Product Assessment

Zenith
Investment Partners Pty Ltd

Highly Recommended
Recommended
Approved
Not Approved
Redeem

Ausbil Australian Geared Equity Fund

31 Mar 2009

The Ausbil Australian Geared Equity Fund was launched in April 2007 and provides leveraged exposure to the Ausbil Australian Active Equity Fund, a highly regarded style neutral, diversified portfolio of Australian shares. While the timing of the launch of this fund was possibly not ideal, given that it was launched at end of the equities bull market that began in early 2003, over the long term we expect equities markets to outperform the cost of borrowing and as such this type of product is an attractive option for risk tolerant, long term investors.

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 9 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.

The objective of the fund is to maximise risk-adjusted, long-term returns by borrowing to invest in Australian shares. As a rough guide, investors should expect returns from this fund to be up to 2.2 times the underlying fund (i.e. the Ausbil Australian Active Equity Fund), less borrowing costs and fees.

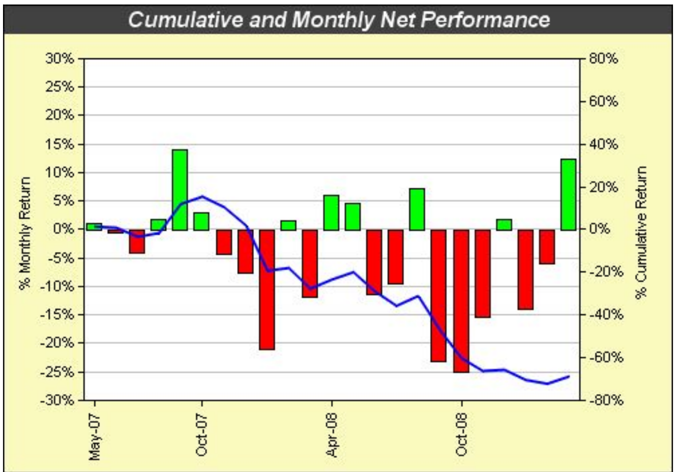
Ausbil employs macroeconomic & sub-sectoral analysis in an attempt to identify how certain economic variables will impact on investment markets. Following this, Ausbil assesses individual companies based on two key factors, sustainability of earnings and quality of management, and uses a proprietary quantitative tool to assign a valuation to each stock. Portfolio management decisions are made jointly by a three 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 experienced team members. Overall, Zenith is of the opinion that Ausbil's investment approach is one of the more robust we have reviewed.

The internal gearing structure of this fund will suit self managed super fund investors, which are restricted from applying external leverage to their investments. The tax effectiveness of these types of vehicles are also attractive given they are able to pass on franking credits based on the total value of the geared portfolio. While turnover within the underlying fund is reasonable (50% per annum on average), this may result in higher than desirable income returns for high marginal tax payers and thus be more appealing to lower tax paying investors. Investors should have a minimum 5-7 year timeframe and be willing to "ride out volatility" in exchange for enhanced returns delivered through gearing. An additional risk particular to the manager 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.

Overall, Zenith believes the fund should appeal to those investors seeking leveraged exposure to the Australian equities asset class. Zenith rates the fund HIGHLY RECOMMENDED.

Key Features	*Description*
APIR Code	AAP0002AU
Asset Class	Australian Shares
Sub-Asset Class	Specialist
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
Leverage	Up to 55%

Cumulative and Monthly Net Performance



Performance Analysis

Performance Statistics	1 Yr (% p.a.)	6 Mths (%)	3 Mths (%)
Performance - Fund	-57.12	-41.44	-9.28
Performance - Benchmark	-29.79	-19.99	-1.85

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The history of the Ausbil Australian Geared Equity Fund is currently too short to draw any meaningful conclusions. However, the significant underperformance to date isn't unexpected given the severity of downturn that followed the credit crisis of late 2007.

Consistency Analysis

Consistency Statistics	1 Yr
History of Monthly Excess Return (%)	41.67
History of Monthly Excess Return (Rising Mkts %)	100.00
History of Monthly Excess Return (Falling Mkts %)	12.50

The history of the Ausbil Australian Geared Equity Fund is currently too short to draw any meaningful conclusions.

Given the use of leverage both gains and losses will be magnified. Therefore, the Fund will tend to outperform strongly in rising markets but perform poorly in falling markets. In the short history available this characteristic has been highlighted.

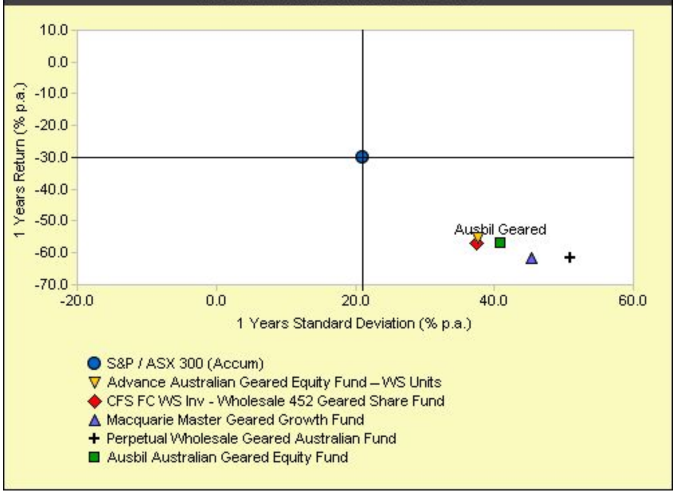
Risk / Return Analysis

Risk / Return Statistics	1 Yr
Information Ratio - Fund	-1.31
Sharpe Ratio - Fund	-1.56
Standard Deviation (% p.a.) - Fund	40.85
Tracking Error (% p.a.) - Fund	20.84

As the Fund employs gearing, tracking error and standard deviation is expected to be higher than the underlying Australian Active Equity Fund.

Given the short history available the Fund has demonstrated volatility and tracking well in excess of the underlying fund.

Risk/Return Chart vs. Peers



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)
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 held equity in the firm, having increased from 5 at the time of our 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 three most senior members of the investment team and those involved in portfolio construction are Paul Xiradis, John Grace and Adam Dixon. Seven 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 his 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 three 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. In 2003 he was promoted to associate director at Ausbil and assumed portfolio management responsibilities. Ausbil's collegiate-based approach to portfolio management is clearly evident and is a result of the three senior members having worked to 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 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 bonuses are heavily skewed to outperformance and vested over numerous 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. However, 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 but the investment team 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.

Gearing Process

Ausbil's gearing process is run by John Honan (Head of Research / Chief Economist) and can range between 0% - 55% although as a working rule its would be unlikely to drop below 30% and the typical level is 50%. The fund's level of gearing is slightly lower than most margin lenders, who typically lend between 50-70%.

A buffer is in place which permits Ausbil to push gearing to as high as 65% provided it returns to its normal range within 3 working days. Like most fund managers, Ausbil has been able to borrow at institutional rates having secured a 364 day revolving line of credit through a syndicate of two major Australian trading banks (previously a single bank). This offers a significant cost advantage over margin lending rates, which are typically 2.5%-3.0% p.a. higher on average. As the fund grows larger, Zenith expects the borrowing costs to reduce with some Australian geared funds in the market securing borrowing as low as 0.25% p.a. above Bank Bill Swap Rate (BBSW).

The gearing decision occurs as part of the Ausbil's Macro and Sectoral Analysis which is chaired by John Honan and attended by Paul Xiradis, John Grace and Adam Dixon. This structure is regarded as a positive given it ensures the investment and gearing decision making are in sync and that the level of gearing reflects the positioning of the portfolio (i.e. portfolio defensively positioned then typically a lower level of gearing). The fact that this meeting structure has been in place for some time also lifts our level of comfort that the process will operate within a rigorous framework. Zenith would however like to see the fund maintain a small cash reserve as an additional buffer, as this would give it additional ability to pay back debt should there be a sharp negative correction in the market.

Security Selection

The Security Selection details below relate to the underlying Ausbil Australian Active Equity Fund.

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 Portfolio Construction details below relate to the underlying Ausbil Australian Active Equity Fund.

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
Gearing (%)	max: 65% provided it returns to its normal range (0-55%) within 3 working days
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.

The Risk Management guidelines detailed below refer to the underlying Ausbil Australian Active Equity Fund.

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. More recently 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.

The Ausbil Australian Geared Equity Fund is also constrained to a maximum gearing of 65% which is in line with its competitors (Perpetual, Colonial First State & Advance). When gearing increases to between 55% - 65%, rules govern the allowable timeframe before which its must be repositioned within the normal 0-55% range.

Risks of the Fund

Unlike Ausbil's flagship product which is considered as style neutral and thus able to deliver excess returns in both rising and falling market conditions, due to the geared nature of this fund it will tend to outperform in bull market conditions. In bearish market conditions any negative returns will be amplified due to gearing within the fund.

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

1 year Excess Correlation Table	
Fund Name	**Excess Correlation**
Advance Australian Geared Equity Fund – WS Units	0.67
CFS FC WS Inv - Wholesale 452 Geared Share Fund	0.46
Macquarie Master Geared Growth Fund	0.90
Perpetual Wholesale Geared Australian Fund	0.91

Given its internally geared structure, the fund is ideally suited for self managed super funds (SMSF), which are prevented from applying external leverage to investments in their underlying portfolio.

Another competitive feature of the fund is its ability to access institutional borrowing rates, which are more competitive than standard margin lending rates. However, the downside of the structure relative to margin lending is that investors cannot negatively gear and claim the interest paid as an expense for taxation purposes.

Like most geared Australian share funds, income and gains for the fund should be greater than the cost of borrowing and other expenses thus enabling the pass through of franking credits to investors based on the total value of the geared portfolio.

Fees

The fees for the Fund are in excess of the underlying Australian Active Equity Fund with the management fee being 1.2% on a net basis (no gearing) but 2.4% on a gross basis (including geared funds assuming a 50% gearing ratio). This is quite high, particularly when including the geared portion of the Funds, and would only serve to magnify losses in down markets beyond that being experienced due to gearing.

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