HYPERION ASSET MANAGEMENT

SATELLITE REPORT January 2011

Inside the investment team...

Tech talk: the Hyperion approach to picking tech stocks

While tech stocks form a low 1% of the overall index, Hyperion Asset Management has a significantly higher holding, with some 22% of the Hyperion Australian Growth Companies Fund in the sector. Our investments team explains why.

First and foremost, it's important to understand that, although Hyperion's asset allocation may appear heavyweight in the tech sector, this is purely because an increasing number of tech companies meet certain quality criteria that, in our view, make them worthy of investment. The fact that they also happen to be tech stocks is, in a sense, by the by.

However, looking at the technology sector as a whole allows us to show the Hyperion stock picking process in action – and examine some of the companies that do (and don't) meet our standards.

Which brings us to the question of what is a quality company. And, when it comes to the tech sector in particular, which companies' stocks make the grade?

Yardsticks for quality

Firstly, we look for stocks that exhibit:

- **Return on capital:** this is our primary metric. Specifically, we look for ROE greater than 15% over a minimum of three years.
- **Low debt:** interest cover greater than four times.
- **Strong organic growth:** a three-year track record of organic growth that's well in excess of GDP.
- **A clear value proposition.**
- **Sustainable competitive advantage.**
- **Strong management team:** while we know that past performance is no guarantee of future performance, there is nonetheless a real nexus between performance and the management team. We are looking for management teams that are stable, collegiate, deep and are aligned with shareholder interests.

Secondly, we assess all of these characteristics against a long-term investment horizon, that is, a minimum five years - in line with our investors' expectations. We tend not to focus on performance in the next three or six months, keeping our eye on the longer term game.

Making the cut

A number of technology companies, by virtue of the fundamentals of their businesses, meet the criteria that Hyperion demands. Some examples include:

WOTIF [ASX:WTF] is an online business that continues to tick the quality boxes. Supported by relatively low capital requirements and low debt, its competitive advantage is clear - it is a hotel booking model that takes a 10% commission compared to its conventional competition, travel agents, which traditionally take commission in the region of 25%. There is still room in the market for the model to grow and so it has but in a manner that enables it to continue offering a high return on capital.

IRESS [ASX:IRE] is another online service model, providing share market, wealth management and client data management solutions to the finance sector. It is not alone in this space, but we believe it exhibits a number of characteristics that make it worthy. Once again, we are looking at a company with low capital outlays and low debt and a business that has very strong competitive advantage. In this case, its advantage is due not only to its large market share, but also to the deeply entrenched relationships IRESS has with its clients. The company has followed a considered strategy of building multiple contact points with its customers - choosing in a mature and very well penetrated market to add products, rather than customers and in so doing increasing its average revenue per customer.

Although its links to global stock markets provide the prospect of short-term volatility, here we are looking at the long-term and believe it can well and truly stay the course and deliver strong, predictable returns in the double digits.

Some popular tech stocks we avoid

A number of similar companies might, at first glance, seem to meet our quality criteria. However, here are some examples of well-known tech stocks we have consciously avoided:

WebJet [ASX:WEB] is a popular tech stock we have avoided despite initial positive appearances. Although it passes the high return on capital/low debt test, following closer scrutiny, we have doubts on whether the value proposition is strong enough to sustain its current growth rates in the longer term. WebJet primarily offers an at-a-glance comparison of major airlines' fares along with booking facilities. Alternatively, customers can go to individual airline websites, compare fares with multiple open screens, and - most importantly - ultimately get cheaper fares directly from the airlines concerned (as travellers avoid the Webjet service charge). So, despite its undeniable success to date our approach dictates that if we have some doubts about the company then we will stay out.

Computershare [ASX:CPU] is another strong, popular tech stock we currently don't hold for a number of reasons. Firstly, because it is a relatively mature company, it is looking for growth via acquisition rather than organically. We usually shy away from companies sourcing the majority of growth via acquisition. Not only is this type of growth hard to extrapolate, once an acquisition is made, the successful integration of the new company into the parent is notoriously difficult - and expensive. As we put real emphasis on a company's track record, it's understandable we avoid companies making large acquisitions as they make the historical track record of the company mostly irrelevant.

The Hyperion approach

We've talked a lot about the notion of 'quality' stocks and provided examples of what we define as strong - or otherwise - value propositions, and features that we believe constitute competitive advantage - or don't. Our adherence to these fundamental criteria is the external articulation of the philosophy that underpins all of Hyperion's investments, be it in tech stocks or any other. The economics of a business drives its long-term share price so to us it makes logical sense to search for companies with superior economics.

Thankfully not everyone agrees with this approach, meaning the market allows us to buy these high quality companies at prices that have produced long-term investment success for our clients.

Reporting season should highlight quality

According to one leading broker's forecasts, the resources sector is expected to deliver EPS growth of above 60% in the February reporting season. This compares to their forecasts of no EPS growth for the industrial (ex-financials) segment. Clearly, this level of earnings growth in the resources market is not sustainable and has been driven by strong commodity prices. Our holdings are again expected to outperform the reported results of their peers in February, with solid earnings and dividend growth predicted for the portfolio. The investment team is confident that the reporting season should highlight the superior quality and growth characteristics of the portfolio. With a predicted IRR of 19% pa over five years, the portfolio should produce attractive returns for clients over the long-term.

Short-termism provides buying opportunity

The Hyperion Australian Equities Composite marginally underperformed the S&P/ASX 300 Accumulation Index during January. The portfolio returned -0.08% versus the index return of 0.11%. The biggest contributors to active return included Macquarie Group (9.75%), WorleyParsons (3.40%) and not owning Newcrest Mining (-8.56%). The biggest detractors from performance during the month included Wotif.com Holdings (-14.86%), Cochlear (-4.12%) and Platinum Asset Management (-4.41%).

The Hyperion Australian Equities ASX 300 Composite was largely in-line with the S&P/ASX 300 Accumulation Index during the month. The portfolio returned -0.20% versus the benchmark return of 0.11%. The largest contributors to active performance included Macquarie Group (9.75%) and WorleyParsons (3.40%), and not owning Newcrest Mining (-8.56%). The largest detractors from active performance were Wotif.com Holdings (-14.86%), Cochlear (-4.12%) and not owning Wesfarmers (6.34%)

Wotif.com's substantial share price reduction provided us an opportunity to increase our position. In the absence of company specific news which would negatively impact the share price of the company, the Queensland floods seemed to fuel concern about the short-term prospects for the Queensland travel industry and by extension Wotif.com. Management responded to the ASX's price query confirming that nothing out of the ordinary had occurred within the business that should cause the share price to depreciate by this magnitude. We believe the market is currently over-concerned with short-term cyclical headwinds in the industry.

Woolworth's shares ended the month down 1%. Woolworths reported its first half of 2011 sales result and reduced its financial year 2011 earnings guidance (5% to 8% NPAT growth versus 8% to 11%). While its

Australian food and liquor business showed decent growth rates, its discretionary businesses (Big W and consumer electronics) were affected by a challenging trading environment. Woolworths was also impacted directly by the floods in Queensland.

Performance	1 mth	6 mth	1 year	2 year	5 year	10 year
Hyperion Australian Equities Composite	-0.08	5.20	5.78	28.41	7.41	10.40
Excess Performance over S&P/ASX 300 Accumulation Index	-0.19	-3.39	-2.93	6.96	3.74	2.39

Hyperion Australian Equities Composite Top 10 Stock Holdings		
Stock	**Absolute Weight**	**Active Weight**
Cochlear	7.32%	6.94
Rio Tinto	7.11%	3.92
Seek	6.59%	6.40
Commonwealth Bank of Australia	6.48%	-0.59
BHP Billiton	6.26%	-6.67
Platinum Asset Management	6.16%	6.06
Macquarie Group	5.10%	3.89
Woolworths	5.01%	2.19
WorleyParsons	4.73%	4.24
Sky Network Television	4.29%	4.29

Performance	1 mth	6 mth	1 year	2 year	5 year
Hyperion Australian Equities ASX 300 Composite	-0.20	4.69	5.62	27.21	8.57
Excess Performance over S&P/ASX 300 Accumulation Index	-0.31	-3.90	-3.09	5.76	4.89

Hyperion Australian Equities ASX 300 Composite Top 10 Stock Holdings		
Stock	**Absolute Weight**	**Active Weight**
Rio Tinto	8.45%	5.26
Seek	7.82%	7.63
BHP Billiton	7.61%	-5.32
Cochlear	7.24%	6.86
Commonwealth Bank of Australia	6.69%	-0.38
Platinum Asset Management	6.30%	6.20
WorleyParsons	5.15%	4.66
Macquarie Group	4.78%	3.56
Woolworths	4.76%	1.95
AMP	4.34%	3.37

Small cap portfolio continues to shine

The Hyperion High Conviction Small Growth Companies Portfolio outperformed the S&P/ASX Small Ordinaries Accumulation Index during January. The portfolio returned -0.49% versus the benchmark return of -2.18%. The largest contributors to active performance during the month included Sky Network Television (6.15%), Reckon (5.98%) and IRESS Market Technology (2.75%). The largest detractors from active performance included Wotif.com Holdings (-14.86%), not owning Aurora Oil & Gas (36.16%) and not owning GrainCorp (13.94%).

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Performance	1 mth	6 mth	1 year	2 year	5 year
High Conviction Small Growth Companies Portfolio	-0.49	5.86	4.54	37.91	11.55
Excess Performance over S&P/ASX Small Ords Accumulation Index	1.69	-14.92	-14.93	2.78	7.25

High Conviction Small Growth Companies Portfolio Top 10 Stock Holdings		
Stock	**Absolute Weight**	**Active Weight**
Sky Network Television	9.88%	9.88
IRESS Market Technology	9.57%	8.73
Reckon	9.50%	9.50
Wotif.com Holdings	8.07%	7.60
The Reject Shop	7.91%	7.58
REA Group	7.80%	7.19
Carsales.com	7.40%	6.95
Platinum Asset Management	6.92%	5.85
Count Financial	6.80%	6.80
Navitas	4.38%	3.64