

QUARTERLY  
**REPORT**  
30 JUNE 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](http://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/ASX300<sup>TM</sup>" exists pursuant to an arrangement between ASXO and Standard & Poor's (S&P<sup>TM</sup> 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.*

## ORBIS/SM AUSTRALIA EQUITY FUND AT 30 JUNE 2007

Total Rate of Return	From Inception	From	2007	Latest
	on 1 Jan 2006	4 May 2006*	to Date	Quarter
	% Annualised		% Not Annualised	
<b>Orbis/SM Australia</b>	<b>26.4</b>	<b>24.8</b>	<b>13.1</b>	<b>6.8</b>
S&P/ASX 300 Accumulation Index	25.6	23.2	12.9	5.6
Relative Performance	0.6	1.3	0.2	1.1

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

The market experienced another quarter of strong returns. Fortunately, the Fund's returns were even higher than that of the market. We continue to caution that the returns recently enjoyed by investors do not reflect a reasonable expectation for the long term.

Thirty years ago our parents did not have flat screen TVs, the Internet or cheap airlines. But they had investment opportunities we can only dream of. In 1977, you paid less than 7 times the annual profits for the average share on the ASX. But even more important was that these profits were depressed and on the verge of a huge secular growth phase.

Unfortunately, we may have all the modern gadgets today, but good investments are very hard to come by. The average stock on the ASX now trades on more than 15 times profits and these profits are at all-time highs even relative to our strong economy. Financial analysis, which was a relative backwater in the 1970s, is now a huge industry employing more PhDs than the space programme. Very few shares are not analysed to exhaustion.

Most analysts work for large banks and brokerage houses. In these institutions, employees receive the bulk of their compensation in the form of an annual bonus. This leads to a certain market dynamic. Because you are paid annually, there is little incentive to do work that will be of long-term benefit. If your idea takes 5 years to mature, the odds are that you will be working elsewhere (the industry has very high turnover rates) and that someone else will be receiving 'your' bonus. This focus on short-term analysis and returns provides Orbis with our biggest competitive advantage and we have discussed this in a number of previous reports.

But there is another opportunity that the institutional mindset provides us with. Analysts hate companies where there are unpredictable events that can have a major impact on the share price. If you are right on such a share, your clients (and your boss) will give you little credit, because they will realise you have been lucky. Hence your bonus opportunities are limited. Yet, if you are wrong, you will probably be blamed and may well lose your job.

You may ask why we should fare any better trying to forecast the outcome of something unpredictable. Sometimes the market is so obsessed about a certain unpredictable risk in a share that the price will almost reflect the worst possible outcome. If the worst comes to pass, the investor may lose a little. But for any other outcome, the upside is considerable. In the same way, potential huge positives that are uncertain will be completely ignored until the outcome is known.

One such company in the Fund's portfolio is Roc Oil Company (ROC). The upside in ROC is a highly unusual and untested investment that the company has – an oil exploration business in Angola. Should ROC be successful, the pay-off will be enormous. Should ROC be unlucky, the downside is limited. But before we go any further, some background is needed.

ROC was founded in 1997 by the current CEO, John Doran, and then listed on the ASX (1999) and AIM in London (2004). It is a diversified independent oil exploration and production company that buys exploration licenses, drills for oil or gas and then sells the product on the open market. Such companies can do very well if they are clever or lucky, but many sink without a trace never finding anything economic.

What attracted us to ROC in the first place was its excellent track record and strategy that we could identify with. John has grown the company by buying assets or exploration rights that were neglected, too small for the major oil companies to worry about or where adverse political circumstances scared other buyers away. Over the past decade, the company has built up a solid portfolio of oil and gas producing assets in the UK, Australia, West Africa and China. Of these, its assets in China are by far the most valuable, and were cleverly bought when a major American oil and gas company, Apache Corporation, decided to exit China.

Analysts use a standard method to value oil producers. They typically look at all the discovered and economically viable oil and gas assets that the company has – called 2P (Proven and Probable) reserves. They then estimate when the oil and gas will be produced and at what price it will be sold. From this, they subtract the capital needed to develop all these fields, the costs of producing and transporting the oil to the nearest market, overheads, as well as the royalties and taxes payable on the oil and gas that is produced. In addition, a discount factor is applied to account for the fact that the profits are only received over many years.

While all this is horrendously complex, a typical oil analyst is well educated, very well paid and has done nothing but this for many years. Most analysts produce values that are very similar with the same oil price assumptions. ROC is trading at about 1.2 times this value. Most oil companies trade at a premium. Reserve numbers generally understate the total amount of oil and gas that will be produced and oil companies sometimes have discovered oil or gas that the independent reserve evaluators have not yet included in reserves. ROC's premium is in line with that of other smaller oil companies, but below the premium paid by the market for Santos and Woodside.

Most analysts put very little value on exploration results or drilling until an oil or gas find is proven to be economically viable. The assumption is that for oil and gas the world has been pretty well explored and that there are no 'easy hits' left in the industry. This is certainly true in general, but we believe there is one glaring exception. Between 1958 and 1971, Cabinda Gulf Oil Company (CABGOC) explored for oil in Cabinda, the northernmost province of Angola on the west coast of Africa. CABGOC made some very exciting discoveries, but was slow to develop the fields because there was no infrastructure in that part of the world and the oil price was below \$1/barrel. Before CABGOC could go any further, a major civil war broke out in Angola and its activities focused on its offshore assets which were considered more secure.

The war raged until 2002, but even during the conflict, offshore production was expanding, making Angola one of the leading oil exporters in the world, and since January this year a member of OPEC. However, no access to onshore Cabinda was possible. CABGOC relinquished its license for the onshore Cabinda South Block which ended up in the hands of Elf (now Total), the French oil company. For them, the license was no more than an irritation and the decision was taken to get rid of the license.

Enter ROC. Between 2001 and 2003, it managed to buy 60% of the license for less than \$1 million. The other 40% is held by a local Angolan partner and the Angolan Government. Since the end of the war, ROC has done all the seismic work one normally does on a new prospective field before drilling. The results are extremely promising with a number of new very prospective leads and prospects identified with the backing of modern technology and a much higher oil price.

Drilling has started this month and the first results are imminent. While nothing is certain in the oil drilling game, management (which is usually very conservative) is estimating the oil-in-place in ROC's first five holes to be between 344 million and 1.4 billion barrels. Usually about 30% of oil-in-place ends up being proven for production purposes. A barrel of proven oil is typically worth about \$20/barrel. Should ROC be successful in Angola, it could add billions of dollars to ROC's market value. ROC's total enterprise value is currently \$1.2 billion. Angola could thus increase ROC's value by multiples should management's expectations be accurate. Given the area's history, the surrounding discoveries and management's conservative nature in the past, we believe this is at least probable. Should we be disappointed, most of ROC's value can be accounted for by its other assets and our downside will not be much.

We have a number of other investments in the Fund's portfolio similar to ROC with significant uncertainty that could lead to some downside. But we think there is a good probability of a positive outcome with significant upside. These investments include Alchemia, SMS Systems, ChemGenex, Bendigo Mining and AJ Lucas. While we may lose some money for investors on some of these investments, we believe both the odds and pay-off for their shares are very much in our favour.

Yours sincerely,



Simon C Marais

Sydney, Australia  
11 July 2007

# ORBIS/SM AUSTRALIA EQUITY FUND AT 30 JUNE 2007

## STATEMENT OF NET ASSETS (UNAUDITED)

Security	Market Value A\$ 000's	% of Fund
Centennial Coal	25,891	7
Consolidated Minerals	21,394	6
Santos	19,475	5
National Australia Bank	18,834	5
PMP	17,810	5
Ridley	16,346	4
Acrux	14,145	4
McGuigan Simeon Wines	13,819	4
Roc Oil	13,100	4
Tower	12,868	4
CSR	11,331	3
Boral	10,901	3
Australia and New Zealand Banking Group	10,858	3
Thakral	8,799	2
Funtastic	8,545	2
Riversdale Mining	8,434	2
Pharmaxis	8,346	2
Alchemia	8,311	2
Bunnings Warehouse Property	8,293	2
Fisher & Paykel Appliances	8,262	2
Bemax Resources	7,918	2
Commonwealth Property Office Fund	7,347	2
Newcrest Mining	6,953	2
AVJennings	6,685	2
Westfield	6,610	2
Westpac Banking	5,319	2
BHP Billiton	5,007	1
Air New Zealand	4,638	1
Bendigo Mining	4,585	1
ChemGenex Pharmaceuticals - Common and Options	4,475	1
AJ Lucas Group	4,055	1
ALE Property Group	3,977	1
Symex Holdings - Common and Convertible Notes	3,883	1
Positions less than 1%	25,495	7
<b>Total Equity Exposure</b>	<b>362,709</b>	<b>97</b>
<b>Stock Index Futures Bought*:</b>		
SPI 200 9/2007	7,370	2
<b>Net Current Assets</b>	<b>4,186</b>	<b>1</b>
<b>Net Assets</b>	<b>374,265</b>	<b>100</b>
<b>Net Asset Value per Unit</b>	<b>A\$ 1.4197</b>	

\* 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

<b>Investment objective</b>	The Fund seeks higher returns than the Australian stockmarket without greater risk of loss.
<b>Investments</b>	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.
<b>Structure</b>	Registered Managed Investment Scheme aimed at Australian investors.
<b>Who should invest?</b>	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.
<b>Minimum initial investment</b>	A\$50,000. Subsequent investments minimum A\$10,000.
<b>Minimum withdrawal</b>	A\$10,000. Minimum investment balance is A\$50,000.
<b>Applications/withdrawals</b>	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.
<b>Dealing deadlines</b>	<p>Written applications for Units received by the Administrator by 2:00 p.m. Australian Eastern Standard Time (the “<b>Deadline</b>”) 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 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>
<b>Fees and expenses</b>	The Management Fees payable from the Fund have a fixed component (the “ <b>Base Fee</b> ”) and a performance component (the “ <b>Performance Fee</b> ”). 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.

