

QUARTERLY  
**REPORT**  
30 SEPTEMBER 2008



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, and 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

**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 Responsible Entity'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.** *Equity Trustees Limited AFSL No. 240975 is the issuer of units in the Orbis/SM Australia Equity Fund (the "Fund") and Orbis Investment Management (Australia) Pty Limited AFSL No. 298487 is the Fund's investment manager. A Product Disclosure Statement for the Fund ("PDS") is available from [www.orbisfunds.com.au](http://www.orbisfunds.com.au) or by contacting Orbis' Client Services Team on +61 (0)2 82248600. You should consider the PDS in deciding whether to acquire, or to continue to hold, units in the Fund. This report should not constitute an offer to sell, or a solicitation to buy, units in the Fund.*

*This report provides general information only and should not be construed as financial product advice. This report is current as at its date of publication, is given in good faith and has been derived from sources believed to be reliable and accurate. It does not take into account your individual objectives, financial situation or needs. Subject to applicable law, we do not provide any warranty of accuracy or reliability in relation to information in this report or accept any liability to any person who relies on it.*

**Risk Warnings.** *Past performance is not indicative of future performance. The Fund's unit price will fluctuate and is not guaranteed. When making an investment in the Fund, an investor's capital is at risk.*

**ORBIS/SM AUSTRALIA EQUITY FUND AT 30 SEPTEMBER 2008**

Total Rate of Return in Australian dollars	From Public Launch on 4 May 2006		Latest	2008 to Date	Latest Quarter
	2 Years	1 Year	% Annualised		
<b>Orbis/SM Australia*</b>	<b>0.9</b>	<b>0.8</b>	<b>(23.3)</b>	<b>(26.0)</b>	<b>(6.0)</b>
S&P/ASX 300 Accumulation Index	(0.8)	(1.6)	(27.1)	(25.1)	(10.7)
Relative Performance	1.7	2.4	5.2	(1.2)	5.3

\* Fund returns are gross of all income, net of all expenses and fees and assume reinvestment of distributions.

These are difficult times for investors. While bank deposits have provided decent safe returns over the past few years, there is now every expectation that these rates will be coming down significantly. The 10-year bond rates in Australia have fallen by almost 1.5% over the past two months.

**10-Year Commonwealth Government Bond Yield**



Source: Iress

There has been a massive effort on the part of authorities to push money into the financial system given the banking crises. Printing extra money does risk inflation – ask anyone living in Argentina or Zimbabwe. So while 5.1% may not look so bad for the next 10 years, we believe there is a higher than average probability that inflation over the same period may be much higher than it has been recently and investors may find that bonds do not maintain the real value of their money.

As if anyone needs reminding, the stockmarket also has its risks. While Price/Earnings (P/E) ratios for shares are pretty modest by historic standards, companies in Australia have never been more profitable than they are now. Should the economy slow significantly, something which is very overdue, one could find a ‘cheap’ 10x P/E stock quickly turning into a 20 or 25x P/E stock which does not look like such a bargain at all.

For this reason, we focus on shares where we have confidence that earnings are robust even if economic growth slows. Infrastructure and property shares, normally safe havens in turbulent times, have turned out to be one of the worst performers in this market. To understand this, let’s have a look at the accounts of one of the largest of these, Macquarie Infrastructure Group (MIG), an operator of toll roads in various countries. MIG are by no means the worst example of the excesses that were prevalent in the system and our reference to them should not be construed as an opinion or recommendation regarding whether to buy, sell or hold MIG securities. The financial accounts on the following page are from MIG’s own presentation to analysts on 21 August 2008 (but simplified to some degree by us).

In the year to 30 June 2008, MIG earned A\$262 million, but it paid out dividends of A\$482 million. Currently, the stockmarket values MIG at just over A\$5.5 billion – a distribution yield of over 8% per annum.

This may look attractive, but the fact is that the actual profits earned cover only half of the dividend paid. The rest was paid for by increased borrowings which are expected to be repaid many years later using future profits.

MIG Income Statement <i>for the year ending June 2008</i>	A\$ millions <i>(unaudited)</i>
Operating Revenue	1,144
Operating Expenses	(310)
Gross Income	834
Other Costs & Taxes	(209)
Net Interest	(363)
MIG Net Earnings	262
Distribution for 2008	482
Total Net Debt at year-end	9,411

Source: MIG

While prices were going up and debt was plentiful, it was possible for these funds to put off the day of reckoning by doing transactions which had the added 'benefit' of generating fees for Macquarie Bank. But in these more careful times, banks are unlikely to extend as much debt as before and transactions are hard to do. Suddenly, investors are focusing on the underlying cash flow yield of just over 4% (and rightly so) and wonder about the sustainability of a dividend paid for by ever increasing debt.

In addition, there is a real risk that even the low yield may be at risk as the net interest paid by MIG on borrowings of over A\$9 billion is only A\$400 million – a rate close to 4%. In the current climate and given their debt burden, this is likely to go up. An increase to 7% may wipe profits out altogether.

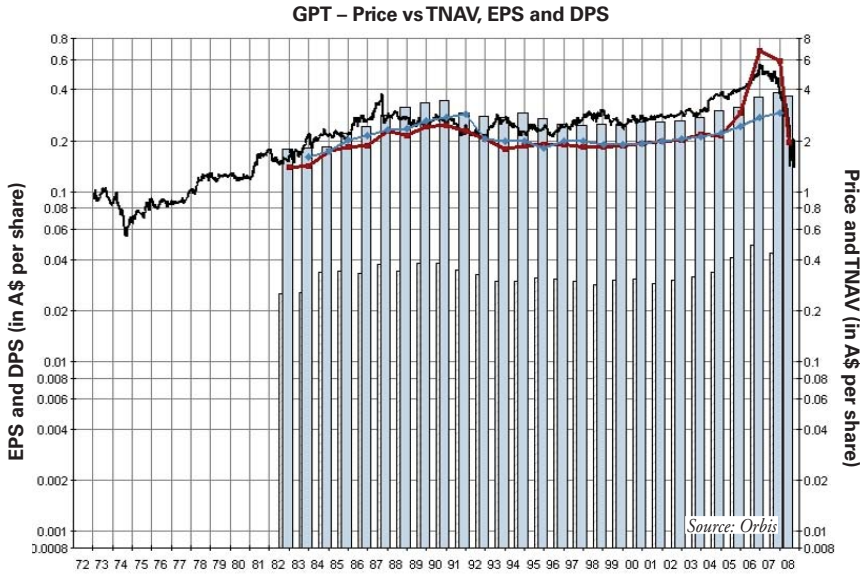
Many of the other funds managed by some of the now much smaller investment banks have far worse structures than MIG. For some of these, dividends have ceased altogether and there is a high risk that the debt holders will probably end up owning the funds.

It has started to dawn on investors in these funds that their 'safe' income-yielding investments may be anything but safe, and that they had better head for the exit. Most high-yield funds we have spoken to have had outflows and are forced sellers. New buyers are hard to find and the large share price falls we have seen are inevitable. When market panic sets in, many shares with more solid fundamentals than MIG also decline as the loss in confidence spreads to innocent bystanders. This is where we often find great investment opportunities on your behalf and this time has been no exception.

GPT Group is one of Australia's oldest property trusts and for years it was a solid but unexciting company, trading around the value of its assets and yielding 7 to 8% in dividends fully covered by earnings. This changed in 2004 when GPT entered into a joint venture with Babcock & Brown which suddenly promised more growth than was achieved for a few years, largely through 'more advanced' accounting techniques and extra debt. The market loved this and the stock rose to a record level of almost twice its asset value.

The graph on the opposite page shows GPT's share price (black line) together with its Tangible Net Asset Values per share (TNAV, blue bars), Earnings Per Share (EPS, red line) and Dividends Per Share (DPS, blue line).

With the meltdown, the market has turned viciously against GPT pushing the stock price to its lowest level since 1981. We aren't fans of GPT's deal with Babcock & Brown, but we do not believe it has destroyed nearly as much value as the market price implies. The basic pool of high quality office towers (Governor Phillip Tower, Australia Square and the MLC Building) and retail centres has been untouched. And while GPT probably has a little more debt than one would like in this environment, its debt is still very far from being unacceptably high.



At \$1.50 per share (where the share traded in large volumes) it traded for less than half of its underlying asset value. This year GPT is expected to earn around 22 cents per share with proper accounting. Of this amount, between 2 and 4 cents is likely to be retained to reduce debt and pay for maintenance, leaving 18 - 20 cents for a distribution. This may not grow for a few years as tough economic conditions prevail and GPT clears up its balance sheet, but over the longer term should track inflation.

At these prices one receives a real yield of well over 10% per annum, a large portion of which is tax deferred. This should more than compensate for any risk assumed and investors may receive a healthy capital profit once markets return to normal. There are a number of similar examples which your Fund owns – ALE (which we discussed earlier in the year), Thakral, Australand and ING Real Estate Entertainment Fund. Centro Retail Trust, while having more risk, offers exceptional value trading at less than 10% of its net asset value (after a hefty write down by new management) and less than one year's earnings.

While many investors have been selling, we have been buying and property share holdings now account for almost 20% of the Fund. We are confident that these shares will one day provide good capital returns, but while we wait the stocks are yielding sustainable distributions of more than 10% per annum.

Yours sincerely,

Simon C Marais

Sydney, Australia  
10 October 2008

# ORBIS/SM AUSTRALIA EQUITY FUND AT 30 SEPTEMBER 2008

## STATEMENT OF NET ASSETS (UNAUDITED)

Security	Market Value A\$ 000's	% of Fund
Australia and New Zealand Banking Group	30,003	7
PMP	27,878	6
National Australia Bank	23,453	5
PaperlinX	19,612	4
Iluka Resources	18,720	4
Pharmaxis	17,956	4
Roc Oil	17,496	4
CSR	17,090	4
ALE Property Group	16,979	4
Australand Property Group	14,300	3
GPT Group	14,095	3
Fisher & Paykel Appliances	13,468	3
Thakral	13,224	3
Centennial Coal	12,655	3
Caltex Australia	10,661	2
Nuplex Industries	10,525	2
Platinum Asset Management	10,423	2
Boral	10,345	2
Ridley	10,206	2
Air New Zealand	9,858	2
Centro Retail Trust	8,667	2
Guinness Peat Group - CDI	8,625	2
Salmat	8,581	2
Acrux	7,924	2
ING Real Estate Entertainment Fund	7,387	2
Tower	6,967	2
Challenger Financial Services Group	6,438	1
Australian Vintage	6,434	1
Mortgage Choice	6,256	1
AVJennings	5,269	1
nib Holdings	5,208	1
Austal	4,830	1
Riversdale Mining	4,731	1
Positions less than 1%	40,692	9
<b>Total Equity Exposure</b>	<b>446,956</b>	<b>97</b>
<b>Stock Index Futures Bought*:</b>		
SPI 200 12/2008	7,687	2
<b>Net Current Assets</b>	<b>4,153</b>	<b>1</b>
<b>Net Assets</b>	<b>458,796**</b>	<b>100</b>
<b>Net Asset Value per Unit</b>	<b>A\$ 0.9938</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.

\*\* Some of the Fund's institutional investors transferred out of the Fund into their own segregated accounts managed by us during the quarter via a direct share transfer. Our mandates for these institutional investors have exactly the same investment goals and restrictions as the Fund (Strategy) and we would expect similar performance over a period of time. Total assets under management for the Strategy were A\$912 million at the end of September 2008.

## 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.

