

## Ausbil - Australian Active Equity Fund

28 Feb 2009

Ausbil Dexia Limited's (Ausbil) Australian Active Equity Fund (AAAEF) is a style-neutral product offering exposure to a diversified portfolio of Australian shares. The AAAEF is highly regarded by Zenith, based on Ausbil's experienced investment team and intuitive investment approach that combines both top-down and bottom-up inputs.

Ausbil was established as a boutique Australian equities manager in August 1997 as a joint venture between the foundation investors, including senior members of the investment team, and Dexia Asset Management, a subsidiary of the Dexia group. Dexia, a major European bank, remains a 70% stakeholder in Ausbil with the remaining 30% held by the Ausbil investment team. Ausbil has a well resourced investment team consisting of 8 staff directly involved in Australian equities stock selection and/or portfolio management. They are supported by 2 quantitative analysts, 2 equities dealers and an economist. Ausbil's key investment staff, Paul Xiradis (CEO/Head of Australian Equities) and John Grace (Portfolio Manager), are both considered quality investors, 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. Research responsibilities are divided along industry lines, with analysts generally responsible for around 25-30 stocks. Zenith has met with all key members of the Ausbil investment team and has a positive view in regards to the quality of investment professionals and the structure of the investment team.

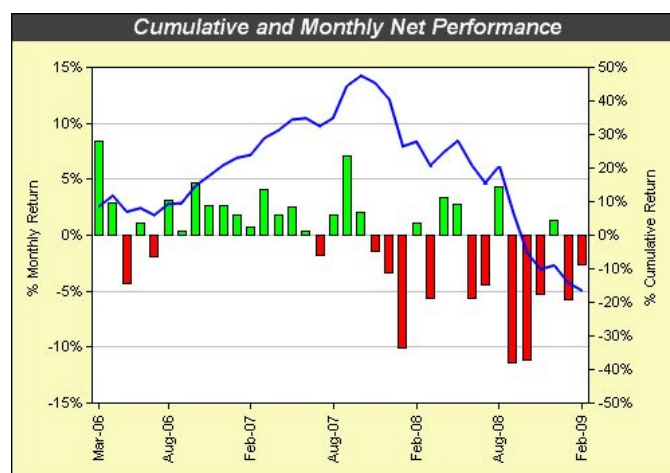
Ausbil aims to outperform the index by 3% p.a. (before fees) over rolling 3-year periods, with a tracking error targeted at between 2-4% p.a. Ausbil expects to achieve this objective based on its ability to identify earnings and earnings revisions early which it believes are the key drivers of stock prices. Impressively, the Fund has managed to outperform the index by a comfortable margin since inception in 1997.

Ausbil employs macroeconomic & sub-sectoral analysis in an attempt to identify how certain economic variables will impact on the investment markets. Following this, Ausbil assesses individual companies based on 2 key factors: sustainability of earnings and quality of management, and uses a proprietary quantitative tool to assign a valuation to each stock. Portfolio management decisions are made jointly by a 3 member portfolio construction committee (comprising Paul Xiradis, John Grace and Adam Dixon), with Xiradis holding the right to veto portfolio decisions. Portfolio construction efficiently combines the investment team's top-down and bottom-up inputs with an intuitive overlay from these 3 experienced team members. Overall, Zenith is of the opinion that Ausbil's investment approach is one of the more robust we have reviewed.

Despite the recent declines in the Australian market Ausbil's total funds under management (FUM) in the Australian equities sector has grown considerably in recent years and, as at 31 October 2008, totalled \$7.1 billion. While Excess levels of funds under management (FUM) can hamper a fund manager's ability to generate excess returns Zenith believes Ausbil isn't currently constrained by its volume of FUM. Having viewed its capacity methodology and models and believes that the Manager adequately manages its liquidity profile. An additional risk specific to Ausbil relates to the uncertainty at the parent entity, the Dexia Group, which 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.

In summary, the AAAEF is highly regarded by Zenith and we believe the fund can be held as a stand alone exposure to the sector or blended with other products to achieve a more diversified exposure. Zenith has assigned this fund a HIGHLY RECOMMENDED rating.

Key Features	Description
APIR Code	AAP0103AU
Asset Class	Australian Shares
Sub-Asset Class	Large Companies
Investment Style	Neutral
Benchmark	S&P / ASX 300 (Accum)
Recommended Investment Timeframe	5 + years
CEO/Head of Aust 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	8.03	-5.89	-34.70
Performance - Benchmark	4.20	-8.32	-37.26
Performance - Median Manager	4.25	-8.24	-36.43

Ausbil aims to outperform the index by 3% p.a. (before fees) over rolling 3-year periods, with tracking error targeted at between 2-4% p.a.

Ausbil's longer term 3 and 5 year performance has been solid, having comfortably achieved its target of outperforming the S&P/ASX 300 Accumulation index by 3% and outperformed the median manager.

## Consistency Analysis

Consistency Statistics	5 Yrs	3 Yrs	1 Yr
History of Monthly Excess Return (%)	63.33	52.78	66.67
History of Monthly Excess Return (Rising Mkts %)	61.54	36.84	66.67
History of Monthly Excess Return (Falling Mkts %)	66.67	70.59	66.67

The AAAEF has consistently delivered excess returns on a monthly basis with the history of excess returns above 50% over the long term.

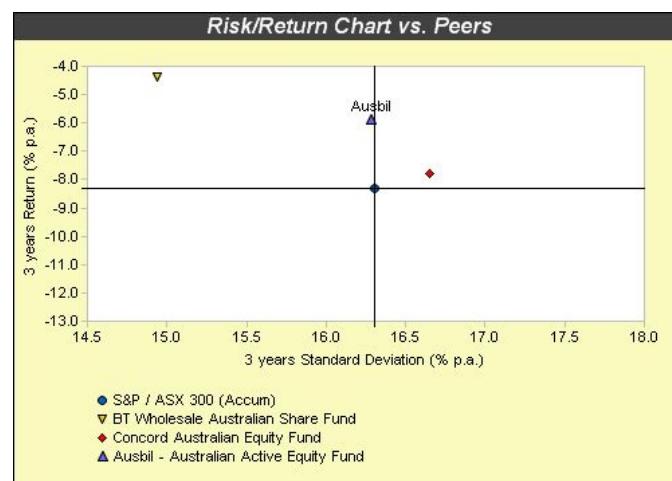
Ausbil's style-neutral investment style results in the potential for the manager to deliver sound excess returns in a range of market conditions, both when the market is rising and falling.

## Risk / Return Analysis

Risk / Return Statistics	5 Yrs	3 Yrs	1 Yr
Information Ratio - Fund	1.04	0.58	0.54
Information Ratio - Median Manager	0.03	0.04	0.36
Sharpe Ratio - Fund	0.12	-0.77	-2.37
Sharpe Ratio - Median Manager	-0.15	-0.94	-2.46
Standard Deviation (% p.a.) - Fund	14.79	16.28	17.62
Standard Deviation (% p.a.) - Median Manager	14.10	15.99	17.51
Tracking Error (% p.a.) - Fund	3.70	4.18	4.76
Tracking Error (% p.a.) - Median Manager	3.37	4.18	5.16

Ausbil's volatility of returns (as measured by standard deviation) has been higher than that of the median manager over the past 5 years, likely the result of a relatively concentrated portfolio and a focus on earnings growth. This additional volatility has been more than justified by above median returns.

Ausbil targets a tracking error of 2.5-3.5% p.a.. Although slightly higher over the long term when combined with Ausbil's significant excess returns it has resulted in a strong information ratio.



## Investment Personnel

Name	Title	Time with Manager
Paul Xiradis	CEO/Head of Aust Equities	12 Yr(s)
John Grace	Portfolio Manager	8 Yr(s)
Adam Dixon	Portfolio Manager	10 Yr(s)
John Honan	Chief Economist / Head of Research	12 Yr(s)
Brendan Wong	Investment Analyst	4 Yr(s)
Nicholas Condoleon	Investment Analyst	2 Yr(s)
Sarah Lau	Investment Analyst	2 Yr(s)
Graeme Petroni	Investment Analyst	1 Yr(s)
Tony Waters	Investment Analyst	7 Mth(s)
Khay-Tuck Chow	Associate Director, Quantitative	9 Yr(s)
Shanelle Hoong	Associate Analyst	2 Yr(s)

Ausbil was established as a boutique Australian equities manager in August 1997 as a joint venture between the foundation investors, including senior members of the investment team, and Dexia Asset Management, a subsidiary of the Dexia group. Dexia Asset Management remains a 70% stakeholder in Ausbil with the remaining 30% owned by key Ausbil staff. Currently 9 investment staff retain equity in the firm, having increased from 5 in the previous review. Zenith is encouraged by the greater spread of equity between Ausbil staff as it ensures their interests are better aligned with the business and the greater equity participation should promote staff retention. However, Zenith would still prefer an increased share of equity held by the investment team to ensure continued autonomy from an investment perspective. Nevertheless we acknowledge that Ausbil's substantial funds under management and continued future growth means that 30% is a substantial financial stake in the business. Prior to a change in the ownership structure in 2006, the equity was split

approximately 50/50 between Dexia Asset Management and Ausbil staff.

Ausbil has a well resourced investment team consisting of 8 staff directly involved in Australian equities stock selection and/or portfolio management. They are supported by 2 quantitative analysts, 2 equities dealers and an economist. The 3 most senior members of the investment team and those involved in portfolio construction are Paul Xiradis, John Grace and Adam Dixon. 7 investment staff, including Grace and Dixon, have stock research responsibilities with responsibilities divided along industry lines, with each analyst responsible for around 25-30 stocks (other than Xiradis who has relinquished all stock responsibilities since becoming CEO in April 2004). The group's Chief Economist is John Honan who also acts as Head of Research. He is responsible for the management, monitoring and coordination of the equity analyst team. Prior to Honan assuming the Head of Research role in late 2006, John Grace held this responsibility (in addition to his analyst and portfolio management responsibilities) and Zenith believes this restructure has enabled Grace to remain more focused on day-to-day investment tasks. Further to this restructure Grace has also relinquished most of analyst responsibilities, allowing him to concentrate primarily on his portfolio management duties. The quantitative analyst team and the dealing function still report through to Grace, as Deputy Head of Equity.

As a founding member and CEO/Head of Equities of Ausbil Xiradis contributes a wealth of investment experience gained over almost 3 decades. Commencing his career at Westpac Investment Management Division Xiradis progressed to investment management roles at Delfin and Mercantile & General Reinsurance Group. He later served in equity management roles at Legal and General Asset Management and BZW Investment Management before helping to establish Ausbil. Whilst Xiradis remains a vital and key ingredient within the overall group, particularly given his dual role as CEO/Head of Equities, greater depth within the Australian equities investment team has mitigated a significant component of key person risk. Zenith is comfortable with Xiradis' decision to relinquish his stock responsibilities as it ensures his continued involvement in portfolio management, without his responsibilities being too onerous.

As contributing members to portfolio construction Grace and Dixon also contribute vast experience. Grace gained his initial investment experience in stockbroking at MCall & Horden (Sydney) and later Cazenove & Co (London). He then transitioned to asset management roles at Royal Insurance Asset Management and Legal & General Asset Management prior to joining Ausbil in 2001. Dixon initially gained investment experience in roles at MKS (Sydney) and BZW (London) where he was exposed to commodity and currency markets before joining Ausbil as an investment analyst in early 2001. In 2003 he was promoted to associate director at which time he assumed portfolio management responsibilities. Ausbil's collegiate-based approach to portfolio management is clearly evident and is a result of the 3 senior members having worked together for many years. Zenith regards these members highly and recognises that they possess strong investment knowledge and contribute complementary skill sets to the team.

Apart from the equity ownership the team is incentivised via a bonus structure based on portfolio outperformance, stock selection outperformance and a discretionary component. To ensure a focus on performance the bonus is heavily skewed to

outperformance and vested over a few years to ensure staff retention. Whilst overall team numbers have been slowly increasing, there have been 4 staff departures from the investment team in recent years. Ausbil was quick to appoint experienced replacement analysts, with Nicholas Condoleon (10 years investment experience) and Ben McGarry (8 years experience) both joining the firm in March 2007 and Graeme Petroni (5 years experience) joining in July 2007. In April 2008, McGarry departed after receiving an offer to work elsewhere and was replaced by Tony Waters (15 years investment experience, most recently at IML). Zenith held some concerns regarding the high level of staff turnover that has occurred over the period 2006/2007. This now appears settled and none of the departures were considered by Zenith critical.

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 ideas, with a clear decision making hierarchy that leverages off the experience of the senior portfolio managers.

### Investment Process

Ausbil's investment philosophy is centred on a core belief that earnings and earnings revisions are the key drivers of stock prices. To this extent, identification of these revisions at an early stage facilitates outperformance.

Ausbil will seek to exploit inefficiencies across the entire market at all stages of the cycle through the adoption of a style neutral active investment process.

### 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 (eg. US, Japan, Europe, and China), the outlook for the Australian economy (e.g. growth, employment, inflation, profits, currency), the company earnings outlook, offshore market trends, equity valuations and liquidity flows. A formal draft paper is prepared for this monthly macro & economic meeting chaired by John Honan (Chief Economist). Xiradis is also heavily involved in this top-down debate. As well as this formal monthly meeting analysts also discuss these top-down factors on a weekly basis.

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 25-30% 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, the team's increased capacity is an important factor which has enabled Ausbil to steadily increase the number of on-site and/or one-on-one company management contacts. Also important in this process is the continual exchange that the Ausbil team has with brokers in the context of formal broker panels and constant dialogue with individual analysts.

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 which consists of the top 100 stocks, portfolio stocks and those stocks that rank highly in the ranking model. All have 2 written pro-forma template reports: a snapshot and a research paper. The snapshot contains the analyst recommendation, P/E relative chart, market data, and earnings forecasts and is updated on a quarterly basis or when a major change occurs. The research paper is more in-depth and focuses on earnings and generation of free cashflows as well as qualitative issues such as SWOT analysis. Of these 150 stocks, just over 100 have more detailed financial models constructed, which drill down to separate divisions of the business. While Zenith would prefer to see this level of analysis undertaken on all stocks, it's encouraging that the number of models has been increasing steadily as the team has expanded.

Zenith is of the opinion that the Ausbil investment process is one of the more 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. The 3 key staff involved in portfolio construction are Xiradis, Grace and Dixon. A distinguishing feature of this collegiate approach is that each member brings to the monthly 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. However, before 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 will typically contain 30-40 stocks, providing a relatively concentrated exposure. Portfolio turnover tends to average around 50% p.a.

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
Cash (%)	0% to 10%
Weight - Holding Rel. Portfolio (%)	max: 3% for stocks below 0.5% index weight
Weight - Security Rel. Index (%)	max: 3% for stocks b/w 0.5% - 2% index weight
Weight - Security Rel. Index (%)	max: 7% for stocks over 2% index weight
Weight - GICS Rel. Index (%)	max: 6% for sectors under 5% index weight
Weight - GICS Rel. Index (%)	max: 8% for sectors over 5% index weight
Tracking error (% p.a.) - ex-ante	max: 5% p.a. Typical 2.5%-3.5%
Portfolio Turnover (% p.a.)	max: 75% p.a.

Ausbil has implemented several risk management guidelines based on stock relative to index, sector tilts and a liquidity test.

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. In recent years this occurred with Aristocrat Leisure, where despite its <0.5% index weight, the portfolio position exceeded the maximum 3.0%. While this example 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.

Given the fact that the risk management guidelines are generous (e.g. maximum 3 times index weight for stocks over 2% index weight) when compared with many of its peers, Zenith would be more comfortable if these guidelines were changed to formally mandated constraints.

To ensure the Fund is maintained within these guidelines Ausbil also runs the portfolio through GSJBWere Analytics software once a month. The program highlights the tracking error of the portfolio, identifies key portfolio positions and sources of risk. For reference and audit purposes the output of each month is archived.

### Risks of the Fund

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 fund is well positioned to cope with gyrating markets given its short term investment focus picks up changes in earnings and earnings surprises. Operating under a style-neutral investment approach also protects the fund from market conditions that are biased towards value or growth. In the past, the value and growth cycle has caused some dramatic changes in fortune for managers with, for example, the period 1998-2000 significantly favouring growth managers and the period from 2000-2003 significantly favouring value managers.

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.

Due to market movement in 2008 Ausbil's total funds under management (FUM) in the Australian equities sector has fallen over the past year and, as at 31 October 2008, totalled A\$7.1 billion. Ausbil's assesses final capacity dynamically according to a model which considers 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. Previously Ausbil's Australian equities products were closed to new institutional investors, with inflows coming solely from existing institutional investors and retail wrap platforms. Due to some spare capacity Ausbil was accepting a very limited number of institutional mandates. Given that Ausbil awareness of capacity constraints Zenith believes FUM should be manageable over the medium term.

Excess levels of funds under management (FUM) can create issues for Australian shares fund managers, hampering their ability to efficiently enter and exit stock positions. Zenith does not believe Ausbil is currently constrained by its volume of FUM and therefore has the flexibility to continue to deliver excess returns, however, we will continue to monitor Ausbil's growth in FUM closely.

As with most boutiques, key person risk needs to be considered. In Zenith's view, there are 2 key staff within the Ausbil team, Xiradis and Grace, and the departure of either would be a material loss. While boutique managers seldom have the depth of personnel of their mainstream peers, Zenith would argue the potential risk of losing key individuals in these firms is often less given key staff are generally afforded significant equity ownership.

### Applications of the Fund

3 years Excess Correlation Table	
Fund Name	Excess Correlation
BlackRock Wholesale Australian Share Fund	0.56
BT Wholesale Australian Share Fund	0.21
Concord Australian Equity Fund	0.16
Fortis Investments Australian Equity Fund	-0.03
Perennial Value Shares Wholesale Trust	0.15
Perpetual Wholesale Australian Fund	0.31

The AAAEF is Zenith's preferred choice in regards to style-neutral Australian equities products and we believe the fund is ideal for any investor seeking an actively managed exposure to Australian equities.

Zenith is comfortable for the Ausbil Australian Active Equity Fund (AAAEF) to be held as a stand-alone exposure to the Australian equities sector for investors with low investment amounts. However, manager specific risk can be avoided by blending the AAAEF with other Australian equities funds.

The AAAEF can be blended with other style-neutral, value and/or growth orientated Australian equities products (as per the Zenith Model Portfolios) to achieve a more diversified exposure to the sector. The above table highlights the fund's low/negative excess correlation with other funds in the sector.

### Fees

Ausbil has a simple fee structure that consists of a 0.90% p.a. ongoing base fee, which in Zenith's opinion is highly competitive relative to other long-only Australian share funds in the market.

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