

**Presenting
debate on
contemporary
and emerging
portfolio
construction
issues**



portfolio
construction

CONFERENCE

15 & 16 August 2007 | AJC Convention Centre, Randwick, Sydney



SG Hiscock & Company

IC²E

*Intangibles that **C**reate the **C**ompetitive **E**dge*

Callum Burns
Portfolio Manager – SG Hiscock & Co



Presentation to PortfolioConstruction Conference 2007



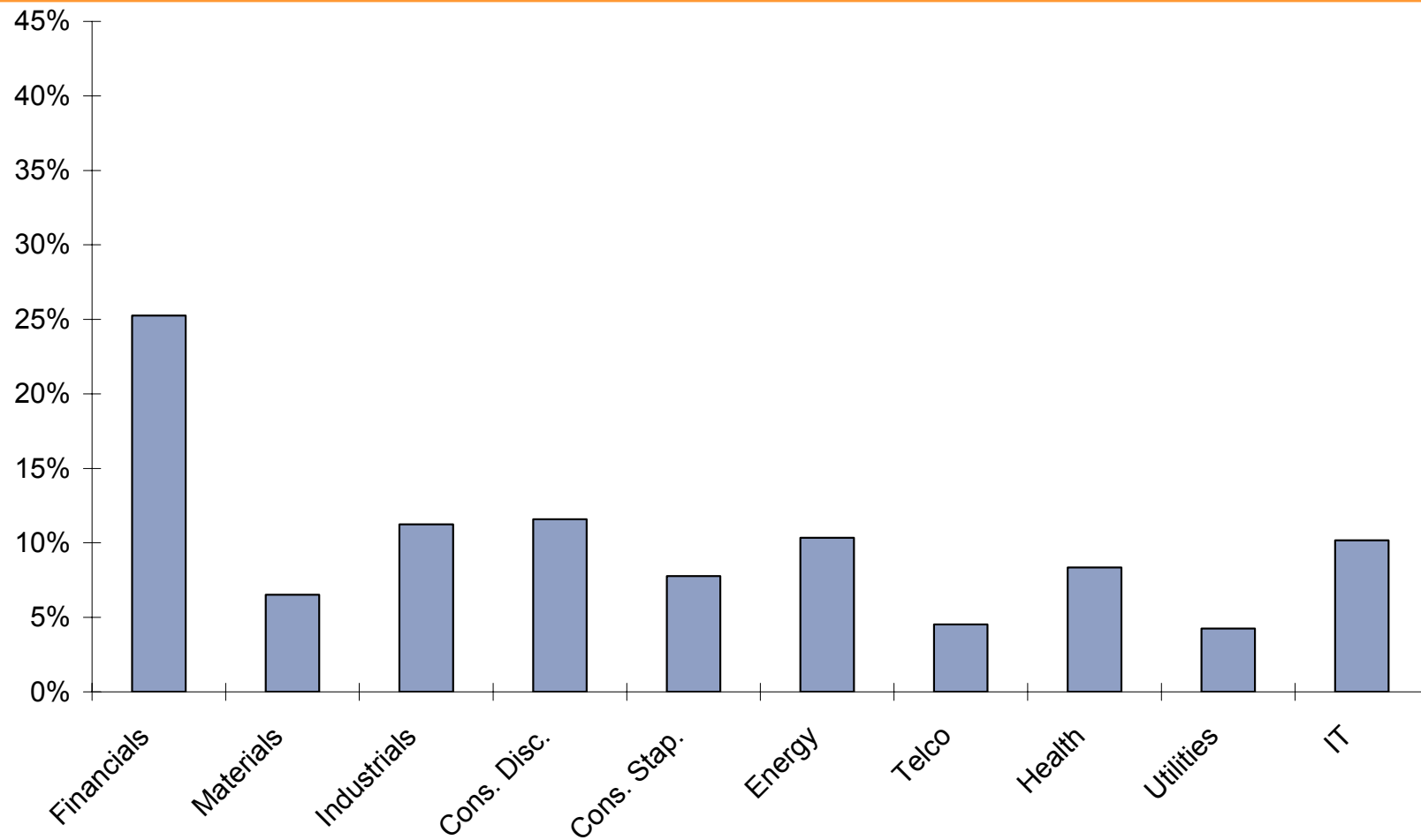
SG Hiscock & Company

Towards the Ideal Equity Investment

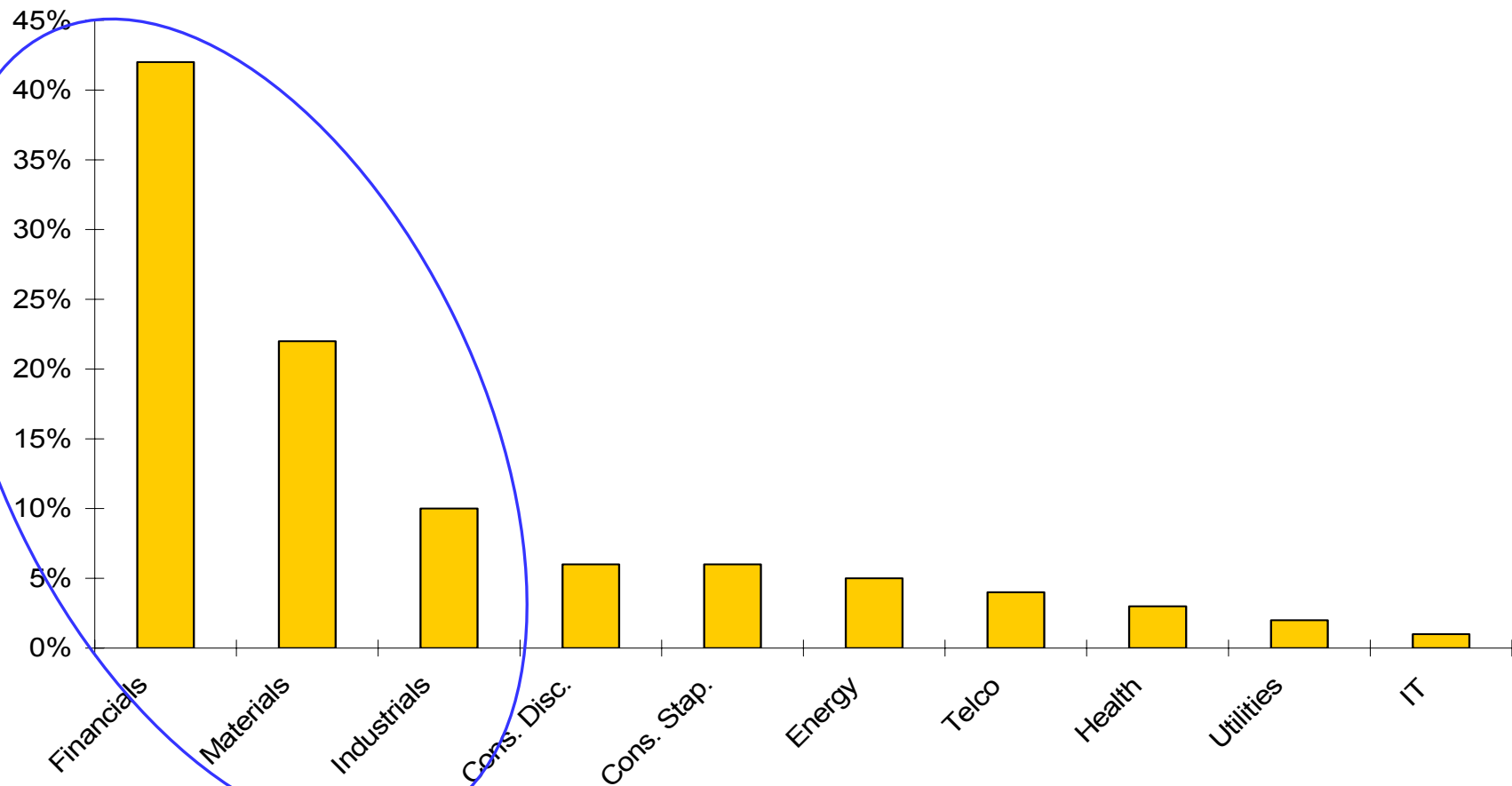
- Diversified, quality industry exposure
- Retain the tax benefits of investing in Australia - ASX
- Make money

With that in mind.....

Global equities are diversified



ASX is very skewed



Outperformance by investing in...

*ASX listed Companies with an **entrenched** position in their product markets*

-

*Many of the company's product markets or comparator companies are **global***

Objective

Construct portfolio that invests across a “lifecycle” of such companies

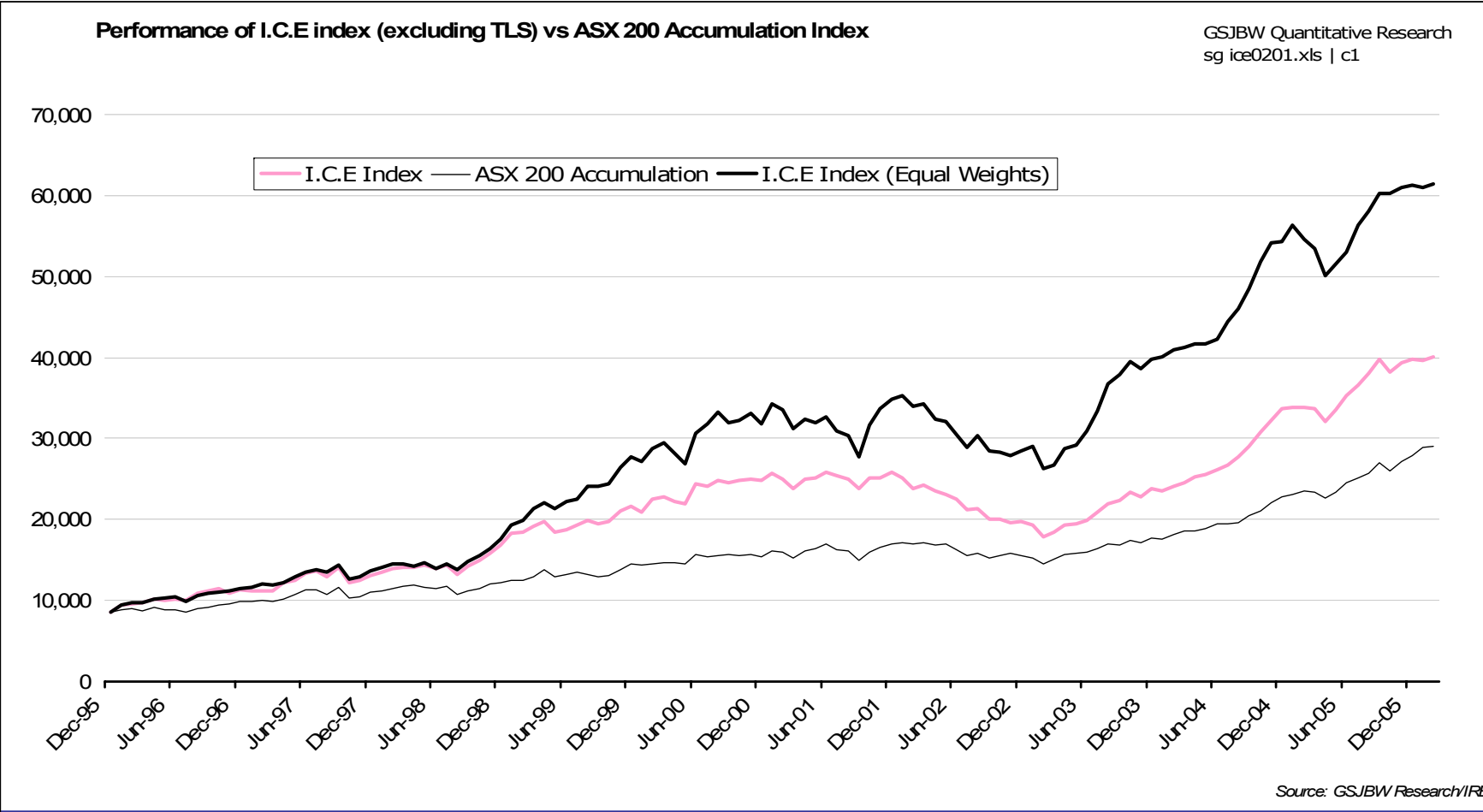
- Invest in companies with a “sustainable” competitive edge
- Find assets that are **difficult to replicate**
 - eg licences, patents, brands, captive client base
- Look for an **entrenched market position**
- Don't pay too much
- Carefully manage capacity
- Examples – Cabcharge, Tatts, Universal Bio, Brambles, HFA, Etrade

IC²E - “Intangibles that Create the Competitive Edge”

Why is this an attractive space?

- These companies should outperform over the medium/long term
- Stockpicking attention is less:
 - Bulk of Aust. investment resources focussed on other parts of the market
 - Much of the arena is too small for global players
- Boutique size opportunity requiring global industry expertise
- Multi-cap approach allows early identification of good businesses
 - And retained through their lifecycle
- Complements and broadens orthodox Australian Equity portfolios
 - While maintaining tax benefits

Quantitative research supports proposition



Global industry insights drive outcome

Industry	Company	Insight	Mkt Cap*
IT	Bravura	UK wrap years behind Aust. US companies not competitive due to tax complexity.	\$230m
Payments	Cabcharge	Aust. electronic payment % penetration low vs global levels.	\$1500m
Funds Dist'n	HFA	Validity of and increasing adoption of Absolute return products. Proprietary distribution	\$480m
Funds Mgmt.	Henderson	Outflows reducing. High margin alternative asset margin offsetting Institutional outflows	\$2300m
Medical	Uni Biosensors	J&J IP ownership trail & Backers commercialisation credentials.	\$140m
Medical	Pharmaxis	VC / Backer credentials & small no. of sales touch points = direct sales.	\$570m
Renewable	Style	Global growth strategy gaining traction. Corporate contact base.	\$100m

* To June 07

...Any fool can outperform

Taking account of the key factors of:

- Volatility
- Sharpe Ratio
- Draw-downs versus market
- Number of holdings
- Size of positions
- Market cap. of top contributors

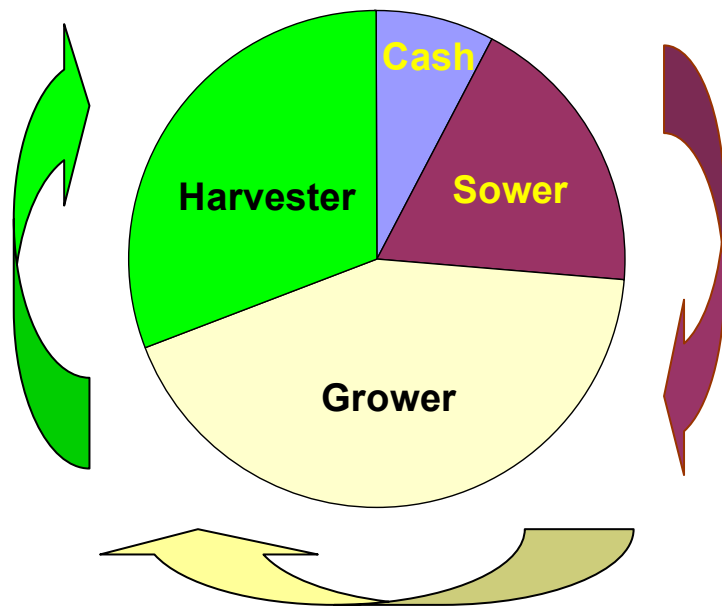
Research & Portfolio Construction

Objective.....revisited

1. Invest in companies with a “sustainable” competitive edge
2. Look for assets that are **difficult to replicate**
3. That drive an **entrenched market position**
4. Invest at the right price
5. Across the lifecycle

Life Cycle

1. Correctly Identify companies with intangibles
Retain them through the lifecycle (at right price)



Category	Example
Sower	<i>Peplin</i>
Grower	<i>IBA</i>
Harvester	<i>Brambles</i>

Opportunity brings consequence

Information asymmetry between those who know & those who don't.
Results in:

- **Abnormal gains / losses** to informed / poorly informed investors
- The **volatility** of firm's stock price can increase.
- Decreased **investors' confidence** in the integrity of reported information
- **Increasing bid-ask spreads** (as self-protection against asymmetric informed investors)
- Leading to **decreased volumes of trade** (as buy / sell cycle is more expensive)
- Leading to **increasing cost of capital**
- Means **slow corporate growth**

Opportunity is there- MUST get it right

Correct valuation is critical

Upside of *Intangibles*

- **Upside, value-increasing characteristics:**
 - Intangible assets don't have to be scarce
 - Increase in value when used
 - Are not subject to diminishing returns
 - Have strong network effects
 - Create future value

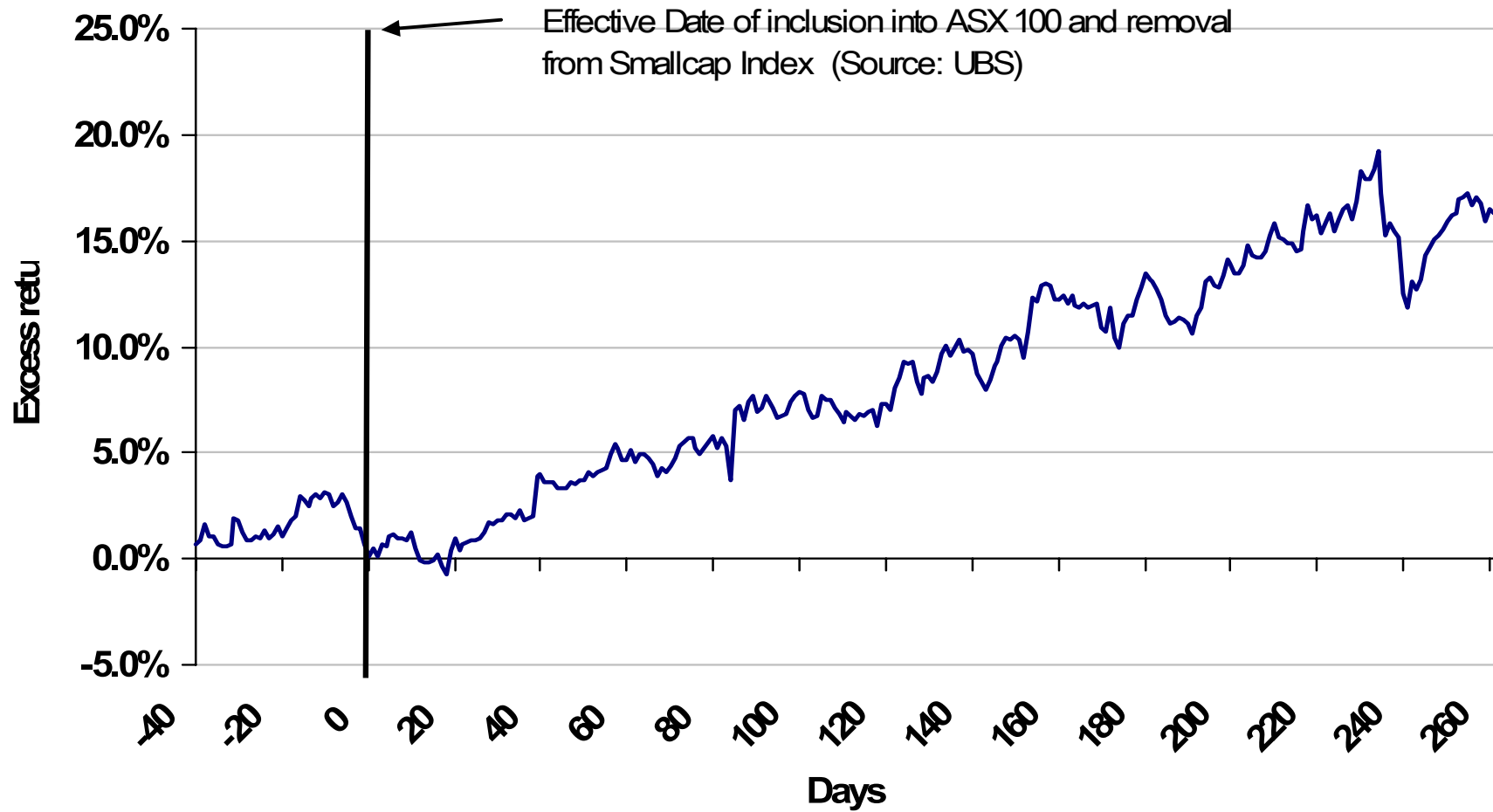
- **All intangibles are future-oriented**
 - So are ignored by traditional accounting systems

Downside

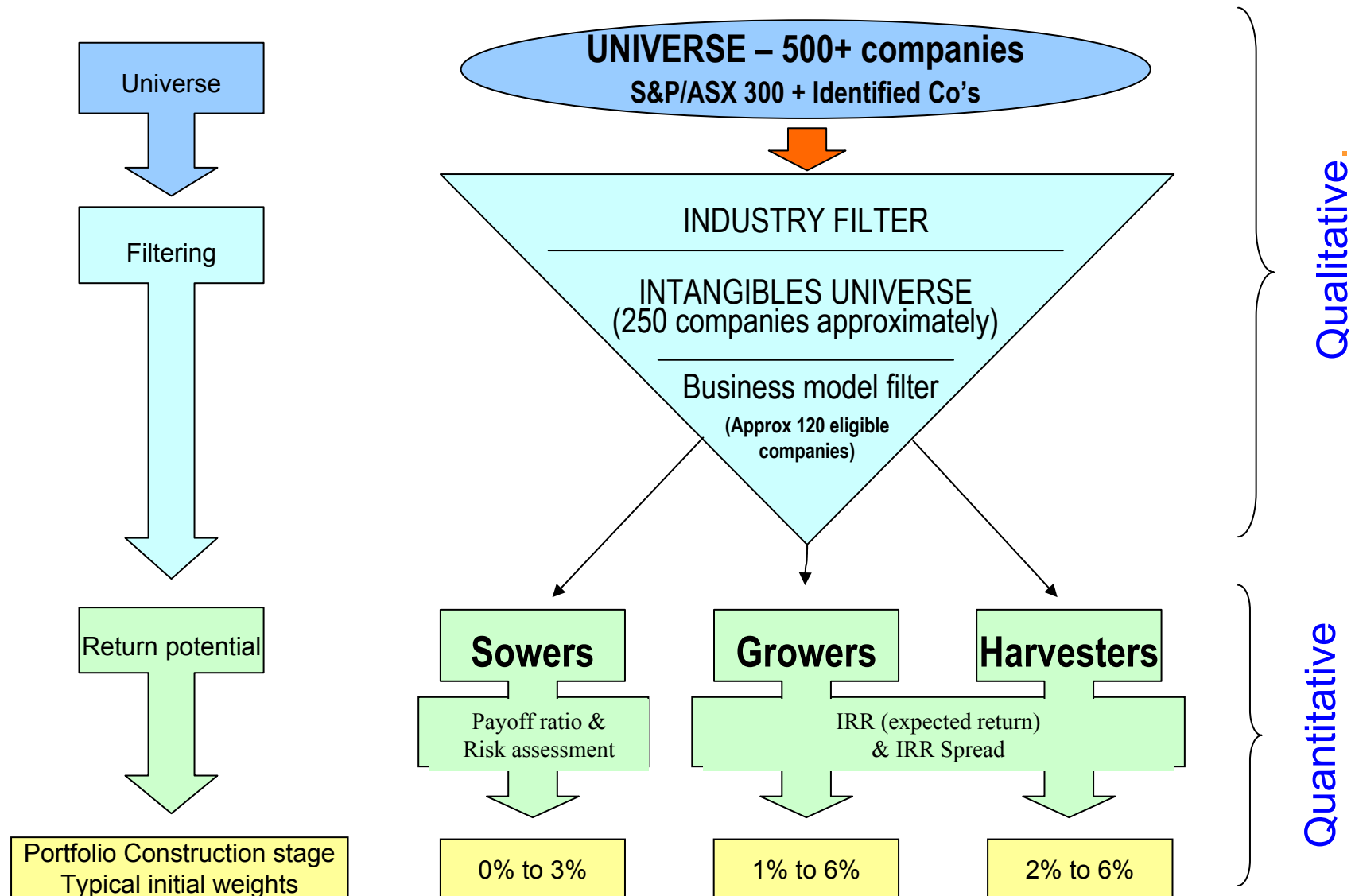
■ Value-decreasing characteristics:

- Can be difficult to manage & exclusively control.
- Harder to exploit a mind than a machine
- Copying or re-engineering can sometimes be easy,
- Limited ability to protect by property rights
- Cannot be owned (except legal property rights).
- Are typically more risky
- Being non-physical and inherently difficult to trade.
- Valuing them is difficult.
- They are not evidenced by financial transactions

Exploit Industry Imposed Barriers



Need for a clearly Defined Methodology



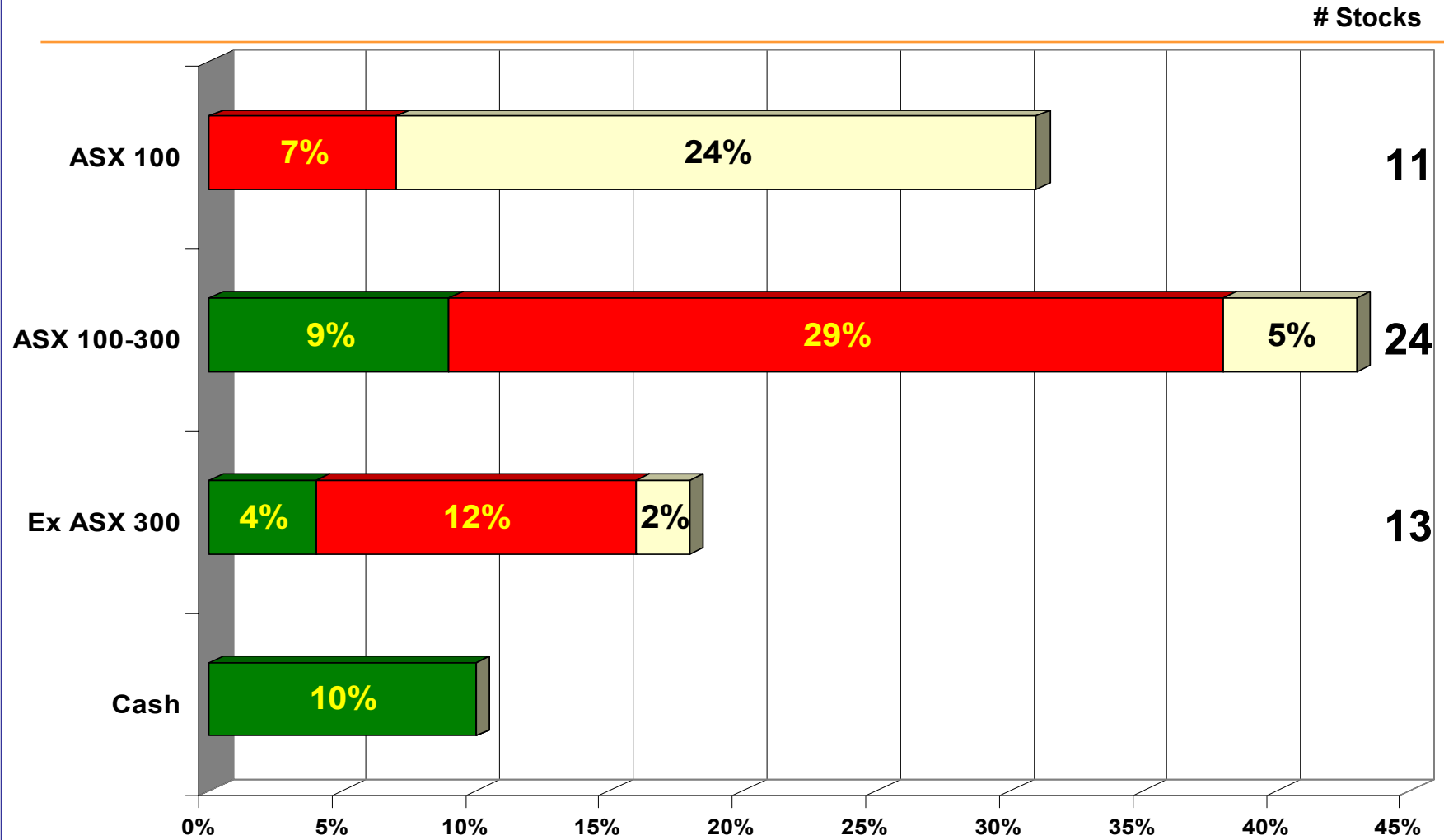
Structured Portfolio Construction

- an additional risk management tool

Category type	Category	Example of investment in category (%)	Current examples
<ul style="list-style-type: none"> ■ Of significant potential but not yet entrenched, or ■ Excellent company with high potential but overvalued 	1	2%	Realestate.com
<ul style="list-style-type: none"> ■ Establishing entrenched position ■ Good IRR/payoff 	2	8%	Vision
<ul style="list-style-type: none"> ■ Entrenched position established or path clear ■ Good IRR/payoff 	3	19%	Oak Apartments
<ul style="list-style-type: none"> ■ Well entrenched, some business risk ■ Good IRR 	4	28%	Austar
<ul style="list-style-type: none"> ■ Quality entrenched business ■ Good IRR 	5	27%	Cabcharge
<ul style="list-style-type: none"> ■ Well entrenched business ■ Excellent/outstanding potential ■ High IRR 	6	8%	Customers

Invest across the life cycle

[Sample portfolio on a look through basis]

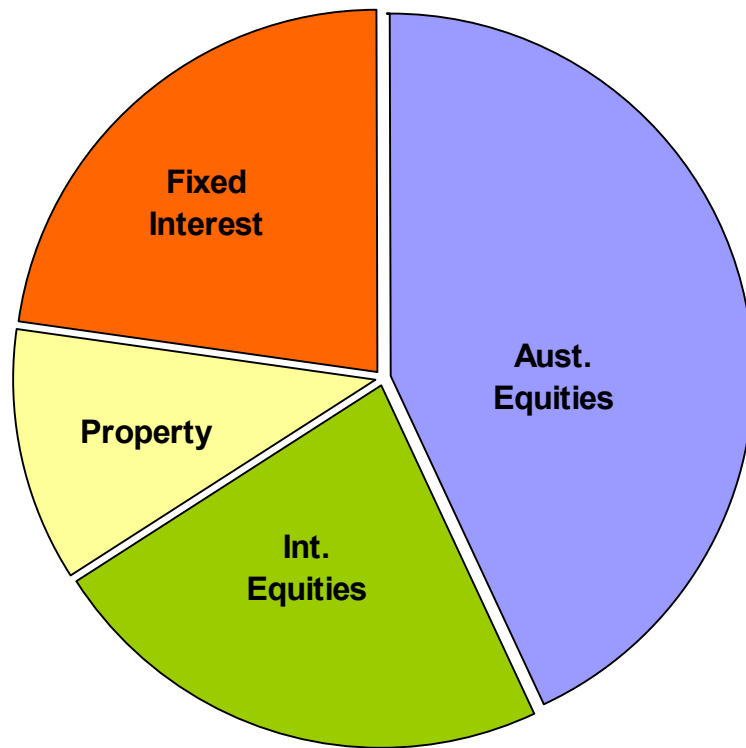


Refresh- why *these* companies?

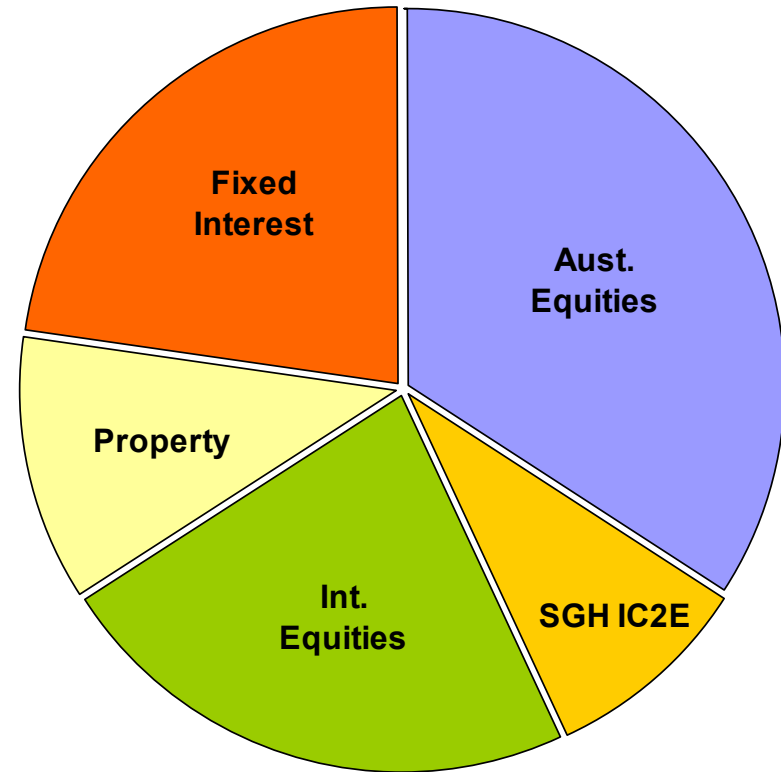
- “IC²E” arena should outperform over the medium/long term
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[IC²E - “*Intangibles that Create the Competitive Edge*”]

Where IC^2E fits in a portfolio



BEFORE



AFTER

Actual fund

SGH IC²E performance to 30 June 2007

	1 mth	3 mths	6 mths	1 year	Inception (pa) 13 Feb 2006
Total Net Return	0.3%	5.8%	17.7%	55.7%	41.7%

15.375% (inclusive of GST and an estimate of RITC) of the Fund return above the performance hurdle being the daily percentage movement in the S&P/ASX 300 Accumulation Index plus 1.20% per annum calculated on a daily basis may also payable. Distribution Return is the return due to distributions paid by the Fund, Growth Return is the return due to changes in initial capital value of the Fund, Total Net Return is the Fund return after the deduction of ongoing fees and expenses assuming the reinvestment of all distributions and Total Gross Return is the Total Net Return with ongoing fees and expenses added back. Past performance is not indicative of (or necessarily a guide to) future performance.

Relies on Multiple layers of research

Callum Burns
Portfolio Manager
SGH IC²E

PROPRIETARY INTERNAL RESEARCH

Equities

Callum Burns	19 yrs PM exp.
Robert Hook	32 yrs “
John Thomson	22 yrs “
Adrian DiMattina	20 yrs “
Sam Scollo	19 yrs “
James Ewinger	5 yrs “

Property

Stephen Hiscock	20 yrs PM exp.
Grant Berry	15 “ “ “
Melissa Woodgate	4 “ “ “

PROPRIETARY EXTERNAL RESEARCH

IT Advisor	25 yrs Industry experience
Bio/Health Advisor	20 yrs “ “

***“Share research
and ideas but not
decisions”***

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