

**Analyst(s):** Justine Gorman; James Gunn

## Standard & Poor's View

S&P rates this fund three stars, reflecting our conviction that the manager will consistently generate risk-adjusted returns in-line with both its relevant investment objectives and its peers.

S&P believes the fund offers investors a "true-to-label" valuation-driven portfolio of Australian industrial shares. The total-return approach focuses specifically on the company's ability to sustain earnings, and the company's willingness to pay dividends.

The relatively low portfolio turnover makes this product a more tax-aware investment vehicle. Realised capital gains and dividends can be reduced with the use of call options, although these instruments are used infrequently by the manager.

Absolute stock limits are based on the whether the stock is a large-, mid-, or small-cap stock permitted to "drift" up to 50%. Given that the manager reviews all valuations when target price is reached, S&P is less concerned that allowing a stock's weight to drift is loosening the investment process.

The manager's risk-management framework is centred around the portfolio- construction process, ensuring more influence is given to stocks with the greatest upside, and that there is adequate diversification. The main risk-mitigation approach used by value managers is to purchase stock at a discount to intrinsic value. In future, S&P would like to see the manager develop stronger catalysts for the revaluation of stocks they select for the portfolio.

S&P has noted its concerns regarding the significant level of instability in the team, which has been an ongoing problem. With Hugh Giddy's appointment to the newly created role of head of research, S&P would like to see a closer engagement between the analyst team and management, and stronger conviction in recommendations.

Performance has been modest over the five years to Dec. 31, 2009, outperforming the benchmark by 0.7% per year. Since its start date in May 2002, the fund has outperformed by 2.6% per year gross of fees.

## Investor Suitability

- An Australian industrial shares strategy with exposure across the full market capitalisation.
- Up to 20% can be invested in cash, to reduce the effect of falling equity markets.
- A specialist fund, it is suitable for investors looking to manage their industrials exposure. The fund has no exposure to the resources sector.
- The manager focuses on total returns to deliver investors capital gains and dividend income.
- Low portfolio turnover and some use of covered call options make this fund more tax aware.
- Due to the manager's value style and conservative stock-selection process, there will be periods of underperformance.
- May also underperform the broader market when resources are rallying.
- Suitable for investors with an investment time horizon of over five years.

## Key Strengths

- The manager keeps its investment approach "true-to-label" throughout the market cycle.
- The new equity plan gives a significantly larger portion of the ownership in the business to the staff.
- Lead portfolio manager, Mr. Tagliaferro is willing to be a shareholder activist.

## Key Weaknesses

- Although the team is one of the largest Australian-equity teams, it has been unstable for a number of years.
- The current team has only been working together since January 2010.
- Understanding industry dynamics isn't as strong as peers.

## Risks

- Further instability in the team. Specifically, the loss of key individuals such as Mr. Tagliaferro or Mr. Giddy.
- The manager does take significant positions in small-cap stocks which can be difficult to trade when markets are risk averse.

<b>APIR code</b>	IML0004AU	<b>Performance Fees (%)</b>	na
<b>Fund status</b>	Open	<b>Investment Manager</b>	Investors Mutual Limited
<b>Inception date</b>	May 1, 2002	<b>Redemption policy</b>	Daily
<b>Responsible Entity</b>	Investors Mutual Limited	<b>Distribution frequency</b>	Half yearly
<b>Peer group</b>	Australian Equities - Large Cap Sector Specific	<b>High water mark</b>	-
<b>Benchmark</b>	S&P/ASX 300 Industrial Accumulation Inde	<b>Hurdle rate</b>	-
<b>Investment style</b>	Sector-specific	<b>Return objective (%)</b>	Outperform the benchmark, on a net of fees basis, over rolling 4 year periods
<b>Multi manager</b>	No	<b>Tracking error objective (%)</b>	Below 6% per year
<b>Fund Size (\$A)</b>	319.12 .mil (at Feb. 28, 2010)	<b>Average portfolio turnover (3yrs) (%)</b>	25
<b>Minimum investment (\$A)</b>	500000	<b>Maximum cash holding (%)</b>	20
<b>ICR / MER (%)</b>	0.97	<b>Typical number of stocks</b>	50
		<b>Release authorised by</b>	Leanne Milton

## Investment Objectives and Fees

The fund aims to outperform the S&P/ASX 300 Industrial Acc. Index, on a net-of-fees basis, over rolling four-year periods. The manager aims to contain tracking error below 6% per year. The fund has a total-return approach, investing in Australian industrial shares for long-term capital growth and dividend income. Although the manager applies a minimum market capitalisation of A\$300 million to its stock-selection process, there have been a number of instances when this rule has been breached.

The fund is managed on a relatively benchmark-unaware basis, with absolute limits, rather than benchmark relative limits, placed on stock positions. This approach gives the manager more flexibility to implement its best stock ideas. The portfolio is diversified and typically holds around 50 stocks. Hard sector limits of +15% from the benchmark are applied to ensure diversification is maintained.

The fund allows a cash holding of up to 20%, to minimise the impact of falling equity markets on returns.

The ICR for the fund is 0.974% per year which is slightly above the median ICR for the Australian large-cap sector, which is 0.92%. There is no performance fee on the fund. The bid/offer spread on the fund is 0.25%/0.25%, this cost represents the investor's share of the transaction costs, incurred when the fund is purchasing or selling assets. This cost is built into the unit price.

Distributions reflect the investor's share of any distributable income and taxable capital gains and losses, and are generally paid half-yearly at June 30 and Dec. 31.

The recommended investment time horizon is five years plus.

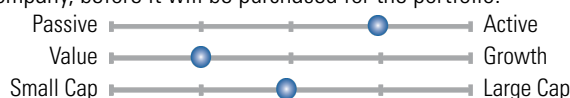
## Investment Philosophy and Style

IML's investment philosophy is based on a belief that a company's share price will reflect its underlying value in the long term. Given that markets are not fully efficient, there will be times that a company's share price will not reflect what it believes to be the company's true underlying value.

Employing an active, "bottom-up" fundamental approach, the manager directs its research effort toward identifying companies that meet its investment criteria. The criteria focuses on quality companies, which the manager determines to be those that have a competitive advantage, reliable and predictable earnings, capable management, and the ability to grow over time.

Understanding how a company deploys its earnings is a good indication of how its future earnings are likely to grow.

From a valuation perspective, companies must be trading at a price below what IML believes represents the long-term underlying value of the company, before it will be purchased for the portfolio.



## Investment Team

### Structure

Under the leadership of IML's founder and investment director, Anton Tagliaferro, the Australian-equity team consists of 10 Sydney-based investment professionals and a dedicated dealer. Mr. Tagliaferro is also the lead portfolio manager for the IML funds.

The team recently underwent a restructure after the announcement by Treasury Group in January 2010 that one of its boutique incubatees, Cannae Capital Partners (Cannae) is ceasing business, and that four of its staff would join IML.

Cannae's managing director, Mr. Giddy, joined the team as head of research, a role created to take responsibility for the management and oversight of the research process. Mr. Giddy has also been tasked with mentoring the less experienced members of the team.

Stock coverage is allocated to each analyst on an industry basis and extends to the full market capitalisation spectrum. Previously, IML analysts operated in distinct large- and small-cap teams.

Three of the senior equity analysts also have portfolio-management responsibilities.

At the previous S&P review, and again in 2009, S&P has noted its concerns regarding the significant level of instability in the team. Staff retention has been an ongoing problem for the team, with turnover of around 27% per year from 2007 to 2009. Over the past 18 months, equity analysts Peter Moller, Tony Waters, Chris Prunty, Mark Wade, quantitative analyst Vessela Tasker, and most recently senior equity analyst, Hugh Dive, have departed from the team. S&P would like to see some stability transpire before it has a higher level of conviction in the team.

The IML team is one of the larger Australian-equity teams rated as part of the S&P Australian-equities review. The manager believes it is currently fully resourced.

### Key Investment Personnel

Name, Position	Years*	Experienced†
Anton Tagliaferro, investment director, lead portfolio manager	11	25
Hugh Giddy, head of research, senior portfolio manager	0	19
Simon Conn, senior portfolio manager-small caps	11	14
Jason Teh, portfolio manager, senior equity analyst	9	10
Don Facchino, senior equity analyst	3	16
Daniel Mueller, senior equity analyst	0	4
Julian Beaumont, equity analyst	1	6
Daniel Moore, equity analyst	0	4
Michael O'Neill, equity analyst	0	2
Rob Bishop, equity analyst	1	5
Average tenure with current firm	3.6	-
Average industry experience		10.7

\*Years with current firm. †Years of relevant industry experience.

### Portfolio Managers

The Australian-equity team is headed by Mr. Tagliaferro, who has been with the boutique since its founding in May 1998. He brings 25 years' experience to the group, having held a number of Australian-equity portfolio-management tenures prior to joining IML. Mr. Tagliaferro has led the investment decision-making process since the fund started and is continuing to do so.

Other portfolio managers include Simon Conn, Jason Teh, and Mr. Giddy. Both Mr. Conn and Mr. Teh took up their first portfolio-management roles at IML, with a solid amount of experience and training gained as analysts with the group, under the tutelage of Mr. Tagliaferro. Prior to joining IML in June 1998, Mr. Conn held the position of investment officer at QBE Insurance Ltd. from May 1995. Mr. Teh joined IML in December 2000, from Advance Funds Management, a boutique multi-manager and the asset-management arm of St. George Bank. He brings 10 years' experience to the group. Mr. Giddy is the most recent senior portfolio-management hire, bringing 19 years' investment experience. His investment experience includes the position of portfolio manager at Perennial Value Management Ltd. and Platinum Asset Management. Prior to this Mr. Giddy spent two years in academia.

Mr. Giddy will play a key part in the IML investment-management process, engaging with analysts in the team and driving stock conviction

in their recommendations. He brings a valuation approach that focuses very much on company cash flows and returns on capital employed, rather than earnings, which S&P believes may bring further depth to the existing process. The team appears open to looking at valuation from a number of metrics.

#### Research Team

Company research is conducted by nine analysts, including those individuals with portfolio-management responsibilities. On average, analysts are responsible for around three industries each, depending on the number of securities in each industry and the complexities of each. The high level of team turnover over the past few years has meant a meaningful amount of change has been made to the analysts' coverage. All analysts have secondary research-coverage responsibilities, which apart from providing peer review, gives some research continuity should an analyst decide to leave.

Although some fund managers operate with a modest level of rotation as part of a planned development process, S&P does not believe staff turnover and short-term coverage measures are conducive to the delivery of valuable investment insights, and would therefore hope to see this settle down in the future.

Following the announcement regarding the Cannae business, IML gained three additional analysts in January 2010. Although Daniel Mueller, Daniel Moore, and Michael O'Neill all hold solid professional qualifications, they come to the group with a modest level of experience. The investment philosophy at Cannae was style neutral, focusing on companies that exhibit strong cash-generating ability. S&P acknowledges there will be a greater focus on valuation at IML, but believes the new team members are keen to make the team successful and are willing to adapt.

Other new additions include equity analysts Julian Beaumont and Rob Bishop, both joining the group in mid-2008. Mr. Beaumont joined from financial services group, Montpelier Group, and brings six years' relevant experience. With a similar level of experience, Mr. Bishop joined from Southern Cross Equities, where he was a sell-side analyst covering the resources sector. S&P believes his resources background will be a good complement to the skills in the team.

Andrew Harrison and Paul Winter joined the group as quantitative analysts, in July 2008 and August 2008, respectively. Mr. Harrison left IML in February 2010.

The team has an average of 10.7 years' relevant experience, and an average tenure with the group of 3.6 years. These analyst statistics include senior equity analyst Don Facchino, who returned to IML at the end of March 2010, following a six-month sabbatical.

#### Alignment and Accountability

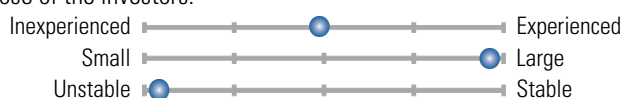
The remuneration structure is made up of three components, a market competitive base salary, a short-term incentive plan, and a revised equity plan that takes effect on March 31, 2010.

The short-term incentive plan, or "target incentive plan" is set on July 1 each year, and is conditional on individual key performance indicators (KPIs) being met. The KPIs include the performance of the analyst's model portfolio and the quality of their investment research. Each of these KPIs has a weighting of between 25% and 75% of the overall incentive plan. The total short-term incentive can lead to an annual bonus of up to 50% of base salary. The equity analysts' model portfolios are paper portfolios, constructed with stocks from within their industry coverage. The performance of the paper portfolio is measured against an equal weighted benchmark of stocks within the representative industry's investment-grade universe. Senior portfolio managers are measured on the performance of the portfolios for which they have investment discretion.

Following the union of the IML and Cannae businesses, IML Investment Partners was formed to enable the team to take a meaningful share in the future of the investment business. From March 31, 2010, the investment team will own 60% of the equity in the business, of which Mr. Tagliaferro owns 33%, and the remaining 67% is allocated among investment staff. Existing shareholdings in IML will remain, and dividends will continue to be paid. Mr. Tagliaferro holds 43% of the IML shares, with staff holding 10% and Treasury Group holding 47%.

Staff will fund their share allocation through a non-recourse loan provided by IML. If staff members leave IML, their shareholding is automatically bought back at cost. If a shareholder leaves IML after five years' service they receive a three-year trailing dividend.

S&P believes the change in equity ownership structure to be a significant improvement from previously, giving staff a greater share in the success of the group. A remuneration structure that incorporates an equity share plan better aligns the interests of the fund manager with those of the investors.



## Investment Process

#### Overview

IML is a fundamental active manager with an emphasis on stocks that are able to deliver predictable and recurring earnings, and have the ability to grow over time. The investment process is broken into a number of logical steps, which includes a five-stage valuation process. The portfolio-management stage combines the stock's expected upside and analyst's confidence ranking, to determine the stock's appropriate weighting in the portfolio.

#### Research Process

The stock-selection process consists of four steps which are clearly defined and well structured. The manager's investment process remains unchanged since our last S&P review.

##### 1. Determine the Investment Grade Universe

The manager filters the listed Australian-stock universe by excluding stocks that by definition would not qualify as suitable holdings in the portfolio. A quantitative filter run through FactSet screens out: stocks with a market capitalisation of below A\$300 million, ex-S&P/ASX 100 index stocks that have reported negative earnings over the past two years, stocks that have net interest cover of less than two times, or those that are domiciled overseas. This process results in an investment-grade universe of around 330 stocks. The investment-grade universe filter is run on a quarterly basis.

##### 2. Review Process

The investment-grade universe is reviewed each week at the team meeting. Any stocks that were rejected in the filtering process will be reviewed by the team to ensure they are not excluding any stocks they could be classified as exceptions to the initial screening process. These exceptions may include small-capitalisation stocks that the manager believes are currently undervalued and has confidence that they will be revalued by the market in the near term.

Within each sector, stocks will be ranked by price-to-earnings. Research priorities will be discussed based on the output from this report. The team also reviews historic price-to-earnings, dividend yield and other earnings/valuation metrics. Each of the nine analysts will be reviewing around five to 10 stocks at a time, to ensure the most appealing investment opportunities are investigated promptly.

Although team members discuss stocks on a regular basis, the weekly meeting is the main forum for discussions between the analysts and

portfolio managers. Most stock discussions are initiated as a result of sudden stock price falls or changes to company fundamentals.

Stocks are also categorised as "value", "growth", "cyclical", "financial", or "listed property trusts", which helps the manager generate and test ideas from an earnings profile perspective. Stock ideas may also come about following discussions with members of the broking community, competitors and suppliers to a covered company, and other industry participants.

### 3. Stock Assessment and Valuation

The stock assessment stage begins with the preparation of segmented analysis on each of the company's business units. For each segment, the analyst will assemble financial reporting data covering the past five years, so it can look for trends in items such as; sales, earnings margin, cash flows, and dividends paid. This exercise provides the analysts with an overview of some of the operational efficiency metrics, which will be discussed in more detail when they meet with management. To understand how the company will grow the business and increase shareholder value, discussions with management will also focus on business strategy. To confirm its views or verify company statements, IML will also engage with a covered company's suppliers. S&P believes that a manager's confidence in the valuation process is improved when a company has sustainability of earnings.

Subjective stock-risk ratings are determined by the analyst, and require consideration of factors such as; the macroeconomic outlook, characteristics of the industry, the company's earnings profile and capital structure, the quality of management and environmental, social, and governance factors. The risk rating helps the analyst determine an appropriate discount rate for the valuation process. S&P considers the manager's stock-specific risk assessment lighter than its stronger peers.

IML uses a two-stage discounted earnings model to forecast the company's earnings profile. An assessment of the company's earnings reinvestment policy and the stock's implied rate of growth, supplements the valuation process. Analysts will also use a number of relative value metrics. These metrics are both earnings and valuation based, making it easier for the team to make peer relative assessments.

The analyst prepares a stock valuation report which includes an overview of the corporate structure, the earnings profile of each business segment, a SWOT analysis, a risk rating and stock valuation, and a notes section covering recent earnings announcements and company meetings.

The analyst will establish a target price for the stock which gives the portfolio manager some guidance on the stock's expected return potential.

### 4. Confidence Rank

The confidence rank acts as a risk-management overlay and is independent of the valuation. The analyst will rank each stock from 1 (very high) to 5 (very low) based on the level of confidence they have that the company is able to sustain current earnings and grow them in the medium to long term. Confidence ranks are also determined relative to their peers.

### ► Portfolio Construction

The portfolio will be constructed with consideration given to the stock's expected upside, the analyst's confidence ranking, and the portfolio-construction guidelines. IML will typically hold around 50 stocks in the portfolio. The portfolio manager will establish the appropriate weight for the stock using a systematic approach, after categorising stocks based on their expected performance. These categories are; tier 1 (+15%), tier 2 (+10%), tier 3 (5%+), and tier 4 (<5%). To ensure adequate diversification, stock, sector, and market capitalisation limits help shape the portfolio-construction process. The stock limits are absolute, and limit the amount of stock that can be purchased for the portfolio.

Stocks that represent more than 3% of the S&P/ASX 300 Index will be limited to twice their index weight in the portfolio. For the largest 50 listed stocks, an absolute limit of 6% applies, the next 50 stocks are limited to 4%, and ex-S&P/ASX 100 index constituents are limited to 2% of the portfolio. S&P believes that this approach gives the manager the flexibility to take meaningful positions. However, stock weights are able to drift from these soft bounds by another 50%, giving the manager some room to allow their stronger conviction holdings to rally. Given that the manager reviews the valuation when a stock approaches its target price, S&P is less concerned that allowing a stock's weight to drift is loosening the investment process.

Relative sector limits are set at the index weight plus 10%. As with stock limits, sector limits are able to drift another 50%, to the index weight plus 15%. Sector limits this wide are not uncommon for less benchmark-aware managers.

To determine whether the target price should remain unchanged, the analysts will reassess the company valuation as the share price moves closer to its target price. If the target price remains unchanged, then the share price now reflects intrinsic value, and the stock will be sold. A stock may also be sold if IML believes the company fundamentals have changed and it is unlikely the share price will appreciate.

As a stock approaches its target valuation, IML may sometimes sell call options against the stock rather than selling the physical holding. This course of action can be used to manage realised capital gains, or allow an expected dividend to be paid on an incumbent stock. These covered calls are used fairly infrequently by the manager, with the fund currently having exposure of around 0.5% to these derivatives. When option premiums are high they provide a source of income, but will typically account for less than 5% of the total income distributed by the fund.

The fund can hold up to 20% in cash, with the actual level being dependent on the manager's ability to identify undervalued stocks. Currently, it is around 7% of the portfolio.

### ► Risk Management

The risk-management framework is centred around the portfolio-construction process, where stock and sector limits are applied to ensure adequate diversification. Portfolio constraints on absolute stock weights, range from twice index weight for the largest listed stocks, down to 2% for ex-S&P/ASX 100 index constituents. "Soft" relative sector weights of the index plus 10% also apply. Drift limits that allow both stock and sector allocations to increase a further 50% beyond the soft limits, have been put in place to allow high conviction positions to rally. Given the manager's adherence to a target-valuation sell discipline, S&P is not overly concerned with this approach.

A stock-specific risk assessment is incorporated in the analyst's view of the sustainability and predictability of earnings, and in the determination of the discount rate used in the valuation.

IML uses Northfield to measure risk exposures, including tracking error and each stock's marginal contribution to risk. Tracking error is maintained below 6% per year, which the manager has been able to achieve over the past 18 months of volatile markets.

As a general rule, stocks below A\$300 million market capitalisation are screened out of the investable universe. Having said that, the manager does take positions in companies with a market capitalisation of below A\$300 million. These positions can be significant at 5% to 15% of the company's invested capital. The manager maintains a register of these holdings and they are monitored on a daily basis.

Over the past 12 months the portfolio turnover was 25%, which compared to many other Australian-equity strategies is relatively low. Stock positions are on average held for between three and five years.

Call options may be sold to manage realised capital gains and to access expected dividends from holding the physicals. Derivatives are also permitted for short-term cash-management purposes, reducing the effect of cash drag on the portfolio.

IML's investment-management system is used by the portfolio managers to request trades following approval by either Mr. Tagliaferro or Mr. Giddy. Daily reports are generated by the system, which highlights any inconsistencies between like portfolios. The investment-management system includes a compliance module which is monitored each day ensuring there have been no mandate breaches.

The legal, compliance, and risk-management function is outsourced to Treasury Group Investment Services Ltd. (TIS), a fully owned subsidiary of Treasury Group Ltd. The TIS risk-management team reports to Conor Byrne, the IML compliance officer, the board, and compliance committee.

RBC Dexia Investor Services Australia Pty Ltd. performs all valuations and back-office functions, which includes performance attribution, unit pricing, and distributions. All these functions are audited on an annual basis by Deloitte.

### Risk Constraints

Typical number of stocks	50
Active stock limits (%)	Absolute limits based on market capitalisation
Active sector limits (%)	Benchmark + 10% (plus 50% drift)
Maximum cash holding (%)	20%
Targeted tracking error (%)	Below 6% per year
Active country limits (%)	-

### Performance

The fund was launched in May 2002, to provide investors with a portfolio of industrial shares. The S&P/ASX 300 Industrial Acc. Index includes stocks listed on the S&P/ASX 300 Acc. Index, but excludes those in the energy sector, and metals and mining companies within the materials sector.

The fund's investment objective is to outperform the S&P/ASX 300 Industrial Acc. Index, on a net-of-fees basis, over rolling four-year periods.

At Oct. 31, 2009, the fund produced an annual return of 15.6%, on a net-of-fees basis, compared to the benchmark return of 18.4%, underperforming by 2.8%. The fund's underweight to financials (ex REITs) was the largest detractor of performance for the period. From a stock-selection perspective, overweight positions in Amcor Ltd. and Crown Ltd. were positive for performance, while underweight holdings in ANZ Banking Group Ltd., Wesfarmers Ltd., and Macquarie Bank Ltd. hurt performance. Poor stock-selection decisions with regard to Qantas Airways Ltd., Viridis Clean Energy Group, Suncorp-Metway Ltd., and Westfield Group, also added to the performance problems during the year.

Over the five years to Oct. 31, 2009, the fund produced an annualised net-of-fees return of 5.3%, compared to the benchmark return of 5.9%, underperforming by 0.6% per year.

Since inception to Dec. 31, 2009, performance was stronger, producing an annualised return of 9.4% compared to the benchmark return of 6.8%, outperforming by 2.6% per year on a gross of fees basis.

Although the fund will experience periods of underperformance as a result of its value style and conservative stock-selection process, the manager has been able to outperform over the longer term. Short-term performance is generally strongest over periods where the market has fallen.

### Portfolio Review

IML's bottom-up investment process initially applies a combination of quality and somewhat flexible liquidity filters to the entire S&P/ASX 300 Industrial universe every quarter. The portfolio of stocks is a mixture of large- and small-cap holdings. The portfolio will typically exhibit a skew towards the consumer sectors and industrials, and away from financially engineered sectors like listed property and infrastructure, while excluding the energy sector.

The manager is a long-term investor in companies and will typically hold key positions for a number of years, assuming the investment thesis holds. On an absolute basis, the key portfolio holdings of over 2.5% (for the year to Oct. 31, 2009) were Amcor Ltd., CBA, Crown Ltd., Fosters Group, IAG, NAB, Sky City Entertainment Group, Transurban Group, Telstra, Westpac, and Woolworths. These 11 holdings represent around 60% of the portfolio. The smaller holdings range from 0.3% to 2.5%, and improve the portfolio's diversification. Nine positions in the portfolio were significant holdings, these being between 5% and 15% of the company's invested capital. The fund held 7% in cash.

At Oct. 31, 2009, the manager held a significant underweight position in large- and mid-cap stocks, which was partly offset by a small overweight position in ex-300 stocks. The manager held approximately 8% of the portfolio in ex-benchmark stocks.

#### Top Five Contributors and Detractors (at Oct. 31, 2009)

Contributors	Sector	1 Year*
Crown	Consumer Discretionary	1.26
Amcor	Materials	1.02
Westfield Group	Financials	0.83
Amalgamated Holdings	Consumer Discretionary	0.76
Ridley Corporation	Consumer Staple	0.52

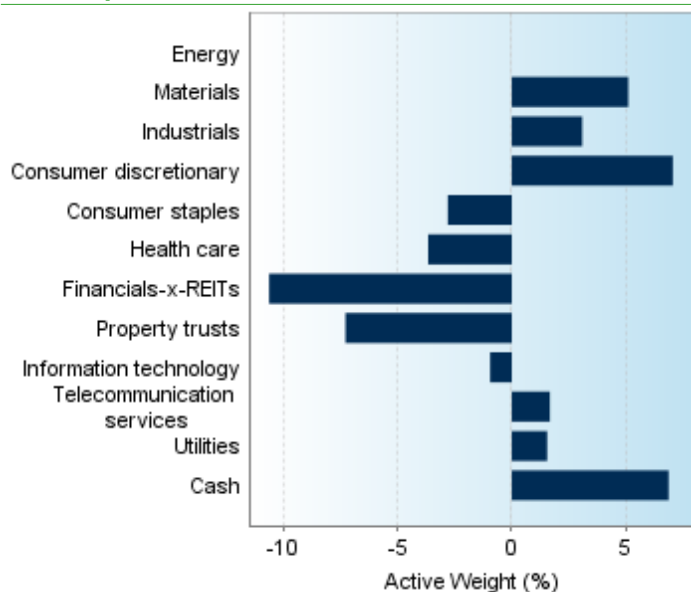
Contributors	Sector	3 Years*
Brambles	Industrials	0.32
Incitec Pivot	Materials	0.32
CBA	Financials	0.31
Westfield Group	Financials	0.25
Amcor	Materials	0.24

Detractors	Sector	1 Year*
ANZ Group	Financials	-3.1
Qantas Airways	Industrials	-0.55
Suncorp-Metway	Financials	-0.34
ConnectEast Group	Industrials	-0.33
Hastings Diversified Utilities Fund	Utilities	-0.25

Detractors	Sector	3 Years*
ANZ Banking Group	Financials	-0.75
Tabcorp Holdings	Consumer Discretionary	-0.50
CSL	Healthcare	-0.29
Qantas Airways	Industrials	-0.27
IAG	Financials	-0.24

\*Value Add (% p.a.). Source: Investors Mutual Limited.

**Sector Exposure Versus Fund Benchmark (at Oct. 31, 2009)**



Source: Investors Mutual Limited.

**Management Group Profile**

IML was established by Anton Tagliaferro in May 1998. An Australian-equities specialist, IML has grown steadily from A\$3 billion at our last review in May 2009, to A\$3.4 billion at Dec. 31, 2009.

In June 1998, IML launched two wholesale funds; the Australian Share Fund and Australian Smaller Companies Fund. Several years later, in May 2002, IML introduced two further wholesale funds; the Industrial Share Fund and Future Leaders Fund. The Smaller Companies Fund and the Future Leaders Fund closed to new investors in 2005, due to capacity constraints.

In December 1999, IML formed an alliance with Bendigo Bank subsidiary, Sandhurst Trustees Ltd. The retail Sandhurst Industrial Share Fund and Sandhurst Future Leaders Fund, offered to investors by Sandhurst Trustees, is managed exclusively by IML under a long-term investment-management agreement.

Since 2001, IML has been supported by listed boutique incubator, Treasury Group Ltd.

In November 2004, IML launched a diversified equity fund, with an international component managed by Global Value Investors (GVI). GVI is a special international-equities manager, which was established in 2004 by its key investment staff, Treasury Group, and IML.

In February 2007, the new IML Small Cap Fund was launched. The manager also reopened the IML Future Leaders Fund once the mandate was broadened to include ex-S&P/ASX 50 stocks.

In January 2010, Cannae Capital Partners, a boutique fund manager within the Treasury Group suite, ceased conducting business and was absorbed by IML. The Cannae business will take on a sub-advisory role in the management of the IML funds and will earn a management fee. As a result of this commercial arrangement, the Cannae business has changed its name to IML Investment Partners, to enable the investment team to own 60% of the underlying investment business, giving key staff a meaningful share in the success of the business. Of the 60% staff ownership, Mr. Tagliaferro holds 33%, with 67% being divided among other investment staff. Treasury Group represents the remaining 40% of the business, a typical allocation taken by the boutique incubator.

David Cooper has been appointed chief executive officer of IML, and remains an executive director of Treasury Group.

**Funds Under Management**

At Dec. 31, 2009, IML was managing Australian equity assets of around A\$3.4 billion, of which the Australian industrial shares strategy represents A\$346 million. Over the past 12 months the strategy has experienced outflows of A\$216.2 million.

Although the manager does not estimate a capacity limit for this strategy, it does measure its trading performance to ensure liquidity and trading costs are not eroding returns for investors. The manager has undertaken an analysis of the liquidity of the fund, and concludes that a cash flow of approximately A\$50 million, can be 97% invested, over a period of five days. The manager's longer-term holding period means there is relatively less pressure to trade quickly and suffer market impact costs.

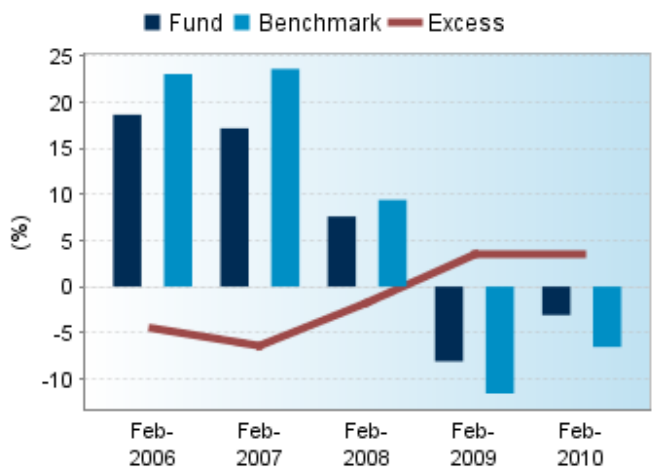
**Funds Under Management Table (at Dec. 31, 2009)**

Current pool size (\$)	346 million
Total FUM in strategy (\$)	3.4 billion
Estimated capacity for strategy (\$)	Not measured
Total FUM across all asset classes (\$)	3.4 billion
Net strategy flows over past 12 months (\$)	-35.9 million

Source: Investors Mutual Limited.

**Performance Analysis**

**3yr Rolling Returns, Over 5 Years**



Source: Investors Mutual Limited.  
 Benchmark: S&P/ASX 300 Industrial Accumulation Inde.

**Annualised Net Returns % (at Feb. 28, 2010)**

	1 Year	3 Years	5 Years	7 Years
Fund performance (% p.a.)	38.49	-3.09	3.86	8.72
Income (% p.a.)	7.45	6.11	6.37	-
Growth (% p.a.)	31.04	-9.2	-2.51	-
Benchmark performance (% p.a.)	48.25	-6.55	4.2	-
Excess return (% p.a.)	-9.76	3.46	-0.34	-

Benchmark: S&P/ASX 300 Industrial Accumulation Inde.

## Fund Rating Philosophy

A star rating is a forward looking assessment of a manager's ability to consistently generate risk-adjusted returns (net of fees) in excess of both its relevant investment objectives and its peers.

## Fund Rating Process

In assigning a star rating to a fund, Standard & Poor's evaluates: the size, skill, and stability of the manager's investment team; the clarity, implementation, and risk management of the investment process; the fund's objectives, fee structure and portfolio characteristics; and the manager's business management.

## Fund Rating Definitions

**S&P FUND RATING**  
★★★★★ Standard & Poor's has very high conviction that the manager will consistently generate risk-adjusted fund returns in excess of its relevant investment objectives and relative to its peers.

**S&P FUND RATING**  
★★★★☆ Standard & Poor's has high conviction that the manager will consistently generate risk-adjusted fund returns in excess of its relevant investment objectives and relative to its peers.

**S&P FUND RATING**  
★★★☆☆ Standard & Poor's has conviction that the manager will generate risk-adjusted fund returns in-line with its relevant investment objectives and relative to its peers.

**S&P FUND RATING**  
★★☆☆☆ Standard & Poor's has conviction that the manager will not generate risk-adjusted fund returns in-line with its relevant investment objectives and relative to its peers.

**S&P FUND RATING**  
★☆☆☆☆ Standard & Poor's has high conviction that the manager will not generate risk-adjusted fund returns in-line with its relevant investment objectives and relative to its peers.

**S&P FUND RATING**  
**ON HOLD** Issues that may affect the fund's management have emerged; and the fund rating is temporarily suspended, pending clarification.

**S&P FUND RATING**  
**SELL** Significant issues exist that potentially will adversely affect the fund's performance. Investors should consider obtaining advice on switching or redeeming funds.

**NEW** **Fund Rating Subscript**—here the investment process, fund manager, or the fund has a relatively short history, or the analytical team has changed significantly, but a relevant and demonstrable track record is shown on similar funds.

## Glossary of Terms

<b>Benchmark</b>	The standard (e.g. an index) by which an investment is measured against to evaluate performance.
<b>Excess Return</b>	Return of an investment relative to its benchmark.
<b>FUM</b>	Funds Under Management - The total value of the funds managed by an asset management firm.
<b>High Water Mark</b>	The highest net asset value (NAV) of a fund achieved to date. If the NAV of a fund falls below this level, no performance fee will be payable to the investment manager until this level is subsequently exceeded.
<b>Hurdle Rate</b>	A minimum rate of return that a fund should achieve before a performance fee can be charged.
<b>Performance Fees</b>	A fee payable above the ICR that rewards the fund's investment manager for performance in excess of the hurdle rate.
<b>ICR-Indirect Cost Ratio</b>	This is the ratio of indirect costs to the total investment in a particular fund expressed as a percentage. It includes the MER, expense recoveries, and other costs associated with running the fund.
<b>Information Ratio</b>	Is a measure of the relative reward for the relative risk taken (excess returns of an investment (above the benchmark) divided by the tracking error). A positive information ratio would indicate efficient use of risk by the manager.
<b>MER-Management Expense Ratio</b>	This ratio is a calculation of investment management, marketing, trusteeship, legal, accounting and auditing costs of a managed investment fund expressed as a percentage of a fund's net asset value. It is the ongoing charges for managing a fund.
<b>Peer Group Return</b>	The average return of the funds in the relevant S&P peer group.
<b>Sharpe Ratio</b>	Is a measure of risk-adjusted performance, measuring the absolute reward for the absolute risk taken (return of the investment less the risk-free rate (e.g. bank bills) divided by the standard deviation). The higher the Sharpe ratio the greater the efficiency produced by the manager.
<b>Standard Deviation</b>	Measure of the variability or volatility of the monthly returns of the fund.
<b>Tracking Error</b>	How closely a portfolio follows or "tracks" an index to which it is benchmarked. (the standard deviation of monthly excess returns against the benchmark).
<b>Ex Ante Trading Error</b>	Predicted or forecast of tracking error.
<b>Ex Post Trading Error</b>	Historical or actual tracking error.

Disclaimer: Standard & Poor's Information Services (Australia) Pty Ltd (ABN 17 096 167 556) (Standard & Poor's) rating and other opinions are and must be construed solely as statements of opinion and not statements of fact or recommendations to purchase, sell or hold any financial product(s). Conclusions, ratings and opinions are reasonably held at the time of completion but subject to change without notice. Standard & Poor's assumes no obligation to update any information following publication. No warranty, express or implied, is given or made by Standard & Poor's as to the accuracy, timeliness, completeness, merchantability or fitness for any particular purpose of any Standard & Poor's rating, opinion or other information and Standard & Poor's will not be liable to any party in contract or tort (including for negligence) or otherwise for any loss or damage arising as a result of any party relying on any such rating, opinion or other information (except in so far as statutory liability cannot be excluded). Any statement of fact is based on information provided to Standard & Poor's by our clients or obtained from sources which Standard & Poor's considers reliable. Standard & Poor's does not perform an audit in connection with any rating and may rely on unaudited information. Because of the possibility of human or mechanical error by our sources, Standard & Poor's or others, Standard & Poor's does not guarantee the accuracy, adequacy, or completeness of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. Readers should make their own inquiries.

Warning: Past performance is not a reliable indicator of future performance. Any express or implied Standard & Poor's rating or advice is limited to "General Advice" and based solely on consideration of the investment merits of the financial product(s) alone. The information has not been prepared for use by retail investors and has been prepared without taking account of any particular person's financial or investment objectives, financial situation or needs. Before acting on any advice, any person using the advice should consider its appropriateness having regard to their own or their clients' objectives, financial situation and needs. You should obtain a Product Disclosure Statement relating to the product and consider the statement before making any decision or recommendation about whether to acquire the product. Each rating or other opinion must be weighed solely as one factor in any investment decision made by or on behalf of any adviser and any such adviser must accordingly make their own assessment taking into account an individual's particular circumstances.

Disclosure: Analyst Disclosure: Analyst(s) remuneration is not linked to the rating outcome. The Analyst(s) may hold the financial product(s) referred to in a Standard & Poor's rating or other research report but Standard & Poor's considers such holdings not to be sufficiently material to compromise the rating or opinion. Analyst(s) holdings may change at any time. Standard & Poor's Disclosure: In the event of any person subscribing to any rated financial product(s), such subscriptions may result in a Standard & Poor's client receiving a commission, fee or other benefit or advantage. Details of any such benefits can be obtained from your financial adviser. Standard & Poor's itself does not receive any commission. Prior to the assignment of any rating, the fund manager or another Standard & Poor's client agreed to pay Standard & Poor's a fee for the appraisal and rating service rendered. Standard & Poor's assigns ratings using comprehensive and objective criteria. Standard & Poor's fee is not linked to the rating outcome. Costs incurred during the rating process, including travel and accommodation expenses, may be paid for by the fund manager or another Standard & Poor's client to enable onsite reviews. Standard & Poor's does not hold or have a material interest in any rated financial product(s). Standard & Poor's associates may hold rated financial product(s) but detail of these holdings are not known to the Analyst(s).

Standard & Poor's from time-to-time provides fund managers and other clients with investment data, research software, and other financial planning services. Standard & Poor's is a wholly owned member of The McGraw-Hill Companies, Inc, a New York Corporation. The analytic services and products provided by Standard & Poor's and its associates are the result of separate activities in order to preserve the independence and objectivity of each analytic process. Each analytic product or service is based on information received by the analytic group responsible for such product or service. Standard & Poor's and its associates have established policies and procedures to maintain the confidentiality of non-public information received during each analytic process. Standard & Poor's holds an Australian Financial Services Licence Number 258896. Please refer to Standard & Poor's Financial Services Guide for more information at [www.fundsinsights.com.au](http://www.fundsinsights.com.au). "S&P" and "Standard & Poor's" are trademarks of The McGraw-Hill Companies, Inc. Copyright 2010 Standard & Poor's Information Services (Australia) Pty Limited. Certain funds data contained herein may be proprietary to Morningstar Inc.