

Analysts: Simone Arblaster; Leanne Fook

Products Facts

Manager	Souls Funds Management Limited	Fund type	Retail	Boutique	Yes
APIR code	VIM0002AU	Specialisation	—	Multimanager	No
Fund status	Open	Peer group	Australian Equities - Large Cap	Inception date	April 19, 2006
Min. investment (A\$)	25000			MER (% pa)	—

Standard & Poor's View

S&P rates this fund three stars, reflecting our conviction that the manager will consistently generate risk-adjusted returns in-line with both its relevant investment objectives and its peers.

Souls Funds Management (Souls) started building up its research coverage in the large-cap space in 2005 by hiring three experienced analysts. Souls is better known for its small-cap fund that it began in 1998, which S&P regards highly. This fund has been downgraded from four stars to three stars, due to peer-group-relative assessment.

The team comprises six investment members, including chief investment officer and small-cap portfolio manager, Frank Villante. Mr. Villante has been managing the small-caps since early 2004 and is now dedicated to small-caps research, although he provides useful feedback on large-cap company research.

Mike Byrne is the large-cap portfolio manager and is responsible for managing this fund and the Australian Equity Fund. He became the portfolio manager in September 2007, taking over from Mr. Villante, and was one of the 2005 recruits. Mr. Byrne has 13 years of investment experience, with prior experience predominantly spent doing equity analysis on Australian and global resource companies, and a range of industrial stocks. This is his first opportunity in portfolio management.

The fund began in 2006 and provides investors exposure to 20-40 stocks within the S&P/ASX200 Index, with a focus on the largest 100 companies. This is a high-conviction, concentrated portfolio that may show high levels of volatility over the shorter-term, relative to the benchmark positioning and performance. There is only a limited track record for this fund; however, it marginally outperformed its benchmark over the two-year period to April 30, 2008. S&P's conviction will increase as the fund establishes a track-record of consistently meeting its objectives.

Product Features

The Souls Select Australian Share Fund (the fund) aims to provide investors with capital gains over the medium-to-longer-term. The fund seeks to hold high-conviction positions while targeting a tracking error of 4%-6%. The fund typically invests in 25-30 large-cap stocks, with the mandate permitting up to 25% of the portfolio to be invested in S&P/ASX ex-100 stocks; of these, up to 10% can be invested in companies outside the S&P/ASX 200. Investors should be aware that there are no maximum limits on the allocation of assets to economic sectors, and therefore any sectoral bias will be as a result of the stock-selection process.

The fund has a management expense ratio (MER) of 0.7%. This is good value relative to peers; however, there is also a performance fee of 20%, which is applied to the manager's performance over the benchmark return plus 2% for the calendar-year period. It measures the performance fee and makes it payable bi-annually. The fund must recover any underperformance in any half-year period in the subsequent half-year

period before a performance fee can be earned. The fund's bid/offer spread is high relative to peers, at 0.8%.

Fund Objectives

Benchmark	S&P/ASX 200 Accumulation Index
Target return (% p.a.)	Benchmark + 3.0% p.a, over rolling 3 yr periods
Target tracking error	4% - 6%

Investment Style

The manager employs a valuation-driven, bottom-up approach to identifying Australian large-cap stocks. Fundamental stock analysis is the foundation of the investment process. The approach aims to identify companies that are trading at a discount to the manager's assessment of their intrinsic or fair value. The valuation process focuses predominantly on the analysis and valuation of free cash flow, enterprise values, and earnings. A catalyst is also required to close the valuation gap. The team values research highly, and the manager will only invest in a stock if it understands the business model, management track record and capital stewardship, and the quality of financial accounts.

The approach is style-agnostic, in that it has no predetermined bias to either growth or value factors. That said, the portfolio may display growth or value tilts from time to time.

Passive					Active
Value					Growth
Small Cap					Large Cap

Investment Team

Mr. Villante, the chief investment officer, leads the team. He joined Souls in January 2004 and brings to the fund 23 years of investment experience, including investment-analysis and portfolio-management experience at NRMA Investments and Bankers Trust between 1988 and 2001. More recently, Mr. Villante was employed in consulting roles for listed and unlisted companies, and has been involved in project work for ASIC.

In September 2007, Mr. Villante handed over large-cap portfolio-management responsibilities to Mike Byrne, and now focuses his time on the management of the small-companies fund and small-companies research. He will continue to be involved with the large-cap team, acting as a sounding board and challenging analysts' recommendations.

Mr. Byrne joined in September 2005 as a senior analyst and was appointed as the head of large-cap research in September 2006. He has 13 years of investment experience, which covers the analysis of Australian and global resource companies, and a range of smaller industrial stocks. Prior equity-analysis experience includes two years with Edey Rogers and Co. in South Africa, more than three years with both Ord Minnett/JP Morgan and Goldman Sachs, and most recently two years with Paradise Cooper Investors on the small-companies fund. This is Mr. Byrne's first opportunity in portfolio management.

The large-cap team comprises an additional four investment analysts: Paul Biddle (14 years' investment experience, three years with Souls), Anoop Kalra (14 years' investment experience, two-and-a-half years with Souls), Scott Armstrong (14 years' investment experience and joined Souls in February 2008), and Dr. Andreas Stephens (nine years' investment experience, nine years with Souls). Mr. Biddle, Mr. Byrne, and Mr. Kalra joined in 2005, primarily to research the large-cap market place; however, they also have some small-cap coverage. Each analyst covers approximately 25 stocks as primary and 15-20 as a secondary. The team operates in a collegiate manner, so that there is an equilateral split of stocks by market capitalisation.

S&P views the team as well-resourced. Individually, the team members have good investment experience; however, we believe that it lacks large-cap portfolio-management skills relative to its peers.

Washington H. Soul Pattinson has been described as an ideal parent, viewing its holding in Souls as a long-term investment. In September 2007, the parent owned 67% of Souls, Souls staff owned 26%, and outside investors owned the remaining 7%. The staff equity level will increase over time, and is conditional on the fund meeting its performance targets. Investor interests are aligned through several means: the issue of staff equity that vests over a minimum of four years; bonuses being dependent on profitability, and staff performance against performance indicators; and a high-water mark performance fee. S&P considers that these create a good alignment with investors.

New					Experienced
Small					Large
Unstable					Stable

Investment Process

The investable universe comprises stocks listed on the S&P/ASX 200 Index, with a focus on the largest 100 stocks. A qualitative filter is applied to the universe, which excludes companies on the basis of Souls' knowledge and assessment of their financial statements (typically five years of financial history will be analysed). The quality of the management and composition of the board are key factors in Souls' assessment, these individuals being stewards of the company's capital.

Souls conducts in-depth research on companies that it has highlighted as potentially suitable investments. To thoroughly grasp the company, the team conducts a Porter-style analysis to understand the industry dynamics and potential for growth. Souls will hold discussions with customers, suppliers, competitors, and other industry groups to better gauge industry trends. Although it uses broker-sourced data to provide consensus information, it will modify this data if Souls believes it to be an inaccurate reflection of a company's value. S&P considers this to be where active managers can significantly add value.

Souls will quantify the company's intrinsic value using a three-phase growth model, which it applies to the company's free cash flow and focuses on a medium-term investment outlook. It will use additional sources of value to supplement the model, including enterprise value-to-EBITDA, price-to-earnings, return-on-equity, and profit margins. The level of a company's debt usage is also a valuable indicator of the company's ability to grow its business in the future. Analysts will update inputs into the valuation model as new information becomes available.

Once it has performed the modelling, the analyst will prepare a stock review to present to the team. The stock review includes an assessment of the multiple valuation metrics relative to the market, an outline of the reasons for investment, and what milestones need to occur to ensure that the investment idea plays out over time. Souls will monitor the milestones, and may take action if the stock does not realise these. The analyst will also estimate the stock's expected return, based on its target-price estimate and the level of confidence it has in the company actually making this return on investment. These two factors are the centrepiece of the portfolio-construction process.

The portfolio-construction process is very structured. Souls has constructed a portfolio-return matrix that will give an indicative stock weighting, which it bases on a combination of expected-return potential and the team's level of conviction that the stock will realise this return. The manager categorises return potential as "Tier 1" if its return potential is 25% or more, "Tier 2" if it is 15%-25%, and "Tier 3" if it is 5%-15%. It gives a level of confidence to each return estimate of either "High", "Strong", or "Modest".

Although a stock's target price may be reached, selling out of the position will not necessarily be automatic. Before selling the valuation, Souls reviews the model and return conviction. As the price of a stock moves closer to its target price, the manager may trim the portfolio weight and redeem the funds to invest in another stock with greater upside potential. Earnings surprises, changes to management, or business models can also trigger the sale of holdings.

Performance

The fund aims to outperform the S&P/ASX 200 Accumulation Index by 3% p.a. (before fees) over rolling three-year periods.

Since the fund's inception in April 2006, the fund has outperformed its benchmark by 2.1% p.a. on a gross basis. The fund is therefore not meeting its objectives; however, this is over a relatively short time period, which is less than the minimum investment period that the manager advises.

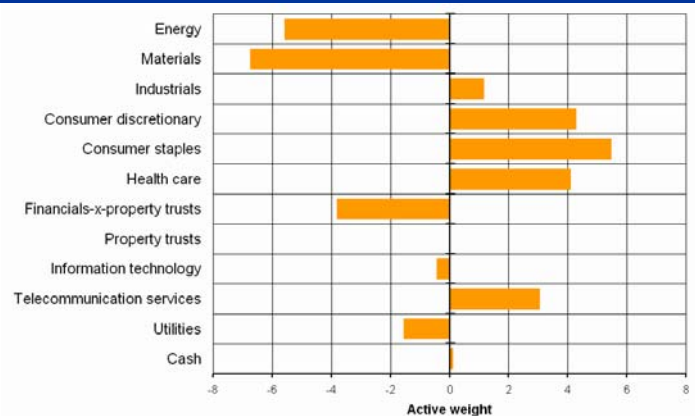
For the 12 months to April 2008, the fund had underperformed its benchmark by 1.5%. Underweight holdings in Rio Tinto and Woodside Petroleum, and an overweight holding in Fletcher Building detracted from performance. An underweight position in Commonwealth Bank and an overweight position in OneSteel Ltd. added value.

Performance Measures

Average portfolio turnover (%)	110
Typical number of stocks in portfolio	20-40

Source: Souls Funds Management Limited.

Sector Exposure Versus Fund Benchmark (at Dec. 31, 2007)



Source: Souls Funds Management Limited.

Risk Management

The fund may invest in all industry sectors. No sectoral limits apply to the management of the portfolio, with sectoral bias being the result of the stock-selection process. Souls filters and captures stock risk factors in the qualitative assessment of the company. It manages portfolio risk using general portfolio guidelines: diversifying the fund by requiring it to hold a minimum of 15 stocks from the S&P/ASX100; and limiting maximum exposure to any one stock to the greater of 10% of the Net Asset Value of the fund, or 5% above the S&P/ASX All Ordinaries Index stock weighting (at the time of purchase).

The maximum cash level is 10%. Souls does not use derivatives in the management of its portfolios. The manager view risk as the risk of capital loss.

Management Group Profile

Souls Funds Management Ltd. is a boutique investment manager that specialises in Australian equities and offers its capabilities to wholesale investors, high-net-worth clients, and through platforms (master trusts and wraps) for the retail market. Souls expanded its research coverage in 2005 to include an Australian large-cap capability. Souls believes that this expansion has increased the quality of its small-cap research by encouraging lateral thinking.

The funds-management organisation dates back to 1998, through the formation of Flinders Asset Management Pty Ltd. Flinders became Veritas Investment Management Ltd. in 2002. In September 2003, Washington H. Soul Pattinson (the parent) became the majority stakeholder in Veritas Investment Management, renaming the funds-management business Souls Funds Management Ltd. Vincent Parrott is the managing director, and has 27 years' industry experience covering many facets of the industry, including investment research and portfolio management; business development; client service; marketing; and general management. Mr. Parrott set up Veritas Investment Management in 2001.

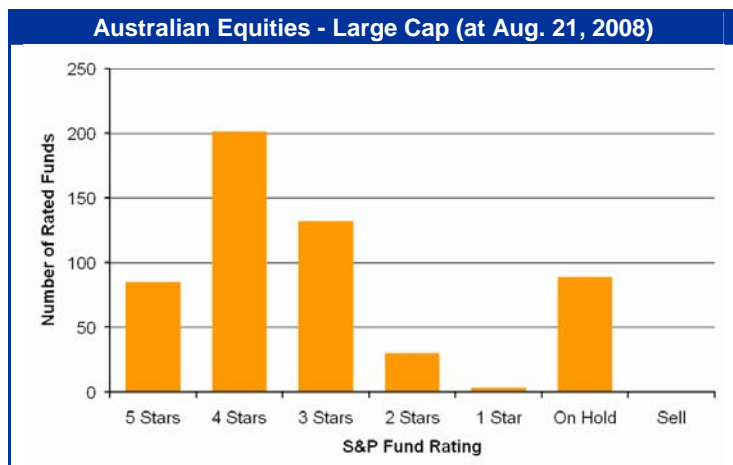
Market Share

Souls aims to market its capabilities to wholesale investors, high-net-worth clients, and the retail market through platforms. As at September 2007, Souls' total funds under management (FUM) was A\$478 million--a decrease of 4% from Dec. 31, 2006. Of this amount, A\$32 million is Australian large-cap FUM. In March 2008, the Select Australian Equity Fund had A\$10.8 million in FUM.

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Release authorised by: Mark Hoven.

S&P Fund Rating Reference Information



Reference Material

Sector Reports www.standardandpoors.com.au/funds
Reader's Roadmap www.standardandpoors.com.au/funds
Glossary www.standardandpoors.com.au/funds
Guide to S&P Qualitative Fund Ratings www.standardandpoors.com.au/funds
Fund Rating Team Biographies www.standardandpoors.com.au/funds

Fund Rating Peer Groups by Sector

Australian Equities	International Equities	International Fixed Interest	Alternative Assets
Large Cap Diversified	Diversified Equities	Diversified Fixed Interest	Commodities
Large Cap Income	Emerging Markets	Diversified Fixed Interest Income	Multi-Sector
Large Cap Indexed	Emerging Markets Asia ex Japan	Fixed Interest	Private Equity Listed
Large Cap Industrials	Emerging Markets China	Fixed Interest High Yield	Private Equity Unlisted
Long Short	Emerging Markets India	Fixed Interest Income	Infrastructure Listed
Small Cap	Large Cap Diversified	Mortgages	Infrastructure Unlisted
Specialist	Large Cap Income	Mortgages High Yield	Alternative Strategies
Australian Fixed Interest	Large Cap Indexed	Mortgages High Yield Hybrid	Single Strategy Funds Multimanager
Cash	Large Cap Industrials	Mortgages Conventional	Single Strategy Funds Single Manager
Cash Enhanced	Long Short	Mortgages Hybrid	Multi-Strategy Funds Multimanager
Fixed Interest	Long Short Specialist	International Property	Multi-Strategy Funds Single Manager
Fixed Interest Income	Long Short Regional	Direct Commercial	Multi-sector
Mortgages	Regional Japan	Direct Development	Capital Guaranteed
Mortgages High Yield	Regional UK/Europe	Direct Diversified Direct	20
Mortgages Conventional	Regional US	Direct Industrial	40
Mortgages High Yield Hybrid	Regional Asia	Direct Residential	60
Mortgages Hybrid	Small Cap	Direct Retail	80
Australian Property	Specialist Healthcare	Direct Rural	100
Direct Commercial	Specialist Information Technology	Direct Specialised	Equity
Direct Development	Specialist Resources	Diversified Property	Other
Direct Diversified Direct		Listed	
Direct Industrial			
Direct Residential			
Direct Retail			
Direct Rural			
Direct Specialised			
Diversified Fixed Interest Listed			








Fund Rating Philosophy

A star rating is a forward-looking qualitative assessment of a manager's ability to consistently generate risk-adjusted fund returns (net of fees) in excess of both its relevant investment objectives and its peers.


Fund Rating Process

In assigning a star rating to a fund, Standard & Poor's evaluates: the size, skill, and stability of the manager's investment team; the clarity, implementation, and risk management of the investment process; the fund's objectives, fee structure, and portfolio characteristics; and the manager's business management.

Fund Rating Definitions

	Standard & Poor's has very high conviction that the manager will consistently generate risk-adjusted fund returns in excess of its relevant investment objectives and relative to its peers.
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	Standard & Poor's has conviction that the manager will generate risk-adjusted fund returns in-line with its relevant investment objectives and relative to its peers.
	Standard & Poor's has conviction that the manager will not generate risk-adjusted fund returns in in-line with its relevant investment objectives and relative to its peers.
	Standard & Poor's has high conviction that the manager will not generate risk-adjusted fund returns in-line with its relevant investment objectives and relative to its peers.
	Issues that may affect the fund's management have emerged; and the fund rating is temporarily suspended, pending clarification.
	Significant issues exist that potentially will adversely affect the fund's performance. Investors should consider obtaining advice on switching or redeeming funds.

Fund Rating Subscript

 The investment process, fund manager, or the fund has a relatively short history, or the analytical team has changed significantly, but a relevant and demonstrable track record is shown on similar funds.

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