

About this Review	
Sector reviewed	<b>Small Cap Australian Equities</b>
Total Funds rated	35
Date of this Sector Review	January 2012
About this Fund	
Fund reviewed	<b>Fairview Emerging Companies Fund</b>
Fund Size (\$M)	135
Responsible Entity	nabInvest Managed Investments Limited
Fund Commenced	October 2008
Wholesale Fee (p.a.)	1.20% + Performance Fee of 20.5% of the Fund's return above the benchmark, subject to high watermark
Structure Availability	Platforms, Wholesale
About the Fund Manager	
Fund Manager	Fairview Equity Partners (FEP)
Ownership	54% staff, 46% National Aust Bank
Assets Managed this Sector (\$M)	135
Years Managing this Asset Class	3
Investment Team	
Team Size Dedicated to this Fund	3
Portfolio Manager	Chris Adams, Leigh Cronin, Michael Glenane
Number of Analysts	3
Departures/Team Ratio (past 2 yrs)	0%
Investment Process	
Style	Core
Targeted Excess Return (p.a.)	5%
Typical Tracking Error (p.a.)	5% - 7%
Typical Stock Numbers	25 – 55
Typical Capitalisation bias	9% Mid caps, 53% Small Caps, 37% Micro Caps, 1% Cash
Franking Level (FY11)	23.5%
Tax efficiency - Income in total distribution (FY11)	0.1%
Discount Gains as in Total Capital Gains (FY11)	14.9%
Maximum of Portfolio in any One Stock	Index ± 5%
Maximum of Portfolio in any One Sector	Index ± 10% (soft)
Maximum of Issued Capital of any One Stock	No Limit
Minimum Capitalisation (\$M)	60 (soft limit)
Maximum Size Limit of Fund (\$M)	500 – 600
Rating history	
January 2012	Recommended
January 2011	Recommended
January 2010	Recommended

## What this Rating Means

➤ The **'Recommended'** rating indicates that Lonsec has conviction that the fund or product can achieve its objectives and, if applicable, outperform peers over an appropriate investment timeframe. The manager or product has a number of competitive advantages in people, process and product design. The investment is a recommended entry point to access this asset class or strategy.

### Fund Risk Characteristics

	Low	Moderate	High
Capital Volatility			▲
Corporate Risk		▲	

*Risk categories are based on Lonsec's qualitative opinion of the risks inherent in the product's asset class and the risks relative to other products in the relevant Lonsec sector universe.*

## Using this Fund

➤ **This is General Advice only and should be read in conjunction with the Disclaimer, Disclosure and Warning on the final page**

➤ Small cap funds invest in a market that is less liquid and more volatile than the large cap Australian equity market. This Fund should be used to complement large cap exposure in clients' portfolios, rather than replace it, with up to one fifth of the Australian equities component of a portfolio being invested in small caps, depending on client risk preferences. Lonsec's model portfolio asset allocation is limited to 'Growth' and 'High Growth' risk profiles.

➤ The Fund is subject to equity market risk and movements (both positive and negative) in the share prices of the underlying securities in the portfolio. Investors should therefore be aware that the Fund may experience periods of negative returns and that there is a risk of potential capital losses being incurred on their investment.

## Changes since last Review

➤ There have been no changes since the last Lonsec review.

## Lonsec Opinion of this Fund

### Philosophy/Style

➤ Fairview Equity Partners (FEP) employs an investment style best described as 'core'. The manager targets a return of Index + 5% p.a. (gross) over 5 years (Index being the S&P/ASX Small Ordinaries Accumulation Index) with a targeted Tracking Error range of 5% to 7% p.a.

➤ The Manager is one of the more benchmark aware managers assessed by Lonsec in the small cap universe. While this does not mean that the benchmark drives stock selection, the Manager is aware of index sector weights and they do factor into portfolio construction. The major impact of

this is that the Fund will over the long term maintain a closer to index weighting in the small resources sector than many peers. Lonsec has observed that most small cap managers are naturally materially underweight resources due to the large number of speculative and poorer quality stocks (often stocks with no earnings and/or a high level of business risk) in the sector. FEP will generally upweight its exposure to higher conviction, higher quality resource stocks rather than invest in poor quality names in order to maintain its resources sector weighting.

### People and Resources

- The investment team at FEP is relatively small, comprising three portfolio managers in Chris Adams, Leigh Cronin, and Michael Glenane. That said, Lonsec notes that small teams are common in this sector and the team has more experience than others in this sector with an average of 17 years of investment experience. Glenane and Cronin have 6 and 7 years of experience in funds management and prior to that were highly rated broking analysts in healthcare and banking respectively. Adams' experience includes in excess of 16 years in funds management. Adams, Cronin, and Glenane have also worked together for a period of time, having been employed together at Goldman Sachs JBWere prior to founding FEP.
- Whilst the three portfolio managers are suitably experienced, only Chris Adams has a track record in portfolio management prior to FEP. Adams was portfolio manager at Goldman Sachs JBWere for a year and prior to that was a "generalist", which is a role akin to a portfolio manager but not ultimately accountable for the performance of the Goldman Sachs JBwere fund.
- Unlike many other small cap fund managers reviewed by Lonsec, the team does not form part of a larger Australian equity team and therefore FEP is not able to draw on the additional insights of a team of analysts or other resources such as in-house economists.
- The three founders of the firm own 54% of the equity in FEP, equally shared between them (18% each). The remaining 46% is owned by nabInvest, a subsidiary of the National Australia Bank. nabInvest provides the firm with financial, sales and marketing, and infrastructure and back office support. nabInvest also fulfils the Responsible Entity role. Lonsec regards the presence of an institutional backer to be an attractive feature, allowing investors to enjoy the traditional benefits of a boutique (such as high alignment of interest with investors) without the usual downsides of a boutique (such as poor balance sheet strength, and lack of infrastructure).
- FEP employs a co-portfolio manager decision making structure with no formal sector allocation in terms of research. Research and portfolio management functions are on a collaborative basis. Lonsec is generally less supportive of group decision making structures, believing them to be less accountable. However, they are common in the small caps sector and have proven to be relatively successful. FEP's 3 member collaborative structure has not caused issues in the Fund; the team has a prior working relationship and Lonsec is comfortable with the current structure.

- Lonsec regards alignment of interest between investors and FEP to be high. Variable remuneration is wholly driven by fund performance, and the investment team has a meaningful co-investment in the Fund alongside investors.

### Research and Portfolio Construction

- Lonsec considers FEP's research process to be comprehensive. Initial screening of stocks encompasses negative and positive filters, and both quantitative and qualitative screens to reduce the investment universe (1000+ stocks) to a manageable number of candidates for further research.
- The research process encompasses industry and company specific research. There is a focus attached to company and industry contacts and proprietary research. The manager has also attended 485 company visits in 2011.
- Lonsec notes that FEP's research process is less structured than some peers assessed. Lonsec has reviewed more structured processes which use standardised templates and scoring systems. Whilst the FEP process lacks these features, Lonsec believes one of its advantages is the strength of the peer review, given the experience of the portfolio managers and the time they have worked together. FEP will typically involve at least two of the three portfolio managers in each company meeting and the analysis of each stock.
- While the output of the research process is the expression of a valuation upside and an associated conviction in the investment thesis, Lonsec is pleased to see explicit consideration of potential downside risk in each stock. FEP integrates into its process quantitative measures such as earnings momentum, earnings dispersion as well as qualitative assessment of the short term earnings outlook. Balance sheet strength and the refinancing profile are also considered alongside the market liquidity of each stock.
- The portfolio construction process is less formulaic than other managers rated by Lonsec, with active positions determined by the team's level of conviction in the strength of the investment thesis, qualitative assessment, valuation, and risk assessment. Whilst this makes it less transparent than some of the more structured processes assessed, Lonsec takes comfort from the high level of accountability and alignment of interest in the firm, and the level of comprehensiveness and strength of peer review in the research of each stock.

### Risk Management

- Risk management is tightly integrated into the research process through peer review, and consideration (including sensitivity analysis) of assumptions and forecasts underlying an investment thesis. Quantitative analysis of earnings dispersion and earnings revision trends are used to monitor potential risk to market earnings estimates and care is taken to monitor market liquidity as part of the exit strategy for each stock.

## Capacity

➤ FEP currently manages \$135m in this strategy and has a target capacity of \$500m-\$600m. Lonsec does not believe the manager has any capacity constraints at this time.

## Performance

- The Fund has outperformed the benchmark and achieved its stated performance objective over all time periods assessed. Over the two and three year periods assessed, the Fund has also clearly outperformed the Lonsec assessed peer average.
- The Fund has delivered returns over all time periods with an above average level of absolute risk (as measured by Standard Deviation). While the volatility of monthly returns has been high, the consistency of returns (as measured by Outperformance Ratio) has also been high at 75% over the three year period assessed to October 2011. This means the Fund has outperformed in 27 of 36 months.

## Overall

- Lonsec has maintained the Fund's rating at "Recommended" for this review. Lonsec views the strengths of the Fund as being the high level of alignment of interest between the manager and investors, the manager's low level of FUM, and the institutional support offered by nabInvest (which substantially reduces the business risk of this boutique).
- While the team has a significant level of market experience, its members are relatively less experienced as PM's. Lonsec would prefer to see the team continue to develop its track record before reconsidering the Fund's rating.

## People & Resources

### Size and Experience

The FEP investment team comprises three portfolio managers in Chris Adams, Leigh Cronin, and Michael Glenane. The team and firm are relatively new, having been founded in August 2008. However Adams, Cronin, and Glenane worked together at Goldman Sachs JBWere Asset Management from 2005 until the founding of FEP.

Chris Adams has 17 years of investment experience, including 10 years at Goldman Sachs JBWere. His role at Goldman Sachs JBWere included a substantial period as a "generalist" (akin to portfolio manager) before more formally taking on the role of portfolio manager of the Goldman Sachs JBWere Emerging Leaders Fund for 12 months.

Leigh Cronin has 15 years of investment experience, starting at Goldman Sachs JBWere as a sell side analyst in the banking and finance sector team before joining the asset management business, where he had broader research coverage.

Michael Glenane has 20 years of investment experience. Like Cronin, Glenane was a sell side analyst prior to joining Goldman Sachs JBWere, where he also had broad research coverage. Lonsec notes that Glenane was a highly rated healthcare analyst during his tenure at brokerage firm Credit Suisse First Boston.

## Team Structure

Name	Position	Years at FEP	Years Industry Experience
Chris Adams	Co-Portfolio Manager	3	17
Michael Glenane	Co-Portfolio Manager	3	20
Leigh Cronin	Co-Portfolio Manager	3	15

FEP employs a collaborative approach towards research and portfolio management, so as a result there is no formal allocation of stock/sector responsibilities. However, in practice, each stock has a "lead analyst" and typically at least two of the three members of the team will attend each company meeting and are involved in the research process for a stock.

## Turnover

There have not been any departures or appointments to the team since the firm was established in August 2008.

## Key Person Risk

Lonsec considers key person risk to be relatively low in this structure, due to the collaborative approach adopted by the FEP team. Key person risk is also mitigated by the relatively high level of experience in the team and the high equity ownership by the three principals of the firm.

## Remuneration / Alignment of Interests

Variable remuneration is wholly driven by fund performance and is formulaic. The size of bonuses is directly related to the Fund's Information Ratio. As the Fund is managed collaboratively, there is no performance attribution and the three portfolio managers will share equally in any bonuses. The investment team also has a meaningful co-investment in the Fund alongside investors.

## Investment Style

### Style and Philosophy

FEP is a core active manager, employing a collaborative approach to research and portfolio construction. Features of FEP's style include high levels of company contact, detailed analysis, a robust peer review process, and appropriate risk controls. "Top down" sector and factor exposures are controlled so as to not become dominant influences on the Fund.

FEP's objective is to outperform in all cycles and therefore the investment style may vary at times. The manager believes imposition of style constraints may unnecessarily limit the Fund's potential for outperformance.

## Research Approach

### Overview

<b>Investment Style</b>	Core
<b>No. of stocks in universe</b>	>1000 (pre screens)
<b>No. of stocks fully modeled</b>	150
<b>Key Screens</b>	Exclude: loss makers, listed investment companies and concept stocks, management quality, business quality, balance sheet strength, robust & transparent cashflows, proprietary quant screen (value, momentum, accrual factors)
<b>Top-Down</b>	10-20%
<b>Bottom-Up</b>	60-80%
<b>Technical Analysis</b>	10-20%
<b>Qualitative Analysis</b>	Management quality, balance sheet quality, earnings quality, competitive position, industry analysis (porter analysis)
<b>Research Inputs</b>	Site visits – companies, suppliers & competitors, industry contacts, industry conferences, seminars
<b>Use of broker research</b>	IBES Broker consensus data, broker conferences

### Valuation Approach

<b>Primary</b>	Multiple approaches including DCF, PER multiples, EV/EBITDA multiples vs. the market and similar stocks, sum of the parts valuations, book value
<b>Secondary</b>	N/A

## Portfolio Construction

### Overview

Portfolio construction is a collaborative process, with active positions determined by assessing the level of conviction in the investment thesis for a stock, its qualitative and risk assessment, and its valuation upside. However, FEP does not use hard price targets in determining upside, but rather valuation ranges.

Sector and factor exposures in the portfolio construction process are controlled to ensure there are no unintended biases.

The Manager's sell discipline is to typically divest stocks once valuation objectives are met or the original investment thesis is no longer valid. However, stocks approaching valuation targets are reviewed rather than automatically sold down.

### Risk Monitoring

Active stock positions are generally limited to +/- 5% of the index weight whilst sector limits have a soft limit of +/- 10% of the index weight. Cash is limited to a maximum of 10% of the Fund, whilst the exposure to midcap stocks (ASX50-ASX100) is 20%. The Fund is managed to a Tracking Error target range of 5% to 7% on an ex-ante basis.

### Funds Under Management

FEP managed \$135 million as at the time of this report making it one of the smaller managers assessed by Lonsec in this sector. At current FUM Lonsec does not consider the manager to have any major capacity issues. Rather, Lonsec believes that the relatively small size of the Fund (compared to a number of its peers) to be an advantage, as it should allow the Manager to move in and out of the market in a more nimble manner.

### Risks

***An investment in the Fund carries a number of standard investment risks associated with investment markets. These include performance, liquidity, counterparty, market and tax risks. These and other risks are outlined in the PDS and should be read in full and understood by potential investors. Lonsec considers the following to be the major risks:***

#### Equity Market

Investments in equity markets are subject to numerous factors which may have an impact on the performance of an investment (both positive and negative). Unexpected changes in economic, technological, structural, regulatory or political conditions can have an impact on the returns of all investments within a particular market.

#### Derivatives

The manager has scope, via the PDS, to purchase futures contracts. Lonsec does not expect this to be a widely adopted strategy and it will primarily be used to equitise significant cashflows ahead of investment. Derivatives cannot be used to leverage the Fund.

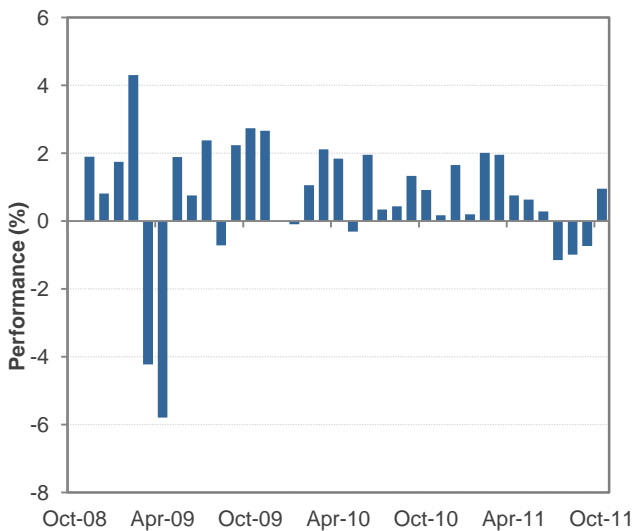
Quantitative Performance Analysis

Annualised after-fee % returns as at 31 October 2011

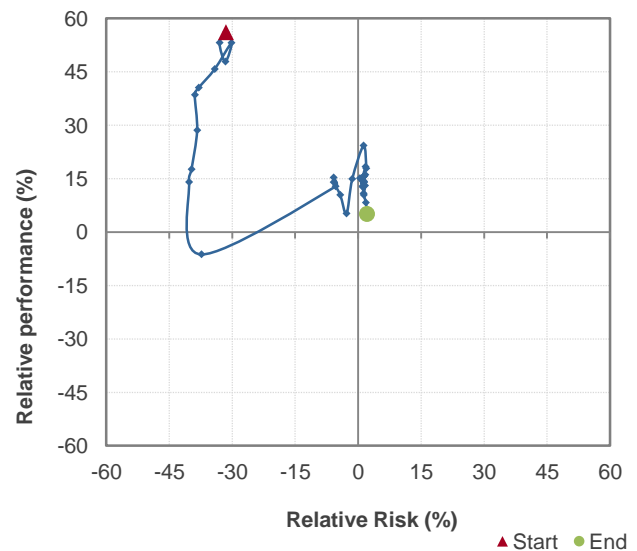
	1 Year		2 Years		3 Years		5 Years	
	Fund	Peer Group	Fund	Peer Group	Fund	Peer Group	Fund	Peer Group
Performance (% pa)	<b>-3.16</b>	-0.11	<b>10.21</b>	7.11	<b>22.81</b>	18.58	n/a	n/a
Standard Deviation (% pa)	<b>19.32</b>	14.65	<b>19.59</b>	15.50	<b>19.79</b>	17.88	n/a	n/a
Excess Return (% pa)	<b>5.06</b>	8.11	<b>9.07</b>	5.96	<b>10.18</b>	5.95	n/a	n/a
Outperformance Ratio (%)	<b>75</b>	67	<b>75</b>	58	<b>75</b>	56	n/a	n/a
Worst Drawdown (%)	<b>-21.04</b>	-16.27	<b>-21.04</b>	-16.27	<b>-21.04</b>	-16.27	n/a	n/a
Time to Recovery (mths)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Sharpe Ratio	<b>-0.42</b>	-0.35	<b>0.28</b>	0.15	<b>0.93</b>	0.79	n/a	n/a
Information Ratio	<b>1.36</b>	1.93	<b>2.52</b>	1.63	<b>1.59</b>	1.07	n/a	n/a
Tracking Error (% pa)	<b>3.72</b>	4.20	<b>3.60</b>	3.65	<b>6.41</b>	5.56	n/a	n/a

Fund: Fairview Emerging Companies Fund,  
 Peer Group: Average among Lonsec Rated Australian Equity (Small Cap)  
 Manager Universe Benchmark: S&P/ASX Small Ordinaries Accumulation Index

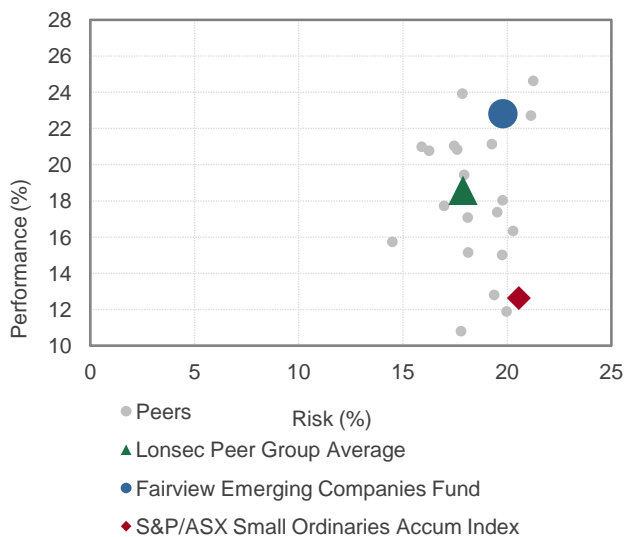
Excess Monthly Returns over three years



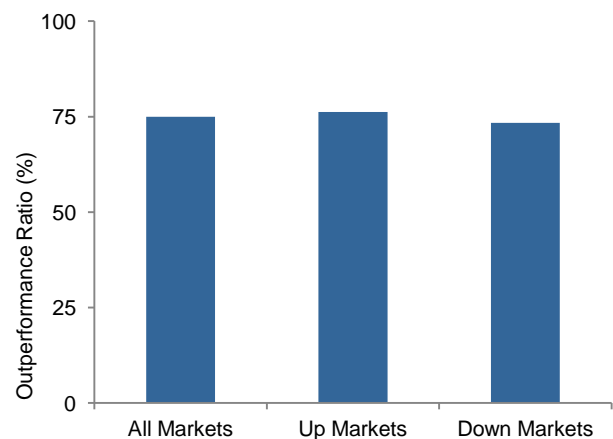
Snail Trail over three years



Risk-return Chart over three years



Outperformance Consistency over three years



## Glossary

<b>Absolute Return</b>	'Top line' actual return, after fees
<b>Excess Return</b>	Return in excess of the benchmark return
<b>Standard Deviation</b>	Volatility of monthly Absolute Returns
<b>Tracking Error</b>	Volatility of monthly Excess Returns against the benchmark (the Standard Deviation of monthly Excess Returns)
<b>Sharpe Ratio</b>	Absolute reward for absolute risk taken (outperformance of the risk free return (Bank Bills) / Standard Deviation)
<b>Information Ratio</b>	Relative reward for relative risk taken (Excess Returns / Tracking Error)
<b>Worst Drawdown</b>	The worst cumulative loss ('peak to trough') experienced over the period assessed
<b>Time to Recovery</b>	The number of months taken to recover the Worst Drawdown

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**Date Prepared: January 2012**

**Analyst: Lin Ngin**

**Release Authorised by: Paul Pavlidis**

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