

QUARTERLY  
**REPORT**  
30 SEPTEMBER 2009



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 19 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 returns are gross of all income, net of all expenses and fees, assume reinvestment of distributions and exclude any spreads that might be 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. Any implied figures or estimations are subject to assumptions, risks and uncertainties. Actual figures may differ materially and you are cautioned not to place undue reliance on such information. 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 2009

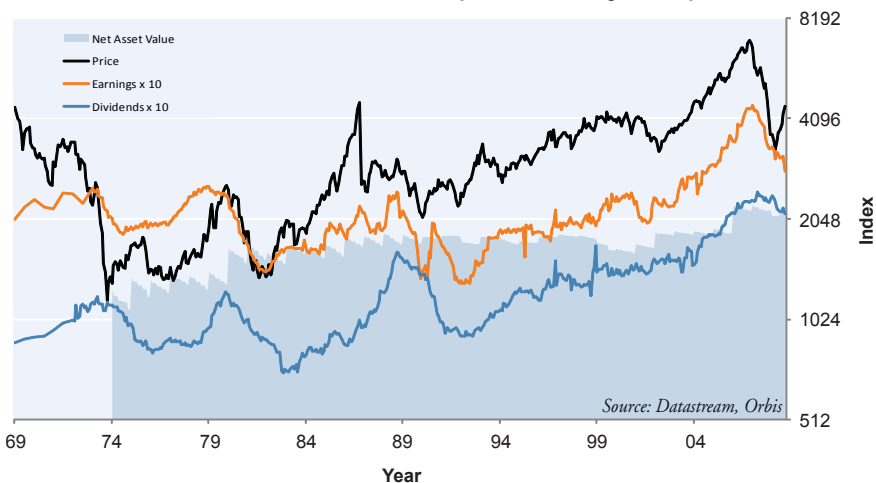
Total Rate of Return in Australian dollars	From Public Launch on 4 May 2006	Latest			Latest Quarter % Not Annualised
		3 Years % Annualised	2 Years	1 Year	
<b>Orbis/SM Australia</b>	<b>4.4</b>	<b>4.8</b>	<b>(6.8)</b>	<b>13.2</b>	<b>30.7</b>
S&P/ASX 300 Accumulation Index	1.8	1.6	(11.0)	8.5	21.6
Relative Performance	2.6	3.1	4.7	4.3	7.5

The last six months have been a fantastic time for equity investors around the world. Despite the Fund’s very poor performance in the lead up to the March quarter, those investors that maintained confidence in the Fund at a time when most advisors were preaching caution have been thoroughly vindicated for their contrarian stance. It would be a natural human reaction to be confident after all this and to continue with the strategies that have worked over the past year; but if there is one thing that the history of investments teaches us, it is that the time for re-evaluation and critical assessment of a portfolio is after some great performance, when there is actually little pressure to do so.

The Australian stockmarket has recovered so well off its bottom in March that for most investors the global financial crisis is little more than a memory. Many investors see the downside, but also note that from current levels at around 4,700, the ASX 300 must rise by more than 40% to get back to its previous peak. A huge debate is raging over whether the economy will have a V- or W-shaped recovery, whether inflation or deflation will prevail and what commodity prices will do over the next few years. Try as we might, clairvoyant we are not and our view is that nobody really knows. Despite all the research, very few commentators predicted the past crisis. Given the complexities of the world economy and its many non-linear feedback loops, the same is likely to be the case with the current crop of analysts. There will be many predictions, some of which will inevitably be right, but it is impossible to pick in advance who will be right and who will be wrong.

To us, the only long-term predictor that has really stood the test of time is value. We have shown the graph below in previous quarterly reports, but we do think it offers the best overview of the stockmarket. The graph shows the available history of the ASX 300 Index for what we think are the three most important fundamental factors that drive share prices: earnings (the profits the company generates), dividends (the income it pays to its investors) and net assets (the book value of the company’s assets after debt). To make the graph more meaningful, all variables have been adjusted for inflation, and we have changed the scale to a logarithmic one and adjusted the scale for earnings and dividends by a factor of 10.

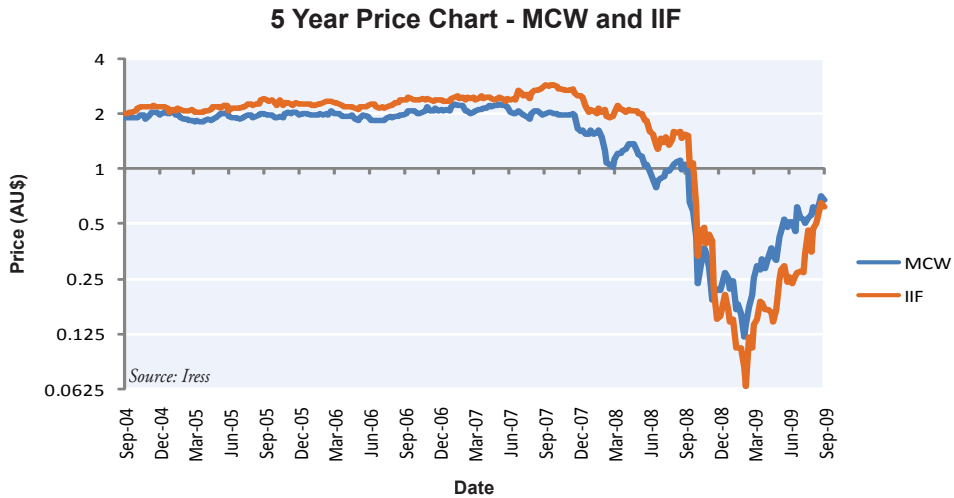
**Australian Stockmarket (Inflation Adjusted)**



**ORBIS/SM AUSTRALIA EQUITY FUND AT 30 SEPTEMBER 2009**

The graph clearly shows that when the price of the ASX 300 Index was plunging towards 3,000, it was offering the best value in decades. After the recent rises in share prices, values are now average at best. While the Index is still trading well below the prices of 2007, these were generational highs in terms of valuation. From here, the stockmarket is unlikely to yield returns better than inflation plus the dividend yield – about 4% per annum in real terms at present.

While the Index has given investors a volatile ride, this is nothing compared to what has happened to many of the underlying stocks. Starting with our December 2008 report, we regularly mentioned the very depressed levels of listed property shares. The graph below shows the share prices of two of our larger holdings during 2009 – Macquarie CountryWide Trust (MCW) and ING Industrial Fund (IIF). The time axis covers five years (and for more than three of those years nothing really happened), while the price axis spans a 64-fold increase/decrease.



Both companies own properties that produce stable income streams that covered their interest expense twice, even in the depths of the recession. This did not prevent the shares from falling more than 90% off their highs to levels where the share price accounted for about six months worth of income after interest. Since then, both have suffered from huge property write-downs, falling income and dividends and, in the case of MCW, management action that destroyed significant value in our opinion. It would be fair to say that the underlying fundamentals of these shares turned out a little worse than we expected nine months ago.

Yet despite all the adversity, the shares have increased more than sixfold. Expectations were for conditions to be absolutely awful and they turned out to be merely bad. After the huge rises, we see far less value in these shares and have sold the Fund’s entire MCW position while reducing the IIF position significantly.

It has not been easy to re-deploy the proceeds given the steep rise in the price of many shares. Many stocks need strong economic conditions to justify the current share price and offer limited upside. However, in the rush not to get left behind should the economy take off, some shares that are not economically sensitive have been overlooked and it is here that we have found some value for the Fund. The Hastings Diversified Utilities Fund (HDF) is now the largest single investment for the Fund.

HDF has two principal assets, 2,000 kms of underground gas pipelines in Australia and an investment in a UK water utility. The gas pipelines include a link between South Australia and the gas fields in central Australia and Queensland, accounting for over 80% of HDF's income and value.

This pipeline is the only one servicing the route and the only way in which South Australia can realistically get its gas supply. Given the dwindling gas reserves in the Bass Strait and growth in Melbourne gas consumption, gas is more likely to flow from

Adelaide to Melbourne than the other way round. Time consuming negotiations with hundreds of land and native land title holders makes it difficult for a competing pipeline to be built.

HDF has some long-term contracts with large gas producers to transport their gas from the production centres down to the South Australian markets. These contracts typically require the producers to pay a fixed amount for the use of the pipeline (even if they do not need it) which escalates by the Consumer Price Index (CPI) every year.

Unlike many other utilities in Australia, HDF's accounts give a fair reflection of the underlying business and its cash flows. The cash flows which HDF generates from its pipelines are sustainable, require no financial engineering and will grow with CPI given the nature of its contracts.

This year, HDF will earn and pay investors \$0.10 per share from its pipeline operations. At the current share price of around \$1.00, this provides investors with a real income yield of 10% per annum. Given current market levels, this offers excellent value in our opinion.

But there is more. We haven't touched on HDF's equity stake in the UK water utility. This utility is highly regulated and has very high levels of debt which makes forecasting difficult. But the investment has paid HDF \$0.02 per share annually and there is no reason to believe that this will not be maintained. Also, HDF does not guarantee any of the water company's debt and so HDF's downside is limited.

To summarise, HDF yields 10% per annum which is very secure and likely to grow by at least CPI plus another 2% per annum which is likely to continue. In addition, HDF has spare capacity in its pipelines and, together with new pipelines being considered, should also benefit from growth in gas volumes. Growth may well exceed inflation over the next decade. In this market, we believe HDF offers excellent value with far below average risk. HDF may well lag the market for a while as it continues to boom, however we expect HDF to give investors annualised double digit real returns over an extended period of time, something which very few shares do.

Yours sincerely,



Simon C Marais

### HDF Pipelines



Sydney, Australia  
7 October 2009

# ORBIS/SM AUSTRALIA EQUITY FUND AT 30 SEPTEMBER 2009

## STATEMENT OF NET ASSETS (UNAUDITED)

Security	Market Value A\$ 000's	% of Fund
Hastings Diversified Utilities Fund	22,738	4
National Australia Bank	20,148	4
PaperlinX	19,427	4
Australia and New Zealand Banking Group	19,241	4
Australand Property Group	18,778	4
Iluka Resources	17,707	3
APN News & Media	16,360	3
Caltex Australia	16,236	3
PMP	16,086	3
ALE Property Group	14,499	3
Roc Oil	13,230	3
Valad Property Group	12,971	3
Fisher & Paykel Appliances	12,461	2
Pharmaxis	12,040	2
Centro Retail Trust	11,117	2
Tower	10,747	2
Air New Zealand	9,923	2
Nuplex Industries	9,745	2
Acrux	9,259	2
Salmat	8,989	2
Centennial Coal	8,604	2
Guinness Peat Group - CDI	8,547	2
ChemGenex Pharmaceuticals - Ordinary and Options	8,532	2
Suncorp-Metway	8,432	2
SP AusNet	8,306	2
Nexbis	8,075	2
Ridley	7,734	1
Macquarie Office Trust	7,114	1
Thakral	6,682	1
Sunland Group	5,924	1
Peplin - CDI, Options and Warrants	5,335	1
Positions less than 1%	86,567	17
<b>Total Equity Exposure</b>	<b>461,554</b>	<b>91</b>
<b>Stock Index Futures Bought*:</b>		
SPI 200 12/2009	38,578	8
<b>Net Current Assets</b>	<b>4,933</b>	<b>1</b>
<b>Net Assets</b>	<b>505,065</b>	<b>100</b>
<b>Net Asset Value per Unit</b>	<b>A\$ 1.0879</b>	
<b>Total Assets Under Management for the Australian equity strategy (000's)**</b>	<b>A\$ 1,337,773</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.

\*\* Orbis Investment Management (Australia) Pty Limited also manages several segregated accounts that have the same investment goals and restrictions as the Fund.

## 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 "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 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 "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.



ORBIS INVESTMENT MANAGEMENT (AUSTRALIA) PTY LIMITED (AFS Licence No. 298487) • LEVEL 2, CHALLIS HOUSE,  
4-10 MARTIN PLACE, SYDNEY, AUSTRALIA NSW 2000  
TELEPHONE: +61 (0)2 82248600 • E-MAIL: [clientservice@orbisfunds.com.au](mailto:clientservice@orbisfunds.com.au) • WEBSITE: [www.orbisfunds.com.au](http://www.orbisfunds.com.au)