

Ausbil - Australian Emerging Leaders Fund

28 Feb 2009

Ausbil Dexia Limited's (Ausbil) Emerging Leaders Fund (AELF) is a well managed portfolio offering a style neutral exposure to mid and small cap stocks (expected to be around 70% / 30% portfolio split respectively). Ausbil employs a large investment team comprising 13 individuals which are dedicated to both the large cap and small cap segments of the Australian equities market. Zenith rates the investment team highly based on our positive view of the key investment personnel at the Manager, and the structure and depth of the team. Under its unique investment approach, which combines both top-down and bottom-up analysis, AELF has established an impressive long term track record of relative outperformance of the benchmark and median manager.

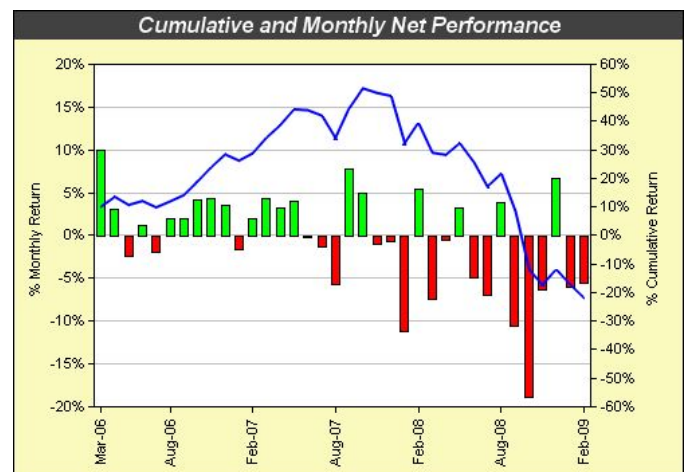
Ausbil's investment team is well resourced, with a total of 8 staff directly involved in the Australian equities investment process, supported by 2 dedicated quantitative analysts, 2 equities dealers and an economist. Analyst research responsibilities are divided along industry lines, with each analyst responsible for 25-30 companies. Ausbil's key investment staff, Paul Xiradis (CEO/Head of Australian Equities), John Grace (Director, Equities) and Adam Dixon (Associate Director, Equities) are all considered quality investors by Zenith, with each possessing a strong understanding of macro-economic influences on the Australian share market and a detailed knowledge of individual companies and their key earnings drivers. These 3 members combine to form the portfolio construction team and are the decision makers on stocks and weightings in the portfolio. Zenith has met with all the key members of the Ausbil Investment team on many occasions and has a positive view of the quality of the investment professionals and the structure of the investment team.

Ausbil's investment process contains 4 stages including: Macro Analysis; Sectoral Analysis; Stock Selection; and Portfolio Construction. The first 2 stages are a top-down approach, taking a 12 month view which assesses current economic and market conditions and identifies attractive sectors and portfolio themes. Following this, a bottom-up stock selection process is used to uncover the most attractive individual investment opportunities. Ausbil assesses each company based on 2 key factors, those being the strength and sustainability of earnings and the quality of management. The Fund will generally be fully invested and will typically hold between 30 - 40 stocks.

Ausbil is owned 70% by its parent entity Dexia Asset Management with the remaining 30% owned by key investment staff. Although Ausbil is a highly profitable and long standing funds management business, Dexia Group (the owner of Dexia Asset Management) has encountered significant difficulties during the global financial crisis. As a result Dexia Group has sought to sell or close down certain components of its business including its underlying lending operations in Australia. This uncertainty at the Dexia Group level raises concerns over its ongoing ownership stake in Ausbil. Ausbil stresses that it expects Dexia Group's sale of other components of its business to have no effect on the operations of Ausbil. In Zenith's view organisational uncertainty can have a negative impact on Fund Managers and in turn investment teams, and as such we have held discussions with Ausbil on this issue. Zenith is comfortable with the response provided by Ausbil and believes that adequate thought has been put into contingency plans.

Based on Zenith's high regard of the investment professionals responsible for the management of the Fund, as well as our positive assessment of Ausbil's disciplined and effective investment process, Zenith has rated the Fund **HIGHLY RECOMMENDED**. We strongly endorse the product for use within investor portfolios.

Key Features	Description
APIR Code	AAP0104AU
Asset Class	Australian Shares
Sub-Asset Class	Small Companies
Investment Style	Neutral
Benchmark	S&P / ASX Small Ordinaries (Accum)
Recommended Investment Timeframe	5 + years
CEO/Head of Equities	Paul Xiradis
Investment Team Size	13



Performance Analysis

Performance Statistics	5 Yrs (% p.a.)	3 Yrs (% p.a.)	1 Yr (% p.a.)
Performance - Fund	6.97	-7.94	-43.95
Performance - Benchmark	-0.56	-14.84	-53.14
Performance - Median Manager	2.69	-9.42	-45.28

AELF has established an impressive track record since its inception having significantly outperformed its benchmark and the median manager over both bull and bear market periods. Zenith attributes this outperformance to astute stock and sector selection from the investment team.

For comparative purposes, the benchmark used in the performance tables of this report is the S&P/ASX Small Ordinaries Accumulation Index. It should be noted however that Ausbil internally uses a composite benchmark, consisting of the S&P/ASX Midcap 50 Accum Index (70% weighting) and the S&P/ASX Small Ordinaries Accum Index (30% weighting).

The objective of AELF is to add value across all market conditions. Specifically AELF seeks to outperform its combined benchmark by a minimum of 3% pa over rolling 3 year periods. This objective has been exceeded since the Fund's inception.

Consistency Analysis

Consistency Statistics	5 Yrs	3 Yrs	1 Yr
History of Monthly Excess Return (%)	56.67	55.56	58.33
History of Monthly Excess Return (Rising Mkts %)	53.85	52.38	50.00
History of Monthly Excess Return (Falling Mkts %)	61.90	60.00	62.50

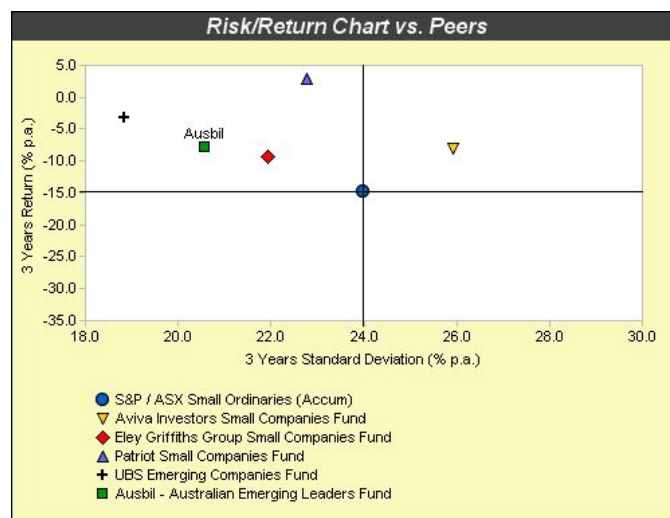
In terms of consistency, AELF has demonstrated the ability to outperform in both "bull and bear" phases of the market cycle. Zenith believes this is an output of Ausbil's style neutral investment approach, which provides the scope to outperform in all market conditions.

Risk / Return Analysis

Risk / Return Statistics	5 Yrs	3 Yrs	1 Yr
Information Ratio - Fund	0.97	0.80	0.81
Information Ratio - Median Manager	0.45	0.59	0.75
Sharpe Ratio - Fund	0.04	-0.71	-2.21
Sharpe Ratio - Median Manager	-0.22	-0.78	-2.01
Standard Deviation (% p.a.) - Fund	18.02	20.57	23.10
Standard Deviation (% p.a.) - Median Manager	18.19	21.25	24.83
Tracking Error (% p.a.) - Fund	7.73	8.63	11.28
Tracking Error (% p.a.) - Median Manager	7.03	8.02	9.95

Strong relative returns coupled with volatility similar to that of the median manager over the past 5 years has resulted in a strong Information ratio relative to peers over the longer term.

The below risk/return chart graphically illustrates the performance of AELF relative to some of its competitors.



Investment Personnel

Name	Title	Time with Manager
Paul Xiradis	CEO/Head of Equities	11 Yr(s)
John Grace	Deputy Head of Equities	7 Yr(s)
Adam Dixon	Portfolio Manager	9 Yr(s)
John Honan	Chief Economist / Head of Research	11 Yr(s)
Brendan Wong	Investment Analyst	4 Yr(s)
Nicholas Condoleon	Investment Analyst	2 Yr(s)
Graeme Petroni	Investment Analyst	1 Yr(s)
Tony Waters	Investment Analyst	6 Mth(s)
Sarah Lau	Investment Analyst	1 Yr(s)

Ausbil employs a large investment team comprising 13 individuals which are dedicated to both the large cap and small cap segments of the Australian equities market. Zenith rates the investment team highly based on our positive view of the key investment personnel at the Manager, and the structure and depth of the team. There are 8 staff directly involved in the Australian equities investment process, supported by 2 dedicated quantitative analysts, 2 equities dealers and an economist. The 3 senior members of the investment team, Paul Xiradis, John Grace and Adam Dixon have worked together for in excess of 7 years, which is clearly evident in their collegiate-based approach. Portfolio management decisions are made jointly by these 3 senior members who together form the portfolio construction committee, with Xiradis holding the right to veto portfolio decisions. Research responsibilities are divided along industry lines, with each analyst responsible for around 25-30 stocks (other than Xiradis who, since becoming CEO in April 2004, has relinquished all sector responsibilities).

Xiradis has over 30 years of experience in investment management, including over 10 years at Ausbil. Xiradis' extensive background includes senior fund management roles at: Westpac Investment Management, Mercantile & General Reinsurance, Legal and General Asset Management and BZW Investment Management. Grace has over 20 years of experience in investment management and equity research including roles at stockbrokers McNall & Hordern (Sydney), Cazenove & Co (London), Royal Insurance Asset Management and Legal & General Asset Management where he worked under Xiradis. Dixon has been with Ausbil for over 9 years and has around 15 years of industry experience. Prior to Ausbil, Dixon had roles at MKS Capital and BZW Investment Management where he gained experience in commodity and currency markets. Zenith has the highest regard for the management of the AELF and considers them to be a critical component of the investment team's strong historical performance.

Within the investment team, John Honan takes on the dual role of Chief Economist and Head of Research. Under the latter role he is responsible for management, monitoring and coordination of the equity analyst team. The quantitative analysts and the dealing team report through to Grace.

Retention within the investment team has been sound over the life of the business except for a short bout of instability in late 2006 and early 2007 when 3 analysts departed, and an additional analyst departure in early 2008. Although Zenith is always mindful of staff instability we are comfortable that the departures were not a result of a poor working environment but were rather a number of separate career decisions made by individuals. One advantage for staff retention in a boutique is the prospect of equity participation in the business. However, greater prospects for promotion / different career avenues in other organisations can outweigh this advantage for certain individuals.

Importantly, the 3 members of the portfolio construction committee continue to be intimately involved in the research process and Zenith considers these individuals to be the key to Ausbil's long term success. Whilst Xiradis remains vital to the overall group, particularly given his dual role as CEO/Head of Equities, the "3 pronged" senior structure within the Australian equities team has mitigated a significant component of key person risk.

Zenith has a positive view in regards to the quality of investment professionals and the overall structure of the Ausbil organisation. We believe Ausbil successfully combines a collegiate investment approach, where all team members are encouraged to put forward stock or sector views (both positive and negative) for discussion. Following team based discussion there is a clear decision making hierarchy in place that leverages off the experience of the senior portfolio managers.

Investment Process

The Manager believes that stock price movements are a function of macroeconomic, sectoral and individual stock influences and hence incorporates both top-down (macroeconomic) analysis and bottom-up (stock selection) analysis into its process. Ausbil's investment philosophy is centered on a core belief that earnings and earnings revisions are the key drivers of stock prices.

Ausbil will seek to position its portfolio towards those sectors and stocks which it believes will experience positive earnings

revisions and through early identification of revisions, will attempt to pre-empt stock price movements.

Ausbil will seek to exploit inefficiencies through the adoption of a style-neutral active investment process across the entire market spectrum (ex- the ASX top 50) and throughout the market cycle.

Security Selection

There are 2 stages to the Ausbil stock selection process:

1. Macro & Sectoral Analysis

Ausbil arrives at a view of the current macro economic and market framework after identifying the global and local influences at work on the Australian sharemarket. Factors considered in this analysis include international economic developments (e.g. US, Japan, Europe, and China), the outlook for the Australian economy (e.g. growth, employment, inflation, profits, and currency), the company earnings outlook, offshore market trends, equity valuations and liquidity flows. A formal draft paper is prepared for a monthly macroeconomic meeting chaired by John Honan (Chief Economist). Xiradis is also heavily involved in this top-down debate.

Sectoral analysis seeks the early identification of sectors subject to earnings revisions, both upwards and downwards, over the coming 12 months. Each analyst is responsible for assigning a strategic and tactical bias to each of their respective sectors. The strategic bias looks at the overall long term attractiveness of each sector "through the cycle" while the tactical bias looks at the current direction of price "within the cycle". In addition to the individual analyst sector input, Xiradis prepares a financial market overview paper and chairs the sector debate.

Ausbil expects to derive approximately 20% of its value add from macro & sectoral analysis, with the remainder sourced from bottom-up fundamental research. Ausbil's focus on top-down market influences is a key competitive advantage, enabling the manager to identify what it considers to be attractive segments of the market and direct its fundamental research accordingly.

2. Individual Securities Analysis

The most critical stage of the process is to identify those stocks which Ausbil believes will achieve the strongest 12 month outperformance, which it achieves via a combined qualitative and quantitative approach. The qualitative process primarily focuses on 2 key factors: sustainability of earnings; and quality of management. In assessing earnings sustainability Ausbil considers each company's business profile, growth outlook, margins and balance sheet strength, while the assessment of management quality focuses on factors including track record and technical ability. Given that this part of the process requires an in-depth understanding of each stock and a significant company visitation schedule, Ausbil's significant team depth is an important factor in its ability to effectively cover the stock universe.

Company valuation is backed by a proprietary quantitative ranking model, FERRET (Forecast Earnings Relative Ranking Evaluation Tool). There are 3 components to the model: 65% TERRA (Total Expected Relative Return Analysis), which calculates the expected stock performance over the coming 12 month period; 20% REMA (Relative Earnings Momentum Analysis), which monitors consensus earnings revisions; and

15% 2 Years earnings per share (EPS) growth. The actual output of the TERRA component of the model is a forecast P/E relative (for comparison with the current P/E relative), which is based on consensus forecast 12 month EPS growth and a multi-factor qualitative/financial scorecard.

The valuation output is assessed in conjunction with the qualitative analysis and a recommendation (positive, neutral or negative) is assigned for each stock. These recommendations are discussed formally at a monthly stock selection meeting, with any stock developments or recommendation changes discussed informally at the daily team meeting.

The Ausbil universe covers approximately 150 stocks, all of which have 2 written pro-forma template reports: a snapshot (which contains the analyst recommendation, P/E relative chart, market data, and earnings forecasts); and a research paper (SWOT analysis etc). Of these 150 stocks, approximately 105 have had detailed financial models constructed, which drill down to separate divisions of the business.

Zenith is of the opinion that the Ausbil investment process is one of the most robust we have reviewed, incorporating top-down indicators, a sound valuation process and intuitive qualitative inputs. While the shorter term forecast period used within the process differentiates the manager from many in the marketplace, Zenith is supportive of this aspect given the additional uncertainty introduced by long-term forecasting.

Portfolio Construction

The aim of the portfolio construction process is to combine the output of Ausbil's macroeconomic/sub-sector analysis and its bottom-up fundamental analysis. Xiradis, Grace and Dixon make up the portfolio construction team and meet on a monthly basis usually the day after the stock selection meeting. A distinguishing feature of this collegiate approach is that each member brings to the meeting, an independently derived recommended model portfolio (based on the output of the Security Selection process). In practice, differences between team members tend to be with regard to weighting decisions rather than on stock or strategy issues. The final agreed stock weighting or active bet at the portfolio level is a subjective call made by the portfolio construction team.

The portfolio will be biased towards those sub-sectors and stocks most likely to outperform, subject to liquidity guidelines and other risk considerations. Prior to taking an aggressive sub-sector or stock position, Ausbil generally waits for confirmation of earnings revisions. We consider this a conservative and prudent approach, ensuring that a company has the ability to deliver on expectations before taking significant portfolio risks.

Active stock positions are typically index plus 1 to 3%, ensuring that all positions carry a meaningful exposure and no "dead money" exists in the portfolio. The portfolio is expected to contain around 30-40 stocks (typically 33 to 37), providing a relatively concentrated exposure. Portfolio turnover tends to average around 75% p.a. Analysts recommendations and expected return forecasts are particularly important in the portfolio construction stage. The relative weighting that a stock is likely to have in the model portfolio is largely influenced by the expected return forecast through FERRET. All buy/sell decisions are formally reviewed from a risk/return perspective assuring that the tracking error of the portfolio remains within its risk parameters.

In terms of market capitalisation biases Ausbil's internal composite benchmark consists of a 70% weighting to mid caps and a 30% weighting to small caps. The Manager expects to remain relatively in line with this internal benchmark over time.

The dealing responsibility is assigned to the dedicated dealing team. The dealer's objective is to outperform VWAP (Volume Weighted Average Price), which is a measure of the price at which the majority of a given day's trading in a given security took place. Zenith believes the employment of a dedicated dealing team and the clear objectives that the team has been set, demonstrates that Ausbil regard dealing as a vital component of execution. Zenith believes this aspect will assist in extracting maximum value from Ausbil's investment process.

Zenith has a positive view of Ausbil's portfolio construction process. In our view, the fact that each member of the portfolio construction committee brings their own individually derived portfolio to the construction meeting ensures the whole committee is playing a part in value add for the portfolio, and ensures rigorous debate at both a stock holding and weighting level.

Risk Management

Portfolio Constraints	Description
Security Numbers	30 to 40
Weight - Security Rel. Index (%)	-5% to 10%
Weight - Holding Rel. Portfolio (%)	max: 10%
Weight - Holding Rel. Issued capital (%)	max: 5%
Portfolio Turnover (% p.a.)	Typically around 75% up to Max 100%
Market capitalisation (\$)	Will invest down to the 200th stock by market capitalisation
Tracking error - ex ante (% p.a.)	max: 6% p.a.
Cash (%)	0% to 10% Typically fully invested

Ausbil has implemented several risk management guidelines based on stock relative to index, sector tilts and a liquidity test (assuming the portfolio is being managed at Ausbil's funds under management maximum capacity target). In addition, a cash limit, tracking error constraint and stock number limit exists.

While these guidelines are typically adhered to, they are not "hard" constraints and the manager does have the flexibility to breach these limits. While moving beyond the guidelines is the exception rather than the rule and will typically only occur due to strong price appreciation (which is a positive for portfolio performance), Zenith would become alarmed if the frequency of these events increased.

If a stock moves outside the composite benchmark the portfolio has 1 calendar month to exit the position. This constraint is tighter than many of its peers but ensures the portfolio remains true to its mid cap mandate and is considered a plus with regard to risk management and portfolio construction.

Given the fact that the risk management guidelines are wide compared with many of its peers, Zenith would be more comfortable if these guidelines were changed to formally mandated constraints.

There is also a liquidity constraint in place whereby each stock is assigned a liquidity rank, based on its prior 30 day trading volume. This attempts to align market liquidity with portfolio movements. Another liquidity constraint is that the Fund will not invest in companies below the 200th stock by market capitalisation.

Risks of the Fund

Market Risks

As is the case with all Australian equities based products, the biggest risk to this Fund is a sustained downturn in the Australian shares sector, which could lead to negative performance. This risk can be significantly reduced by investors adopting a medium to long-term (5+ years) investment time frame when investing in this Fund.

The risks of AELF are slightly different to that of many other smaller companies funds in that AELF's investment universe can include mid cap stocks. This means that the returns from AELF will not closely track "small cap" performance given its different risk / return profile. None-the-less, it is important for investors to note that the mid and small companies segment of the market will typically be more volatile than the large companies segment of the market. Small and mid companies have traditionally underperformed large caps in bear market environments where there is typically a 'flight to quality'.

Manager Specific Risks

Although Ausbil is a highly profitable and long standing funds management business, Dexia Group (the owner of Dexia Asset Management) has encountered significant difficulties during the global financial crisis. As a result Dexia Group has sought to sell or close down certain components of its business including its underlying lending operations in Australia. This uncertainty at the Dexia Group level raises concerns over its ongoing ownership stake in Ausbil. Ausbil stresses that it expects Dexia Group's sale of other components of its business to have no effect on the operations of Ausbil. In Zenith's view organisational uncertainty can have a negative impact on Fund Managers and in turn investment teams, and as such we have held discussions with Ausbil on this issue. Zenith is comfortable with the response provided by Ausbil and believes that adequate thought has been put into contingency plans.

Another major risk for fund managers is excessive funds under management (FUM). Excessive FUM can cause serious problems particularly in the small companies sector given its lower liquidity and can therefore hinder a manager's ability to react to market movements in a timely manner. Ausbil managed a total of approximately \$1.19 billion in the ex top 50 segment of the market as at 28 February 2009 (which includes \$580 million in the Emerging Leaders strategy and the remainder in large cap portfolios).

Ausbil's final capacity figure dynamically changes with market movements and stock liquidity. Zenith has undertaken detailed analysis on Ausbil's capacity methodology and models and believes that the Manager adequately manages its liquidity profile. As a general 'rule of thumb' Zenith considers small and mid cap manager's capacity to be around 1% of the market

capitalisation of the universe. Ausbil currently manages approximately 0.9% of the mid cap and small cap indices by market capitalisation. Zenith will continue to monitor Ausbil's FUM, however, pleasingly the Manager is closed to new institutional mandates and we therefore consider fund flows to be manageable. Zenith is cognisant that assessing FUM as a percentage of market capitalisation is a crude measure of determining capacity and therefore assesses each Manager on an individual basis (with reference to the manager's specific investment approach and style).

As with most boutiques, key person risk needs to be considered. In Zenith's view, there are 3 key members of the Ausbil team, being Xiradis, Grace and Dixon. The loss of any of these 3 members would result in a review our rating on the Fund. Whilst key person risk exists within Ausbil, Zenith would argue the potential risk of losing key individuals in boutique firms is often less relative to mainstream managers given that key staff are generally afforded significant equity ownership in boutique businesses.

Applications of the Fund

3 years Excess Correlation Table	
Fund Name	Excess Correlation
Aviva Investors Small Companies Fund	0.28
Eley Griffiths Group Small Companies Fund	0.36
Patriot Small Companies Fund	0.30
UBS Emerging Companies Fund	0.45

The Ausbil Emerging Leaders Fund's (AELF) relatively unique ex-ASX top 50 mandate means that the product sits somewhere between a large cap Australian shares product and a small cap Australian shares product. This mid-cap space is an area of the market that is not heavily utilised, meaning that the AELF offers a degree of diversity within the Australian Equities market.

Zenith believes the Fund is most appropriate for those investors seeking a growth based investment and who are prepared to invest for a period of at least 5 years in order to maximise their potential for optimal results. From a portfolio perspective, Zenith believes the Fund is best used in combination with a large company Australian equities fund in order to achieve sound diversification and exposure to all market segments. Portfolio turnover tends to average around 75% p.a. which is higher than most competitors and therefore higher levels of income distributions should be expected, which has tax consequences for investors.

Ausbil's investment process can be broadly described as "style neutral". In other words Ausbil is indifferent to style, meaning that the portfolio can over time have either a value or growth tilt depending upon market opportunities. Due to its solid, well rounded offering, the AELF is suitable for all investors seeking a mid/small cap exposure in Australian equities.

Fees

Fees include the Management Fee of 0.85% and a performance fee of 15% of the gross outperformance of the benchmark for this Fund subject to a high water mark. The benchmark used is a mix of 70% S&P / ASX Midcap 50 Accumulation Index and 30% S&P/ASX Small Ordinaries Accumulation Index.

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