to bolster growth in the US and clean up the sovereign debt concerns plaguing Europe remains a key headwind to a market struggling to regain confidence. Appropriate economic leadership is unlikely to emerge quickly and we should therefore anticipate a continuation of the overhang in the short term. Notwithstanding this, valuations have retreated to extreme levels and are now reflective of the expectation of dire economic settings going forward. In numbers we see the market (represented by the S&P/ASX Midcap 50 index) trading on an FY12 PE of 10.0 times and yielding 5.8%, with FY13 sitting at 8.6 times and 6.4%. Even allowing for earnings downgrades in the prospective year, valuations appear to be very reasonable. The S&P/ASX Small Caps are trading at less extreme valuations with an FY12 PE multiple of 12.5 times and a dividend yield of 3.9%. Unlike the largely recapitalised large cap market segment we continue to bear witness to some residual equity recapitalisations at the smaller end of the market, making it important to distinguish the quality from the more structurally challenged. Notwithstanding this element, cheap valuations such as those currently on offer have already induced corporate activity across the market capitalisation spectrum and are likely to continue to do so, with the added prospect of corporate buybacks as an additional indicator of value.

# Portfolio Overview

## Performance Return

Period	Portfolio Return%		Benchmark %	Out/Under Performance%	
	Gross	Net		Gross	Net
Three Months	-16.77	-17.00	-13.83	-2.94	-3.17
One Year	-9.80	-10.86	-11.71	1.91	0.86
Three Years p.a	2.52	0.75	-3.10	5.63	3.86
Five Years p.a	0.85	-0.52	-3.07	3.92	2.56
Seven Years p.a	8.60	7.12	4.36	4.24	2.76
Since Inception p.a. Date: Dec 2006	12.44	10.80	7.55	4.88	3.24

## Top 10 Stocks

Name	Portfolio%	Index%	Tilt%
Mineral Resources	5.22	0.39	4.83
Challenger Financial	6.10	1.62	4.48
Gloucester Coal	4.58	0.16	4.42
Iluka Resources	4.02	0.00	4.02
REA Group	3.48	0.20	3.27
Oz Minerals	5.37	2.25	3.12
Seven Group Holdings	3.35	0.25	3.10
Bradken	3.00	0.35	2.65
Primeag Australia	2.17	0.00	2.17
Western Areas NL	2.34	0.20	2.14

## Portfolio Sector Tilts

Name	Portfolio%	Index%	Tilt%
Energy	9.05	5.47	3.58
Materials	28.74	26.09	2.66
Industrials	16.81	14.85	1.96
Consumer Discretionary	16.14	15.41	0.73
Consumer Staples	5.67	5.48	0.19
Healthcare	6.37	8.62	-2.24
Financials (x REITs)	6.10	6.63	-0.53
REITs	6.67	10.69	-4.02
IT	0.00	0.89	-0.89
Telecommunications	1.63	0.96	0.66
Utilities	0.00	4.90	-4.90
Cash	2.82	0.00	2.82
Total	100.00	100.00	-

## Portfolio Activity

### Major Purchases & Sales for September Quarter 2011

Purchases	Sales
OneSteel Austar United Communications	Mesoblast

During the month of July the Portfolio purchased OneSteel (OST), the leading manufacturer and distributor of steel and metal products in Australasia. OST provides leverage to a turnaround in the domestic economy whilst also offering good exposure to Chinese growth via sales of iron ore from its Project Mag-net mines near Why-alla. There were no sales during the month.

There were no significant purchases or sales during the month of August.

In September the Portfolio initiated a position in Austar United Communications (AUN). AUN is a Pay TV service provider that dominates market share in regional Australia, it has a strong financial position with strong cash-flow and low net debt. Foxtel has announced a takeover of the company at a price of \$1.52. However the stock trades below the takeover price as the market awaits ACCC approval. If the takeover fails, AUN has the equivalent of 16cps it can deliver as a capital return to shareholders. Mesoblast was sold to fund the purchase of AUN.

## Contact Details

The following personnel will be available to comment on details mentioned in this report:

Mr. Chris Terzis  
Senior Manager, Client Services.  
Phone: +61 2 9259 0211