CI AUSTRALIAN EQUITIES FUND
QUARTERLY REPORT

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

SEPTEMBER 2015

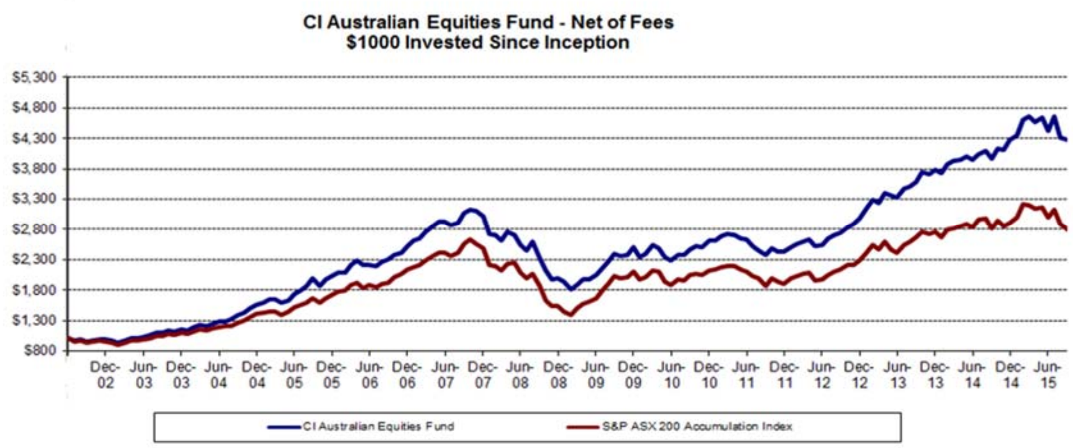
"As our circle of knowledge expands, so does the circumference of darkness surrounding it." Albert Einstein.

"Until the Great Depression, most economists clung to a vision of capitalism as a perfect or nearly perfect system. That vision wasn't sustainable in the face of mass unemployment, but as memories of the Depression faded, economists fell back in love with the old, idealized vision of an economy in which rational individuals interact in perfect markets." Paul Krugman, "How Did Economists Get It So Wrong?" New York Times, Sep. 2, 2009.

"Moreover, ultra easy monetary policies have a wide variety of undesirable medium term effects - the unintended consequences." William R. White, Federal Reserve Bank of Dallas working paper 2012.

	****PORTFOLIO**	**#BENCHMARK**	**VALUE ADDED**
ROLLING 3 MONTH	-2.51%	-6.58%	4.07%
ROLLING 1 YEAR	9.67%	-0.68%	10.35%
ROLLING 3 YEAR	17.41%	9.36%	8.05%
ROLLING 5 YEAR	12.93%	6.55%	6.38%
ROLLING 7 YEAR	10.26%	5.93%	4.33%
ROLLING 10 YEAR	9.05%	5.34%	3.71%
SINCE INCEPTION*	12.82%	8.09%	4.73%
SINCE INCEPTION^	394.16%	180.13%	214.03%

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



Market and Portfolio Performance

The market correction that began in the June quarter continued into the September quarter, with the benchmark down 6.58% for the quarter. The annual return for the market now sits in negative territory, at -0.68%.

The Australian stock market followed other global markets lower with August delivering the worst monthly performance for the Australian market since 2008, when financial markets were in the grip of the financial crisis. In the US the S&P 500 Index declined 6.9% for the quarter, and the MSCI World index lost 8.2%.

The equity market weakness was sparked by concerns surrounding global growth, and in particular slowing economic growth in China. This was exacerbated in part by the surprise move by Chinese authorities to modestly devalue their currency and the significant falls seen in the Chinese equity market.

In Australia the equity market weakness was led by materials stocks, with the resources sector falling 16% for the quarter. Slowing global demand, particularly continued softness in the economic data coming out of China, is seeing market concerns focus on the on-going over supply in some commodity markets. We have remained cautious on these sectors and hold an underweight exposure to resources.

Banks were also in focus and were a significant drag on the market, with the bank sector returning -11.35% for the quarter. The focus was on capital requirements, as the management at both CBA and ANZ followed NAB to bolster their bank's capital position through substantial equity raisings.

Positive contributors to performance over the quarter included CSL and Fisher & Paykel Healthcare (FPH), both of which delivered solid operating results, and TPG Telecom (TPM), with the telecommunication industry continuing to consolidate and TPM leveraging their network scale. On the negative side SKY Network Television (SKT) underperformed the market (the company reported a fall in net subscriber numbers), as did Boral (BLD; underwhelming outlook for FY2016 and market concerns surrounding the outlook for the Australian housing market).

The Portfolio

The banks continued to increase their equity capital bases with both **ANZ** and **CBA** raising further equity during the quarter.

ANZ raised $2.5bn at a price of $30.95 in a share placement to institutions in August and a further $0.72bn in a share purchase plan for retail shareholders at a price of $26.50. The portfolio did not participate in the ANZ capital raising. In conjunction with its 2015 results CBA raised approximately $5.1bn through a 1:23 rights issue at a price of $71.50. The portfolio did take up its rights in the CBA issue.

It is expected that Westpac will raise further capital when it releases its full year results in November.

These capital raisings increase the banks common equity Tier 1 ratios however we expect the banks will have to continue to raise further equity over the next year or two as more stringent capital requirements are placed on banks around the world. There has been a lot of discussion on whether the banks payout ratios and current dividends are sustainable. Clearly there are many factors that banks will have to consider regarding dividends, our view is banks may be able to hold their dividends at current levels but it will be very unlikely they can grow at rates we have seen in the past.

Regis Healthcare (REG) was added to the portfolio during the quarter. REG is a high quality exposure to the residential aged care industry in Australia and, along with Summerset Group (SUM), provides exposure to the investment theme of growth in the ageing demographic, which is a strong underpinning of future demand. The highly fragmented aged care industry in Australia provides significant opportunities for consolidation, which, when combined with REG's proven ability to execute on high returning greenfield and brownfield development opportunities, makes REG an attractive investment opportunity.

South 32 (S32) which was demerged from BHP in May was sold out of the portfolio during the quarter. The fund received one South 32 share for each BHP share. Although management at South 32 espouse a focus on efficiency and capital discipline we remain concerned regarding the inherent risks and prospects for some of their operations, particularly in South Africa. In addition, we could not get comfortable with the commodities that the business has exposure to and saw no value latency of significance.

We participated in the capital raising for Murray Goulbourn through the IPO of units in the **MG Unit Trust (MGC)**. The IPO provided investors, who were not dairy farmer suppliers to Murray Goulbourn, their first opportunity to gain exposure to the operations of the co-operative. The capital raising was undertaken at an attractive price at a weak point in the dairy commodity cycle and is discussed further below.

Stock News

Consolidation in the telecommunication sector continued with the announced merger of Vocus (VOC) and M2 Telecommunications (MTU) which will form the 4th largest telco player listed on the ASX, providing services to both retail and corporate customers. The other notable announcement was **TPG Telecom (TPM)** agreeing with Vodafone to extend its network to provide dark fibre services to Vodafone mobile cell sites and migrating its current mobile reseller arrangement from Optus to Vodafone.

TPM reported a good full year result. Strong momentum in its consumer business continued, which saw the company grow its subscriber base organically and expand its margins. The pleasant surprise was in the corporate business, where management has shown its ability to extract efficiencies and expand margins in the AAPT business it acquired in late 2013. The agreement with Vodafone (noted above) will expand the company's network, which should put it in a good position to gain market share in the corporate sector. We believe there is good momentum in the business over the next couple of years as management integrate the iiNet (IIN) acquisition by leveraging its existing infrastructure and reducing costs.

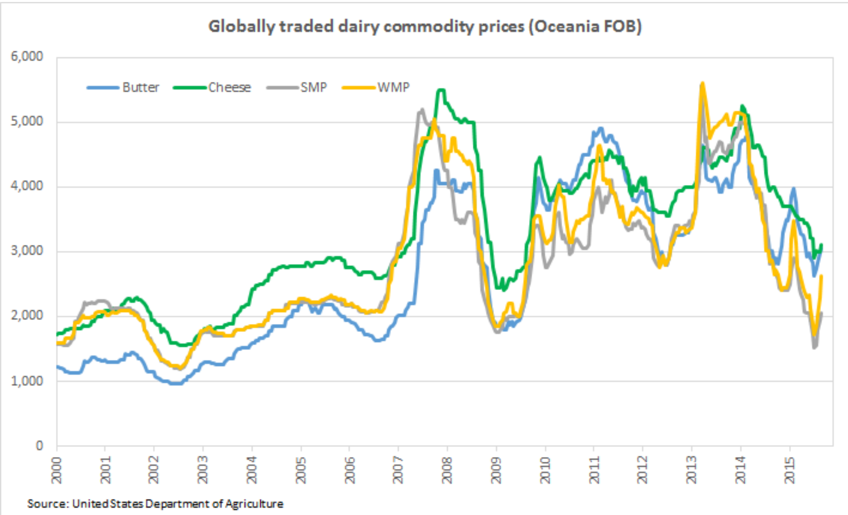
Telstra (TLS) reported its full year result showing good operational performance in its key mobile and fixed broadband businesses. Management is increasing its investment in its mobile business to maintain its network leadership, which is one of the company's key competitive advantages. The insatiable data demand should benefit its mobile division, but is being partly offset by a pickup in competitive intensity from Optus and Vodafone. NBN payments are only starting to ramp up, which should support a growing dividend stream over the next few years.

Woodside Petroleum (WPL) approached **Oil Search (OSH)** with a proposed takeover offer. The approach was a non-binding indicative proposal that offered 1 WPL share for every 4 OSH shares, effectively valuing OSH at around $11.6 billion or just over $7.60 a share. Prior to the approach OSH was trading at $6.73.

WPL's approach was rejected by the Board of OSH, with the Board concluding that the approach by WPL was "opportunistic and grossly undervalues the Company". OSH has two globally competitive LNG projects in front of it; the train 3 expansion of PNG LNG and the development of the Elk/Antelope fields as Papua LNG. These projects have the ability to add significant value to OSH shareholders over the next 5-6 years. WPL on the other hand has limited viable growth projects at current oil prices. Although we do see some strategic merit in the combination of WPL and OSH, as with any stock based transaction it needs to take into account the relative value of both OSH and WPL's asset bases. It remains to be seen if WPL come back with an offer at a level that more fully reflects the value of OSH's assets.

MG Unit Trust (MGC) provides economic exposure to Murray Goulbourn, an unlisted public company that through its co-operative structure has the primary business of the sourcing and processing of milk into a range of dairy products. Growth in global demand for dairy products is underpinned by increasing per capita consumption trends in emerging markets. Murray Goulbourn's milk supply is mostly sourced from Victoria, a low cost and relatively stable region, near the key growth market of Asia, and is supplied by more than 2,500 supplier-owners. Current management have been in place since 2012, when the current strategy began to be implemented. They have a clear and deliverable strategy. The strategy is to focus on cost leadership and to increase the value added component of dairy products produced, at the expense of the more purely commodity products.

The chart below shows that global dairy commodity prices have fallen significantly over the last 2 years. This is a function of over supply due to the supply response from previously elevated product prices and Russia implementing an import ban from some of the major dairy producing regions. Prices are now near cyclical lows and with farmers in some of the prime milk producing regions likely to be loss making at recent price levels, a supply response is likely to gradually move the market back into balance over the coming years. This should see dairy commodity prices stabilise and gradually improve over the medium term. Although MGC has a strategy of reducing its exposure to commodity products, they still represent 37% of revenue and are likely to continue to be a meaningful amount of production for some time.



With the closure of the Kurnell refinery late last year and the successful move to external sourcing with the expansion of their Ampol Singapore operations, **Caltex Australia (CTX)** has made significant progress to improve both the return profile of the business and the sustainability of those returns. The reduced volatility in future earnings is likely to see CTX's balance sheet headroom expand even further, from an already strong position, and provides a key component of our view of value latency.

In the August profit announcement CTX management made their desire to grow the business clear. Although we encourage companies to invest where they see value adding opportunities within their core capabilities, we would be concerned to see CTX utilising its strong balance sheet to invest outside of its core transport fuel related competencies, an area where we continue to see ample opportunity for growth.

CTX is currently sitting on just over $1 billion of franking credits. We are pleased by management's comments regarding the preferred form of returning additional capital to shareholders via an off-market buyback, as this is an effective mechanism to get these franking credits into the hands of shareholders. However we would add that there is no value for CTX shareholders in these franking credits remaining on CTX's balance sheet and we strongly encourage CTX's board and management to move to return these to shareholders in a timely manner.

A similar company to CTX, and a clear example of a company sticking to their core competencies, is **Z Energy (ZEL)**. Z Energy operates in the same industry segment as CTX, albeit in New Zealand. In June, Z Energy moved to acquire Chevron's New Zealand downstream transport fuels business, one of their three major competitors, for NZ$785m.

While the transaction still requires clearance from the New Zealand Commerce Commission, the acquired business clearly sits within Z Energy's core capabilities and strengthens their market positon in New Zealand fuel distribution. The transaction is being undertaken at an attractive price for Z Energy shareholders and is expected to be at least 34% accretive before synergies. Z Energy management have exhibited a high degree of capital discipline and operational expertise which they will be able to call upon to make this a successful value adding acquisition.

DUET Group (DUE) entered into a scheme of arrangement with **Energy Development (ENE)** under which DUE would acquire all of the shares of ENE for $8.00 cash. This is an attractive price relative to our valuation of ENE and as such we will be voting in favour of the scheme. The transaction is expected to be completed in October.

International Trip

USA Trip

We recently travelled to the United States where we visited with the management teams of various listed and unlisted companies. On a sectoral level the primary focus was on furthering our knowledge of **Iron Mountain (IRM**) / **Recall (REC)**, **Brambles (BXB)** and **Sims Metal Management (SGM)**. Our thoughts regarding REC and IRM are included in the Market Observations section below. Other key takeaways from the trip were:

- BXB hosted an investor event which showcased a range of the company's senior executives in a forum that was open and interactive. The event provided useful information on where BXB's $1.5bn growth capex (planned over the next four years) is being allocated and the expected returns it should generate. It also provided somewhat of a roadmap to how the company intends to reach its group level 20% ROIC target by 2019.

- Whilst we acknowledge the need for improvement in the US economy in order to meet these long term targets and believe management overestimated the quality of their existing US pallet pool, we see opportunity for BXB to materially grow earnings at pleasing rates of return as it deploys its capital over the next four years. The business retains a highly valuable asset network which is very well managed in the context of maintaining absolute market leadership and, at current levels, the share price does not reflect the publicly stated objectives of the company.

- When in New York we met with the scrap metal industry. On a macro level the messaging was loud and clear that scrap metal market conditions are incredibly tough with no expectations for a recovery in the near term. Contributing factors to this are the slow-down in global demand for steel at the same time as Chinese steel exports are on the rise. While this very tough dynamic is a severe headwind for the company, we remain very impressed with SGM's strategy of turning the company from somewhat of an ad-hoc scrap metal trader to a well-managed scrap metal and e-recycling logistics business with a highly valuable and globally integrated asset network.

- The company has good competitive advantages in terms of its waterside assets and international land bank. This assists in product sourcing and shipping costs relative to its smaller competitors while also enabling its US product to be sold predominantly offshore rather than within the country. With a large net cash balance sheet we look to SGM to maximise this severe downturn by potentially buying distressed competitors in deals that are highly accretive to returns while also strategically important in rationalising the industry.

China trip

During the quarter, we spent two weeks in China, visiting Beijing, Tangshan, Jinan, Chengdu and Shanghai. The major theme of the trip was resources related, but this was balanced with visits to companies in other sectors including health, technology, media and agriculture. We came away feeling that businesses in the heavy industries will remain under pressure for some time. These industries expanded at a rapid pace during China's economic development and now there are overcapacity issues that need to be addressed given the slowdown in demand. A lot of the companies we visited in the steel and aluminium industries are unprofitable and are hoping that demand will pick up and/or their input costs will fall. There is also hope they can export some of this overcapacity via "One Belt One Road" (OBOR); an initiative to build out infrastructure in emerging economies neighbouring China. The other cost that needs to be addressed is pollution, which was particularly evident in the Beijing skyline. There is no doubt there has been misallocation of capital in China but it can also be argued that there have been substantial benefits from the build out, such as first class infrastructure (highways, high speed trains). Overall, it is difficult to get enthusiastic on the commodity demand outlook, especially given the government's aim to transition the economy from investment to consumption.

General observations

- Overcapacity in steel and aluminium: demand for steel is weak and domestic consumption is down ~4% in the 1H vs. the last year. Demand growth in aluminium is being exceeded by supply growth. The sentiment was negative in the majority of these meetings.
- A lot of talk about exporting overcapacity via OBOR and there has been a pickup in steel and aluminium exports this year. The policy banks we met (China Development Bank, Export-Import Bank) have been directed by the state to lend to domestic companies that go abroad and lend to developing economies to support the build out of their infrastructure.
- Too many people employed in heavy industries and it is very difficult to retrench people. The general view is that the government is not doing enough to retrain workers. As an example, a state-owned mining company we met is considering demerging its unprofitable iron ore division which employs 10,000 people because it has been too difficult to close the operation.
- A lot of locals dismiss the view that there is a debt problem in China and think the central government will provide the back stop. It appears a lot of the debt is held at the local government level directly and indirectly through local government finance vehicles. We got varying estimates of debt to GDP in our discussions. One thing for sure is that leverage has increased significantly post-GFC.
- Non-performing loans (NPLs) are trending higher. Reported NPLs is ~1.3% but actual is probably above 3%. The usual suspects with high NPLs are the steel, mining, cement and property companies.
- People want to live in tier 1 and 2 cities. Even though housing is very expensive already in Beijing and Shanghai, the general view is that prices will continue to rise. A property developer we met said that land in Shanghai is being acquired at a similar price to an equivalent established building, so they are essentially speculating prices will increase when they start to presell. In tier 3 and 4 cities, there is an oversupply issue (inventory level of ~3 years) and this is where the majority of property construction is taking place.
- It was hard to gauge the exact level of home ownership in China but it is high relative to other countries around the world.
- Chinese people have a general view that property is a good store of wealth and is passed down to future generations. Other options include depositing at the bank where interest rates are low and investing in the stock market which is still in its early development phase.
- Property demand in developed economies such as Australia, US and Canada is likely to continue. Prices in Beijing and Shanghai are more expensive than Sydney and Melbourne. Other reasons include health, education, property rights, diversification etc.
- Coal accounts for two-thirds of the country's energy mix. There is a strong push for alternative options such as solar, wind, nuclear and hydro.
- Wage inflation is an issue and is increasing at high single digits.
- Strong trends in consumer spending: there is still strong demand for luxury/aspirational brands from the upper and middle class. China's share of total world luxury spend is now ~29%.
- Strong internet thematic: we learned a new acronym "BAT" which stands for Baidu, Alibaba and Tencent; the leading internet companies in China. We visited Zhaopin (Seek is a substantial shareholder) and Autohome (Telstra is a substantial shareholder) and we were impressed by their business models and industry trends.
- There is strong interest from Chinese investors in the agricultural and dairy sectors in Australia. The dairy industry outlook is positive where volumes are expected to grow at mid to high single digits to 2020. Exports from Australia should increase due to the Free Trade Agreement.

- There was a lot of chatter about the stock market. It appears that the central government has this idea that a strong share market will allow SOE and private companies to recapitalise their balance sheets via IPOs / capital raisings.

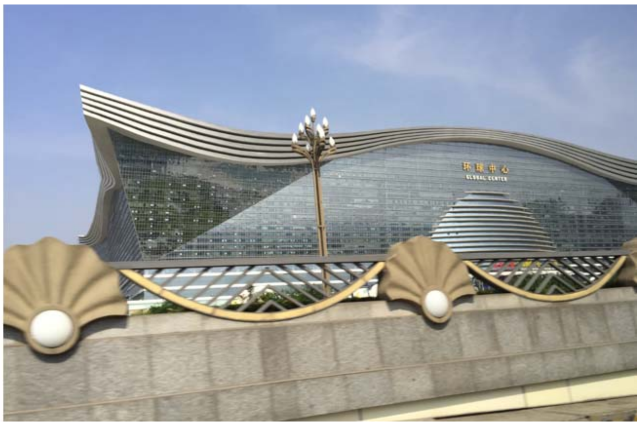
Some photos we took along the way:

A steel mill we visited in Chengdu.

Beijing’s skyline on a normal day.

These pictures were taken on our high speed train ride from Beijing to Tangshan, and show the mammoth build out of residential apartments.

Our preferred mode of transport.



Global Trade Centre in Chengdu, probably bigger than the MCG!

Market Observations

Recall (REC) ~ Good idea wrong price

Since being divested from Brambles in 2013 Recall (REC.ASX) has made good progress in increasing its earnings while developing a platform for future sustainable growth. This includes reinvesting into its sales and support teams generating 2 year average annual organic carton growth of 2%, while also divesting poor performing assets such as SDS Germany. We believe this organic carton growth is sustainable over the medium term as our analysis indicates that although paper usage in developed economies has been falling, paper storage is increasing at modest rates thanks largely to increased legal and compliance requirements. In developing economies it is estimated that paper usage is actually increasing, fuelling solid single digit storage growth rates.

REC has also increased its scale with strategic acquisitions that have both built out the company's network and driven 2 year average annual total net carton growth of 8%. Management has achieved this while simultaneously improving constant currency margins from 24.2% in FY14 to 25.2% in FY15 as it tracks toward its medium term goal of 30%.

In December 2014 Iron Mountain (IRM.US) proposed to acquire REC in a bid valuing REC at the time at A$7.00 per share (comprised of A$5.73 in IRM shares and A$1.27 cash). This was rejected by the REC board. In June 2015 a revised bid comprising 0.1722 IRM shares and US$0.50 per share cash (currently valuing REC at A$8.31) was agreed to by both boards, subject to shareholder and regulatory approval. Combining the IRM and REC businesses represents an excellent value creating opportunity for both sets of shareholders. It is particularly favourable to IRM shareholders for the following reasons:

1. At the low end of the net synergy target of US$155m (when fully synergised) IRM estimates the deal will be **26% accretive to its EPSadj (prior to US GAAP purchase price adjustments). We estimate this accretion to increase to 40% when applying REC's stated $248m synergy target.** Given the high duplication of some assets and REC's current corporate structure being established in preparation for larger scale we believe the higher end synergy benefits are achievable.

2. The deal will **significantly de-lever IRM**. Based on the mid-point of IRM's 2015 OIBDA forecast and its debt as of 2Q15 it is trading on net debt/OIBDA of 5x relative to REC's FY15 net debt/EBITDA of 2.5x.

3. **IRM trades on a higher earnings multiple**, commanding 12x CY15 EV/OIBDA relative to REC's FY16 EV/EBITDA multiple of 10x.

4. REC is **one of the last major acquisitions** in the document storage space available for IRM to acquire, given IRM and REC are the clear number one and two players globally.

5. REC provides **a beachhead for further growth into Asia** both with regard to REC's site network and its management expertise. Asia has a good long term outlook given the developing status of a number of its economies. REC has been expanding its presence in this region which now represents 9% of revenue (up from 7% in the pcp).

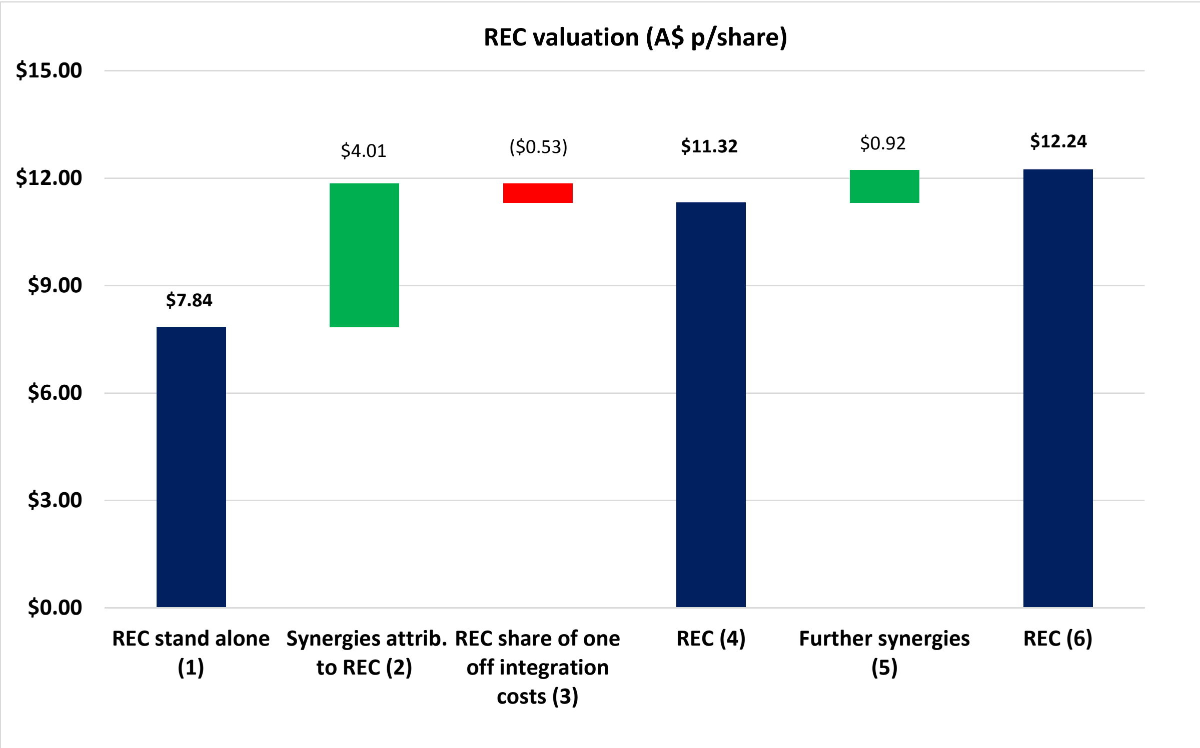
6. Material cost out (US$155 – US$248m) opportunities related to personnel, real estate and transportation as well as tax savings upon REC converting into IRM's REIT structure.

7. Where IRM is focussed on the larger Enterprise client segment, REC is more weighted to the less price sensitive SME space.

8. REC will potentially increase IRM's "non-REIT" earnings which should improve IRM's capital management optionality – its ability to organically fund dividend growth and acquisitions.

9. IRM has had challenges around a deterioration in its services gross margins and heightened SG&A costs. REC's management IP and added scale can assist in addressing these issues.

Iron Mountain's bid at current prices is worth A$8.31 to Recall shareholders. We believe the **bid will FAIL** because the current offer does not represent our view of fair value of A$11.32 to $12.24 per Recall share as detailed below**:**



(1) Cooper Investors standalone valuation is based on a discounted cash flow basis. Notably, at this valuation the ev/ebitda multiple of Recall is 10.2x and still much less than the current 12x ev/oibda multiple for Iron Mountain
(2) We have applied 50% share of US$202m in annual synergy benefits to REC, discounted the number back to a present A$ per share value and applied a multiple of 11x. This synergy figure is based on the mid-point of IRM and REC's publicly stated numbers (US$155m-US$248m)
(3) Applying 50% share of one-off costs (based on IRM's publicly stated US$300m figure) to REC which has been discounted back to a present A$ per share value.
(4) Valuation of REC when adding the per share uplift in point 2 less the decline in point 3
(5) We have applied 50% share of the incremental uplift if applying REC's publicly stated annual synergy target of US$248m less our US$202m used in point 2. We have discounted this US$46m number back to a present A$ per share value and applied a multiple of 11x.
(6) Valuation of REC when adding the further incremental uplift in point 5 to the valuation in point 4

REC as a stand-alone entity has an excellent asset network, management team and operating initiatives underway which present a clear roadmap to delivering long term value. We continue to believe in the underlying recurring nature of the document storage business which is complemented by current management's track record in generating solid synergies as it acquires assets across the globe. Therefore, we view the current offer price as far too low as it doesn't fairly share the synergy benefits. Given the existing services and cost challenges within IRM we believe there is **better optionality in remaining with the REC stand-alone entity**.

SEPTEMBER 2015

Note: During the quarter the Transaction Costs applicable to Applications and Redemptions in the Fund were reduced from 0.3% to 0.2%.