Investment Market Update

Issue 51 – Summer 2013

Message from the Manager

It's been a very big year for CIPL. We now offer personal financial services across three states, and business and economic consulting services globally. It's not a bad effort for a business originally established in Regional Queensland.

The coming year is likely to be a tough one for the Australian economy – in fact we will be lucky to avoid a recession. The GST take is likely to fall significantly putting the states under significant pressure. Against this the share market is likely to benefit from low interest rates, and low debt levels amongst most companies, and a falling Australian dollar. Opportunities will present in the form of Government asset sales, and other company floats on the ASX.

As 2014 progresses, we will continue to provide excellent financial and investment advice, and we will begin to take further advantage of the new network we have within ILH Group Limited. This includes the planned placement of a lawyer in the Rockhampton office from early 2014, and also the benefits of integration of the various skills of the Rockhampton and Melbourne offices.

Our comfortable new offices are now open at 103 Bolsover Street, and thankfully offer car parking and the convenience of a ground floor location. We look forward to seeing you soon.

David French
Managing Director
Senior Investment Advisor

A 'Grand' Opening

Have you driven past the new building that is now CIPL's new Rockhampton home? Perhaps unusual for a regional city, the building was designed by Sydney Based Architects, Wood + Day partnership. In recognition of The Grand Hotel which previously stood on the site, the architects' charter was to build a "modern Queenslander".

The history of the development is quite long and involved. Soon after CIPL was sold out of The Rock Building Society, we embarked on a project to launch a managed fund. This was a bit different for us, because we have only ever included managed funds in client portfolios in limited circumstances. There were sound reasons for this seeming inconsistency. One was to give smaller investors the ability to get access to good quality assets at a reasonable price, managed by people they know. Another was to enable all clients to obtain access to assets that they might not otherwise be able to invest in – things like commercial property, infrastructure and corporate and Government bonds – all of which come in big licks.

Anyhow, around the time of embarking on the development of the fund, the Grand Hotel became available. It was just across the road from our then premises, and being in such an excellent position, seemed a sensible site for a commercial office. About $1 million was raised from a small group of investors and that provided the seed capital for the fund and the wherewithal to purchase The Grand. Well that was a bit of a journey in itself. Owning an operating pub was not all

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beer and skittles. One (very proper) new CIPL director was dismayed when he was accosted by one of the locals – much to the mirth of the other directors. I helped out with band nights, and on one particular rough night took over the bar and till while Lavinia swept the riff-raff out the door.

Notwithstanding the huge efforts of managers Clyde and Lavinia – which were well above and beyond the call of duty – the pub never made a profit, and it became clear that the redevelopment would have to happen sooner rather than later. The trouble was the GFC had set in, and raising more money in that environment was extremely hard. Not only that ASIC (perhaps gun-shy on account of the GFC) made us jump through extraordinary hoops to get the managed fund to a level where it could accept public subscriptions. Persevering, we got the Product Disclosure Statement away, and set about raising the additional money. We were supported by some locals and a large number of clients, and soon we were on our way to investing in a range of assets including the redeveloped Grand Hotel.

The next hurdle came in the form of the engineering report on the old Grand. We had intended to refurbish the building, and acting on earlier advice we commenced down that track. Soon, however the architects and engineers identified that this was not going to be possible. Wood + Day was commissioned to design an entirely new building. Around that time the adjacent properties of Legacy House and a small residence became available for sale, and the investment committee decided that the property would be much enhanced with this additional land.

The plans were completed and Hutchinson Builders was selected to undertake the project. Some modifications were undertaken to reduce development costs and to make the remaining land (on which the car park is situated) suitable for future development. Eventually we were ready to start construction. No sooner had this started than the rain came down – can you believe, 500mm in one night. Delays ensued, but eventually the building came out of the ground and began to take shape.

Coincident with that, CIPL was approached by Suncorp, which following extensive negotiation has become the building's anchor tenant, and namesake. CIPL also entered into a lease.

The building took about 9 months to complete. With CIPL and Suncorp now ensconced and up and running, I hope you will agree that the project was well worth the effort.

The question is what next for CDIF. We are investigating additional investment in bonds, and some interesting infrastructure opportunities.

David French
Managing Director CIPL

22 April 2013

16 May 2013

23 May 2013

4 June 2013

2 July 2013 – Slab pouring

16 July 2013

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Business Update

Financial planning

CIPL continues to grow as a subsidiary of listed company ILH Group Limited. Aside from moving into the new offices, we have been undertaking a lot of integration work with the Melbourne office (Pentad). Sharing resources has already sped up some processes, and while other measures have suffered from a bit of “indigestion”, mostly they are progressing at a pleasing pace.

CIPL’s new purpose-built offices are now open at 103 Bolsover Street in Rockhampton. We have never had nice new offices, and it is a credit to staff that they have persevered over the years in what have sometimes been sub-optimal conditions. Our staff work very hard on clients’ behalf, and it’s fitting that these comfortable offices are a reward for commitment.

The office will be closed from Friday 20 December at midday, reopening on Monday 6 January, as all staff take a well-earned break. We look forward to seeing you in the New Year.

Financial Planning

The Archer who shoots at nothing hits the target every time

2013 has been a big year in many ways. The stock market has risen by over 530 points for the year to date, which has resulted in excellent portfolio returns.

A random sample for the preceding year shows returns ranging between 14.16% and 19.06% for a balanced portfolio. These same portfolios have returned between 2.52% and 14.75% since they were established between 1 and 10 years ago. The lowest return was for a portfolio established around the peak of the market preceding the GFC and the highest was for a portfolio that was purchased just over 12 months ago.

Risk Profile	Inception Date	IRR – past year	IRR – since inception
Balanced	27/10/2003	19.06%	3.91%
Balanced	13/07/2007	15.44%	2.52%
Balanced	08/03/2012	14.16%	14.75%

The results are impressive and very welcome, particularly after having endured low returns for the years since the GFC.

In our client reviews for the past couple of years, we have focused on ensuring that super fund members have current beneficiary nominations in place, that risk profiles have been checked against the portfolio actually owned and that investment strategies have been renewed. Risk profile review is particularly important because it forms the basis for our portfolio recommendations. These important checks will be ongoing tasks for 2014.

Christmas and New Year are always times for reflection and of course the making of New Year resolutions, many of which are lucky to see out the month of January!

One of the important aspects of your original financial plan was to identify your ongoing goals and objectives. We all need to have a very clear idea about what we want to achieve each day, week, year – these are your goals. They become most powerful when they are written down and they are checked often.

In your quiet time during the upcoming holiday season, I urge you all to set yourself some new goals for the future – it doesn’t matter whether you are 21 or you are 81, having worked for and achieved a goal is a very satisfying experience, and it is just as important to set another when the first is achieved. Your goal may be as simple as taking a walk around the block each afternoon when it is cool, or it may be to take that long yearned for trip to Kazakhstan.

Exploring your goals and objectives will be a focus of my client review meetings for 2014 and beyond so that your portfolio is positioned to assist wherever possible.

We all wish you a very Merry Christmas and a Happy New Year and look forward to welcoming you to our new office at 103 Bolsover Street. This new building is something of which we at CIPL are very proud and I am sure that you as the investors will feel the same way – it is yours!

Sue Dunne
Financial Advisor

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Insurance

Do you have a financial back-up plan?

- ❖ One in five families with dependent children will be impacted by death, a serious accident or major illness that renders a parent unable to work#.
- ❖ Two thirds of families with kids at home couldn't meet their expenses beyond 12 months of the main breadwinner having passed away†.
- ❖ 95% of families do not have adequate levels of insurance#.

Where would you (or someone you care about) turn in a health crisis? How are the bills to be paid?

It's a natural instinct for parents and relatives to do whatever it takes to help out at times of need, but how would an additional financial burden impact their lifestyle aspirations? Potentially in a significant and detrimental way.

When you consider the maximum disability support pension available from Centrelink is only $670.90 per fortnight ($17,443.40 p.a.)^, an extended period out of the workforce could leave a big hole in the budget, at any age. That's if there's eligibility for any government assistance at all! Qualification is based on the extent of physical change and is means-tested.

A tailored protection strategy gives a financial back-up plan if someone is sick or injured and can't work, or if someone the family relies on dies. A tailored protection strategy can provide financial security and independence, and prevent disruption to others' lifestyle and retirement plans as well.

Many families discuss their major financial decisions with one another. Major events like getting married, buying a house, having children or changing jobs are good reasons to talk about a protection strategy. Has your family had this discussion? If not, why not?

Peace of mind might come at a very affordable price. For example, a standard risk 30 year-old male clerical worker can take out $500,000 life insurance (with Total and Permanent Disability cover), plus $4,000 a month income protection to age 65 (90 day waiting period), for around $3 a day (Source: AIA Australia, ABN 79 004 837 861, AFSL 230043).

This cover would provide some on-going financial assistance in the event of serious sickness or injury. It would also make available a lump sum on death or Total and Permanent Disability that could be used to pay off debts, medical bills or help the family meet ongoing living costs.

If you're concerned that you or someone you care about has too little protection in place – and remember that 95% of families do not have adequate levels of insurance – do something about it! Give CIPL a call and let us help design and implement a tailored protection strategy.

'The Lifewise/NATSEM Underinsurance Report' – February 2010
† 'Analysis of Insurance Needs', Rice Warner Actuaries – May 2005
^ Centrelink Disability Support Pension, maximum single rate from 20 March 2011

This information does not take into account your personal needs and financial circumstances. You should consider the appropriateness of the information having regard to your objectives, financial situation and needs.

Morgen Harris
Advisor – Insurance

Staff profile – Morgen Harris

We are pleased to confirm we now have a senior risk adviser on our team, Morgen Harris – based in our Melbourne office.

Morgen has been with Pentad for over seven years and is an experienced risk adviser in both personal and business risks.

She is well aware of how valuable having the right level of cover can be, having assisted several of her clients claim on their policies and being in the unfortunate situation of having to claim herself.

She would be pleased to assist in providing advice in the areas of life, disability and trauma protection to assist with meeting family or personal needs in the event of an unforseen health event, as well as considering the risks of a business including; business succession funding, key person and/or loan protection requirements.

Morgen Harris
Risk Protection Adviser

Who is Michael Blanchflower?

Michael Blanchflower is a staff member that many of you would not have met. Michael carries out a number of roles for CIPL but most importantly he is our General Manager and Head of Strategy based in Sydney, New South Wales. In an attempt to find out a bit more about Michael Blanchflower for you, he suggested that he really wasn't all that interesting… however he did tell me that he once met Steve Waugh at a Law Central networking (a division of ILH www.lawcentral.com.au) event where he regaled us with the truth behind David Boon's infamous beer drinking record.

Steve Waugh is the brand ambassador for Law Central. They provide online access to legal documents.

In a story that is considered part of Australian sporting folklore, and subject of an article in the weekend Australian Magazine, Boon is said to have consumed 52 cans of beer on a flight from Sydney to London in 1989. This has never been confirmed by Boon, but CIPL are now in a position to confirm via eye witness testimony from Australian of the year, Steve Waugh that this legendary achievement is indeed true.

Each Ashes team flight from Australia to London, one member of the team was nominated to drink for the record. In 1989 David Boon was without doubt the in-form player for the job. After hitting the record David was assisted from the plane as he could literally not walk. Luckily there was a 4 day recovery period before the first day of play…during which Boony was seen at least twice in the nets, but otherwise remained in his darkened hotel room.

Michael Blanchflower
Head of Strategy / General Manager

Investment Briefs

ORICA

The times are changing for companies servicing the mining sector. One only needs to look at the decimation of once market darlings (Monadelphous, NRW Holdings and more recently Forge Group) to get an idea of how the market perceives the operating environment over the medium term. However, although mining construction has been ravaged, chemicals and explosives company Orica (ORI) has held up relatively well. Its main business is in the providing of chemicals and commercial explosives to mining companies predominately in Australia but also across Africa, Latin America and Asia.

ORI has experienced a wild ride over the last six months. In mid-July, the company fell 13.5% in one day with the market expecting a torrid full year 2013 profit result. However, from that point on, the company began to rally and upon announcing its results rallied 21% in only two days as management reported numbers beating consensus forecasts. The explosives business showed resilience against a relatively soft economic backdrop, whilst the company was able to diversify its explosives product mix and at the same time become a more efficient organisation. Importantly, operating cash flow surged and management pointed to an improvement in next year's earnings from current levels.

Interestingly, ORI may continue to enjoy relatively healthy industry dynamics. Due to the high fixed cost base for mining companies, production levels may not differ dramatically despite movements in underlying commodity prices. Furthermore, ORI has developed unique explosive products that can give it a discernible edge over its competitors.

It appears the market may have misjudged ORI. Despite the recent price appreciation the company looks inexpensive from an earnings perspective, trading at around 10.5x FY14 forecasts with a very healthy forecast free cash flow yield of 5.4% and dividend yield of 4.4% before partial franking. ORI will also benefit from further declines in the $AUD due to a portion of its earnings being derived offshore. ORI has long been a star performer recording high return on equity, averaging 18.7% in the last three years alone.

The Capricorn Diversified Investment Fund (CDIF) is continually looking at quality small capitalised business' that can qualify for investment. Navitas (NVT) is a company that we will be looking at very closely. NVT is an education services provider offering University programs via pathway colleges and managed campuses across Australia, the United States, Canada, Kenya and Sri Lanka. It is operating in the fast growing educational sector and the company has a number of long dated contractual agreements with major universities such as Macquarie University in Sydney and La Trobe University in Melbourne.

At its recent Full Year 2013 results presentation, Management delivered guidance for FY14 below market expectations. This was caused by higher costs incurred from increased marketing and the development of a new student management system both of which we are comfortable with considering these activities are long term investments into the business. What is encouraging is the consistently solid growth in student enrolment numbers - a clear sign this internal business investment is paying dividends.

NVT operates in favourable industry dynamics due to the relatively consistent nature of schooling as students seek to either enter an industry for the first time or seek to retrain in other areas. NVT is forecast to grow earnings by a very healthy compound rate of around 19% for the next three years. Furthermore, it enjoys very high levels of return on equity at the current rate of 31.6% and is a cash cow, producing a current free cash flow yield of 6%.

Since the onset of the GFC, the Australian Healthcare Sector (XNJ) has outperformed the S&P/ASX 200 Index (XJO) by a considerable 94% (see the charts pack below). The outperformance can largely be attributed to CSL (CSL) but one other component of the XNJ, Ramsay Healthcare (RHC), has also pulled its weight. Owning 66 hospitals Australia wide RHC is Australia's largest listed operator of private hospitals. The Group also has ownership of private hospitals in France, the United Kingdom and Indonesia.

Ageing demographics and favourable sector demand dynamics have been key contributing factors to the exceptional success of RHC for over a decade. RHC has delivered 21% annual compound growth in earnings per share since 2005, whilst dividends have grown at a very attractive 19.5% annual compound growth rate since 2000. RHC has built up considerable scale through a very astute acquisition strategy and this is being realised in its profit results year on year.

However, RHC has many more avenues to pursue further growth in the years ahead. It has recently entered the Asian market with a joint venture alongside Sime Darby. Once again favourable industry dynamics such as an ageing and increasingly affluent population led the decision to enter this market.

Growth in RHC's European markets (UK and France) is expected to stem from further health care reform and once again, favourable demographics. Healthcare expenditure is becoming a significant component of government outlays and with the increasing debt burdens of Federal Government's this plays right into the hands of a private operator such as RHC.

Growth is by no means slowing down for the foreseeable future. Management have forecast growth in earnings per share of between 12% - 14% next year. We believe RHC is a suitable candidate as a long term holding in portfolios due to its outstanding track record. Return on equity has increased steadily from 5.1% in 2005 to 17.8% this year, underpinning our endorsement of RHC's Management and company strategy. Although at current levels the company may be considered as slightly expensive, any pull back in the share price can be considered as a good opportunity to purchase a top quality company.

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Client Services Update

Where are we now?

Just a reminder that Capricorn Investment Partners Limited can now be found in the New Grand in Suite 1B, 103 Bolsover Street. All of our other contact details remain the same.

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The best way to access the new office is via the car park. Enter from Archer Street, come in the main doors off the car park and we're right there to your right.

Entrance to CIPL

Portfolio Reviews

We will be contacting clients early in the New Year to schedule reviews, if you have specific dates you are planning to be away or would prefer to contact us at a convenient time please feel free and we will endeavour to meet the dates and times you require.

The content of the newsletter constitutes general advice and does not take into account your particular needs. Please seek appropriate advice before acting on anything contained herein.

Your team at Capricorn Investment Partners Limited

David French
Managing Director

Michael Blanchflower
Head of Strategy
General Manager
(Sydney)

Stephen Moss
Board Member
Managing Consultant
(Sydney)

Sue Dunne
Financial Advisor

Bob Stewart
Senior Advisor - Equities Dealing

Lachlan McKenzie-McHarg
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Roger Cameron
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Michael Peet
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Rose Sladden
Client Services Manager

Kathy Donaghey
Portfolio Administrator

Jessica Crane
Chess Administrator
Bookkeeper HSA

Jane Eklund
Compliance Manager

Amy Gill
Receptionist

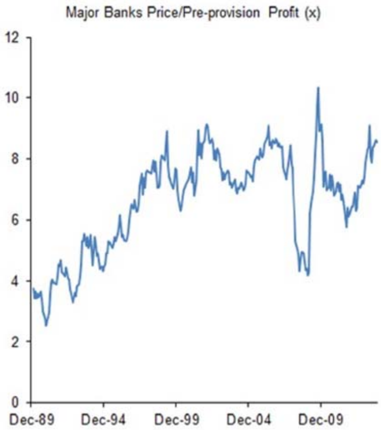
Christine King
Bookkeeper CIPL

Lei Nelson
Assistant Advisor / Insurance

Ming Hou
IT Specialist

CHART PACK

***Information at a glance** (Reuters, NAB)*

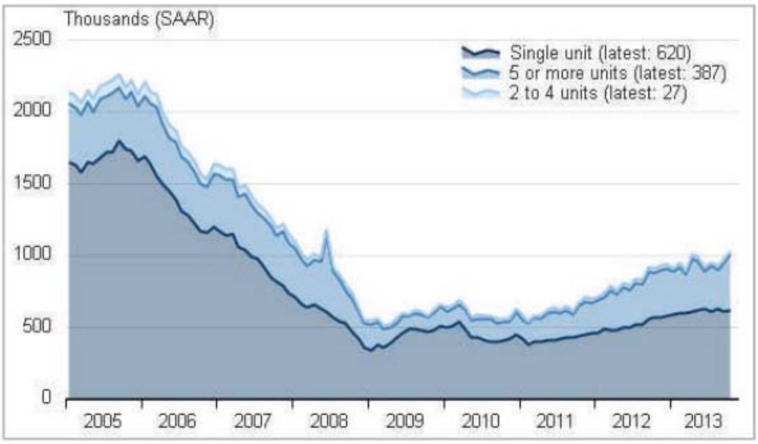


Australian banks still trading at historical premiums

Australian banks look expensive at these levels as the market chases yield.

Healthcare sector continues to significantly outperform rest of the market (since the GFC)

Solid underlying fundamentals and defensive characteristics underpin the strong performance in the Healthcare sector.



US Building Permits – US housing market continues to recover

US housing industry well on the road to recovery. Good signs for the longer term recovery.