

A moment with Manny...



I am often asked about the resources sector, particularly because Hyperion does not hold many resource stocks and more typically in regards to the likely impact on the sector of the Government's proposed super tax. Firstly, our response to the question about why we are not in a particular stock or of-the-moment sector always boils down to the same principle and that is we will not invest in companies that do not meet our strict definition of quality. Mining companies by their very nature are risky. This is because of the risks associated with the mining process itself (variation in quality of deposits, safety etc), the fact commodity prices vary daily and are set internationally and providers cannot differentiate their products e.g. coking coal is coking coal. Therefore, for a mining company to be considered by the investment team it must meet our return on equity and interest cover thresholds and more importantly have a competitive advantage which is to be at the bottom quartile of the cost curve with multiple product output. Few Australian mining stocks pass these hurdles.

In regards to the potential impact of the proposed super tax, the issue for me is the likely impact such a tax will have on attracting investors. The largest costs for any mining company are equipment and fuel which are sourced internationally and priced consistently across the world. The locally determined costs are the only variables where a miner can seek cost curve differentiation when ore grades are similar. Australian labour, a local cost input, is not cheap which therefore leaves the major variable the tax rate. With Australia considering increasing the tax rate, we are potentially handicapping our local miners when it comes to competing in the world market for capital. This is not a compelling proposition when one is attempting to attract investors who will make a decision to invest in projects based on the return they expect to achieve on their investment commensurate with the risk.

Dr Manny Pohl, Managing Director & Investment Team Chairman

Uncertain times present opportunities for quality companies

The current global outlook remains cautious in the near term. In an uncertain economic climate, the market should provide investors with good opportunities to accumulate high quality companies at distressed prices. The current internal rate of return of the fund is at the same level it was in March 2008. Despite a number of earnings downgrades in the market over the past few months, the investment team is confident that the fund will perform strongly during the upcoming reporting season.

Broad cap strategy continues outperformance over 5+ years

The Hyperion Australian Equities Composite marginally underperformed during the month, returning -7.78% versus the S&P/ASX 300 Accumulation Index return of -7.54%. The largest active contributors to performance during the month included an underweight position relative to the benchmark in Banking Financials (-4.88%), Health Care (-0.54%) and an underweight position in Utilities (-1.31%). The biggest contributors to the performance of the fund at a stock level included Cochlear (-1.77%), Platinum Asset Management (-2.55%) and IRESS Market Technology (-1.06%).

The target weight of Platinum Asset Management within the portfolio increased in May. Platinum has a strong presence in the retail market due to its solid track record and has now increased its marketing efforts in order to penetrate the institutional market. The focus on this segment should translate to good institutional inflows over the long-term.

| Performance | 1 mth | 6 mth | 1 year | 2 year | 5 year | 10 year |
|---|-------|-------|--------|--------|--------|---------|
| Hyperion Australian Equities Composite | -7.78 | 1.15 | 34.56 | 6.23 | 11.88 | 12.03 |
| Excess Performance over S&P/ASX 300 Accumulation Index | -0.24 | 5.38 | 13.84 | 13.76 | 5.84 | 3.96 |

| Top 10 Stock Holdings | | |
|--------------------------------|-----------------|---------------|
| Stock | Absolute Weight | Active Weight |
| Seek | 7.59% | 7.36 |
| Woolworths | 6.94% | 3.83 |
| Cochlear | 6.49% | 6.11 |
| Commonwealth Bank of Australia | 6.29% | -1.21 |
| Platinum Asset Management | 5.87% | 5.77 |
| BHP Billiton | 5.35% | -6.75 |
| RIO Tinto | 5.31% | 2.56 |
| REA Group | 5.28% | 5.28 |
| IRESS Market Technology | 4.16% | 4.08 |
| Carsales.com | 3.83% | 3.79 |

Quality online classified companies expected to perform long-term

The Hyperion Australian Equities ASX 300 Composite outperformed during the month returning -6.91% versus the S&P/ASX 300 Accumulation Index return of -7.54%. The largest contributors to that performance during the month included Cochlear (-1.77%), Platinum Asset Management (-2.55%) and Woolworths (-1.66%). The biggest detractors from performance during the month included Seek (-10.73%) and not owning Wesfarmers (-0.65%) or Westfield Group (-1.39%).

In our view, the underperformance of Seek was not driven by any changes to its earnings outlook or operating environment. RBS Equities published a report during the month which was negative about the online classifieds market, suggesting that it is a mature market and that penetration rates will slow in the near future. The investment team remains confident that the structure of the online industry remains favourable and that companies like Carsales and Seek still have the ability to push through significant price rises over the long term. These additional price increases will positively impact the bottom line given their scalable business models.

| Performance | 1 mth | 6 mth | 1 year | 2 year | 5 year |
|---|-------|-------|--------|--------|--------|
| Hyperion Australian Equities ASX 300 Composite | -6.91 | 0.53 | 33.68 | 7.52 | 14.12 |
| Excess Performance over S&P/ASX 300 Accumulation Index | 0.63 | 4.76 | 12.96 | 15.05 | 8.08 |

| Top 10 Stock Holdings | | |
|--------------------------------|-----------------|---------------|
| Stock | Absolute Weight | Active Weight |
| Seek | 9.49% | 9.26 |
| BHP Billiton | 7.94% | -4.16 |
| Woolworths | 7.28% | 4.16 |
| Cochlear | 6.75% | 6.36 |
| Commonwealth Bank of Australia | 6.17% | -1.33 |
| Platinum Asset Management | 5.97% | 5.88 |
| RIO Tinto | 5.96% | 3.21 |
| Carsales.com | 4.98% | 4.93 |
| IRESS Market Technology | 3.87% | 3.79 |
| Macquarie Group | 3.85% | 2.49 |

Ignoring sector biases contributes to performance long-term

The High Conviction Small Growth Companies Portfolio marginally underperformed during May. The portfolio returned -8.93% versus the S&P/ASX Small Ordinaries Accumulation Index return of -8.18%. The largest contributors to active performance at a sector level included our portfolio being underweight Industrials (-14.63%), not owning Property Trusts (-11.37%) and our underweight relative to the benchmark holding in Non-Banking Financials (-5.25%). From a stock level the largest contributors included IRESS Market Technology (-1.06%), Platinum Asset Management (-2.55%) and not owning Virgin Blue Holdings (-44.54%).

| Performance | 1 mth | 6 mth | 1 year | 2 year | 5 year |
|--|-------|-------|--------|--------|--------|
| High Conviction Small Growth Companies Portfolio | -8.93 | 2.52 | 40.56 | 14.09 | 15.06 |
| Excess Performance over S&P/ASX Small Ords Accumulation Index | -0.75 | 8.24 | 21.55 | 28.56 | 10.36 |

| Top 10 Stock Holdings | | |
|---------------------------|-----------------|---------------|
| Stock | Absolute Weight | Active Weight |
| REA Group | 9.77% | 9.77 |
| Carsales.com | 8.43% | 7.89 |
| Platinum Asset Management | 7.85% | 6.74 |
| The Reject Shop | 6.52% | 6.08 |
| IRESS Market Technology | 6.37% | 5.46 |
| Count Financial | 6.11% | 6.11 |
| Fantastic Holdings | 5.47% | 5.47 |
| Reckon | 5.42% | 5.42 |
| Sky Network Television | 5.30% | 5.30 |
| Navitas | 5.28% | 4.29 |

Recent Mandate Wins and Remaining Capacity

A large mandate win booked during April was completed in May and coupled with existing client fund inflow and interest from retail investors via financial planners saw funds under management increase this month. The team is confident funds under management will continue to grow over the coming months, based on expressed interest from potential new institutional clients.

| Product Capacity | | |
|--|----------------|--------------------|
| PORTFOLIO | UNIVERSE | REMAINING CAPACITY |
| High Conviction Small Growth Companies | Small Ords | \$0.1b |
| Australian Equities ASX 300 Composite | ASX 300 | \$1.1b |
| Australian Equities Composite | All Ordinaries | Soft closed |

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