



## RARE Infrastructure Value Fund

INDEPENDENT ASSESSMENT

This report has been prepared for financial advisers only

10 June 2011



**Scope**

The independent assessments are conducted by SQM Research Pty Ltd (SQM Research) on behalf of Barik Pty Ltd trading as Adviser Edge Investment Research (Adviser Edge). SQM Research is an Authorised Representative of Barik.

**Key Principles**

The underlying principles of the assessment process are to:

- identify the long term commercial potential of the Responsible Entity;
- evaluate management's capabilities, previous performance in the specific industry and the stability of the organisation;
- evaluate identified markets (domestic and international – existence, stability and growth potential);
- benchmark key performance assumptions and variables against industry peers;
- weigh up the relevant risks of the Responsible Entity;
- assess structure and ownership;
- determine if the Responsible Entity is structured in such a way as to protect investor's interests; and
- allow an opinion to be formed regarding the investment quality of the Responsible Entity.

**Site Assessment**

SQM Research conducts a detailed site inspection of the projects/properties within the Responsible Entity's managed funds.

The site assessment considers the following areas:

- suitability of the site for the purpose intended;
- management skills, qualifications, capabilities and experience; and
- associated property risks and their management.

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\* Following are descriptions for each of the star ratings, which have been developed for dealer group research and investment committees.

- 4.5 stars – Outstanding. Highly suitable for inclusion on APLs.
- 4 stars to 4.25 stars – Superior. Suitable for inclusion on most APLs.
- 3.75 stars – Good. Consider for APL inclusion.
- 3.5 stars – Average. Consider for APL inclusion, subject to advice restrictions.
- 3.25 stars – Caution required. Not suitable for most APLs.
- 3 stars – Strong caution required. Not suitable for most APLs.
- Below 3 stars – Avoid or redeem. Not suitable for APL inclusion.

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**Report Date**

10 June 2011

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### Adviser Edge Rating

#### Fund Details

Fund Name	RARE Infrastructure Value Fund
ARSN	121 027 709
APIR Code	TGP0008AU (hedged) TGP0034AU (unhedged)
Manager	Rare Infrastructure Limited
Address	Level 18, 1 York Street, Sydney, 2000
Responsible Entity	Treasury Group Investment Services Limited
Custodian	RBC Dexia Investor Services Trust

#### Investment Details

Fund Inception	1 August 2006
Fund Size 31 December 2010	\$387 million (\$1.826 billion for overall strategy)
Fund Type	Unlisted infrastructure securities
Return Objective	To provide investors with regular and stable income comprised of income plus capital growth from a portfolio of global infrastructure securities.
Benchmark	An accumulation index comprised of the OECD G7 Inflation Index plus 5.5% p.a.
Number of stocks in portfolio 31 December 2010	45
Gearing	The Fund is not geared.

#### Investment Specifications Summary

Minimum Application	500,000
Minimum Withdrawal	10,000
Redemption Policy	Redemptions are processed daily.
Distribution Frequency	Currently quarterly
Contribution Fee	Nil
Management Expense Ratio	1.025% (hedged) 0.974% (unhedged)
Buy/Sell Spread	0.45%/0.25% (hedged/unhedged)
Currency Hedging	RARE intends to substantially hedge all of the Fund's currency exposure back to Australian dollars. RARE also offers an unhedged version of the Fund.
Tax Deferral Rate	n/a
Loan Facility	n/a

## Investment Summary

The RARE Infrastructure Value Fund (the Fund) is an open-ended unlisted infrastructure securities fund that invests in listed securities across the globe. The Fund will predominantly invest in securities listed on the stock exchanges of the G7 countries, being the United States of America, United Kingdom, Japan, Germany, France, Italy and Canada. The Fund may also invest into the Asia-Pacific region, developing countries, and cash. As well as investing in listed securities and cash, the Fund can invest in derivatives and depository receipts or other securities where the underlying assets are inaccessible or illiquid. RARE may use options, futures and other derivatives to reduce risk or gain exposure to underlying physical investments. Derivatives are not used speculatively. The Fund is suitable for investors seeking to benefit from a global exposure to infrastructure investments, and who are prepared to accept a moderate level of risk and volatility over the investment term.

The Fund is managed with the objective of providing investors with regular and stable income comprised of dividends, distributions and interest received, plus capital growth. With a portfolio constructed on a benchmark-unaware basis, the Fund invests in securities which offer positive absolute returns, rather than selecting securities in relation to a particular industry standard index.

The Fund's investment rationale is based around a bottom-up approach, combined with a detailed set of processes and controls which seek to ensure that high quality, in-house research covers the quantitative and qualitative factors underpinning each investment decision. This investment style is supported by a global research capability, comprised of sector, country and regional analysis of key themes that may affect the outlook for companies and valuations.

The Fund aims to out-perform an accumulation index comprised of the OECD G7 Inflation Index plus 5.5%p.a. Investors should consider an investment horizon of three to five years in the Fund and should also understand that the value of an investment in the Fund will change over time. The Fund is not currently geared, although it may borrow for the purposes of ensuring that it maintains adequate liquidity. The Fund will not borrow to make investments.

*This report refers to both the hedged and the unhedged version of the Fund. Unless otherwise stated, this report will focus on the hedged version of the Fund. The rating applied to the Fund is applicable to both the hedged and the unhedged version of the Fund.*

**The Fund has received a 4¼-star rating.**

## SQM Research/Adviser Edge's Review

The Fund has an experienced and stable senior Portfolio Management team, with a long track record across infrastructure assets, which is a key strength of the Fund. The Fund's investment management team is led by Senior Portfolio Managers Richard Elmslie and Nick Langley. Mr Elmslie and Mr Langley are the principals of RARE, and have held their positions since the inception of the Fund and the formation of RARE as a fund manager. Mr Elmslie and Mr Langley have a wide range of experience, which includes a combined 35 years of global infrastructure experience. This is unmatched within the sector. Importantly, Mr Elmslie and Mr Langley have previously worked together at ABN AMRO and have experience at a number of well respected global infrastructure fund managers. The Senior Portfolio Managers' combination of skills, and their extensive track record in understanding infrastructure entities and also valuing long-dated assets, is a strength of the Fund.

The size and experience of the Fund's management team positions it strongly among its peers. The team has 10 members in all, which is well above the industry average of seven. This makes it the largest team within the sector in terms of overall resources. On this basis, SQM Research/Adviser Edge views the team as being well structured and effectively resourced, which is a strength of the Fund. While SQM Research/Adviser Edge is satisfied that the team members have the necessary skills and experience to oversee the Fund's development and ongoing performance, it should be noted that a number of Research Analysts and a Portfolio Manager – Emerging Markets are relatively new to their roles, which will be monitored. The average number of years that investment team members have spent with the Fund (2.4 years) is relatively short and below the peer average of four years. The average amount of investment experience is 12.1 years, which is in line with peers. Having said that, the Fund's investment team has been able to remain relatively stable at the senior level since inception. Although there has been some major staff turnover at the analyst level over the past year, the Fund has been able to source replacements, and has also built the overall size of the team. The ability of the Fund to compensate and provide long-term analyst stability will be monitored going forward.

Overall, the performance of the portfolio has been somewhat impressive since inception, particularly against the peer group, where the Fund has recorded consistent outperformance since inception. Over this same time, the Fund has recorded volatility well below peers, with an annualised standard deviation of 13.4% since inception, well below peers' 18.1%. Underperformance against the benchmark over rolling three-year periods largely occurred during the period from 2008 to 2009, where securities to which the Fund was exposed recorded significant declines, against the backdrop of a relatively stable absolute benchmark.

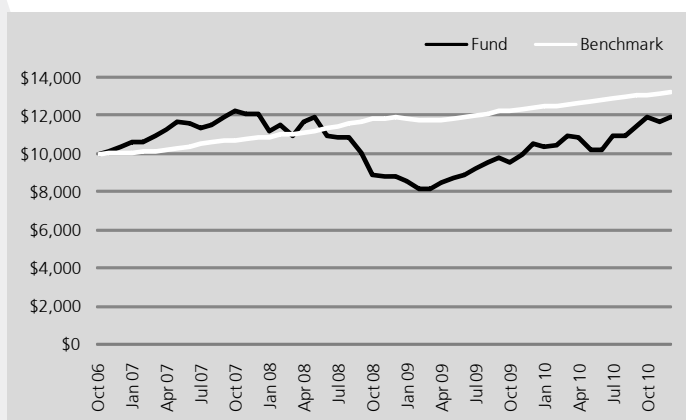
**Fund Performance to 31 December 2010<sup>1</sup> (%)**

	3-Month	6-Month	1-Year	3-Year	Inception
Fund	4.6	17.0	13.2	-0.4	4.3
Benchmark <sup>2</sup>	1.4	3.2	6.7	6.9	7.0
Peer Average	4.0	14.9	11.1	-2.9	0.0

<sup>1</sup> Total return net of fees assuming dividend re-investment, three and five-year returns annualised.

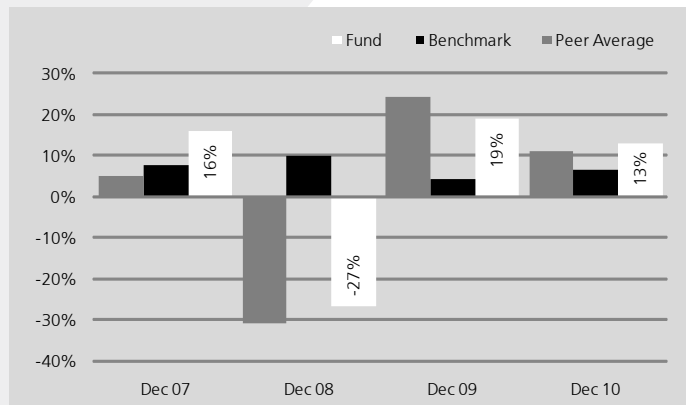
<sup>2</sup> An accumulation index comprised of the OECD G7 Inflation Index plus 5.5% p.a.

**Growth of \$10,000**



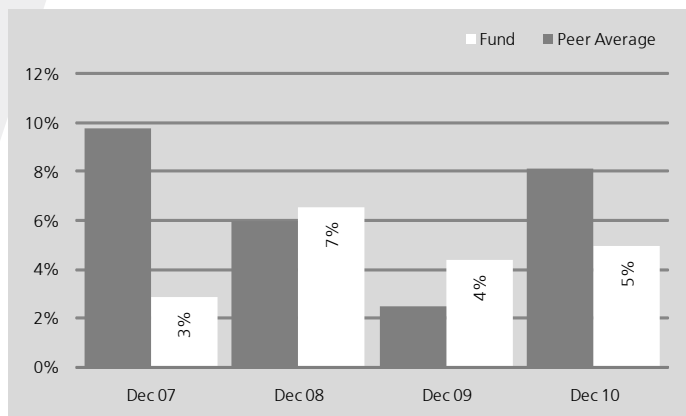
Throughout the review it became clear that the Fund's bottom-up quantitative and qualitative research process is detailed and well presented. As the Fund is not constructed to a benchmark, it has an absolute returns focus, with the risk/returns profile a result of rigorous bottom-up stock analysis. The bottom-up process is driven by quality in-house research, with a combination of quantitative and qualitative factors underpinning each investment decision. A top-down overlay supplements the bottom-up research process, with the overall global research capability also comprised of sector, country and regional analysis of the key themes that may affect the outlook for the underlying bottom-up stock analysis. On this basis, the Fund is well resourced and has access to an Investment Advisory Board, which was created in 2009 to drive the macro-economic research agenda and is comprised of five members, three of whom are external to the investment team. The external members bring with them a range of experience and qualifications, and this is a strength of the Fund. It is estimated that the research and stock selection process is 80% driven by bottom-up analysis, with a 20% top-down macro-economic overlay.

**Comparative one-year returns**



The portfolio construction process is structured and balanced and appears to have been executed successfully since inception. The ranking model in place is detailed and relatively well structured, while the various risk constraints around portfolio construction also appear to be appropriate and adhered to. It should be noted that the Fund is built on a benchmark-unaware basis, providing the potential for greater sector diversification in comparison to a number of benchmarks that are heavily weighted to the utilities sector.

**Comparative distribution yields**



**Strengths of the Fund**

- The Fund has an experienced and stable senior Portfolio Management team, with a long track record across infrastructure assets
- The investment team is well resourced and the largest within the sector under review
- The Fund's predominantly bottom-up quantitative and qualitative research process is detailed and well presented
- The portfolio construction process is structured and balanced and appears to have been executed successfully since inception

- The Fund has outperformed the peer group by a comfortable margin since inception at lower levels of volatility

**Weaknesses of the Fund**

- The Fund has lost a number of analysts over the past year, although replacements have since been placed
- Against its absolute benchmark, the Fund has been unable to provide excess returns since inception

**Other considerations**

- The investment team is based in Sydney, with Portfolio Managers and Analysts spending significant time travelling annually
- The Board of Directors of the Parent and the Responsible Entity's Board of Directors are not majority independent, although there are sufficient compliance procedures in place
- The Fund is built on a benchmark-unaware basis, providing potential for greater sector diversification

The following market overview represents the view of Adviser Edge/SQM Research at the time of publication.

Real GDP Growth (Year on Year %)						
	2008	2009	2010	2011(f)	2012(f)	Average <sup>1</sup>
Australia	2.6	1.3	2.7	3.0	3.5	3.2
China	9.6	9.2	10.3	9.6	9.5	10.0
Japan	-1.2	-6.3	3.9	1.4	2.1	2.2
United States	0.0	-2.6	2.8	2.8	2.9	2.7
United Kingdom	-0.1	-4.9	1.3	1.7	2.3	2.1
European Union	0.7	-4.1	1.8	1.8	2.1	2.0

Source: IMF World Economic Outlook April 2011, Adviser Edge/SQM Research, (f) forecast years. <sup>1</sup> Long-term 30-year average.

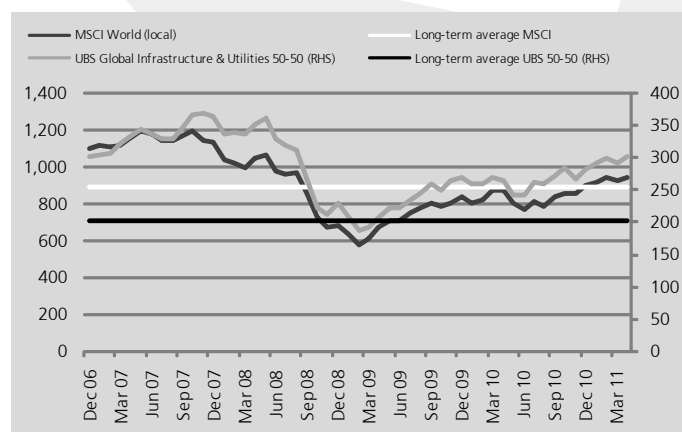
While fears of a global depression receded in 2009 with businesses beginning to rebuild depleted inventories, sentiment remains fragile. Government bond and bank credit default swap spreads in the Europe remain high, pointing to a possible dampening of the positive economic recovery taking place. The fear of default of government debt has spread throughout all financial markets within the Euro zone, although data would suggest these credit events are only concentrated in a few countries such as Greece, Iceland, Ireland, Portugal and Spain. While a bailout package to Greece appears likely, officials supporting the aid package are under pressure from their respective governments regarding the merits of such a plan.

Commodity prices have risen sharply since from the peak of the Global Financial Crisis (GFC), as a result of strong demand from Asia and supply constraints arising from weather disruptions. Brent crude oil prices have been trading at approximately US\$113.21 per barrel in first week of May 2011, up from the lows of US\$50 per barrel two years ago.

**High oil prices act as an indirect 'tax' on businesses and some market watchers believe this may stall global growth. Adviser Edge/SQM Research believes that prices should remain steady in the medium term in the absence of further supply shocks, and due to unrest in North Africa and the Middle East.**

Despite concerns regarding the fragility of the global economy, the International Monetary Fund (IMF) has projected optimistic forecasts in the next two years across all countries. Although these forecasts are not back to the pre-crisis highs, the two-year forecasts are close to the long-term 30-year averages of the respective countries. The recent 9.0 magnitude earthquake and nuclear crisis in Japan has led to some decline in confidence, although it appears to have had minimal ongoing effects in other markets outside of Japan.

### Global Infrastructure and general equities



Source: Bloomberg. Y-axis for all indices above are on the left unless indicated. Long-term averages are calculated over a 13-year period.

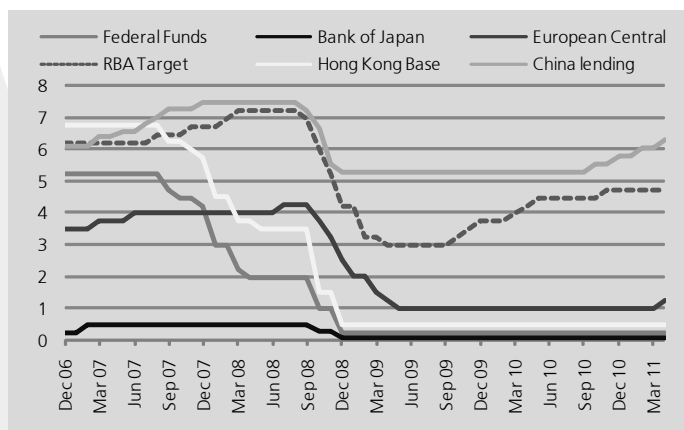
While global financial markets have rebounded post crisis, recovering much of their lost value by the end of 2010, a clear, positive trend has yet to present itself in 2011 despite improved forecasts from businesses, financial analysts and central banks.

**Although the chart above illustrates infrastructure stocks trading above their 13-year average, any further increase in value will need to be supplemented with stronger GDP growth and improved confidence. While infrastructure and utilities were previously regarded as relatively defensive plays, the GFC highlighted the fact that risks in the stocks were underestimated. Investors underestimated declines in energy consumption and road travel as the crisis worsened during the second half of 2008, with these declines ultimately affecting the earnings of infrastructure and utilities companies. During that six-month period, the MSCI World Index and UBS Global Infrastructure and Utilities 50-50 Index fell by approximately 40% each.**

**Overall, Adviser Edge/SQM Research believes that improvements to underlying fundamentals will occur over the medium to longer-term, albeit at a slow pace.**

*Some short-term volatility is expected as consumers and businesses adjust to the new economic environment, which will persist while governments convene to tackle the European sovereign debt crisis and create plans to further stimulate and sustain global economic growth.*

**Funding rates**



Source: Bloomberg.

With the positive IMF forecasts across all countries in its April 2011 Economic Outlook release, as a rule of thumb, one will expect central banks around the world to tighten monetary policy. On the contrary, all countries are maintaining accommodative monetary policy to provide support to the frail economic rebound, with the exception of Australia and China. The Reserve Bank of Australia (RBA) began lifting rates in October 2009, moderately stepping up the pace in the subsequent periods thereafter, to address inflation concerns. On the other hand, the People's Bank of China (PBC) began lifting rates in October 2010, as the emergence of a property bubble threatened to derail China's booming economy.

With the exception of China and Australia, interest rates are at a 10-year historical low. However, credit markets remain sluggish, pointing to continuing weakness in business and consumer confidence.

In terms of fiscal policy, governments around the world are implementing structural cutbacks in their budgetary plans in order to reduce outstanding fiscal deficits. These austerity measures are employed by existing governments, to preserve and regain credibility, in light of the high over-run in public debt levels over the past decade. Any sovereign default in the near future will significantly disrupt the global economic recovery process, especially following the recent government bailouts of overleveraged financial institutions in 2008.

**Adviser Edge/SQM Research expects loose monetary policy to remain in place throughout 2011 (except Australia and China) as the world battles emerging fears of a stalled economic growth engine.**

**Austerity measures will likely continue to be implemented until public debt levels decline to manageable levels. Most G20 economies are aiming to halve their respective fiscal deficits by 2013, relative to 2010 deficit levels.**

**Global Infrastructure**

In the previous year, infrastructure and utilities companies concentrated on diversifying their debt funding sources, which led to large private debt issuances in Europe and in the United States, amounting to \$1.5 billion and \$1.2 billion respectively. Public Private Partnerships (PPPs) and the privatisation of government assets were headline stories in 2010, and will continue to be global themes in 2011 as the trend for both these types of transactions increases in the coming year.

PPPs are joint venture arrangements between the government and the private sector, which involves setting up special purpose vehicles to develop, build and maintain specific assets for a contracted period. Due to the scale and complexity of the projects coming to market, the private sector partner in the PPP arrangement will provide the skilled labour and financing to execute the project to completion while the government partner provides grants, regulatory and tax incentives. The Australian government in its Budget plan for 2011-2012 indicated that it will remove tax impediments for certain infrastructure investments, provide incentives to encourage private and superannuation investments into the sector, and pledged \$36 billion capital investment into developing roads, rail and port infrastructure across the country. It has also established an Infrastructure Financing Group, made up of private and public sector advisers, to identify further areas of work surrounding private financing of infrastructure.

**Adviser Edge/SQM Research believes that PPP will be the preferred structure for project financing going forward. However, complications with impending carbon tax legislation, a finite skills base and an appropriate risk-sharing model will be among the key issues continuously debated, as projects are executed.**

With debt costs remaining elevated relative to 2007, government incentives are likely to remain in place in the medium-term to sustain the global infrastructure pipeline. Private debt issuance is expected to be buoyant in coming years as the global pipeline grows while bank debt liquidity remains constrained.

Following the financial crisis, government entities globally have been stepping up asset privatisation programs to repair their impaired balance sheets, as mentioned earlier in this report. Some of the notable transactions to date include Greece's \$67 billion asset privatisation program, the privatisation of Queensland Rail (QRN: ASX) and the Port of Brisbane by the Queensland state government, and the privatisation of Spanish airport assets.

As a result, many global pension funds and sovereign wealth funds (SWFs) have built up infrastructure investment capabilities 'in-house', in order to participate in direct investment schemes rather than invest with infrastructure fund managers, while some infrastructure development companies such as Lend Lease, Balfour Beatty and John Laing are diversifying into infrastructure funds management. Over the past year, the Canadian Pension Plan Investment Board (CPPIB) has been actively investing in toll roads in Canada and Australia, while Abu Dhabi Investment Authority took a minority stake in the Port of Brisbane. With this growing trend, fund flows into the listed securities sector appear to be subdued relative to pre-crisis highs.

**Adviser Edge/SQM Research expects more entrants into the infrastructure sector in the longer-term, either via global pension funds, infrastructure development companies or niche specialist infrastructure managers, as more public assets are privatised and growth spurts in emerging economies such as Africa and India demand larger, more efficient infrastructure assets to accommodate increased energy consumption and services provided by other infrastructure assets. This highlights the large capital outlays required for development pipelines and asset purchases, underpinning the importance for continuous, stable financing provided by global pension funds and SWFs.**

**While this structural shift appears to be detrimental to existing infrastructure securities fund managers, Adviser Edge/SQM Research believes that there will still be capital flows to infrastructure managers who deliver consistent**

**returns over the longer-term. Investors will still require a diversified manager base and pay a fair premium for value-add.**

A total of four benchmarks were utilised by funds within the Global Infrastructure Securities Sector Review 2011, and Adviser Edge/SQM Research notes that the performance variances between these benchmarks have been substantial, as noted in the tables above. In particular, over the past three years the performance of the UBS Developed Infrastructure and Utilities Index (UBS Developed Index) was less volatile than the peer indices. The performance recorded by the three indices for the year to December 2010 was relatively tightly disbursed, ranging from 5.66% to 7.51%. This analysis does not include the Dow Jones Brookfield Global Infrastructure Index Australian Dollar Hedged, as this data has not been supplied.

It is noted that the UBS Developed Index has the largest exposure to Utilities (87.1%), which is almost double the exposure to this sector held by the other three comparable indices. It also has the smallest exposure to Airports at 1.2%, relative to the other indices.

**Although recent data shows small performance discrepancies between the indices, the large differences in their sub-sector compositions should lead to varied recorded returns for each index going forward.**

**As a result of the findings above, a fund's performance relative to its peers is largely driven by the performance of the benchmark that it tracks.**

**Peer Benchmark Return Comparison**

Benchmark	Number of Funds	2008	2009	2010
S&P Global Infrastructure Index (AUD Hedged, Net Total Return)	1	-35.62%	19.75%	7.51%
UBS Developed Infrastructure & Utilities Index Net TR Index (\$A Hedged)	1	-27.54%	9.96%	5.66%
UBS Global 50/50 Infrastructure & Utilities Index (net)	1	-	17.91%	7.00%

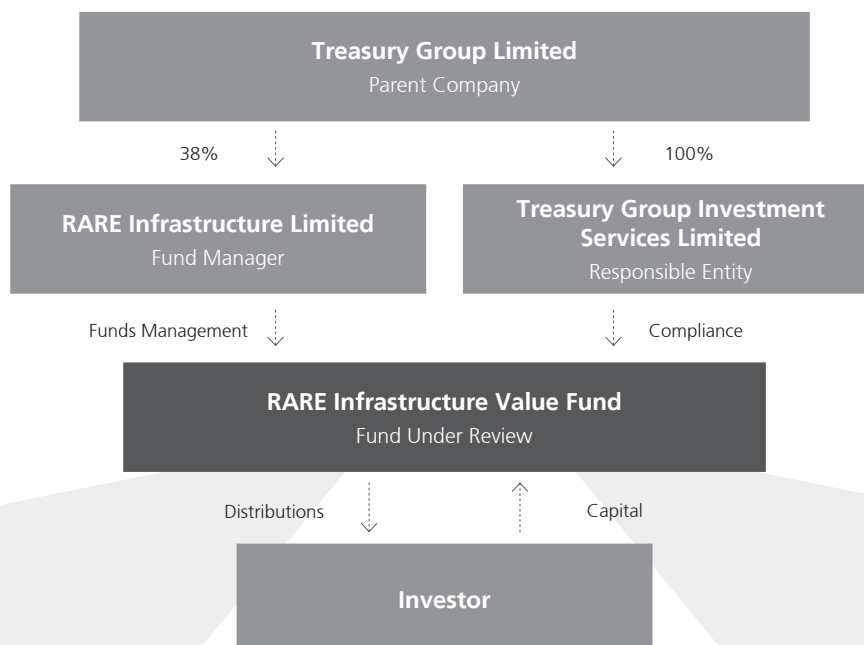
Source: Bloomberg, funds under review.

**Global Listed Infrastructure Sub-Sector Weights**

Sub-Sector	UBS Global 50/50 Infrastructure & Utilities	UBS Developed Infrastructure and Utilities Index	Dow Jones Brookfield Global Infrastructure Index	S&P Global Infrastructure Index
Utilities	49.9%	87.1%	45.7%	38.8%
Communciations	15.0%	3.6%	12.4%	0.0%
Toll Roads	14.9%	4.2%	7.8%	17.4%
Airports	5.0%	1.2%	5.0%	12.1%
Other	15.2%	3.9%	29.1%	31.7%
Total/Average	100.0%	100.0%	100.0%	100.0%

Source: Adviser Edge/SQM Research, Funds under review. As at 31 December 2010.

## Key Counterparties



## Parent Company

Treasury Group Limited (TRG) is an Australian Stock Exchange (ASX) listed company, which sources the majority of its income from a range of boutique funds management business in which it is invested across Australia. TRG currently has investments in eight boutique fund management businesses. Through its wholly owned entity, Treasury Group Investment Services, TRG also provides responsible entity services to the boutique asset management businesses within the Group and to selected third parties. As at 31 December 2010, total funds under management (FUM) was recorded at \$15.5 billion, representing a 7.3% increase from the previous year. Of this FUM, Orion Asset Management Limited, was the largest contributor at 34% of total FUM. As at March 2010, TRG had a market capitalisation on the ASX of approximately \$113 million.

## Board of Directors

The Board of Directors of TRG is composed of six members, three of whom are classified as non-executive (including the Chairman), while only two of the non-executive directors are classified as being independent.

Mike Fitzpatrick is chairman of the Board, and while Mr Fitzpatrick is classified as being non-independent (due to his shareholding in the company), TRG believes that his experience, knowledge, and overall contribution is such that it is appropriate for him to remain Chairman.

*While SQM Research/Adviser Edge prefers to see majority independence at Board level, particularly the Chairman, it is noted that the skill balance and experience of the board*

*members are all appropriate to the nature and extent of company operations. While not being classified as independent, Mr Fitzpatrick's experience and contribution to TRG is seen as invaluable.*

## Corporate governance and compliance

As TRG is listed on the Australian Stock Exchange (ASX), it must disclose its compliance with The ASX Corporate Governance Council's published Corporate Governance Principles and Recommendations (ASX Principles) on an 'if not, why not' basis in its annual report. The ASX Principles are based on what the ASX considers to be best practice in conducting the business of a listed company. TRG complies with a majority of the ASX Principles, with the only noted non-compliance relating to the independence of the Board and the Chairman.

TRG has a number of corporate governance charters and policies in place, with the main elements including:

- A Governance Statement, which is issued annually
- A Board of Directors, Nominations Committee, Audit Committee and Remuneration Charter
- A Continuous Disclosure Policy
- A Directors Code of Conduct
- A Company Code of Conduct

*SQM Research/Adviser Edge believes that the corporate governance policies and practices are broadly in line with*

*peers of similar size and stature. It is noted that the Board of Directors is not majority independent, and the Chairman is also not independent, which is a departure from the ASX Principles. SQM Research/Adviser Edge prefers to see majority independent representation on the Board.*

#### TRG Financial performance and position

Key Financial Data* – Half Year as at 31 December		
Financial Profitability	2010	2009
Revenue (\$m)	2.2	2.8
Net profit* (\$m)	5.2	6.4
Profit margin (%)	234.2	226.6
ROE (%)	9.0	11.4
Market measures	2010	2009
Basic EPS (cents)	22.7	27.8
DPS (cents)	14.0	12.0
Dividend payout ratio (%)	61.7	43.1
Financial Liquidity/Solvency	2010	2009
Net working capital (\$m)	9.9	13.9
Current Ratio	4.0	3.2
Quick ratio	3.9	3.1
Debt equity ratio (%)*	0.0	0.0
Debt ratio (%)**	6.5	11.1

Source: Treasury Group Limited – Half Year Financial Report 2010. Past performance should not be used as a guide for future performance. \* Total interest bearing debt to total equity + total interest bearing liabilities. \*\* Total Liabilities to assets.

For the half-year period ending 31 December 2010, TRG reported a net profit after tax of \$5.2 million. This represented a decrease from the previous corresponding period, driven by favourable non-recurring items in the comparative period, including \$0.3 million on sale and revaluation of investments, \$0.6 on write-up in acquisitions of interests in new boutique managers in late 2009, and a \$0.6 million tax benefit. Excluding these items, net profit remained flat. It should be noted that revenues are in fact lower than net profit, driven by the share of equity accounted investments, which fall under the revenue line. The balance sheet as at 31 December 2010 remained in a strong position, with TRG holding no debt, and key liquidity ratios being recorded at strong levels. Net cash flows from operations increased by 17% to \$4.2 million, while the overall cash position was still comfortable but deteriorated by 15% to \$9.4 million.

*SQM Research/Adviser Edge notes that TRG is in a solid financial position. While TRG is relatively well diversified in terms of its underlying revenue base, it should be noted that fluctuations in equity markets across the globe will be the major driver of performance going forward.*

#### Responsible Entity

Treasury Group Investment Services Limited, a wholly owned entity of the Treasury Group, is the Responsible Entity for the Fund. There are six members on the Board of the Responsible Entity, two of whom are classified as independent. There is also a Compliance Committee in place. The Compliance Committee has four members and is majority independent.

*While SQM Research/Adviser Edge noted that the Responsible Entity is fulfilling its duties by providing a Compliance Committee that is majority independent, SQM Research/Adviser Edge still prefers to see majority independence at the Board level as well as an independent compliance committee, to promote absolute best practice corporate governance.*

#### Fund Manager

RARE Infrastructure Limited (RARE) was created in 2005 as an investment boutique specialising in global infrastructure. The RARE team consists of ten investment professionals, one institutional distribution professional (located in the US), a retail distribution team, an operations team, a finance manager and two administrative executives. RARE outsources to Treasury Group the functions of compliance, risk, human resources, some institutional marketing, and operations. The RARE team is made up of approximately 23 professionals, utilising the equivalent of two full-time employees from Treasury Group. RARE currently manages two funds for investors domiciled within Australia, including the RARE Infrastructure Value Fund and the RARE Series Emerging Markets Fund. The Fund Manager is in the process of releasing an unhedged version of the Infrastructure Value Fund, while the Emerging Markets Fund is unhedged.

*On a consolidated basis, RARE Infrastructure made a small profit of \$0.5 million for FY2010. This followed a loss of \$0.8 million in the previous corresponding period. RARE holds a significant amount of debt, with almost \$5 million relating to a subordinated loan from the Treasury Group. This loan has a 10-year term but is payable on demand by the Treasury Group, subject to approval from ASIC. Solvency was recorded as being moderate, with RARE holding \$1.1 million in working capital, and the current and quick ratios are both comfortably above 1 as at 30 June 2010. It should be noted that there is a degree of counterparty risk in relation to the loan from the Treasury Group. Investors should be aware of this, as any deterioration in the financial position of the Treasury Group could result in a calling of the subordinated loan, and may affect the financial position of RARE and its ability to continue as Fund Manager. It should be noted there is a degree of counterparty risk in relation to the loan from the Treasury Group. Investors should be aware of this, as any deterioration in the financial*

*position of the Treasury Group could result in a calling of the subordinated loan, and may affect the financial position of RARE and its ability to continue as Fund Manager.*

### **Management Risk**

Funds management encompasses not only the operational capabilities of project counterparties but also the corporate abilities of the Responsible Entity to monitor operational performance and meet the regulatory and statutory responsibilities required. For all infrastructure funds there is a risk that financial position and management performance deterioration may temporarily or permanently compromise asset condition, fund outcomes, or regulatory outcomes.

*Overall, SQM Research/Adviser Edge believes that TRG, RARE and their associated key counterparties are appropriately qualified to carry out their assigned responsibilities. Based on this assessment, SQM Research/Adviser Edge rates management risk as being in line with peers.*

Key Investment Staff				
Name	Responsibility	Qualifications	Years with Company	Investment Experience
Richard Elmslie	Senior Portfolio Manager	BCom, Chartered Accountant	5	28
Nick Langley	Senior Portfolio Manager	LLB, BCom	5	15
Rod Chisholm	Head of Research, Portfolio Manager	MBA, BA(Hons)	4	11
Charles Hamieh	Research, Portfolio Manager – Emerging Markets	BEco	<1	13
Shane Hurst	Research	MCom(Advanced Finance), BBus	<1	13
Dan Simmonds	Research	GradCertAppFin, BEcon(Hons.), BA	<1	5
Ann Chau	Research	BCom	<1	9
David Maywald	Research	CFA, GradDipAppFin&Investment, BEcon, BCom(Hons)	4	12
Ben May	Research	BCom, LLB, Chartered Accountant	1	13
Tim Snelgrove	Dealer/Analyst	BCom(Liberal Studies)	2	2
Location of Team	Sydney	Portfolio Managers	4	
Investment Offices	1	Analysts	6*	

\* Rod Chisholm and Charles Hamieh (both Portfolio Managers) perform analyst duties as well.

***The size and experience of the Fund's management team positions it strongly among its peers. The overall team size of 10 is well above the industry average of seven and makes it the largest team within the sector in terms of overall resources. On this basis, SQM Research/Adviser Edge views the team as being well structured and effectively resourced. SQM Research/Adviser Edge is satisfied that the team members have the necessary skills and experience to oversee the Fund's development and ongoing performance. However, it should be noted that a number of research analysts and the Research Portfolio Manager – Emerging Markets are relatively new to their roles. The average number of years with the Fund (2.4 years) is relatively short and is below the peer average of four years.***

## Team Process

The Fund's investment management team is led by Senior Portfolio Managers Richard Elmslie and Nick Langley. Mr Elmslie and Mr Langley are the principals of RARE, and have held their positions since the inception of the Fund and the formation of RARE as a fund manager. Mr Elmslie and Mr Langley have a wide range of experience, which includes a combined 35 years of global infrastructure experience; this is unmatched within the sector. Importantly, Mr Elmslie and Mr Langley have previously worked together at ABN AMRO and have experience at a number of well respected global infrastructure fund managers. The Senior Portfolio Managers' combination of skills, and their extensive track record understanding infrastructure entities and also valuing long-dated assets, is a strength of the Fund.

The Portfolio Management team is well supported by a Head of Research and a research team, which currently includes six analysts. The Head of Research, Rod Chisholm, has been with the Fund since inception, and brings with him solid experience and qualifications. The appointment of a Head of Research is a relatively new position, which brings together the research effort and ensures consistency across the regions and sector. The research team is split between three regions: Asia and the Middle East, the Americas, and Europe and Australia. Two analysts are responsible for each of the three regions, with a third dividing his or her time between the Americas, and Europe and Australia. The research analysts bring a range of experience and qualifications to the team. It should be noted that three of the analysts and the Senior Investment Analyst and Portfolio Manager – Emerging Markets have been with the Fund for less than one year. This follows the loss of key staff to a rival fund. While the loss of staff was significant, this has allowed the fund to further enhance its investment process, and it appears that the replacements are now well settled.

The Investment Advisory Board was created in 2009 to drive the macro-economic research agenda, and is comprised of five members, three of whom are external to the investment team. The external members bring with them a range of experience and qualifications. David Bowers, who sits on the Investment Advisory Board, is Managing Partner of a London-based research house and specialises in economics and strategy for leading global institutions. Mark Burgess, who is Managing Director of the Treasury Group, has a range of experience, mainly across equities, having previously been Global Head of Equities at Credit Suisse Asset Management. Jonathan Mirrlees-Black is the third external

member of the Investment Advisory Board and has a strong background in the regulatory environment, which is crucial to understanding the valuations of many infrastructure assets. Nick Langley and Richard Elmslie also sit on the Investment Advisory Board and also act as the conduit between the Advisory Board and the investment team, essentially feeding the macro-economic data back into the investment process.

There are a number of formal and informal meetings held by the investment team in order to execute the overall research process. The investment team will meet quarterly to review and assess the RARE 200 list of stocks. This represents RARE's investment universe of stocks. It is from the RARE 200 that a focus list of stocks is taken through to the detailed bottom-up research process, as discussed later in this report. The Advisory Board meets quarterly, to review macro-economic data and drive macro-economic risk assessment across the Fund. Further to this consensus data is reviewed and macro-economic forecasts are updated on a monthly basis. A monthly investment team meeting is held, whereby portfolio strategy, performance and research are all discussed. Administration, marketing, performance, markets and key news items are discussed at weekly team meetings. Other meetings include a weekly workflow meeting, and bi-weekly research investment meetings; this is the main forum for initial stock reviews and presentations of research.

Findings from the bi-weekly research investment meetings are the basis for portfolio construction meetings, which are held following each research investment meeting. Investment Directors, Portfolio Managers and the dealer for the Fund attend the Portfolio Construction meetings, with analysts attending as required. While the stock selection is based around a team process and each stock recommendation is debated in the research investment meetings, the Portfolio Managers essentially have the final say in terms of overall stock positions.

***Throughout the review it was clear to SQM Research/ Adviser Edge that the team process was efficient and well documented. The team is well lead and experienced, and there appears to be an impressive culture. The investment team is well supplemented on a macro-economic basis by the Investment Advisory Board, which consists of five members, three of whom are external to the investment team. The formal communication and meetings appear to be well established and are crucial to the ongoing performance of the Fund.***

## Staffing Changes

The investment team has undergone significant changes over the past two years. In early 2009 a Portfolio Manager/Analyst departed the team. During 2010, two Senior Analysts and an Analyst departed to work for a rival fund. Since these departures, the Fund has been working hard to replenish the team. Over the

course of 2010, the Fund placed Charles Hamieh into the role of Research Portfolio Manager – Emerging Markets. Mr Hamieh was previously a Director and Senior Analyst at AMP Capital. Over 2010 the Fund placed three research analysts, effectively replacing the previously departed analysts, plus also adding an additional Dealer/Analyst to the research capability. Importantly, the replacement analysts have a wealth of infrastructure and overall investment experience.

***The Fund's investment team has been able to remain relatively stable at the senior level since inception. There has been some major staff turnover at the analyst level over the past year. Since these departures the Fund has been able to source replacements, and has also built the overall size of the team. The ability of the Fund to compensate and provide long-term analyst stability will be key to the stability of the Fund going forward.***

## Remuneration and Incentives

The investment team's performance evaluations and incentives are primarily based on investment results with performance tracking of analysts' recommendations. There is also a qualitative component relating to aspects such as maintenance of regular company contact, sector benchmarking and regional economic information, and the maintenance of company financial models. In terms of incentives, select Senior Investment staff may participate in an employee equity participation scheme, with these employees eligible for equity in RARE Infrastructure. The equity is designed to encourage employees to remain at RARE and has a nominal value on day one and increases in value between years three and seven. In addition to this, a bonus pool is available to all staff and is aligned to a set percentage of EBIT. On average, it is believed that approximately 50% of staff overall salary will consist of base salary, with the remainder bonus. The percentage of bonus to base will generally increase with seniority.

***SQM Research/Adviser Edge has reviewed staff incentives and remuneration policies and feels that they are in line with industry peers and should provide an effective way to align staff performance with the ongoing performance of the Fund under review going forward.***

Fee Structure		
Entry/Exit Fees	Fund	Peer Standard <sup>1</sup>
Contribution Fee	0.00%	0.00%
Buy Spread	0.45%	0.41%
Sell Spread	0.25%	0.29%
Ongoing Fees	Fund	Peer Standard <sup>1</sup>
Management Fee	1.025%	1.06%
Expense Recoveries	0.00%	0.03%
ICR	1.025%	1.09%
Performance Fees	10.25%	5.09%

<sup>1</sup> Average fee level within peer group of global infrastructure funds as defined by SQM Research/Adviser Edge.

### Entry and Exit Fees

No contribution fees are required for investments in the Fund. This is in line with the peer standard. A buy/sell spread of 0.70% is applicable and payable at +0.45% when investors seek to purchase their units and -0.25% when sold. This spread represents the difference between the application price and the withdrawal price of the Fund, a reflection of transaction costs relating to the underlying assets. The Fund's buy/sell spread is in line with the peer average of 0.70%.

*The Fund recently changed its buy spread, increasing from 0.25% to 0.45%. The manager has noted that this fee now closely matches the actual fees incurred by the Fund. In particular this is a reflection of the tax for investment into Brazil, notably the IOF tax (a tax on foreign currency inflows), which is levied at 2% of all foreign currency inflows into Brazil. After taking into account that the Fund has a targeted weighting of 10% to this market, an increase of 0.20% to the buy spread has been levied.*

### Ongoing Fees

The annual management fee of the Fund is 1.025% p.a. of the Fund's net assets. This cost includes the normal recovery expenses relating to the operation of the Fund, accrued daily and paid monthly, although it does not take into account abnormal expenses, which may also be payable from assets of the Fund. As the Fund's management fee is based on net assets, its indirect cost ratio and management expense ratio are equal. As the performance fee is capped at 0.30% of net asset value, the maximum indirect cost ratio is capped at 1.325% in any one year. The indirect cost ratio is slightly below the peer average of 1.09% excluding performance fees, but well above peers, assuming maximum performance fees are paid in any one year.

### Performance Fees

A performance fee of 10.25% is payable on returns that exceeds the return of the benchmark. The total performance fee in any given year will not exceed 0.30% of the Fund's net asset value. This fee level is above the peer average of 5.09%, with a number of funds in the sector choosing to not charge a performance fee.

Overall Fees (Wholesale)*		
	Fund	Peer Average
12-month	1.72%	1.77%
36-month	1.25%	1.32%

\* Excluding performance fees.

### Overall Fees

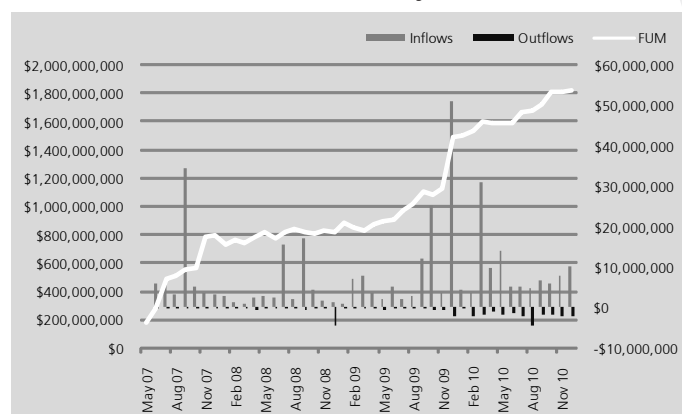
If held and sold within 12 months, total transaction costs amount to 1.72% for an investment in the Fund, and 1.77% for peers. These figures include the indirect cost ratio, and the buy/sell spread. They do not include any performance fees that may be charged, nor do they take into account rebates or negotiations. It should be noted that an investment timeframe of at least five years is suggested by the Fund.

*SQM Research/Adviser Edge believes that the ongoing fee structure of the Fund is competitive when compared to peers. While the overall fees (excluding performance fees) are recorded slightly below peers, the inclusion of an above average performance fee places the Fund's fee structure above peers, assuming maximum performance fees are paid into any given year.*

### Liquidity Management

The Fund monitors its liquidity on a daily basis with respect to its applications and redemption requests. Application and withdrawal requests received before 4pm on any business day are usually processed using the unit price applicable to the close of business that day. Redemption requests will generally be available within seven days from the time of the withdrawal receipt.

### Inflows and outflows trend (monthly)\*



\* Global infrastructure strategy.

The overall global infrastructure strategy being managed by RARE has shown a strong degree of growth since inception. While funds under management stagnated for much of 2008 and 2009, the negative market sentiment was balanced by impressive inflows over this time. Since this time, the amount of funds under management has increased to \$1.8 billion, with overall net inflows across the strategy of \$84 million during calendar year 2010.

**Statistical Overview (50-month history)**

	Fund	Benchmark	Peer Avg.
Total Return <sup>1</sup>	4.3	7.0	0.0
Standard Deviation	13.4	1.2	18.1
Sharpe Ratio	-0.02	0.41	-0.07

<sup>1</sup> Annual compounded return.

**Highest/Lowest 12-Month Returns**

	Fund	Benchmark	Peer Avg.
High	33.2	10.3	41.7
Low	-28.5	3.8	-24.1

**12-Month Detailed Statistics**

	Fund	Rank/12	Peer Avg.
Total Return	13.2	2	11.1
Dividend Yield	4.9	7	8.1
Current Yield	4.6	8	8.2

**Benchmark Tracking**

Excess Return	6.5	3	2.7
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**Risk Measures**

Sharpe Ratio	0.19	2	0.15
Standard Deviation	11.9	4	11.7

Ratios (Sharpe and Information) contained within this summary section and in the charts proceeding provide no reliable comparison in periods where both the Fund and its peers record a negative result.

**Quantitative Insight**

Since its inception in March 2005, the Fund has recorded an annualised net return of 4.3%. This figure is below the 7.0% achieved by its benchmark, which is an accumulation index comprised of the OECD G7 Inflation Index plus 5.5% p.a. Importantly, performance since inception has been well above peers, which have returned 0.0% annually since inception. The portfolio has been far more stable than peers, achieving a standard deviation of 13.4%, below the 18.1% experienced by peers.

While the Fund has struggled to match returns of the benchmark index, on a rolling three-year basis it has clearly outperformed peers by a considerable margin since inception. Underperformance against the absolute benchmark can be explained by the significant decline in equity markets across the globe during 2008 and into 2009, to which the Fund is predominantly exposed. Over this same time, the absolute benchmark, the OECD G7 Inflation Index plus 5.5% p.a., was relatively stable, particularly over rolling three-year periods. Outperformance of the peer group has been both significant and stable since inception based on rolling three-

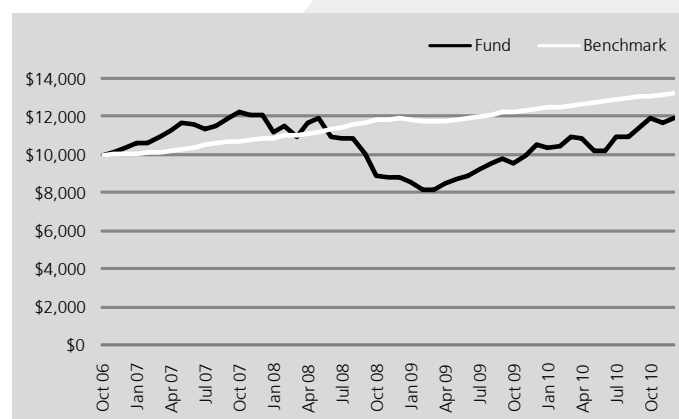
year periods. Performance to December 2010 was recorded at -0.4% as at December 2010, compared to the peer average of -2.9%.

While the Fund initially generated positive accumulative excess returns on its given benchmark, this was followed by a period of negative excess returns over the period from January 2008 through until early 2009. Since the turnaround in the market in March 2009, the Fund's cumulative excess returns have trended positive, with some consistent monthly outperformance of the benchmark over this time.

*Overall, the performance of the portfolio has been somewhat impressive, particularly against the peer group, where the Fund has recorded consistent outperformance since inception. Over this same time, the Fund has recorded volatility well below peers, with an annualised standard deviation of 13.4% since inception, well below peers' 18.1%. Underperformance against the benchmark has largely been driven by the period spanning 2009 and into 2009, where securities to which the Fund was exposed recorded significant declines, despite a relatively stable absolute benchmark. SQM Research/Adviser Edge expects the fund to perform best against the benchmark in less volatile and rising markets, while the Fund should continue to perform best against peers when fundamentals are driving market conditions.*

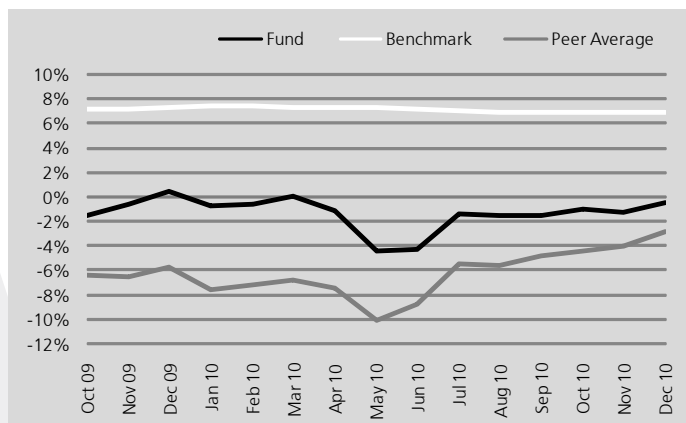
**Returns**

**Growth of \$10,000**



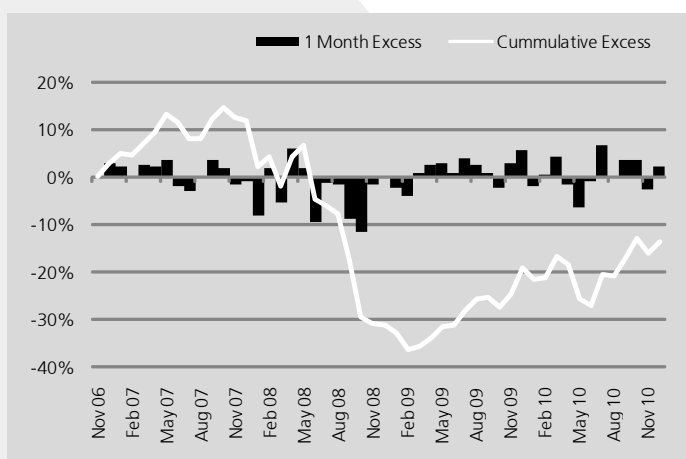
An investment of \$10,000 made at the Fund's inception would have reached its peak value of \$12,221 during October 2007, which was well above the benchmark's \$10,744 at this time. However, due to negative market performance the value of such an investment would have fallen to a low of \$8,190 on 28 February 2009, well below the benchmark at this time. At 31 December 2010, improvements in the market saw the value of the investment reach \$11,919. This growth still compares negatively to that of the benchmark index, which followed a more stable trajectory to \$13,274.

**Three-year rolling returns**



The three-year rolling returns chart shows the compounded yearly return of the Fund over rolling 36-month periods. While the Fund has struggled to match returns of the benchmark index, it has clearly outperformed peers by a considerable margin since inception. Underperformance against the absolute benchmark can be explained by the significant decline in equity markets across the globe during 2008 and into 2009, to which the Fund is predominantly exposed. Over this same time, the absolute benchmark, the OECD G7 Inflation Index plus 5.5% p.a., was relatively stable, particularly over rolling three-year periods. Outperformance over peers has been relatively stable over time, with the Fund returning -0.4% as at December 2010 compared to the peer average of -2.9%.

**Excess returns**



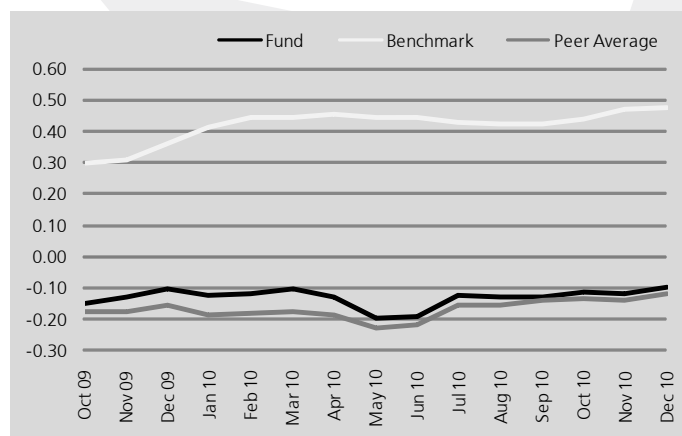
The excess returns chart shows the monthly excess returns of the Fund, as well as the accumulated growth differential, to the given index. While the Fund initially generated positive accumulative excess returns, this was followed by a period of negative excess returns over the period from January 2008 through until early 2009. This negative performance against the benchmark can be attributed to freefalling global equity markets over this time, driven by the global financial crisis, to which the Fund is exposed. The benchmark, which is linked to inflation, was less affected

and hence a large performance gap was recorded. Since the market turnaround in March 2009, the Fund's cumulative excess returns have trended positive, with some consistent monthly outperformance over this time.

Monthly excess returns have generally shown a degree of variability driven by the non-market linked nature of the benchmark. The largest period of variability was clearly demonstrated over the global financial crisis, as would be expected, where the performance gap between equity markets and the Fund's benchmark was extremely wide.

**Risk-Return & Efficiency**

**Three-year rolling Sharpe Ratio**



The Sharpe ratio provides a measure of returns in excess of the risk-free rate, divided by the volatility of returns. This gives what is most commonly known as the 'risk-adjusted return' of the Fund. It is generally accepted that a ratio above one indicates a reasonable risk-adjusted return for investors.

For the entirety of the Fund's history it has recorded a Sharpe ratio below zero, indicating poor risk adjusted returns over this time. While performance over this time has fallen below the benchmark, it has provided a level of outperformance over peers.

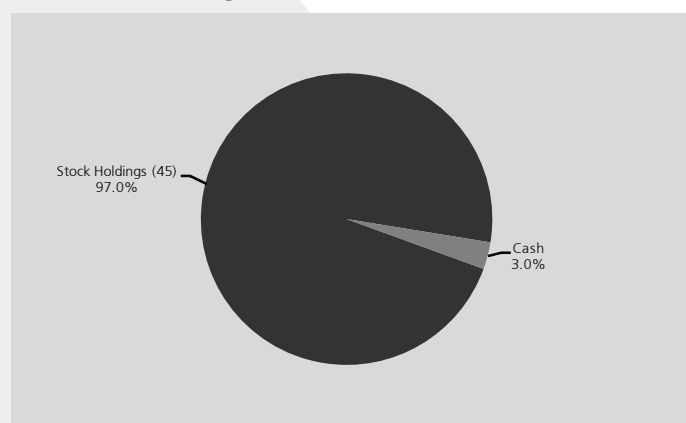
**Underlying Asset Allocations<sup>1</sup>**

	Value (\$ millions)	Current	Maximum	Minimum
Stock Portfolio (45)	375.4	97.0%	100%	80%
Cash	11.6	3.0%	20%	0%
<b>Total Fund Value</b>	<b>387.0</b>	<b>100%</b>		

<sup>1</sup> As at 31 December 2010.

**Top 10 Holdings**

Exchange	Code	Name	Portfolio (%)	Benchmark (%)	Sector	Main Geographic Exposure
PAR	DG	Vinci SA	5.8	n/a	Construction Engineering	France
MCE	ABE	Abertis Infrarstructuras SA	4.9	n/a	Tolls Roads	Spain
HON	152	Shenzhen International Holdings	4.4	n/a	Toll Roads	Hong Kong
LON	NP	National Grid PLC	4.3	n/a	Electricity & Gas	United Kingdom
ASX	MAP	MAP Group	4.0	n/a	Airports	Australia
TOR	TRP	Transcanada Corporation	4.0	n/a	Gas	Canada
NYS	ITC	ITC Holdings Corporation	3.8	n/a	Electrical Transmission	United States
NYS	SE	Spectra Energy Corp	3.7	n/a	Gas	United States
MCE	REE	Red Electrica Corporation SA	3.7	n/a	Electrical Transmission	Spain
PAR	STO	SES	3.5	n/a	Cable & Satellites	France

**Asset allocation at 31 December 2010**

The Fund held a stock portfolio of 45 individual securities at the month end of December 2010, representing a spread of holdings in line with peers. The total value of funds under management at this time was \$387.0 million for the Fund and \$1.8 billion for the overall infrastructure value strategy.

The proportion of cash held by the Fund was 3.0%, slightly lower than the peer average of 4.8%. As the Fund is constructed on a benchmark-unaware basis, the Fund does not stipulate its holdings between index and ex-index holdings.

**Summary<sup>1</sup>**

It is important to note that the Fund is not constructed against a specific infrastructure-based global index. The Fund Manager believes that the major infrastructure indices around the globe are too heavily skewed towards utilities (currently approximately 40% of the S&P Global Infrastructure Index). Hence, the Fund Manager constructs a benchmark-unaware portfolio, which is able to provide greater sector diversification.

On a geographical level, the Fund has shown some small shifts in its allocations over the past year. In particular, allocations to North America have decreased from 27.5% to 22.4%. Allocations to the Asia-Pacific almost halved, falling from 12.1% of the overall Fund to 6.8% as at 31 December 2010. The biggest move over the past year has been the increase in exposure to Australia. Over this time, allocations have almost doubled from 7.0% to 13.4%. Allocations towards the emerging markets of the Americas and India have also increased by approximately 200 bps over the year to 31 December 2010, indicating the Fund's willingness to invest into these growth markets.

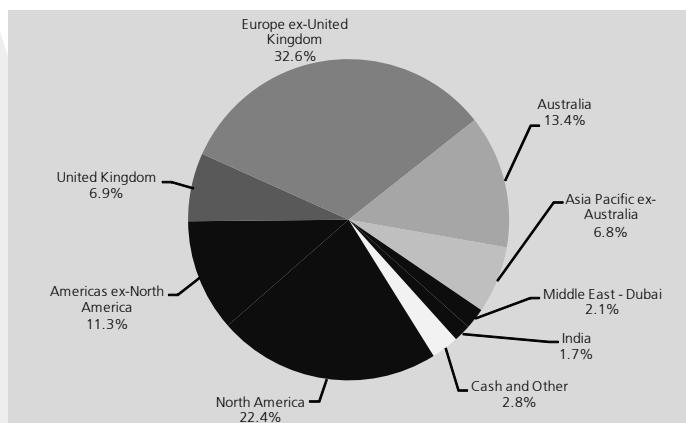
The Fund has been far more subdued on a sector level over the past year, with no material shift in allocations over this time. Of note, allocations towards Airport Services, Air Freight and Logistics has increased from 12.1% to 15.5% over the 12 months to

<sup>1</sup> Note that in this report the Americas exclude North America, the Asia Pacific excludes Australia, and Europe excludes the United Kingdom.

31 December 2010. Of the notable decreases in allocations over this time, the Fund has decreased its allocations towards Multi Utilities, Oil and Gas Storage, Water and Gas from 24.7% to 21.8%.

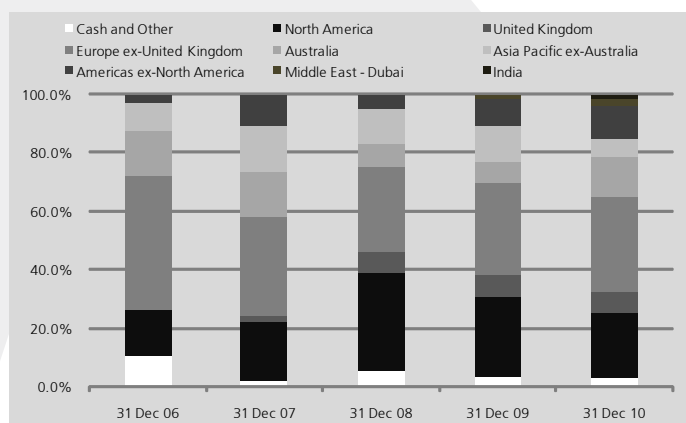
### Geographic Allocations

Geographic allocation 31 December 2010



At 31 December 2010 the Fund's geographical exposures were skewed towards Europe, with an allocation of 32.6%. This was closely followed by North America, with an exposure of 22.4%. These two main regions account for 55% of the Fund as at 31 December 2010. Allocations were recorded against Australia (13.4%) and the Americas (11.3%), while smaller allocations were recorded against the United Kingdom (6.9%) and the Asia-Pacific (6.8%). The rest of the Fund was allocated to the developing markets of India (1.7%) and Dubai (2.1%) as well as Cash and other.

### Geographic trend

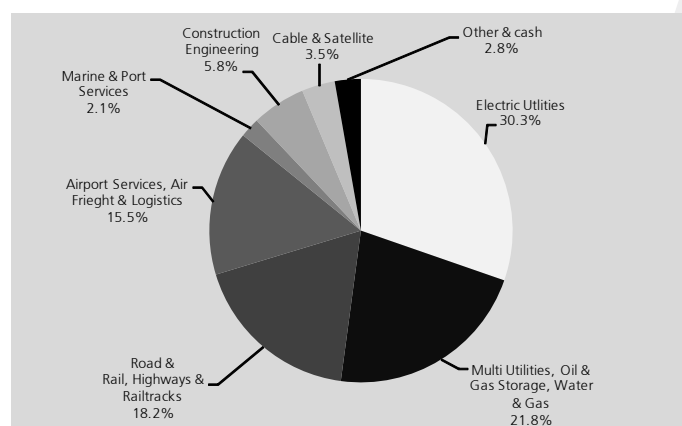


Geographical allocations have shown some degree of variability over the past twelve months. Over this time allocations to North America have decreased from 27.5% to 22.4%. Allocations to the Asia-Pacific almost halved, falling from 12.1% of the overall Fund to 6.8% as at 31 December 2010. The biggest move over the past year has been an increase in exposure to Australia.

Over this time, allocations have almost doubled from 7.0% to 13.4%. Allocations towards the emerging markets of the Americas and India have also increased by approximately 200 bps respectively over the year to 31 December 2010, indicating the Fund's willingness to invest into these emerging markets. It is noted that the Fund is able to invest up to 25% of its assets into emerging markets by asset location.

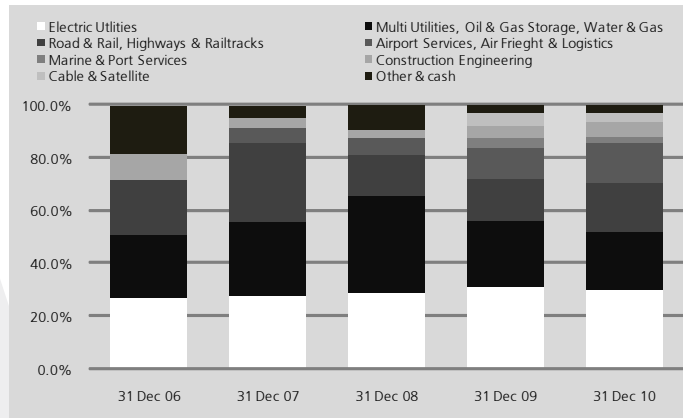
### Sector Allocation

Sector allocation 31 December 2010



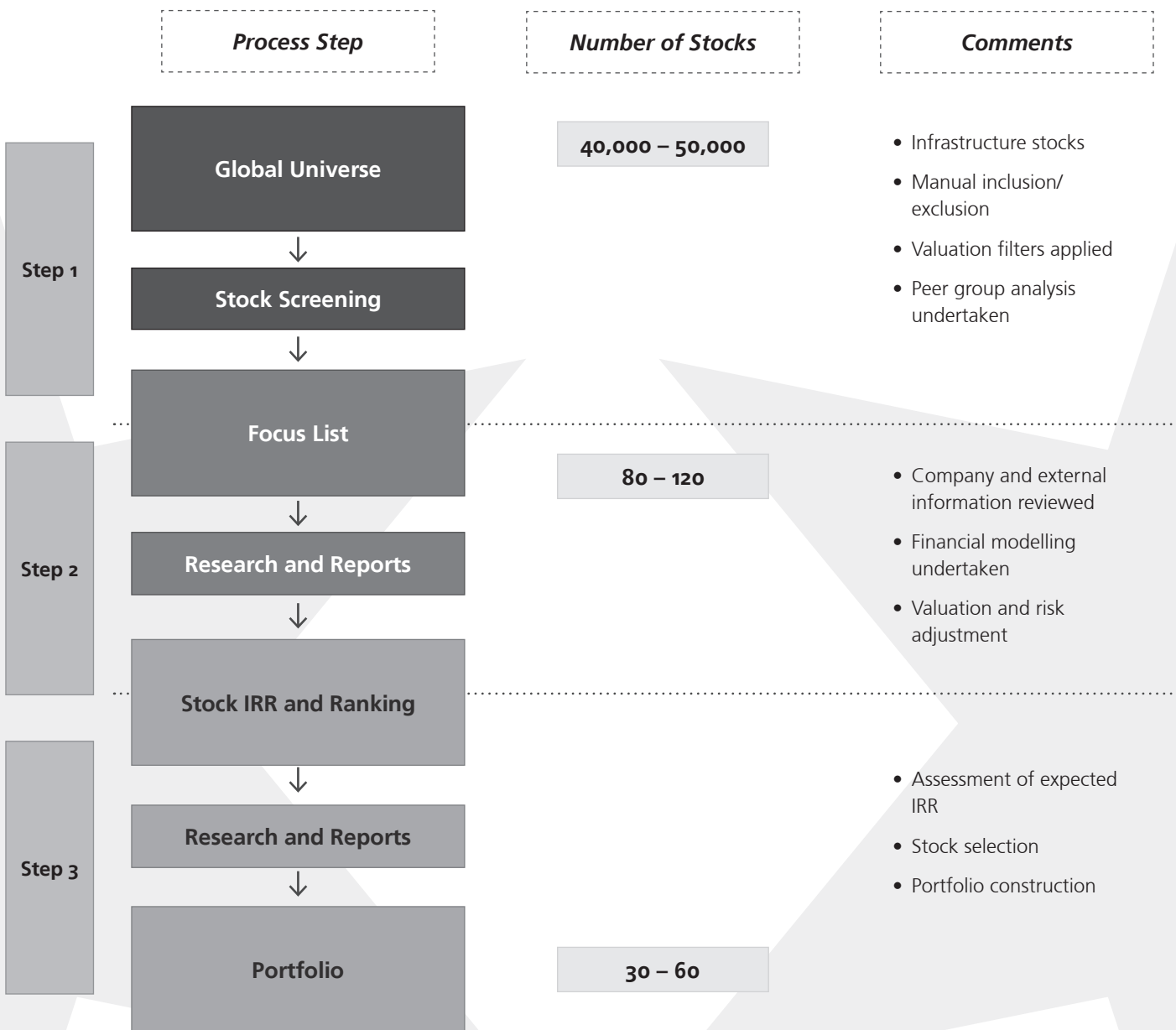
As at 31 December 2010 the Fund's sector allocations were dominated by Electric Utilities at 30.3% of the overall Fund. Electric Utilities includes the transmissions, distribution and generation of electricity, and is the largest sector within the universe of infrastructure stocks globally. The next largest sector exposure was a 21.8% allocation to Multi Utilities, Oil & Gas Storage, Water and Gas. Road and Rail, Highways and Railtracks made up 18.2% of the Fund as at 31 December 2010. This sector includes toll roads, bridges and tunnels and railtrack owners and operators. Some 15.5% of the Fund was allocated towards Airport Services, Air Freight and Logistics. This sector includes airport operators, airport services freight and logistics. The residual sector exposures included Construction Engineering (5.8%), Cable and Satellite (3.5%), Marine and Port Services (2.1%) and Cash and other.

Sector trend



On an absolute sector basis, there have been no material allocation changes over the year to 31 December 2010. Of note, allocations towards Airport Services, Air Freight and Logistics have increased from 12.1% to 15.5% over this time. Similarly, allocations towards Road and Rail, Highways and Railtracks increased from 16.0% to 18.2%. Of the notable decrease in allocations over the past year, the Fund has decreased its allocation towards Multi Utilities, Oil and Gas Storage, Water and Gas from 24.7% to 21.8% as at 31 December 2010.

**Investment Process Diagram**



**Portfolio Manager/Analyst Interaction**

Communication and meetings There are a number of informal and formal meetings held throughout the course of the investment process, with informal communication frequent. A monthly investment team meeting is held, whereby portfolio strategy, performance and research are all discussed. Weekly team meetings are held, whereby administration, marketing, performance, markets and key news items are discussed. A weekly workflow meeting is held, while bi-weekly research investment meetings are held, and are the main forum for initial stock reviews and presentations of research.

Findings from the bi-weekly research investment meetings are the basis for the portfolio construction meetings, which are held following these meetings twice a week.

Number of analysts There are five Research Analysts and a Dealer/Analyst supporting the four Portfolio Managers.

**Initial Screens**

Investable universe RARE believes there are 200 to 250 stocks in the investment universe. From this investment universe, a focus list of 80 to 120 stocks is put forward for detailed research, while the overall target portfolio size is 30 to 60 stocks.

## Screening process

There are a number of steps within the RARE investment screening process. From an initial global stock universe of 40,000 + stocks, an automated sector screen will be run, to make sure that only stocks meeting the definition of Transport (excluding airlines and marine) & Utilities in the GICS and Bloomberg classifications are included. A manual screen is then applied, whereby stocks that fall outside these sectors but which display infrastructure characteristics are included. This universe of approximately 1,200 stocks is then defined as the 'RARE Universe' of stocks.

The RARE Universe of stocks can generally be defined as infrastructure businesses that have the following characteristics:

- Long dated assets
- Resilient and predicable cash flows
- Inflation hedge (e.g. Tariff movements linked to inflation)
- Low maintenance capital expenditure
- Largely fixed operating costs base
- High Leverage
- Attractive yield
- Monopoly power

The RARE Universe is then screened for market capitalisation (greater than US\$500 million) and various financial and valuation parameters (gearing, cash flow measures, valuation multiples and yield). Subsequent to these screens the investible universe of approximately 200 to 250 stocks is defined (RARE 200). A peer group assessment is then made to define a focus list of 80 to 120 stocks. The focus list includes the highest rated stocks within each sub-sector based on performance against all screening measures (as discussed above). The entire focus list will then be considered for detailed bottom-up analysis.

## Stock Research

### Top-down or bottom-up?

As the Fund is not constructed to a benchmark, it has an absolute returns focus, with the risk/returns profile a result of rigorous bottom-up stock analysis. The bottom-up process is driven by the quality of in-house research delivered, with a combination of quantitative and qualitative factors underpinning each investment decision.

A top-down overlay supplements the bottom-up research process, with the overall global research capability also comprised of sector, country and regional analysis of the key themes that may affect the outlook for the underlying bottom-up stock analysis.

It is estimated that the research and stock selection process is 80% driven by bottom-up analysis, with a 20% top-down macro-economic overlay.

### Data collection

Data collection is primarily sourced from information released by each company under consideration. This information is gathered from publicly available sites or through company-specific visits. Discussions with management of the target company and key industry figures are given high priority in the overall data collection process. Economic and industry statistics and market data are sourced from external providers, with the major provider being Global Insights. Regulatory and statutory reports are also utilised in the data collection stage.

External databases such as Bloomberg are used as secondary sources of information. Credit rating analysis and reports are utilised. Broker reports are used as a reference, with RARE tracking various brokers' forecasts to obtain an assessment of the market view of a stock at any time. While broker reports do not form the basis for bottom-up research, they are primarily utilised for in-depth industry information, understanding unusual market value drivers in particular regions/sectors, and are also utilised to gain access to management when arranging overseas trips and telephone conferences.

Research methods	<p>Stock coverage is allocated on both a regional and sector basis. Typically, each analyst will have primary responsibility for two regions. This is crucial to ensure that each region has at least one analyst with primary responsibility at any given time. In terms of sectors, each analyst will have primary responsibility for two sectors and secondary responsibility for at least one sector. Each sector is covered by at least two analysts, either on a primary or a secondary basis. Responsibilities are allocated in a manner that ensures continuity of process throughout the year.</p> <p>As key to the research process and in assessing individual stocks, RARE will undertake a detailed qualitative and quantitative analysis.</p> <p>The key quantitative aspects covered include:</p> <ul style="list-style-type: none"> <li>• Historical and forecast financial performance, position and cash flows</li> <li>• Dividend payout history and growth prospects</li> <li>• A detailed valuation analysis, including a DCF model</li> <li>• Peer group comparison within a sector and across geographic regions.</li> </ul> <p>In terms of qualitative aspects, the team will assess the quality of management and corporate governance, structural complexity and fee leakage, acquisition strategy and refinancing upside. On a peer relative basis, the team will also look for resilient and predictable cash flows, low maintenance capital expenditure, a largely fixed operating cost base, monopoly characteristics, the existence of a regulatory environment and inflation hedge characteristics.</p>
Number of one on one meeting annually	<p>As the team in its entirety is based in Sydney, it is estimated that the Senior Research Analysts will spend two to three weeks every six months visiting companies and various market participants.</p> <p>RARE seeks to maintain regular contact with management of the companies it holds in the portfolio and those held on watch lists. A range of interactions between RARE and the companies include company site visits or conference calls, broker-arranged meetings and company road shows.</p> <p>In terms of global coverage, the investment team must complete a minimum of ten international trips per year to visit companies. Where possible two people will attend each visit.</p>

## Modelling and Valuation

Proprietary modelling	<p>The Fund utilises a detailed proprietary valuation model, which includes a standardised risk-adjusted weighted average cost of capital (WACC) calculation. The output of the valuation model is essentially the equity IRR for each stock. For each stock within the focus list, there is a detailed five-year forecast dividend payment calculated, as well as a target price in year five. The target price in year five is determined by the discount of future expected cash flows back to year five, discounted using the calculated WACC. In assessing future cash flows, the Fund will generally model cash flows based on the entirety of contracts in place, or to ensure that cash flows are in a steady state, generally around the 20 to 30-year mark. On this basis, a terminal value is then assumed, applying a terminal rate in accordance with the Gordon Growth Model.</p> <p>In terms of the discount rate used, a risk-adjusted WACC is applied, which takes into account various stock-specific and relative to peer group risk factors. The risk free rate, market risk premiums, sovereign risk, long bond and debt premiums are standardised across the focus list and are essentially driven by the macro-economic outputs formulated by the Advisory Board. A stock specific risk is applied to the cost of equity, as well as an asset beta, which takes into account each individual asset and the underlying quality of cash flow. The overall equity IRR is then calculated using the current stock price – the five year forecast dividends plus the exit price.</p>
Valuation methodology	<p>For each stock an IRR is calculated using the current stock price, five-year forecast dividends and an exit target valuation price, which is determined by the DCF of the expected future cash flows.</p> <p>The cash flows are discounted using a risk adjusted weighted average cost of capital, as discussed above. In assessing the discount rate, stock specific risks, including quality of management, structural complexity, and acquisition strategy and refinancing upside are considered. Risks relative to peers are also considered, including the resilience of cash flows, low fixed operational cost base, monopoly characteristics, regulatory environment, inflation hedge and the volatility of earnings.</p> <p>The valuation methodology will compute an expected equity IRR, which is used as the basis for portfolio construction as discussed below.</p>

## Portfolio Construction

**Process** The Portfolio construction meetings are held twice weekly following the research meetings and are attended by the Investment Directors, Portfolio Managers and the Dealer for the Fund. Analysts will attend these meetings as and when required. The stock ideas and research, which are discussed on Wednesdays and Fridays at the Investment Research meetings, form the basis for the portfolio construction meetings.

The main focus of the portfolio construction meetings will be to review proposed portfolio changes. It is estimated that the portfolio construction process is based 80% on the bottom-up analysis of the focus list stocks and 20% top-down, based on the experience of the Investment Committee and its expectations of a number of relative value measures between particular regions and sectors. The bottom-up analysis includes utilising the quantitative internal rate of return criteria. The portfolio construction process and guidelines incorporate risk controls within the overall portfolio, including:

- Sector and regional limits
- Asset maturity limits
- Stock limits

After taking into account the risk control noted above, stock weightings are based on a combination of the extent of a stock's undervaluation compared to RARE's view of fair value (as measured by the equity IRR), with the RARE Investment Committee's understanding of the sector and companies used as an overlay.

Accordingly, stocks weightings are based on a ranking model.

	Expected Equity IRR	Maximum Weighting (% Total Portfolio)
Rank 1	13%+	6%
Rank 2	11%	5%
Rank 3	10%	4%
Rank 4	9%	3%

The stock weights in the portfolio are allowed to drift by market movement to a maximum of an additional 33% of the maximum stock buy limits as noted above. To protect the weighting and ranking during the entry process, absolute 'buy' limits are placed on each stock and RARE ceases buying stocks as soon as the buy limit is reached.

**Rules** The Investment Committee is responsible for monitoring portfolio risk, with the main parameters below:

Sector Parameters	Target
Essential Services	45%–70%
Transport	25%–45%
Communications	0%–15%
Community & Social	0%–10%
Cash	0%–20%

Regional Parameters	Target
UK/Europe (Developed)	20%–45%
Asia/Pacific (Developed)	0%–25%
North America (Developed)	20%–45%
Developing	0%–25%
Cash	0%–20%

Asset Lifestyle Maturity	Target
Green field	0%–20%
Developing	0%–20%
Mature	70%–100%

**Trading/Implementation**

Agents and processes	<p>RARE effectively manages a single core portfolio on behalf of its clients. When trades are executed, they are allocated proportionally in terms of numbers and average price across all portfolios.</p> <p>The Fund uses seven global brokers, seven local brokers and one agency execution only broker for Direct Market Access (DMA). Brokers are selected based on a voting and ranking process, with brokers rankings reviewed every six months.</p> <p>As the Fund has a long-term focus, a relatively low turnover approach acts to minimise overall transaction costs. Historic turnover is in the range of 30% to 50%.</p>
Hedging	<p>The Fund hedges 100% of its currency exposure back to Australian dollars. An audited derivatives risk statement is in place to ensure the appropriate processes and procedures are followed.</p>

**Sell Discipline**

Decision process	<p>Each stock has a target valuation and an entry/exit price point recommendation. A number of events will prompt a review of the stock valuation, including:</p> <ul style="list-style-type: none"><li>• Market price movements which alter a stock ranking</li><li>• Fundamental changes to a business model or regulatory environment</li><li>• A stock is excluded from the investment universe during the screening process.</li></ul> <p>If the price of a stock falls, the Fund will thoroughly reassess the fundamentals and then speak with the company's management before deciding whether the stock should be sold or whether there is an opportunity to increase the holding.</p>
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