

## RARE Infrastructure Value Fund

31 Aug 2010

The RARE Infrastructure Value Fund (the Fund) is a high quality offering, providing investors access to a diversified range of global listed infrastructure securities. The manager focuses on regulated and user pays assets and limits exposure to competitive and social assets, which have a less attractive risk return profile. The Fund aims to deliver total returns of 10-11% per annum, over a medium to long term time frame (5+ years). The Manager employs a bottom-up research approach to identify infrastructure securities which possess high quality assets that operate in a monopolistic environment and can deliver resilient and predictable cash flows.

The RARE investment team is well resourced and highly experienced, consisting of 10 investment professionals. All members are based in Sydney and the team is led by Richard Elmslie and Nick Langley. Elmslie has 20 years of global infrastructure experience. Prior to co-founding RARE in 2006, he held positions as Head of Power and joint Head of Infrastructure at UBS. Langley has 12 years experience, which includes 4 years with AMP Capital's infrastructure funds management team. Langley also worked alongside Richard Elmslie at ABN AMRO between 1998 and 2000. In Zenith's view Elmslie and Langley are highly regarded investment professionals. Together Elmslie and Langley form a two member investment committee that drives the portfolio construction process. Each member of the investment team has specific stock research responsibilities (excluding Elmslie and Langley), with responsibilities divided along sub-sector and regional lines. Zenith has met with the majority of RARE's investment team and have been impressed by the depth, experience and structure of the team. The team's high level of experience ensures strong coverage of the investible universe and the collegiate approach promotes a healthy internal debate regarding investment ideas.

RARE specialises exclusively in global listed infrastructure investments. There are three broad components to the investment process: initial screening; fundamental research including financial modelling; and portfolio construction. RARE employs a series of quantitative and qualitative screens (liquidity, gearing, coverage ratios, predictability of cash flows, high yield, low earnings volatility) to reduce its initial investment universe of 1,200 stocks down to a 'RARE 200 universe' before arriving at a focus list of 80-120 securities. Intensive fundamental research is then employed which culminates in a detailed research report for each company. Portfolio construction is benchmark unaware in nature and portfolio weights are therefore expected to deviate significantly from the benchmark. The portfolio will generally contain around 30-60 stocks. In Zenith's view, RARE's portfolio construction process embodies an appropriate blend of fundamental research by the analyst team and portfolio manager skill.

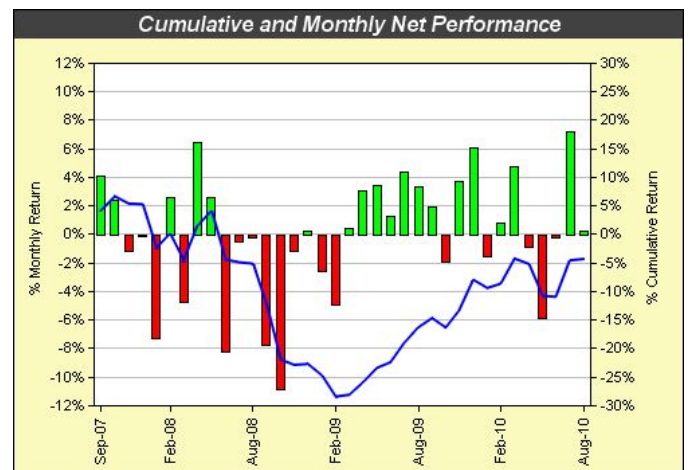
Risk management is an integral component of the investment process employed by RARE, which is predominantly driven by the extensive bottom-up research applied. The Manager aims to identify high quality securities with solid and recurring cash flows, while operating in a low demand elasticity type environment. The portfolio is constructed along broad constraints surrounding region, sector and stock type exposure, while maintaining a benchmark unaware style approach. Zenith is comfortable with the research process applied and the portfolio constraints in place to ensure a best of breed portfolio of infrastructure securities.

RARE applies a management fee of 1.0%, with a performance fee of 10%. The performance fee is based on positive outperformance relative to the benchmark.

In Zenith's view, the Fund is extremely well structured and managed by the highest calibre investment team. We believe there are significant diversification benefits to be gained by adding a global listed infrastructure fund such as the RARE Infrastructure Value Fund to an investor's portfolio.

Zenith rates the Fund **HIGHLY RECOMMENDED**.

Key Features	Description
APIR Code	TGP0008AU
Asset Class	International Shares
Sub-Asset Class	Infrastructure
Investment Style	Listed Securities
Benchmark	S&P Global Infrastructure Index Hedged A\$
Investment Director, Senior Portfolio Manager	Richard Elmslie
Investment Director, Senior Portfolio Manager	Nick Langley
Investment Team Size	10



### Performance Analysis

Performance Statistics	3 Yrs (% p.a.)	2 Yrs (% p.a.)	1 Yr (% p.a.)
Performance - Fund	-1.48	0.43	14.33
Performance - Benchmark	-5.79	-4.34	11.23

Zenith benchmarks all Global Listed Infrastructure Securities Funds to the S&P Global Infrastructure Index (Hedged \$A) to provide a common mark, although we do acknowledge that it is not the ideal benchmark for some funds. Zenith prefers to concentrate predominantly on individual fund performance, return consistency and risk/return output, in comparison to peer group statistics.

The Fund's performance ranks first in comparison to its global peers. Since inception, the Fund has easily outperformed the benchmark, and in the medium term generated strong returns despite the market volatility created by the credit crisis.

As RARE employs a benchmark unaware investment approach, we would expect that future returns may diverge from the prescribed benchmark. Its performance objectives and performance fee structure is based on the Fund's internal index, the OECD G7 Inflation Index plus 5.5% p.a.

### Income/Growth Splits

2007/08: 6.00% (Income); 12.00% (Growth); 18.00% (TR)

2008/09: 2.44% (Income); -17.26% (Growth); -14.82% (TR)

2009/10: 7.2% (Income); -11.56% (Growth); -4.36% (TR)

Ideally, the infrastructure class should generate yields around 3-4%, and provide total returns of around 8-10%.

### Consistency Analysis

Consistency Statistics	3 Yrs	2 Yrs	1 Yr
History of Monthly Excess Return (%)	58.33	62.50	75.00
History of Monthly Excess Return (Rising Mkts %)	42.86	40.00	62.50
History of Monthly Excess Return (Falling Mkts %)	80.00	100.00	100.00

The Fund has generated a consistently and very strong level of outperformance above our benchmark through falling market conditions. This is typical for a fund with defensive characteristics. Additionally, the Fund has achieved a moderate level of outperformance through all market conditions over the medium term.

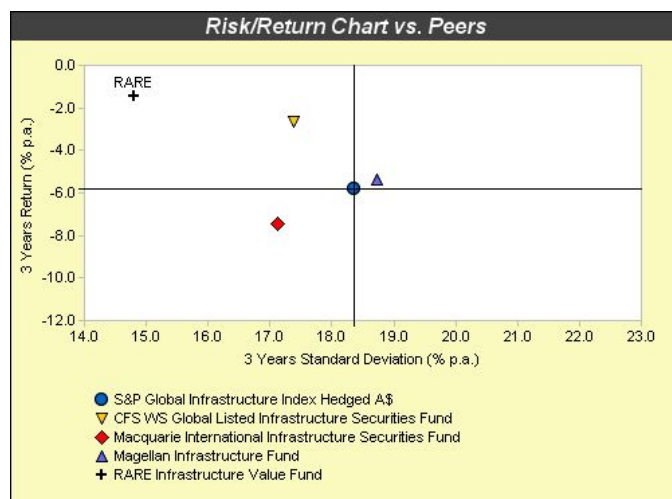
Zenith expects the Fund to generate a positive level of outperformance through all market conditions over the investment timeframe prescribed.

### Risk / Return Analysis

Risk / Return Statistics	3 Yrs	2 Yrs	1 Yr
Information Ratio - Fund	0.59	0.59	1.11
Sharpe Ratio - Fund	-0.47	-0.27	0.81
Standard Deviation (% p.a.) - Fund	14.80	14.74	12.45
Tracking Error (% p.a.) - Fund	7.28	8.09	2.80

The risk of the Fund, as measured by standard deviation, is significantly less than the peer group average.

The risk/return chart below graphically illustrates the Fund's stellar performance over the short term in comparison to its global peers, displaying both the highest return and the lowest risk. The top left quadrant represents the ideal position for any investment on the risk/return chart.



### Investment Personnel

Name	Title	Time with Manager
Richard Elmslie	Investment Director, Senior Portfolio Manager	4 Yr(s)
Nick Langley	Investment Director, Senior Portfolio Manager	4 Yr(s)
David Maywald	Senior Investment Analyst	4 Yr(s)
Rod Chisholm	Head of Research	4 Yr(s)
Tim Snelgrove	Analyst / Trader	1 Yr(s)
Ben May	Investment Analyst	5 Mth(s)
Charles Hamieh	Portfolio Manager and Senior Investment Analyst	3 Mth(s)
Shane Hurst	Investment Analyst	3 Mth(s)
Ann Chau	Investment Analyst	3 Mth(s)
Dan Simmonds	Investment Analyst	2 Mth(s)

## Organisation

RARE Infrastructure Limited is a boutique investment management company that specialises exclusively in global listed infrastructure in both developed and emerging markets. The RARE business is 62% owned by staff (the majority by Elmslie and Langley) and 38% by ASX-listed Treasury Group. Treasury provide RARE with back office support. This structure enables the investment team to entirely focus on investment management functions which is ideal in Zenith's opinion. RARE has grown significantly since inception in 2006, with approximately AUD\$2.6 billion in funds under management.

## Investment Team

The RARE investment team is considered by Zenith to be well resourced. It consists of 10 investment professionals, with an average of 9 years investment experience. The team is centrally located in Sydney and operate an open plan to facilitate healthy internal debate regarding investment ideas.

The investment team is led by Richard Elmslie and Nick Langley. Elmslie has 20 years of global infrastructure experience. Prior to co-founding RARE in 2006, his roles included Head of Power and joint Head of Infrastructure at UBS Investment Bank. Langley has 12 years experience in the infrastructure sector, including 4 years with AMP Capital's infrastructure funds management team. Langley also worked alongside Elmslie at ABN AMRO between 1998 and 2000. In Zenith's view Elmslie and Langley are highly regarded investment professionals in comparison to their peers and possess extensive knowledge of global infrastructure and its various sub-sectors.

Since Zenith's last review, there have been three staff departures. Co-emerging market fund portfolio manager and senior analyst, Sarah Shaw, has departed alongside two analysts, Tim Humphries and Jonathon Reyes. RARE had already implemented a global search for additional analysts, so the departures were replaced in tandem with the new appointments. Zenith believes the personnel changes will have minimal impact on the Fund and that the new appointments will contribute strongly to the team. The new additions are: Charles Hamieh (co-emerging markets portfolio manager and analyst), Ben May, Shane Hurst, Dan Simmonds and Ann Chau.

Hamieh has had previous portfolio manager experience during his 13 years of investment experience, creating and running a dedicated infrastructure fund at Challenger. He has previously worked with Nick Langley at AMP Capital, which we also view favourably. The other team members have an average of more than 10 years of investment experience and come from a diverse array of backgrounds, with prior experience from companies such as Deloitte, UBS Global Asset Management and AMP Capital. The analyst team is led by Rod Chisholm, the Head of Research. Chisholm has over 11 years of infrastructure experience which includes both research and investment banking experience at HSBC.

Whilst Zenith acknowledges that three departures are not ideal, we have met with a number of the new team members, and have been most impressed with their experience and the level of both industry and valuations experience. It is apparent that the new team have a more collegiate culture which will improve discussion of investment ideas. The recent implementation of RARE's employee equity scheme should assist in reducing the risk of future departures.

RARE also have an Investment Advisory Board which includes external appointments. The board comprises Mark Burgess (Managing Director of Treasury Group Limited) and David Bowers Managing Director/Absolute Strategy Research - ASR) as well as Elmslie and Langley. RARE have announced the appointment of a new board member, Jonathon Mirrlees-Black. Mirrlees-Black has over 20 years of experience in the infrastructure sector, including 12 years as a sell side research analyst and 8 years as a management consultant to global infrastructure companies. He also sits on the UK Water Regulator's Advisory Panel. Zenith views Mirrlees-Black's appointment favourably and we believe that his experience and relationships with regulators will add another dimension to the investment process.

All team members (except for Elmslie and Langley) have stock responsibilities divided into both primary and secondary sectors and regions. Portfolio management is driven by a 2-member Investment Committee comprised of Elmslie and Langley with investment ideas based on stock ideas from the team.

The remuneration structure for the investment team includes a highly competitive base salary plus a bonus structure tied to the profitability of the business. RARE have now implemented an attractive employee equity plan which further aligns the interest of the team to the overall success of the business. In Zenith's view, RARE's remuneration policy, ownership structure and employee equity scheme should assist with staff retention.

Zenith has met with all senior members of the RARE investment team, including Elmslie, Langley, Rod Chisholm, and Charles Hamieh. We are highly impressed with the Fund's performance to date and by the depth, level of experience and structure of the team.

## Investment Process

RARE specialises in global listed infrastructure investments. The Fund aims to deliver a total return of 10-11% per annum, over a medium to long term time frame (5+ years). The manager focuses on regulated assets like utilities and user pays assets such as toll roads, whilst generally limiting exposure to the higher risk/return subcategory of competitive assets such as telecommunications and the lower risk/return subcategory of community & social assets.

RARE believes that significant and attractive investment opportunities exist in the listed infrastructure sector and the manager employs a benchmark unaware approach when constructing its portfolio.

## Security Selection

There are 2 broad components to the RARE security selection process:

### 1. Initial Screening

The Fund's investment universe includes only those stocks from the global universe of listed securities that meet the definition of Utilities and Transport (excluding airlines & marine), in addition to a number of hand-picked stocks that display infrastructure characteristics but are classified in different sectors. This leaves a remaining universe of approximately 1,200 stocks.

From here, RARE screens out the majority of stocks with a market capitalisation of less than USD\$500 million, on a

maximum 25% of daily volume turnover, and on a number of basic financial parameters including gearing (Net Debt/Enterprise Value and EBIT/Interest), cash flow and valuation measures (Enterprise Value to EBITDA and Price/Earnings Multiples). Small/micro cap stocks below the USD\$500 million threshold may be considered if the stock is likely to exceed the threshold in the near future. The resultant investible universe includes around 200-250 stocks.

The remaining 200-250 stocks are ranked based on the same financial parameters and the investment team chooses stocks from each industry sub-sector that it considers to provide the most attractive opportunities for further qualitative & quantitative analysis. The 'focus list', consisting of 80-120 securities, will proceed to the full fundamental research stage.

RARE's initial screening stage ensures that whilst a broad range of stocks are given a preliminary consideration, the final focus list is sufficiently small for the team to conduct intensive analysis on each remaining stock. The financial parameters considered by the team at this early stage appear sound and should help the team to identify attractive potential investment opportunities.

## 2. Fundamental Research

The fundamental research process begins with sourcing extensive information on each company on the focus list and the market. Primary information sources include: information releases from the company; economic and industry statistics and market data; regulatory or other statutory body reports; and information obtained from company visits. Secondary information sources include: external databases (e.g. Bloomberg); credit analysis and reports; broker analysis; and broker/industry sponsored conferences. Company visits in particular are a critical component of the RARE process; the investment team undertakes a minimum of 10 international trips per annum of 2 to 3 weeks duration. Generally 2 team members travel per quarter. The travel budget is large, commensurate with the high level of travel. In addition, frequent company contact via telephone calls, conference calls, email and webcast are used as a supplement.

RARE uses this information to build an in-depth understanding of the markets, sectors and/or regions in which a company operates. A standard research report is prepared for each company, which includes analysis of its various quantitative and qualitative attributes. Specific components of the report include: divisional analysis, meeting notes, peer analysis, SWOT analysis, industry information and valuation.

Detailed financial models are produced and maintained for each company, with the forecast cash flows from the models used to construct its discounted cash flow valuations (DCF). RARE spends considerable effort in determining an appropriate discount rate for each company to use in their models. This is an area where RARE believes it can use its insight to add considerable rigour to the valuation process. It considers both stock specific risks (e.g. quality of management and corporate governance, structural complexity, acquisition strategy, refinancing upside) and risks relative to the company's peer group (e.g. level of maintenance capex, earnings volatility and monopoly characteristics). These factors are weighted to arrive at the cost of both debt and equity which are then combined to produce the discount rate. The output of the DCF model is an Internal Rate of Return (IRR) and target entry/exit prices for each company on the Focus List, which is used in the portfolio construction stage.

Following its analysis, RARE will discuss its findings with management of the target company and other industry participants (including competitors and regulators), which can help generate new ideas or clarify existing assumptions.

RARE has enhanced its investment process by establishing an Investment Advisory Board consisting of Elmslie, Langley, Mark Burgess (Managing Director of Treasury Group Limited), David Bowers (Absolute Strategy Research), and new appointee, Jonathon Mirrlees-Black. The Board meets every two months to evaluate high level global macroeconomic issues on a sector and regional basis, with output filtering into RARE's investment process. In Zenith view the Investment Advisory Board complements the existing process by providing a pure top-down global macroeconomic assessment.

RARE's approach to fundamental research appears comprehensive and very well structured. The high level of experience across the investment team ensures that a significant number of companies can be analysed at an in-depth level.

## Portfolio Construction

The portfolio construction process is undertaken by the 2 member Investment Committee, which first considers the IRR of each stock on the Focus List, where a ranking system is used to set maximum stock limits relative to expected IRRs. Limits are as follows:

- Rank 1: 13%+ IRR = maximum 6% weight;
- Rank 2: 11-13% IRR = maximum 5% weight;
- Rank 3: 10-11% IRR = maximum 4% weight; and
- Rank 4: 9-10% IRR = maximum 3% weight.

The portfolio will consist of predominately Rank 1 and 2 stocks but stock weights are permitted to drift via market movement up to an additional 1/3rd of the maximum weights.

The Investment Committee uses this matrix as a guide and determines weightings within these bands. RARE estimates that weightings within the portfolio are 80% based on the stock's IRR, and 20% based on subjective opinion. The additional factors considered include the overall portfolio allocation across infrastructure sub-sectors and regions, as well as macro-economic inputs. These macro-economic inputs are guided by quarterly broker panels where a panel of 5 brokers are asked for their 3-5 year outlooks. These outlooks are subsequently fed into the models and also used in portfolio construction.

The Manager believes approximately 20% of its value-add is derived from top down influences, with the remaining 80% coming from bottom-up stock selection.

The portfolio construction process is benchmark unaware and portfolio weights are therefore expected to deviate significantly from those of the standard infrastructure sector benchmarks at a stock, sub-sector and regional level. The portfolio will generally contain around 30-60 stocks, each typically with a minimum 1% weight. Portfolio turnover is expected to average 35% p.a. over the long term. The Fund can allocate up to 25% to emerging market opportunities. The emerging market opportunities are primarily chosen from the superior stocks of the RARE Series Emerging Market Fund.

RARE has a strong focus on liquidity to ensure that its buy/sell decisions can be executed in a timely manner. The Investment Committee uses the target entry/exit prices to trade the

portfolio. Each week an IRR stock ranking list is printed and any changes in rank are examined. In addition to this change in IRR ranking, a number of trigger events will also prompt a stock valuation review. These include: fundamental changes to the business model that impact RARE's view on the stock's prospects; a significant market price decline; or a stock is excluded from the "investment universe" during a screening process. Where a stock price declines, RARE will reassess the company's fundamentals to determine if the stock should be sold or the holding increased.

In summary, the portfolio construction process is an intuitive extension of RARE's bottom-up security selection process. In Zenith's view, RARE has achieved an appropriate blend of fundamental research and portfolio manager skill.

### Risk Management

Portfolio Constraints	Description
Sector Constraint - Transport (%)	25% to 45%
Sector Constraint - Community & Social (%)	0% to 10%
Sector Constraint - Communications (%)	0% to 15%
Sector Constraint - Essential Services (%)	45% to 70%
Regional Constraint - Asia/Pacific (%)	0% to 25%
Regional Constraint - UK/Europe (%)	20% to 45%
Regional Constraint - North America (%)	20% to 45%
Regional Constraint - Developing Markets (%)	0% to 25%
Asset Maturity Constraint - Greenfield (%)	0% to 20%
Asset Maturity Constraint - Developing (%)	0% to 20%
Asset Maturity Constraint - Mature (%)	70% to 100%
Stock Numbers	30 to 60 guide only

Risk management at an individual security and overall portfolio level is an integral part of the RARE process, however, risk relative to benchmark (i.e. tracking error risk) is not considered. Zenith is comfortable with RARE's benchmark unaware approach and we believe that RARE has a firm grasp of the stock specific risks and the overall exposures within the portfolio.

While not "hard limits", guidelines (as displayed in the above table) are placed around individual stock exposures, infrastructure sub-sector exposures, regional exposures and asset maturity exposures. All guidelines are of an absolute nature, not relative to an index. RARE measures exposure to region and sub-sector based on the location/sector of the assets the company owns, not the stock listing location or GICS classification. Zenith believes this "look through" analysis undertaken by RARE helps provide a more realistic and accurate measure of the risk exposures in the portfolio.

Zenith has a high degree of comfort in RARE's approach to risk management which we consider to be extremely thorough and imbedded into all stages of the investment process.

### Risks of the Fund

The broad risks of a fund investing in listed infrastructure, such as the RARE Infrastructure Value Fund, are comparable to global equities funds. The underlying investments of the Fund are companies listed on global stock exchanges and are therefore exposed to equity market fluctuations. Earnings streams from listed infrastructure companies are potentially more predictable than the broader equities market as a whole, which has historically resulted in lower performance volatility across the infrastructure sector. It should also be noted that the infrastructure sector is still significantly more volatile than defensive asset classes such as fixed interest.

Concerns over high gearing levels during the credit crisis adversely affected infrastructure stocks, which are typically highly leveraged to fund large projects. Over the longer term, these fears have proven to be unfounded, with the majority of infrastructure companies easily able to service debt and obtain re-financing when required.

Whilst Zenith believes there are inherent defensive characteristics in the listed infrastructure sector, including a modest correlation with the broader equities market and high predictability of earnings, it is still an asset class at the "growth end" of the efficient frontier and should be treated as such when used in an investor's portfolio. Zenith recommends that investors adopt a medium to long-term (5+ years) investment time frame when investing in the Fund.

With RARE's total funds under management (FUM) of A\$2.6 billion (as at 31 July 2010), Zenith does not currently consider the high FUM a hindrance to performance of this Fund.

Zenith considers Richard Elmslie and Nick Langley to be the key personnel responsible for the Fund and the departure of either member would be considered a material loss for RARE. However, Zenith currently considers this risk to be low as both maintain a significant equity stake in the business. In addition, we acknowledge that the high level of experience across the team reduces the reliance on a single individual. Zenith looks favourably on the recent introduction of an employee equity scheme which will align employee remuneration to the success of the fund.

### Applications of the Fund

The Fund maintains an absolute return focus built on a bottom-up driven investment process that aims to identify infrastructure securities with portfolio bias towards regulated and user demand assets. The Fund endeavours to provide regular and predictable returns to investors comprising dividend and capital growth, with an investment objective to generate an absolute return before tax over the long term, of the G7 inflation plus 5.5%.

Zenith believes there are significant diversification benefits to be gained in adding a global listed infrastructure fund, such as the RARE Infrastructure Value Fund, to an investor's portfolio. Infrastructure securities provide a long-term reliable income stream, which are resilient to changing economic conditions, are largely protected from inflation (based on income indexed to inflation), and provide less volatility with a lower correlation to other asset classes over the medium to long term. Zenith believes the inclusion of listed infrastructure in an investor's

international equities exposure has the potential to improve the risk/return profile of the portfolio. We believe the allocation to listed infrastructure of the international share component depends on an investor's individual risk profile. For the typical growth profile investor, 15-20% of the international share component may be an appropriate allocation. The allocation may be slightly higher for more conservative investors.

### Currency Hedging

Most fund managers use three month forward contracts to hedge against currency fluctuations. If the Australian dollar moves unexpectedly against the value of the forward contracts, this will generate realised currency losses for the funds. Simultaneously, the decline in the value of the AUD will create unrealised gains on the value of the underlying securities, creating a capital gain. Previously, the tax treatment of currency losses meant that the losses were treated as income losses, meaning that losses could only be offset by income gains. The rise in the value of the underlying assets is considered a capital gain and cannot be used to offset currency losses. This can affect the Fund's ability to pay distributions. The regulations are likely to change in the coming months, so that foreign exchange losses/gains will go into the capitals gains pool and offset the changes in capital gains assets.

Due to the unexpected currency volatility that occurred in 2008-2009, the Fund generated income losses. The Manager continued to pay quarterly income distributions from capital held in the Fund, in accordance with a consensus request from unit-holders. They have now resumed paying quarterly distributions from generated income.

### Fees

RARE applies a 1.0% p.a. management fee, and a 10% performance fee. The performance fee is payable when the Fund generates a positive outperformance of the benchmark. Zenith views the fee structure as attractive and in line with the Fund's global peers.

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