

QUARTERLY
REPORT
31 MARCH 2007



ORBIS MIS
ORBIS/SM AUSTRALIA
EQUITY

ORBIS/SM AUSTRALIA EQUITY FUND

INVESTMENT OBJECTIVE

The Investment Manager seeks long-term returns for investors that are higher than those of the S&P/ASX 300 Accumulation Index, a broad-based index compiled by Standard & Poor's representing the total returns available in the Australian stockmarket. The Investment Manager aims to achieve this without assuming any greater risk of loss than that of an investment in the securities represented on the S&P/ASX 300 Accumulation Index.

INVESTMENT APPROACH

The Fund is managed using the techniques developed at Allan Gray Limited and the Orbis Group over more than 30 years, applied to the Australian stockmarket. The basic philosophy underlying the approach is the belief that while stockmarket prices are the best indicator of value for companies over very long periods of time, substantial deviations of those prices from their true value do occur over the short to medium term. Most businesses (and thus their underlying value) do not change much from one week to the next. Yet their stock prices are often subject to huge moves, often for no particularly good reason. The Investment Manager focuses its efforts on calculating the real underlying value of various companies using the extensive technology developed by the Orbis Group over the past 15 years, the insights of Orbis' global team of analysts as well as a local team of analysts. The Fund's portfolio is constructed by taking all the Investment Manager's best ideas (i.e. where the gap between assessed value and the stockmarket price is the largest) and combining them in a way that seeks to limit the exposure to any single underlying variable.

NOTICES

Retail Offering. *In February 2007, the Investment Manager secured ASIC approval to vary its AFSL to enable it to provide the specified financial services to Retail Clients. Units in the Fund are now offered to both Wholesale and Retail Clients. The expanded offering led to some changes in the Fund's Product Disclosure Statement, most notably the reduction in the minimum investment from A\$500,000 to A\$50,000 and the minimum additional investment or withdrawal from A\$100,000 to A\$10,000. The updated Product Disclosure Statement is available from the Investment Manager or by accessing the Fund's website at www.orbisfunds.com.au.*

Buy/Sell Spread. *The Net Asset Value per Unit of a Class differs from the application or withdrawal price of the Class by the allowance for transaction costs (i.e. the Buy/Sell Spread). The Buy/Sell Spread is the Trustee's estimate of the cost of acquiring, or disposing of, interests in the Fund, and is currently set at 0.35% of the application monies received on an application, and 0.35% of the withdrawal proceeds on the amount of a withdrawal request received.*

Source. *The source for the S&P/ASX 300 Accumulation Index is Standard & Poor's. ASX 300 is the trademark of ASX Operations Pty Limited ("ASXO"); "S&P/ASX300TM" exists pursuant to an arrangement between ASXO and Standard & Poor's (S&PTM is a trademark of Standard & Poor's, a division of The McGraw-Hill Companies, Inc.).*

Returns. *Fund and Benchmark returns are quoted excluding any Buy/Sell Spreads that are payable on some transactions, i.e. on a "mid-to-mid" basis.*

Other. *This report does not constitute an offer to sell, or a solicitation to buy, units of the Fund. Subscriptions are only valid if made on the basis of the Fund's current Product Disclosure Statement. Past performance is not necessarily indicative of future performance. The Fund's unit price will fluctuate and is not guaranteed.*

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Total Rate of Return	From Inception on 1 Jan 2006 % Annualised	From 4 May 2006* % Not Annualised	Latest Quarter
Orbis/SM Australia	25.7	21.0	5.9
S&P/ASX 300 Accumulation Index	25.9	20.5	7.0
Relative Performance	(0.2)	0.4	(1.0)

**The Fund has been open to new investors since 4 May 2006*

The Australian stockmarket had another quarter of strong returns with the Fund lagging its benchmark a little. We are concerned about the overall level of the stockmarket and are continuing to position the Fund cautiously. We may thus continue to underperform a strong stockmarket.

Financial shares (excluding property) make up 33% of the ASX 300 – the Fund’s benchmark for the Australian stockmarket. This is much more than materials, at 21%, and so it seems we are a nation of bankers not miners. Your Fund has only 12% of its investments in financial shares and hence constitutes the Fund’s largest deviation from the benchmark.

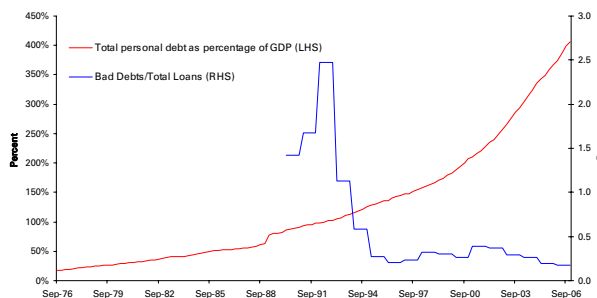
During the stockmarket turbulence of the last few months, financial shares have generally shown less volatility than the market. Given our repeated warnings of the risks investors face at current stockmarket levels, one would expect a higher exposure to non-volatile shares. It is, however, our belief that the downside in financials is substantial.

To illustrate why we are cautious about financials, we will focus on banks, the dominant part of the financial index. First, a little crash course in retail bank analysis. Banks make the bulk of their money in two major ways: by charging their clients more interest for borrowings than they pay for their deposits and by charging clients fees almost every time they think about their money. These profits tend to grow in line with a bank’s asset base.

Against this income, a bank has its operating costs – this includes all the expenses of running all the branches, administration, IT and systems costs and paying for those huge bank head offices that dominate most of our city skylines. In addition, banks have another cost – the risk that some of its borrowers will not pay back their loans. This is termed ‘bad debts’.

In summary, bank pre-tax earnings consist of net interest income plus fee income minus operating costs and bad debts. Over the past decade, banks grew earnings at an average rate of 14% per annum. This is well above inflation (2.6% per annum over the same period) or even economic growth (6% per annum). We can use our summary above to see why banks have been taking an ever larger slice of the economic pie:

- **Rapid asset growth.** The graph below shows Australian personal debt as a percentage of gross domestic product (GDP) as well as bad debts as a percentage of loans.



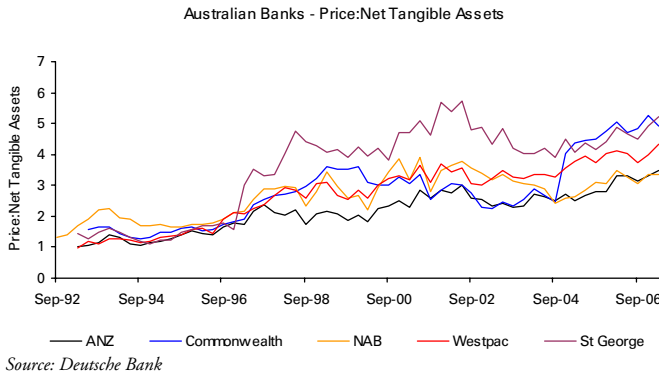
Source: Deutsche Bank

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Over the past decade, Australians have had a love affair with personal borrowing. This is hardly unique in the western world, but it is sobering to note that the ratio of personal loans to GDP has increased from a level that was well below the average for developed countries to a level that is amongst the highest.

- **Improved profitability.** This rapid asset growth has been wonderful for banks - their revenue has been hitched to the loan growth, while operating costs tracked inflation plus a little. In addition, annual bad debts have declined from over 1% of loans 15 years ago to a current all-time low of 0.17%. This has been driven by the strong economy, lower interest rates and the strong housing market. No wonder that bank profits have risen so sharply.

This has certainly fed into the price of bank shares. Most analysts would agree that the best way to value a bank is to look at its share price relative to the value of its net tangible assets. Banks need capital to lend money and given that it is very hard to differentiate yourself (few people really feel passionate about their bank), long-term profits should follow capital. The graph below shows this ratio for Australian banks.



During the early 1990s, Australian banks had major problems. Interest rates went as high as 18% and bad debts soared, largely as a result of poor corporate loans. At the time, expectations were so low you could buy any major Australian bank for no more than the value of its tangible assets – mainly property and cash. You were essentially getting the ongoing banking business for free.

But how things have changed after 15 ‘fat’ years in the banking world. Tangible assets now represent only 25% of a typical bank – the other 75% of the price you pay for a bank is now accounted for by value of the ongoing business. As the table below shows, this is amongst the highest in the world. There is no room for disappointment.

	Price/Net Tangible Assets	Price/Earnings ¹
Commonwealth	5.5	17
National	3.7	17
Westpac	4.5	16
ANZ	3.7	16
Barclays	3.8	10
HSBC	2.9	12
Citigroup	3.6	12

¹ Price/Earnings ratios are historical and based on the most recently reported 12-month period.
Source: Iress, Orbis

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The same is true for insurers – for example, QBE is trading at a big multiple compared to Warren Buffett's company Berkshire Hathaway.

	Price/Net Tangible Assets	Price/Earnings ²
QBE	5.4	17
Insurance Australia	4.3	15
Berkshire Hathaway	2.2	10 ³
AIG	2.1	12

² Price/Earnings ratios are historical and based on the most recently reported 12-month period.

³ Adjusted to reflect unrealised gains on equity investments.

Source: Iress, Orbis

However, at the same time as the prices of bank shares have been rising, the growth prospects have been declining: debt cannot continue to grow faster than the economy without limit. Moreover, risks in the banking system have been building up; it is the income generated by the economy that ultimately must pay the interest on the debt and the higher the debt load of a consumer relative to income, the greater the chance that at some point the consumer will be unable to meet his obligations. While the economy grows, unemployment remains low and interest rates are under control, the problem may not be apparent. But given the record debt load, it is clear that the consequences of an economic crisis could be very severe (even more so than in the early nineties).

We have no ability to predict when or how this will happen, but it is clear that all banks will suffer significant downside. In fact, even if house prices grow at inflation and unemployment remains static, banks that currently sell for a P/E multiple of 16 could still be a disappointing investment. If the growth in debt merely matches inflation, the return of loan default rates to average levels would slow earnings growth considerably.

It is often argued that with better systems and controls the risks are much reduced. However, as recently as 2003, Orbis Global bought a major position in HVB Group, Germany's second largest bank, which, at its bottom, traded for less than half its net tangible assets. The same was true for most German banks notwithstanding interest rates at the time of 2%. Few people would accuse Germans of lax controls. The real problem was rising unemployment and weak property prices after a huge property investment boom – something which is likely to hit us sometime over the next decade.

We recognise Australian banks (and other financials) have many redeeming features (good management, strong capital bases and good competitive positions) and hence have taken a position of about 12% of the Fund in such stocks on your behalf. But given the risks that have been building for years, we are reluctant to expose our clients to the extent that the Fund's benchmark does. Unfortunately, it may take years for our caution to be vindicated (it certainly has cost the Fund significant performance to date), but we continue to believe it is in your best interest.

Yours sincerely,



Simon C Marais

Sydney, Australia
17 April 2007

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STATEMENT OF NET ASSETS (UNAUDITED)

Security	Market Value A\$ 000's	% of Fund
Centennial Coal	23,265	7
National Australia Bank	17,464	5
Consolidated Minerals	16,914	5
Santos	16,307	5
Ridley	14,899	5
PMP	12,728	4
Acrux	10,387	3
Roc Oil	10,297	3
Boral	10,242	3
CSR	10,043	3
Fisher & Paykel Appliances	8,552	3
Australia and New Zealand Banking Group	8,427	3
Pharmaxis	8,144	3
Tower	7,891	3
McGuigan Simeon Wines	7,483	2
Newcrest Mining	7,240	2
Thakral	6,922	2
Bunnings Warehouse Property	6,573	2
Queensland Cotton	6,501	2
Westfield	6,279	2
Commonwealth Property Office Fund	6,010	2
Bemax Resources	5,925	2
Suncorp-Metway	5,886	2
Bendigo Mining	5,643	2
AVJennings	5,530	2
Funtastic	5,313	2
Westpac Banking	5,237	2
Riversdale Mining	4,664	1
Alchemia	4,662	1
Clough - Common and Convertible Note	4,211	1
Air New Zealand	3,998	1
BHP Billiton	3,973	1
Structural Monitoring Systems	3,335	1
Positions less than 1%	22,810	7
Total Equity Exposure	303,755	94
Stock Index Futures Bought*:		
SPI 200 6/2007	13,426	4
Net Current Assets	5,411	2
Net Assets	322,592	100
Net Asset Value per Unit	A\$ 1.3296	

* All stock index futures are fully backed by cash holdings.
 The Fund buys stock index futures to maintain share exposure while investing new subscriptions.
 As selected shares are bought for the Fund, the stock index futures are sold.

CHARACTERISTICS OF ORBIS/SM AUSTRALIA EQUITY FUND

Investment objective	The Fund seeks higher returns than the Australian stockmarket without greater risk of loss.
Investments	The Fund is designed to remain continuously invested in selected Australian equities. These equities are selected using extensive proprietary investment research undertaken by the Investment Manager.
Structure	Registered Managed Investment Scheme aimed at Australian investors.
Who should invest?	The Fund is designed for investors who seek income and long-term capital appreciation by investing in an actively-managed portfolio of Australian equities. This portfolio may deviate meaningfully from the performance of its benchmark in pursuit of superior returns.
Minimum initial investment	A\$50,000. Subsequent investments minimum \$10,000.
Minimum withdrawal	A\$10,000. Minimum investment balance is A\$50,000.
Applications/withdrawals	Weekly, normally each Thursday at the Net Asset Value per Unit, after allowance for transaction costs, calculated at 4:15 p.m. Australian Eastern Standard Time on that day.
Dealing deadlines	<p>Written applications for Units received by the Administrator by 2:00 p.m. Australian Eastern Standard Time time (the “Deadline”) on or before the particular Dealing Day will be processed, and Units will be issued as at that Dealing Day, provided that sufficient cleared funds have also been received by the Administrator in Sydney by the Deadline. All applications are irrevocable after the Deadline.</p> <p>Withdrawal requests should be received by 2:00 p.m. Australian Eastern Standard Time time on a Dealing Day for processing on that Dealing Day. A Unitholder who submits a request for a Significant Withdrawal must make that request by 2:00 p.m. on the day that is 10 Business Days before the Dealing Day. All withdrawal requests are irrevocable after the deadline for their submission described above.</p>
Fees and expenses	The Management Fees payable from the Fund have a fixed component (the “ Base Fee ”) and a performance component (the “ Performance Fee ”). The Base Fee is 0.75% per annum of the Net Asset Value of the Fund. The Performance Fee is 20% of the extent to which the Fund outperforms its Benchmark once the Fund has reached a new High Water Mark. Other expenses such as stamp duty and GST will be deducted from the Fund as appropriate.

