

# Fairview Equity Partners Quarterly Investment Report June 2011 - Retail

## Emerging Companies Fund

Fairview Equity Partners is a smaller company Australian equities manager. The Fairview Equity Partners Emerging Companies Fund seeks to provide capital growth and some income by outperforming the S&P/ASX Small Ordinaries Accumulation Index over the medium to long term.

## Performance Return

Period ending 30 June 2011	3 mths	1 Year	2 Years (p.a) #	Since inception (p.a) #
Fairview Emerging Companies Fund *	-7.75%	29.09%	29.32%	22.47%
S&P/ASX Small Ordinaries Accumulation Index	-9.31%	16.41%	13.78%	9.21%
<b>Net Excess Return *</b>	<b>1.56%</b>	<b>12.68%</b>	<b>15.54%</b>	<b>13.26%</b>

\* Returns shown are net of fees (including management and performance fees) but before tax  
# Returns over 1 year are annualised. Fund inception 8 October 2008

The June 2011 Quarter was negative for the smaller company's benchmark following some major global macro concerns. The Fairview Emerging Companies Fund outperformed in every month during the quarter and posted a solid quarter of out-performance. Smaller resource stocks bore the brunt of the sell off with investors seeking shelter in more defensive Industrial sectors. Given our relatively higher weight to resource sectors than many of our peer managers, we are satisfied to provide a return that is above the Index and reasonably competitive versus the other managers. We continue to suggest that this is testament to strong stock selection and tight sector risk controls.



Return and Index for Quarter ending Dec 2008 not shown as only a part period, but included in cumulative return series.

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## Market Outlook

Although absolute positive returns are the constant long term objective, we have consistently emphasised that equity returns are volatile on a shorter term basis particularly at the smaller end of the market. A 6-7% retracement in the quarter is actually not that unpalatable when you consider the extremely poor macro backdrop and what appears to be a seasonally persistent weak period. If this is as bad as things get and markets now stage a reasonable recovery, then most investors will not have fared too badly.

Valuations are still extremely attractive for many Industrial companies and the fund is trading on only 10.5x 2012 earnings which are attractive by historical standards. Accordingly, there are a number of potentially attractive investments that we are considering for investment.

## Fairview Insight – Mining and Manager Representations

An investor query that we often get is our attitude towards investing in mining companies that are yet to commence production. Our answer is that while we never rule anything out, we are generally reluctant to take a position because the challenges in taking the final steps to production are often considerable. It is much easier for management to talk the talk than walk the walk when discussing future targets but often preliminary studies are shown to be so wide off the mark that they are largely meaningless. The reality is that costs, hurdles and time frames are generally substantially underestimated. Often outcomes can be binary – for instance if Bathurst Coal fail to get the necessary environmental approvals then they may not have a project, yet the market cap is already 700M. In this quarter, we saw Murchison Metals come off 25% due to a negative reality check on their port ambitions.

It is particularly concerning when investors are relying heavily on management representations which are always going to be optimistic and rarely realistic despite how good they look in a power point slide. Often there is too much uncertainty and if you don't know, don't invest although this can be frustrating when such stocks are running hard.

## Portfolio Strategy

Despite the adverse sentiment and weak share price performances from mining related companies, the outlook for this sector continues to improve. We contacted several mining services companies during the period and the feedback was unequivocally positive. Order books are extremely robust and hiring activity is frenetic. Ultimately this will translate to improved earnings and share price performance and thus, it is a sector we are happy to remain strongly positioned in.

On the domestic front, non-mining cyclical Industrials are still battling weak activity levels with the much anticipated lift in construction spending still yet to occur. Despite favourable employment levels, retail conditions remain weak. We are still cautious on holding too many positions in this space and will wait until there are more tangible signs of a turnaround.

Overall we are happy to maintain a portfolio that is more aggressively positioned than the peer group, particularly on the globally economically sensitive stocks (i.e. resources). This is where we believe the most attractive performance prospects are which will benefit in improving markets. We also note that many of the more established Mid Cap industrials are becoming widely covered again and pricing inefficiencies have diminished. At the end of the day, most investors are in Small Caps for enhanced equity market exposure and it is somewhat counter intuitive to have an excessively defensive portfolio that would largely negate positive equity market performance.

## Performance Attribution

We highlight below the largest positive and negative relative performance contributors during the June 2011 quarter.

Positive contributors		Negative contributors	
Regis Resources	Overweight	Gujarat Nre Coking Coal	Overweight
Aurora Oil and Gas	Overweight	Saracen Mineral	Overweight
Pharmaxis	Underweight	Texon Petroleum	Overweight
Amcom Telecom	Overweight	Gloucester Coal	Overweight
Aditva Birla Minerals	Overweight	Telecom NZ	Underweight

## Major Stock Additions

**Flight Centre (FLT):** We added FLT to the fund towards the end of the quarter following a period of substantial share price decline. We were happy to initiate a position as this provided an attractive entry point combined with continuously strong operating conditions.

**Ausenco (AAX):** After a substantial period of subdued activity, the company has finally started to materially convert project studies into EPCM contracts. This will allow the company to substantially lift its earnings and provide for a more compelling valuation.

**Sundance Energy (SEA):** Is a US based oil shale producer. On various measures (NPV/well, NPV/barrel of likely 3P reserves), the company is heavily discounted versus its peers. We forecast Sundance will exit calendar 2011 at approximately 2,000bopd, with solid underpinning cash flow. We consider the company's tenements in the Niobrara Shale fields are not being valued by market.

**Hunnu Coal (HUN):** Is a deeply discounted Mongolian coal play with a very short timetable to first production. If we only value Hunnu's Tsant Uul coking coal project (assuming no wash plant), the stock is trading at a 61% discount to the FEP coal universe. We consider it should trade closer to parity to other developers and we expect first coal late in calendar 2011.

## Major Stock Disposals

**Aquila Resources (AQA):** The investment thesis for AQA has progressively deteriorated to the point where we decided to exit our position. Firstly, there is too much disruption from their JV partner in many projects. Secondly, we are concerned they will divest attractive coal assets to invest in their more marginal iron ore project.

**Thinksmart (TSM):** We believe the TSM share price will tread water for a period of time until they can demonstrate improved earnings growth. The company has a lot on its plate at present and their UK initiatives in particular are still under-performing for various reasons.

**Cooper Energy (COE):** During our due diligence work on Sundance, we continued our discipline of reviewing existing Energy holdings. Of our four Energy stocks, Cooper's thesis had eroded significantly. Repeated dry wells and political unrest in Tunisia had substantially diminished the upside from our initial thesis.

**Extract Resources (EXT):** There was simply a plethora of negatives to emerge that made the position untenable. Firstly, the outlook for Uranium soured materially post the Japanese reactor shut downs and announced bans from Germany and Italy. Secondly, there were substantial capital cost blow outs announced for the proposed mine development and finally, corporate support for the stock price has weakened following the withdrawal of the bid for Kalahari who are Extract's biggest shareholder.

## Top Ten Holdings

We highlight below our top ten holdings within the portfolio (by month end weight), in alphabetical order:

Adelaide Brighton Ltd	McMillan Shakespeare Ltd
Atlas Iron Ltd	Mineral Resources Ltd
Aurora Oil and Gas Ltd	REA Group Ltd
Campbell Brothers Ltd	Regis Resources Ltd
Independence Group NL	SAI Global Ltd

**Number of stock holdings at 30 June 2011:**

**50**

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