CI AUSTRALIAN EQUITIES FUND
QUARTERLY REPORT

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

MARCH 2015

"Any fool can know. The point is to understand." Albert Einstein.

"The more I see, the less I know for sure." John Lennon.

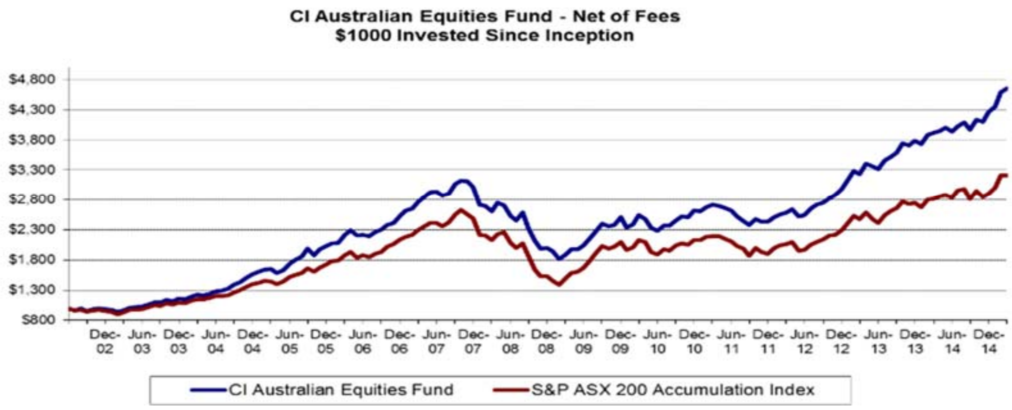
"A thing long expected takes the form of the unexpected when at last it comes." Mark Twain.

"It is the mark of an educated mind to be able to entertain a thought without accepting it." Aristotle.

"We don't see things as they are; we see them as we are." Anaïs Nin.

	****PORTFOLIO**	**#BENCHMARK**	**VALUE ADDED**
ROLLING 3 MONTH	9.47%	10.33%	-0.86%
ROLLING 1 YEAR	20.58%	14.13%	6.45%
ROLLING 3 YEAR	23.04%	15.83%	7.21%
ROLLING 5 YEAR	14.02%	8.59%	5.43%
ROLLING 7 YEAR	9.76%	6.04%	3.72%
ROLLING 10 YEAR	12.13%	8.33%	3.80%
SINCE INCEPTION*	14.05%	9.58%	4.47%
SINCE INCEPTION^	433.93%	220.86%	213.07%

*Annualised
^Cumulative (4 July 2002)
**Before fees and expenses
#S&P ASX 200 Accumulation Index



Market and Portfolio Performance

The Benchmark rose 10.33% over the first quarter of the calendar year and now is up 13.08% over the fiscal year to date. The portfolio has returned 9.47% and 19.74% over these periods respectively. The Australian dollar stabilized at the end of the quarter while the oil price continued its fall from over $100 in June to end the quarter at circa $48. Iron ore prices remained weak and the end of the quarter saw the first potential casualty as Atlas Iron went into trading halt amidst speculation over its ability to continue operations. The stock market has continued to climb a wall of worry about falling commodity prices, geopolitics (Yemen, US/Iran etc), global debt levels continuing to rise, low economic growth rates around the globe, China slowing and a political impasse in Australia.

The positive contributors to performance included:

1. TPG – strong result and announced a takeover offer for iiNet;
2. Macquarie Group – announced the acquisition of a large aircraft portfolio;
3. Spotless Group – no news flow; and
4. Ramsay Health Care – strong result and upgraded guidance.

The worst performers over the quarter included:

1. Oilsearch – continued weak oil price;
2. Transpacific Industries ~ falling oil price negatively impacting their energy business; and
3. Sky Network – result showed a lack of subscriber growth as new internet product comes to the NZ market.

The Portfolio

We included **AMP (AMP)** in the portfolio during the quarter.

AMP is one of Australia's leading financial institutions with a wide array of businesses including wealth management, life insurance, banking and funds management. Its operations are primarily in Australia and New Zealand and it has a number of interests in China and Japan.

For many years AMP was dealing with head winds including exiting the UK, changing regulations, increasing capital requirements and more latterly the integration of the AXA businesses it purchased in 2011. We feel that AMP's management did a good job addressing and dealing with these issues however they did impact on the financial results and meant the share price was relatively weak.

In 2014 AMP announced a new leadership team with Craig Mellor appointed as CEO in January and Simon McKeon appointed Chairman in May. It appears to us that AMP is much more confident of its future now and it is getting on the front foot more than it has been able to in the past. Evidence of this assertion can be seen in the investments the company has made in wealth management businesses in China and Japan, the proactive position it has taken in improving its financial planning businesses and in changing the commission structure in life insurance.

We believe that AMP has most of the building blocks to enable it to emerge as a leader in the financial services industry and that it should be better placed than the banks in wealth management in particular. One thing we can be sure of is that the financial needs of Australians will increase substantially as the population ages and AMP should be able help people achieve financial security.

We also initiated a position in **Boral (BLD)** during the quarter. The new management team under Mike Kane (CEO) has done a great job in taking cost out in a tough market and reshaping the portfolio. Importantly for a cyclical business, the balance sheet is in good shape which means there is optionality around capital management and/or acquisitions given the improving business performance and cash flow.

We believe that there are a number of areas of value latency within the business that could play out in coming years which underpin our investment proposition:

- The core Construction Materials and Cement business is well positioned to participate in the large uptick in infrastructure spending slated to start in NSW and QLD from late 2016.
- The Boral USA business has significant leverage to improving US housing starts. We note that US housing starts of around 1 million per annum is 50% below the 50 year average of 1.5 million housing starts.
- The CSR-Boral bricks joint venture has the potential to improve the Building Products division's underperforming ROFE via cost synergies, better pricing and plant rationalisation. There is also a lot of very valuable land tied up in brick factories that could potentially be sold for residential conversion in coming years if production capacity is rationalised.

- The recent sale of the Western Landfill to Transpacific Industries for $165m upfront plus an inflation-linked royalty of $15m per annum for the life of the landfill indicates there is value tied up in Boral's quarry assets, and we would not be surprised to see more deals of this nature announced in the future.
- The USG-Boral joint venture has significant potential to grow earnings, particularly in terms of penetrating Asia. For example, Asian plasterboard consumption is 1sqm per capita compared with 6-8sqm per capita in more mature countries. The recent USG Corp 4Q14 results suggested the joint venture is going very well and the business should be paying cash dividends later in the year.

Stock News

In one of the largest sell downs on record in Australia, Chevron sold its 50% stake in **Caltex (CTX)**, worth $4.7B, in one fell swoop at a discount of circa 8% to the then prevailing Caltex price. It should have come as no surprise to the market in light of Chevron's well publicized strategy to sell non-core assets in order to realise cash in the current oil price environment. This will give Caltex the opportunity to accelerate the distribution of the $1B+ of franking credits on its balance sheet which up to now have proven difficult to give to shareholders in light of the presence of a majority shareholder who had no interest in franking credits. We expect to see some action in this regard at the half year result later this year.

Macquarie Group (MQG) announced the acquisition of a portfolio comprising 90 aircraft from AWAS Aviation Capital for a purchase price of USD$4B. The deal is to be earnings per share and ROE accretive. We participated in the placement of shares issued to fund the acquisition. The deal is firmly within Macquarie's areas of competency, complements the company's existing aircraft leasing portfolio and adds these aircraft to the AUD$29B of assets and loans under management across sectors including motor vehicles, mining equipment and real estate.

TPG Telecom (TPM) announced a strong result during the quarter. The company continued to add broadband subscribers and to extract synergies from its recent AAPT acquisition and upgraded guidance for its full year result.

The company also announced a takeover offer for iiNET (IIN). The consolidation in the telecommunications industry continues with this takeover offer. TPM made an all cash offer of $8.705 (inclusive of $0.105 dividend) for IIN which represents a 31% premium to the close of IIN's share price on 11 March 2015 and an EV/EBITDA multiple of 9.1x. Based on recent transactions and the general re-rating of the sector, we think the offer is fair and reasonable.

If this transaction goes ahead, there will be four big players left in the fixed broadband market in Australia and TPM & IIN combined will become the second biggest player behind Telstra. This is a remarkable achievement for TPM given its humble beginnings as a small reseller of computer equipment and internet services in 1986. Led by David Teoh, the business has grown organically and it has also made a number of strategic mergers and acquisitions including SP Telemedia, PIPE Networks and AAPT. We are cognisant that IIN will be TPM's largest acquisition to date and carries some extra risks given the difference in culture and customer offering. However, if carefully managed, we think TPM will be able to extract benefits from this acquisition, mainly from:

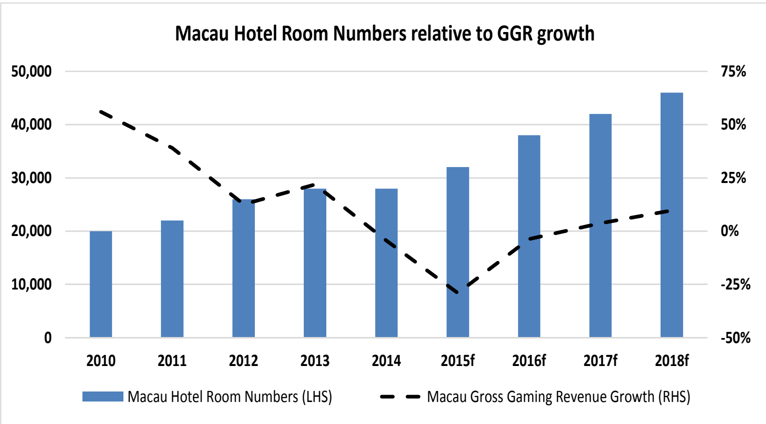
1. Better utilisation of its infrastructure assets by moving IIN customers onto its inter-city fibre network (AAPT) and its PPC-1 submarine cable for international traffic;
2. Reducing the combined companies' cost base e.g. head office, call centre, billing, marketing;
3. Increasing scale in an NBN world to better manage the variable data usage charge called Connectivity Virtual Circuit (CVC); and
4. Expanding TPM's corporate business exposure to SMEs where IIN has a strong presence.

Summerset Group (SUM) reported its 2014 full year results displaying a step-up in operational performance as it opened four new villages and three new care facilities. SUM is on target to meet its build target of 300 units per annum this year and should at least meet this year's medium term development margin target of 17%. Our impression is that it is making good progress on growing its development expertise, which is critical for its self-funding business model and our investment proposition. While 2014 was a transition year for SUM, we expect that 2015 and 2016 should deliver step-changes in earnings growth as the groundwork laid over the last couple of years starts to bear fruit.

Strong demand for SUM's product is necessitating that development is brought forward, which has resulted in an increase in gearing. While SUM has no core debt, it does have working capital and development debt which should run down over time as villages are sold and occupied. If it stopped development the debt would run down quite quickly, which means the debt is less problematic in a dire circumstance than debt in the average company. In addition, we gain comfort from the needs-based nature of its business, which we believe will make it more resilient in the next downturn compared with a 'lifestyle' business.

International Trips

We visited **Macau** at a very interesting inflection point for the region as reflected in March Gross Gaming Revenue (GGR) which was down 39% YOY. This decline is particularly important when considering the committed capacity expansion underway with an estimated 64% increase in rooms (+18,000 to 46,000) and a "targeted" 3,200 increase in table numbers by 2018. These capital allocation decisions were made at a time when forecasts were for GGR to be approaching US$70bn by 2020 versus current consensus predications for this figure to be closer to US$40bn.



Source: Cooper Investors

The key drivers of the large declines in GGR are the Chinese government's corruption crackdown deterring VIP and Premium Mass players, combined with a slowdown in the underlying Chinese economy. While a prosperous Macau is important to Beijing, the Chinese Government is reforming its economy, with Macau being directly impacted both as the economy cools and as Chinese consumers reign in conspicuous spending.

In direct contrast to the contraction in industry revenue, casino operators have committed to large expansions (without the required approval in table allocations) that will now have to proceed. Rather than drive overall GGR, this expansion will likely increase the mass grind market without having a large an impact on the VIP segment. Our view is based on meetings which suggest that the corruption crackdown is a long term initiative and that the junket industry, which is the key source of VIP clientele, is diversifying its operations away from just Macau.

Further concerns include the likelihood that smoking bans will be introduced across all gaming floors, wage inflation as table numbers and rooms increase in a region with full employment and the threat of Beijing increasing its influence in both the monitoring of fund flows and in operational issues such as table allocations, licensing and revenue mix.

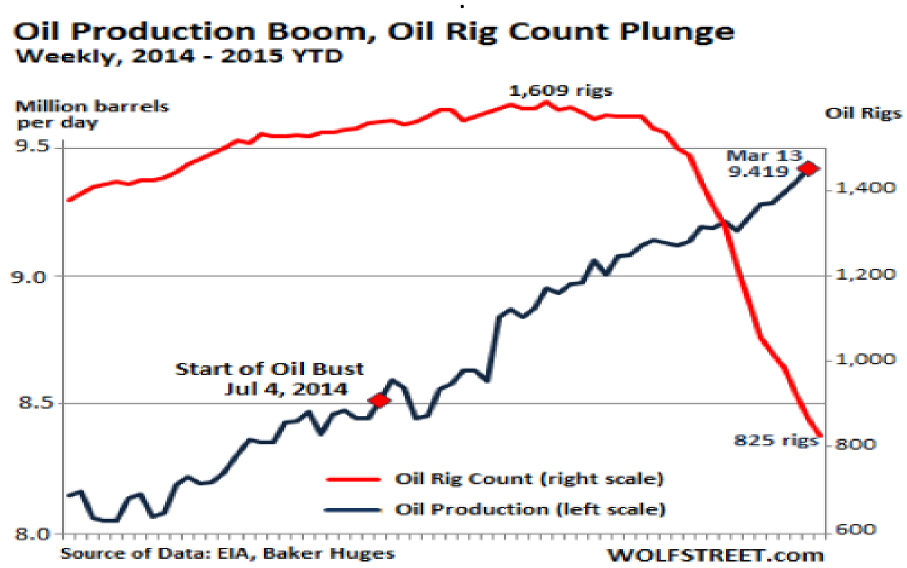
While we see a challenging time ahead for Macau casinos, regional peers (including in Australia) are seeing some benefit as VIPs travel further abroad to gamble, although flows, to these areas will also come under increasing scrutiny from Beijing given it is targeting all Chinese fund flows, not just Macau. Australian operators such as Echo, Sky City Entertainment and Crown (excluding its Melco investment) are currently benefiting from the trend away from

Macau. For example, in the 6 months to December 31st 2014, VIP turnover at Crown's Australian resorts was +61%, Sky City Adelaide International Business was +52%, Echo's Sydney International VIP was +87% and its Gold Coast and Brisbane International VIP was +76% relative to the previous corresponding period.

We also visited the **US** during the quarter, spending some time in New York, Texas and California. The US economy continues to outperform most of the rest of the Western world, albeit with some clouds still around. Our visits to homebuilders indicate that the housing cycle remains roughly on track although it is by no means a V shaped recovery – rather a more subdued but potentially longer cycle is expected, with movement up to the long term average of 1.5m p.a. from a current of approximately 900k p.a. starts (remembering the cycle high was 2m and low was 500k). This type of longer, slower cycle should be positive for most of the players, including Boral. Of interest is the product differentiation homebuilders are bringing to the market. One builder we saw now has three levels of home price/quality – low end, medium and high end. The low end house and land package sells for as little at USD$170k for a 3 bed, 2 bathroom house and, as apparently the fastest selling segment of their book, fits the trend we see globally of a move towards value by consumers in tough environments. Foreclosures no longer appear to be a major problem for the industry and most builders are building to demand rather than on spec so the balance between supply and demand appears intact. One of the risks is that the oil price fall will lead to further job cuts in Texas in particular, which given that state's importance to housing starts, would have an impact on the growth in number of houses built.

The US brick industry structure is improving slowly with a lot of capacity mothballed or shutdown, but it needs more demand to drive higher capacity utilisation, pricing and therefore returns. The decline in brick intensity may have troughed. The trend to smaller houses is moderating and house sizes are starting to increase, as well as slowing multi-family home activity and improving single-family activity. Interestingly, there are new entrants in the US bricks market with Triangle (a German company) building a new plant in Texas, and private equity activity with Bain Capital acquiring CRH's UK and US brickmaking units. These operating trends suggest ongoing improvement in Boral's US business.

There is currently an oil glut in the US. Tanks and pipelines are full. The reason for this can be seen in the chart below. The shale oil phenomenon has meant that US oil production has almost doubled over the last few years (from 5mbd to 9.3mbd) aided by the benefit of technology and as the rig count has soared. At the same time production from the Middle East (Saudi Arabia) has not fallen in response to the decline in oil price. As the US has self-supplied more of its 16mbpd requirement (there is a prohibition in place on US companies exporting oil) Saudi Arabian oil has had to go elsewhere in a tough global demand environment, thus prompting the heavy fall in price.



The oil price has now fallen substantially. It is estimated that to make an IRR of circa 10%, US onshore producers, on average, need a $60 oil price. However they can still make cash at lower prices so very little production has as yet been shut in. As the rig count has fallen, we would expect in time to see oil production stabilize and then fall. However, US production is estimated to reach 9.6mbd before this happens as developments already underway are completed and production brought online. From a global perspective the big international oil companies are all talking about reducing capital spend (including exploration) by 20% or more this year. With a lag, this will have an impact on global production, perhaps also offset by the terms of any deal with Iran signed off by President Obama. We would expect the oil price to remain weak for a little while yet as these adjustments take place.

Macquarie's US business is well positioned to capitalise on the challenges facing many of the US investment banks. The opportunity set in the US is massive with a lot of change being driven by regulation, which has pushed out incumbents in many businesses. Macquarie is focused on the middle markets where it can differentiate itself and be a real alternative as a service provider, and looks to act in an origination/facilitation role rather than necessarily putting its balance sheet at risk. The infrastructure opportunity set is growing significantly for both the advisory/origination and funds management businesses. Given the volatility in commodity and currency markets the Fixed Income, Currency and Commodities business is also seeing higher levels of client activity. Capital allocation continues to receive increasing scrutiny and drives strong disciplines in terms of meeting return hurdles. This is complemented by the strong risk management culture (i.e. businesses are very focused on their pool of risk capital). The US business represents around 30% of group income and we expect it to continue being a strong contributor going forward.

Market Observations

Two stand out features of the current environment are currency movements and interest rates. The USD has appreciated considerably over recent months, especially against the Euro. This will have a very negative effect on the earnings growth of large US multinationals who earn a considerable portion of their revenues and profits outside the US. We will likely see this start to bite in the upcoming quarterly earnings round. At the same time the AUD has dropped against a number of currencies and against the USD and NZD in particular. The AUD now buys approximately USD76c, down from $1.10 at its peak. This has increased the value of the offshore earnings of a number of companies held in the portfolio. The Reserve Bank continues to try to talk the AUD down further, but in the absence of further rate cuts in Australia it will likely remain stable at current levels. The NZD has almost achieved parity with the AUD – something most would have thought highly unlikely until a short while ago – as their economy grows at a quicker pace and the NZ interest rate structure remains relatively high. This has helped the AUD valuations of the NZ companies held in the portfolio.

Interest rate structures around the world have the heavy feel of artificiality about them. Characterised by negative short term rates and negative bond yields in several countries, we are in unknown and uncharted waters. Negative bond yields are particularly problematic – in effect an investor is locking in a negative return if intending to hold such a bond to maturity, or if intending to make a profit in a shorter term the investor must either believe in the greater fool theory or that global economies are going to get worse to the point that negative rates get even more negative. In addition to reducing returns on savings for investors and making unfunded pension liabilities that much larger, very low or negative longer term rates make valuation of equities (traditionally valued using a cost of capital derived from interest rates) more opaque than normal. According to Richard Duncan Economics there are more than $2TR worth of bonds now trading at negative yields. In this environment it is no surprise that investors have chased equities for yield. At some point however we will enter dangerous territory whereby any reversal of yield would have dramatic unpleasant consequences. The table below (courtesy of CLSA) shows the dramatic moves in developed markets two year government bond yields.

Developed markets – 2 year Government Bond Yields

Country	Code	Yield 4Q 2007 (%)	Yield Current (%)	Change %
US	GT02	4.12	0.57	-3.55
Canada	GTCAD2YR	4.38	0.46	-3.93
UK	GTGBP2YR	5.27	0.39	-4.89
Germany	GTDEM2YR	4.03	-0.23	-4.26
France	GTFRF2YR	4.23	-0.14	-4.37
Italy	GTITL2YR	4.28	0.28	-4.00
Spain	GTESP2YR	4.21	0.11	-4.10
Switzerland	GTCHF2YR	2.62	-0.77	-3.39
Sweden	GTSEK2YR	4.27	-0.31	-4.58
Denmark	GTDKK2YR	4.34	-0.65	-4.99
Portugal	GTPTE2YR	3.93	0.09	-3.84
Netherlands	GTNLG2YR	4.20	-0.18	-4.38
Japan	GTJPY2YR	0.81	0.01	-0.80
Australia	GTAUD2YR	6.82	1.77	-5.05
Aggregate		57.51	1.38	-56.13
Average		4.11	0.10	

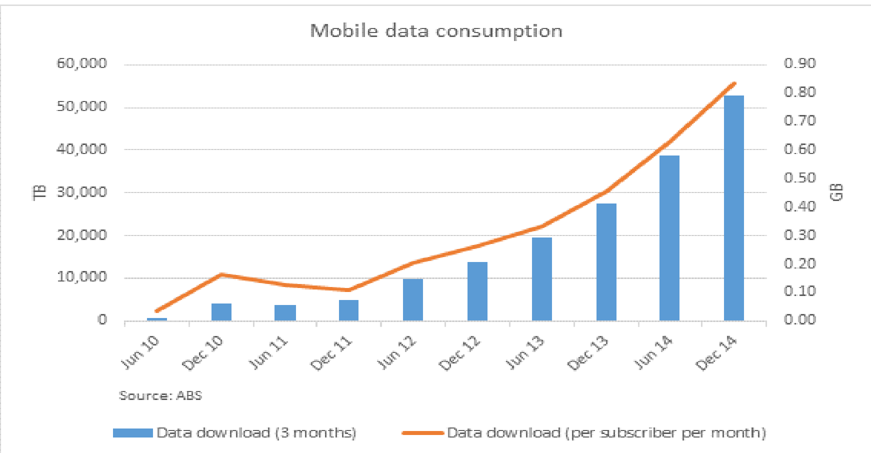
Source: CLSA

Looking to the mobile telecoms industry, the Australian Bureau of Statistics recently released data on mobile data consumption which showed an increase of 91% for the 3 months ended December 2014 compared with the previous corresponding period.

Data consumption growth really started to take off from June 2012 and it is probably explained by a number of things including the continual upgrade of mobile devices to smart phones, growth in video streaming (e.g. YouTube), proliferation of apps and better network coverage and speed.

The mobile industry structure is favourable in Australia with three main players including Telstra, Optus and Vodafone. All three carriers have in the past and continue to invest heavily to upgrade their networks. The key question is whether they will be able to monetise this data consumption growth and make an acceptable return on their investment.

As we noted in our previous quarterly, it appears that mobile competition has picked up slightly following a period where Telstra gained strong market share from its peers. The three players have been quite innovative with their product offerings and have included things like music and video subscriptions and data share plans. More interestingly, the carriers are offering better value and higher data inclusions in their higher tier plans and it is perhaps part of their strategy to monetise this data consumption growth.



MARCH 2015

We have commented on the iron ore industry in the past few quarterlies. The February reporting season showed that all producers reduced costs significantly as expected. The dramatic fall in the oil price and excess capacity has reduced freight costs, and combined with the fall in foreign exchange, has helped all producers lower their all in cash costs. However, as the cost curve has shifted down, so has the iron ore price and it has fallen below $50/t. A lot of producers are now starting to really feel the pain. Australia's third largest producer, Fortescue Metals (FMG), is estimated to be just about cash breakeven at $50/t. FMG has a highly levered balance sheet and debt investors are getting concerned, which saw yields on some of its issued debt spike recently to 14%. We believe that supply is generally sticky (especially in China) and the iron ore price will need to stay at current low levels for a prolonged period to drive meaningful high-cost supply out of the market. It is interesting to note that despite negative earnings revisions and falling commodity prices, the share prices of both BHP and RIO have stabilized somewhat.