



Inside the investment team...

Sold ... after Perpetual under-performance

Hyperion has a proprietary investment process designed to deliver strong, five-year rolling returns for our investors. Following this process without fear or favour is what has delivered us success in the past, and what we firmly believe will continue to deliver it over the long term. Recently, many of our investors saw our process in action in a more visible way than usual, when we sold our longstanding holding in Perpetual.

The story of Perpetual provides us with an ideal opportunity to share with you some of the extensive research, planning and modelling that goes into the construction and management of Hyperion's portfolio. Our aim is to produce a relatively concentrated portfolio of high quality companies with predictable earnings and superior growth potential. To achieve this aim, we have a strong investment philosophy, which is underpinned by strictly defined investment criteria. Only companies that meet these criteria find a place in the Hyperion portfolio.

Adhering to the investment philosophy

As you would expect, an ever changing market and investment environment requires us to regularly review our holdings to ensure they continue to meet our investment criteria. As a result of our most recent review we decided to sell out of Perpetual. Perpetual was one of our foundation stocks and part of our portfolio since before 2000.

However, our concern was that, in recent times, it had ceased to deliver to shareholders. This happens in equity investing and, subject to our investment criteria, we frequently hold onto a stock that is not performing strongly in the short-term because we believe it will outperform in the future. So, of far greater concern for us in this case, was that in our view it simply did not hold realistic prospects of sustainable strong performance in the future.

This was by no means a conclusion that we reached overnight. Rather, it was the final result of the gradual decline in our levels of confidence in Perpetual - a decline which led us to begin gradually selling off our holdings in this stock some time ago. By the time we sold out completely in March 2011, we retained only a very small, one per cent, holding. This weighting was so small that it didn't represent good value for our investors.

A question of growth, management and long-term prospects

This brings us to a consideration of exactly why we lost confidence in Perpetual, and how those reasons broadly reflect our high conviction investment approach. It was a combination of these factors that led to our decision to sell.

One key factor was Perpetual's organic growth prospects, or rather, its lack thereof. The ability of an organisation to grow - organically rather than through the higher risk means of acquisition - is a major Hyperion investment criterion. In the Australian equity market, Perpetual is a mature business that has seen significant past success. However, it has been approaching its FUM capacity for some time, a fact it recognised and sought to address with a number of management initiatives, the release of new products and an attempt to build an international equities business. Unfortunately, these initiatives have enjoyed little success.

The international equities business has failed to grow funds. In the six years since its inception, it has incurred significant losses, estimated at \$60 million, with no real signs of achieving long-term financial success. The new products, including the exact market cash funds and direct property and infrastructure products, also failed to add value for shareholders.

Another, related, factor in our decision was the decline in Perpetual's longer term revenue earnings outlook, along with its lacklustre five-year financial performance. This was - and still is - reflected in its declining share price, which currently sits around \$28, well down from highs of over \$37 last year.

Specifically, five-year revenue growth was below GDP, averaging just over three per cent per annum. That fact alone meant it failed to meet another of Hyperion's criteria, which is to invest only in companies with historic revenue growth above GDP (equivalent to six per cent). We believe that, in the absence of a strong recovery in the markets, Perpetual's growth profile will remain subdued. Additionally, its EPS growth has declined by an average of 3.5 per cent per annum since 2005 - not the kind of loss that can be countenanced over the long-term.

Management strength, too, is a critical component of our investment criteria. An experienced, committed and intelligent team is required to build a strong sustainable business. While there is no doubt that many outstanding people have passed through Perpetual's doors - and still remain there - in our view there has nonetheless been erosion in the quality of the overall management team. While this may yet turn around under the new CEO and MD, this is far from clear to us at this stage and will certainly take time.

This loss of personnel may in part be attributable to last year's failed takeover bid by US private equity giant, Kohlberg Kravis Roberts & Co (KKR). Such events are often followed by career rethinks and moves on the part of key personnel and this may have happened in Perpetual's case.

Looking ahead

The net result of these colliding factors was that the company no longer met our investment criteria. We therefore made the decision to remove Perpetual from our portfolio altogether. The proceeds of the sale have been incorporated across the portfolio, including increasing our weighting in another Australian-based fund manager - Platinum Asset Management - which specialises in international equities and has plenty of room to grow. But that's another story.

Australian dollar expected to moderate over the long term

The Australian dollar's strong momentum continues with commodity prices well above historical averages. A rising, high Australian dollar is a short-term negative for the portfolio with a meaningful proportion of portfolio earnings coming from offshore. Hyperion's focus on quality growth stocks results in the inclusion of a number of global leaders in the portfolio including Cochlear and WorleyParsons. Over the long-term, we expect the Australian dollar to moderate, although we have selected companies with strong management and competitive advantages that at least have some strong cost and pricing levers relative to their peers. The long-term earnings outlook remains sound with the 5-year portfolio IRR at an attractive 19% p.a.

Leighton's profit downgrade reinforces our view on the challenges of contract businesses

The Hyperion Australian Equities composite and the Hyperion Australian Equities ASX 300 composite underperformed their benchmarks for the month of April. The Hyperion Australian Equities composite returned -0.89% and the Hyperion Australian Equities ASX 300 composite returned -1.05% versus the market return of -0.32%.

For the Hyperion Australian Equities composite, the largest contributors to this performance during the month included SEEK (2.81%), REA Group (4.56%) and Wotif.com Holdings (4.40%). The largest detractors from active performance during the month included not owning National Australia Bank (-2.98%), Cochlear (-2.98%) and Platinum Asset Management (-3.95%).

The investment team decided to remove Perpetual from the model portfolio during the month. Its 5-year historical sales CAGR remains below our growth threshold and in the absence of a strong recovery in the market, its organic growth outlook is modest. After further analysis, the investment team decided to completely exit the position as Perpetual's domestic equities business appears mature and past expansion plans remain unproven. We have higher conviction in our position in Platinum Asset Management which does not have the same capacity constraints and in our view, has a stronger business model.

For the Hyperion Australian Equities ASX 300 composite, the contributors to active performance during the month included SEEK (2.81%), REA Group (4.56%) and Wotif.com Holdings (4.40%). The biggest detractors to active performance during the month included not owning National Australia Bank (4.76%), Cochlear (-2.98%) and JB Hi-Fi (-6.06%). There was little news from the companies in our portfolio but it is worth noting the Leighton Holdings downgrade even though it is not a stock we hold.

Leighton Holdings downgraded its guidance for FY11 net profit to a loss of \$427 million versus its previous guidance for a profit of \$480 million. The large change to profitability was due to write backs of expected profits and an impairment of Leighton's investment in the AI Habtoor Leighton Group. Additionally, Leighton announced a fully underwritten 1-for-9 pro-rata accelerated renounceable entitlement offer of new LEI shares. LEI shares fell 11.9% on the first trading day following the announcement. The downgrade reinforces our view of the inherent challenges of contract businesses and the associated earnings transparency. Our preference remains WorleyParsons which focuses on 'cost-plus' work.

Performance	1 mth	6 mth	1 year	2 year	5 year	Since inception (Oct 96)
Hyperion Australian Equities Composite	-0.89	5.59	-0.36	21.71	6.26	14.56
Excess Performance over S&P/ASX 300 Accumulation Index	-0.57	-0.05	-5.52	3.84	3.65	4.96

Hyperion Australian Equities Composite Top 10 Stock Holdings		
Stock	Absolute Weight	Active Weight
Cochlear	8.02%	7.64
BHP Billiton	6.92%	-6.10
Commonwealth Bank of Australia	6.59%	-0.43
Seek	6.43%	6.24
Rio Tinto	5.69%	2.64
WorleyParsons	5.33%	4.78
Macquarie Group	4.92%	3.92
Sky Network Television	4.72%	4.72
Platinum Asset Management	4.71%	4.62
Woolworths	4.62%	1.92

Performance	1 mth	6 mth	1 year	2 year	5 year	Since inception (May 03)
Hyperion Australian Equities ASX 300 Composite	-1.05	6.43	0.02	20.93	7.60	15.53
Excess Performance over S&P/ASX 300 Accumulation Index	-0.73	0.79	3.07	3.07	4.99	4.79

Hyperion Australian Equities ASX 300 Composite Top 10 Stock Holdings		
Stock	Absolute Weight	Active Weight
Cochlear	8.45%	8.07
BHP Billiton	7.94%	-5.08
Commonwealth Bank of Australia	7.56%	0.55
Rio Tinto	6.84%	3.79
Seek	6.43%	6.24
WorleyParsons	6.00%	5.46
Macquarie Group	5.09%	4.08
Woolworths	5.04%	2.34
Platinum Asset Management	4.70%	4.61
Westpac Banking Corporation	4.44%	-1.93

Market overly optimistic about Sigma

The Hyperion Small Growth Companies Fund outperformed the market during April. The fund returned -0.20% versus the S&P/ASX Small Ordinaries Accumulation Index return of -2.61%. The largest contributors to this excess performance during the month included Sky Network Television (5.96%), REA Group (4.56%) and Wotif.com Holdings (4.40%). The largest detractors from active performance during the month included The Reject Shop (-8.65%), Count Financial (-6.50%) and not owning Sigma Pharmaceuticals (56.86%).

While Sigma Pharmaceuticals had a strong run during the month, its performance is from a low base and the company is still facing severe headwinds. After the divestment of its generic drugs business to Aspen last year, Sigma is now solely focussed on the distribution of generic drugs to retail pharmacies. However, it is exposed to a number of key threats. Firstly, there is the risk of further loss of key suppliers (for example, Pfizer brought its distribution in house in December last year) and secondly, its exposure to a class action lawsuit alleging lack of material disclosure to the market around its large write-offs last year. The investment team see it as a poor quality company that the market is currently overly optimistic about.

Performance	1 mth	6 mth	1 year	2 year	5 year	Since inception (Oct 02)
High Conviction Small Growth Companies Portfolio	-0.10	5.56	1.38	28.84	9.96	25.63
Excess Performance over S&P/ASX Small Ords Accumulation Index	2.51	1.98	-9.12	4.79	7.91	14.39

High Conviction Small Growth Companies Portfolio Top 10 Stock Holdings		
Stock	Absolute Weight	Active Weight
Sky Network Television	9.52%	9.52
IRESS Market Technology	9.40%	8.57
REA Group	9.08%	8.40
Wotif.com Holdings	8.54%	7.93
Reckon	8.14%	8.14
Carsales.com	7.77%	6.77
The Reject Shop	7.71%	7.45
Platinum Asset Management	5.90%	4.88
Count Financial	5.81%	5.81
Nick Scali	4.51%	4.51

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