

Celeste Australian Small Companies Fund

31 Dec 2010

The Celeste Australian Small Companies Fund (the Fund) offers investors a pure exposure to the small cap universe of the Australian equities market. Zenith has always been impressed with the transparency of the team and process and believes the current ownership structure provides a strong incentive for continued benchmark outperformance by the Celeste Australian Small Caps Fund

Celeste Fund's Management, originally Souls Funds Management, is a boutique Australian equities specialist with over \$300 million in funds under management. After being acquired by the Treasury Group in 2009, the ownership structure of the business became partnership, with the investment team owning 59%, the Treasury Group holding 39% and the remaining 2% held by minority shareholders. The business is staffed by 4 investment professionals, lead by Chief Investment Officer, Frank Villante, and an operations manager. The team is highly experienced with a combined total of over 88 years of investment experience and is supported in the way of legal services, HR, back office and distribution by the Treasury Group. A culture of diligence and transparency is evident within the investment process which we believe has resulted in a strong long-term track record. Zenith has a high level of confidence in Villante and his team, and is satisfied that an appropriate remuneration and ownership structure is in place to reduce the risk of any departures.

The Fund aims to generate 5% above the ASX/S&P Small Ordinaries Index over a rolling 3 year periods by maintaining a benchmark unaware and relatively concentrated portfolio. Celeste's security selection process is built on the premise that markets are inefficient and occasionally fail to reflect the intrinsic value of stocks. The Manager casts a wide net over 300 securities (excluding the ASX top-100) to identify companies that exhibit cashflow stability, a strong business model and a committed board and management. The research focuses on the company's financial performance history, senior management capabilities, and the robustness of the business model. Each analyst utilises a range of data sources to gain insight on a stock and a range of valuation factors are applied according to the characteristics of the stock's industry. Analysts utilise broker models primarily or construct models internally where there is a significant level of discrepancy amongst broker models. The quantitative and qualitative analysis conducted culminates into a Stock Review document that tabulates the analyst's level of stock conviction, potential portfolio exposure, growth projections, stock milestones and a social, governance & environmental summary. In Zenith's view the stock selection process is thorough, consistently applied and flows fluidly into the portfolio construction process.

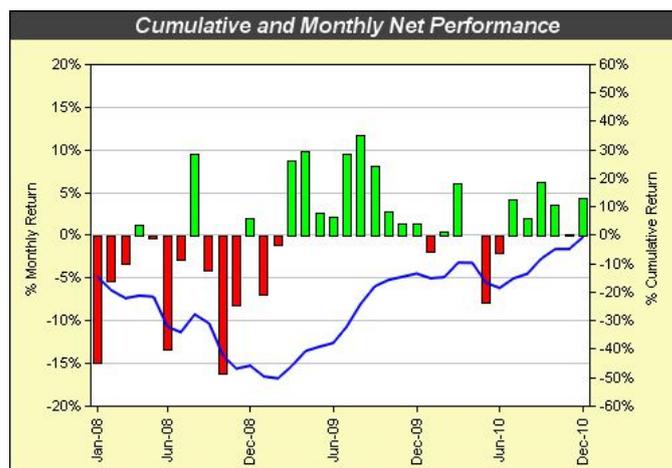
The portfolio construction process is a by-product of the stock research process. The analysts level of conviction and stock return potential are tabled in the Stock Review document that generates a portfolio target weight, determined by the portfolio return matrix. Target weights are subjectively overlaid by Villante based on stock liquidity and current portfolio positioning. The portfolio is benchmark unaware and reasonably concentrated consisting of between 20 to 50 securities (normally around 35), with a tracking error range of 8% to 12%. Risk is managed throughout the investment process from the initial universe filtering to the in-depth research analysis applied. The portfolio manager reviews the portfolio in accordance with the risk parameters in place on a weekly basis through an internally designed risk management system.

Fees include a management fee of 0.95% p.a. plus a 20% performance fee based on positive outperformance of the Fund's benchmark. A high-water mark is included in the Fund's performance fee structure. Zenith considers the fee structure to be highly competitive in comparison to the Fund's small cap peers.

The Fund's neutral investment style and pursuit of finding companies with quality fundamentals makes it ideal for investors seeking an Australia small market capitalisation exposure.

Zenith rate the Celeste Small Companies Fund **HIGHLY RECOMMENDED**.

Key Features	Description
APIR Code	FAM0101AU
Asset Class	Australian Shares
Sub-Asset Class	Small Companies
Investment Style	Neutral
Benchmark	S&P / ASX Small Ordinaries (Accum)
Recommended Investment Timeframe	5 + years
Chief Investment Officer	Frank Villante
Investment Team Size	4



Performance Analysis

Performance Statistics	5 Yrs (% p.a.)	3 Yrs (% p.a.)	1 Yr (% p.a.)
Performance - Fund	10.18	-0.29	14.77
Performance - Benchmark	5.54	-5.89	13.04
Performance - Median Manager	7.89	-1.63	17.84

As demonstrated in the table above, the Fund has a long term track record with a strong level of outperformance above benchmark over this time period. This is a testament to the Team's strong buy/sell discipline driven by thorough and diligent research.

The Fund's investment objective is to outperform the S&P/ASX Small Ordinaries Accumulation Index by 5% per annum (before tax and management fees) over a rolling 3 year period, with an expected tracking error between 8%-12%.

- 01/07/2009-30/06/2010: Income 8.90%, Growth 3.91%, Total 12.81%
- 01/07/2008-30/06/2009: Income 4.20%, Growth 41.57%, Total 45.77%
- 01/07/2007-30/06/2008: Income 9.80%, Growth -53.05%, Total -43.25%

The above return breakdown exhibits a mixture of income and growth derived returns, highlights the Fund's neutral investment approach.

Consistency Analysis

Consistency Statistics	5 Yrs	3 Yrs	1 Yr
History of Monthly Excess Return (%)	51.67	47.22	50.00
History of Monthly Excess Return (Rising Mkts %)	40.00	27.27	25.00
History of Monthly Excess Return (Falling Mkts %)	75.00	78.57	100.00

The Fund's outperformance statistics illustrate the Manager's strong ability to generate outperformance above benchmark in falling market conditions consistently over a 1, 3 and 5 year period. The Fund's benchmark unaware and style-neutral approach to stock selection is reflected in the table above, with the fund outperforming the benchmark approximately 50% of the time. The focus on securities with strong business fundamentals helps to shield the fund against highly volatile securities.

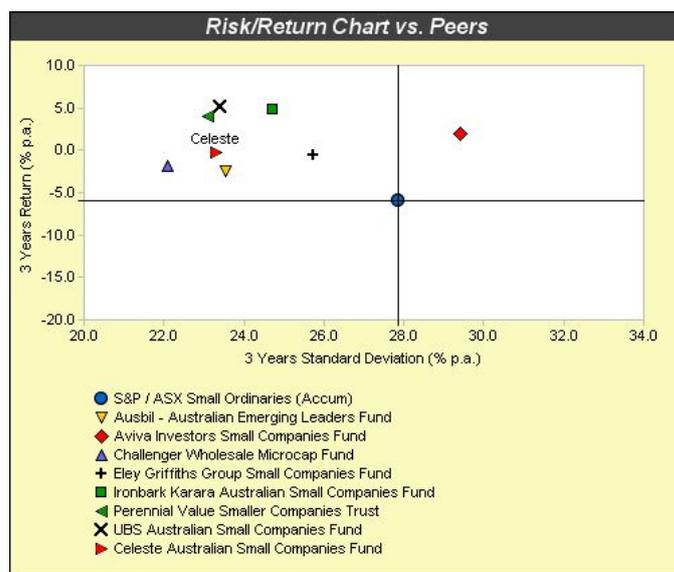
Zenith has confidence that the Celeste team will continue to deliver benchmark outperformance in the medium to long term.

Risk / Return Analysis

Risk / Return Statistics	5 Yrs	3 Yrs	1 Yr
Information Ratio - Fund	0.39	0.41	0.24
Information Ratio - Median Manager	0.39	0.39	1.03
Sharpe Ratio - Fund	0.23	-0.24	0.76
Sharpe Ratio - Median Manager	0.14	-0.29	0.76
Standard Deviation (% p.a.) - Fund	19.72	23.32	13.36
Standard Deviation (% p.a.) - Median Manager	20.59	25.08	17.49
Tracking Error (% p.a.) - Fund	11.76	13.70	7.22
Tracking Error (% p.a.) - Median Manager	7.72	8.86	5.14

The Fund has demonstrated an ability to outperform the benchmark and median manager, as illustrated by the Information and Sharpe ratio, over the medium term. The Fund's absolute risk (as measured by Standard Deviation) remains marginally below the median manager over all time periods although the figure is high in relative sense reflecting the significant level of volatility within the small cap universe over this period.

The Fund has maintained a tracking error within its estimated range of between 8% and 12% over a long term period (5 years), however as the fund is benchmark unaware, this figure is expected to remain above the median manager.



Investment Personnel

Name	Title	Time with Manager
Frank Villante	Chief Investment Officer	7 Yr(s)
Andreas Stephens	Analyst	11 Yr(s)
Paul Biddle	Analyst	5 Yr(s)
Scott Armstrong	Analyst	2 Yr(s)

Organisation

In November 2009 Treasury Group acquired Souls Funds Management from Washington H. Soul Pattinson with the transaction including both the Small Companies Fund and existing investment team. Souls Funds Management was renamed Celeste Funds Management Limited in December 2009.

Frank Villante (Chief Investment Officer) was re-appointed by Treasury, after resigning from the position in October 2009, to manage the Fund. Villante retained a majority of the existing investment team based on their respective small cap experience. Treasury and the entire investment team entered into an equity agreement resulting in the investment team acquiring a 59% stake in Celeste, Treasury retaining 39% and minorities maintain 2%. Treasury provides Celeste with back office support including HR, legal and distribution services. This structure enables the investment team to entirely focus on the investment management functions. Zenith is comfortable that the current ownership structure, and is satisfied sufficient incentives are in place to ensure retention and stability in the investment team.

The Firm manages \$344 million (as at 30 September 2010) and have indicated a target level of assets under management of around \$800 million. The Firm is profitable based on its current level of assets under management.

Investment Team

The Celeste investment team consists of 4 investment professionals, led by Frank Villante (Chief Investment Officer) who has over 23 years industry experience. Villante joined Celeste (formerly known as Souls Funds Asset Management) in 2004 after working previously at the NAB, BT, Bridges Son & Shepherd, and NRMA investments in a range of analytical and portfolio management roles. In Zenith's view Villante is a highly experienced and capable small cap portfolio manager.

The remaining 3 members of the team are investment analysts Andreas Stephens, Scott Armstrong and Paul Biddle, who between them have an average of 14 years of investment experience. In the absence of Villante the portfolio management responsibilities are shared across the team with each analyst possessing a level of portfolio management experience. Zenith considers the investment team to be aptly resourced to provide sufficient coverage of the Fund's investment universe.

The Fund's investment universe encompasses over 300 stocks plus companies of all market cap size, index, and non-index opportunities. The universe is initially filtered based on a range of quantitative and qualitative factors (i.e. financial strength, business model and management capabilities) to

approximately 200 stocks. All stocks have a primary and back-up analyst, with each contributing to the process including management meetings and on-site assessments, while buy and sell decisions discussed as a group.

The remuneration structure incorporates a competitive base salary and dividend stream. The dividend stream is based on the level of equity ownership and subject to the overall profitability of the business. In Zenith's view the equity structure further aligns the interest of the investment team to the performance of the Fund and the overall success of the business.

In Zenith's view the team is currently well resourced with substantial investment and small caps experience. Zenith is also encouraged by the transparent nature of communications with Villante and his team.

Investment Process

The Fund's investment objective is to deliver a return of 5% p.a. above the benchmark over rolling 3 year periods, with an estimated tracking error range of between 8% - 12%. The investment style is best described as neutral (blend of growth and value elements) which is a bi-product of the multifaceted valuation approaches utilised.

The Manager believes at times the market is inefficient, as stock prices do not accurately reflect the securities true intrinsic value. The view is built on a range of factors which include: investors are swayed by emotion and sentiment; not all investors possess the same level of knowledge and information; and investors predominantly possess a short term timeframe. Through a disciplined stock selection and portfolio construction process the manager aims to exploit these market factors in identifying alpha opportunities.

Security Selection

Initial Filter

The Fund's investment universe encompasses all stocks within the Small Ordinaries Index (200 stocks - which are continuously monitored and ranked) plus micro cap stocks and non-listed companies of interest which possess significant investment opportunity (to date the Manager has not incorporated a non-listed opportunity). Attractive micro-cap securities may be included in the portfolio, following a thorough assessment and screening by the whole team.

The initial filtering process focuses on the following factors:

- Quality of Accounts: cashflow quality, avoiding accounting engineering;
- Business Model: durable, robust and competitive business model; and
- Board and Management: successful track record of value creation, board commitment, alignment of interest with shareholders.

The investment universe will reduce to approximately 200 stocks, marked for further research. This initial filter process generally screens listed property trusts, investment companies and speculative stocks.

Security Research

The research universe is then disseminated amongst the investment team. An initial assessment of a company's business segment, operating environment and industry growth

projections is conducted with data and information gathered from a range of sources including company suppliers, customers, competitors, and other stakeholders plus the use of broker analyst data.

The Porter Model framework is applied to assess the company's business model which must be clearly articulated. The factors examined include: defining a company's competitive advantage; barriers to entry; power of suppliers and buyers; and product substitution or technological deficiencies.

The financial accounts are assessed based on at least 5 years historical data as well as 2-3 years forecast. Financial statements which exhibit quality minimise use of provisions and a high level of consistency are favoured with companies terminated from the research universe for accounting engineering. Investment analysts draw on broker models or internally constructed models where there is a significant departure from internal earnings estimates. In Zenith's view the use of broker models is not ideal and we would prefer stock models to be constructed internally, however we are cognisant of the investment team size and the magnitude of investment universe monitored.

The subjective evaluation of company management and board is determined by one-on-one meetings (over 300 in 2009) in order to assess skill sets, track record, and work load, alignment of interest and record of board meeting attendance.

The research process culminates in the production of the Stock Review document which incorporates a stock assessment, valuation and pricing breakdown, profit and loss potential, proposed portfolio weighting (subject to stock liquidity), and growth projections. The document also incorporates a summary of the analyst's recommendation of the stock, business model factors, environmental, social and governance considerations and any other factors which are deemed important for long-term value creation.

The Stock Review output will be presented to the investment team by the primary analyst for debate and discussion with all decisions based on consensus; however as portfolio manager Villante maintains ultimate discretion.

In addition to the Stock Review output, all stock specific research is formally documented within a company File Note, which includes all stock specific information such as management meetings, press and brokerage releases and historical financial information. Zenith has viewed examples of said File Notes and is impressed with the comprehensive and diligent approach to company research.

Security Valuation

The Manager utilises a blend of valuations metrics as detailed below in the evaluation and assessment of the research universe:

- Discounted Cashflow (DCF);
- Price/Earnings (P/E);
- Enterprise Valuation (EV);
- Return on Equity (ROE);
- Comparative dividend yields;
- Debt and gearing; and
- Margins and profitability.

The range of valuation tools are subjectively applied based on the industry and stock under assessment. Zenith views the use

of multiple valuation factors as a positive in order to gain the most accurate stock information via the use of the most appropriate tool.

The statistical output for each prospective stock is tabulated within the Stock Review template; while the investment universe is continually monitored, ranked and discussed within the weekly team meeting.

In Zenith's view the security selection process is comprehensive and well structured which moves fluidly into portfolio construction phase.

Portfolio Construction

The portfolio construction process is a by-product of the stock research process. The Stock Review document outlines the stock's characteristics including expected return, analyst's return confidence, portfolio target weight (based on the portfolio return matrix), index weight and recommended portfolio weight. The stock characteristics are then applied to the Portfolio Return Matrix.

The Portfolio Return Matrix sets guidelines for establishing and managing portfolio positions based on a combination of potential return and return confidence. The matrix is designed to allocate a portion of the portfolio, based on a tiered system, to stocks which exhibit a positive return potential (based on discount to fair value) and the return confidence of the Analyst as High, Strong or Modest.

- Tier 1 (40%+ potential return) - High (7% allocation), Strong (5%) and Modest (2%);
- Tier 2 (25-40% potential return) - High (5%), Strong (4%) and Modest (1%); and
- Tier 3 (15-25% potential return) - High (3%), Strong (2%) and Modest (0%).

The Portfolio Return Matrix is not rigid and the portfolio manager maintains ultimate discretion in stock selection and portfolio weight allocation, although the average initial weighting allocated would be the target weight assigned. Factors which are taken into consideration by the portfolio manager at the time of purchase or sale of a stock are liquidity, stocks index weight, seasonal trends, and a change of management or board members.

The portfolio is constructed based on bottom-up stock research, benchmark unaware approach which may ultimately lead to unintentional sector tilts away from the index. The concentrated portfolio will generally hold 20 to 50 securities, with a tracking error ranging from 8% to 12%. Zenith is comfortable with the portfolio construction process which is built on the best ideas of the investment team.

Risk Management

Portfolio Constraints	Description
Cash (%)	0% to 15%
Security Numbers	20 to 50
Market Cap >\$200 million	20 to 100
Market Cap < \$200 million	0 to 50
Market Cap < \$50 million	0 to 25
Tracking Error (%)	Range between 8% to 12%

The risk management process is implemented at a stock specific level and overlaid by the general portfolio constraints applied. The initial filtering process is aimed at identifying stocks that exhibit financial stability, a strong business model and a solid board and management. An in-depth analysis is applied to the research universe based on a long-term performance track record in addition to numerous meetings with senior management to gain an understanding of the business model and direction going forward.

The portfolios risk constraints in place (as detailed in the table above) include minimum and maximum exposure limits for individual stocks, stock exposure based on market capitalisation, and cash holdings. The portfolio manager reviews the Fund in accordance with the risk parameters in place on a daily basis through an internally designed risk management system. The portfolio is reviewed against the Global Industry Classification Standard (GICS) to assess sector tilts on a monthly basis. While provisions in the fund's PDS allow for investment in unlisted securities, Celeste has never made any allocations to unlisted securities, nor is there any intention of doing so in the future. It should also be noted that while the Fund has an allowance for up to 25% of the fund to be invested in micro-cap securities, historically the Fund has maintained a low allocation to securities with a market cap of less than \$100 million.

Zenith is satisfied that the Fund's risk management processes are imbedded throughout the entire investment process and that liquidity of holdings is adequately monitored.

Risks of the Fund

As is the case with all Australian equities based products, the biggest risk to this fund is a sustained downturn in the Australian small / micro cap universe, which could lead to negative performance. This risk can be significantly reduced by investors adopting a medium term (3+ years) investment time frame when investing in this fund.

The style neutral approach should protect the Fund from market conditions that favour value or growth elements. The Fund is still subject to market forces and in conjunction with maintaining a low cash weighting, the Fund will show a strong correlation with markets. Again investors should be prepared to invest for the medium to longer term to smooth out this volatility.

As at September 30th 2010, the Fund held \$269 in funds under management, which does not present an issue in regards to their ability to efficiently enter and exit stock positions. A panel of brokers is reviewed on an annual basis to ensure brokerage is allocated to the best research providers and those with the best access to liquidity. The Manager has indicated an FUM capacity limit of around \$800 million.

Zenith considers the key person risk within the Fund as significant with Villante as Chief Investment Officer; his departure would constitute a review of the Fund and its rating. Overall, Zenith believes the current equity arrangement firmly negates the risk of his departure.

Applications of the Fund

The Fund offers a pure exposure to the small cap universe and based on the Fund's risk / return profile would best suit those investors seeking absolute rather than relative returns in the Australian small companies sector. The Fund aims to maximise absolute investment returns irrespective of those

returns achieved by the market which is in line with its investment approach of not constraining itself relative to index weights and allowing a tracking error range of 8% to 12%.

The Manager is aware of the attraction of after tax returns, therefore the portfolio turnover is approximately 25% to 30% per annum, with an average holding period of 3 - 4 years. The Fund's tax awareness approach would be ideal for investors on higher marginal tax-rates.

The Fund's benchmark unaware investment style makes it ideal for investors seeking a single fund exposure to Australian small companies, providing an ideal option to blend with an Australian large-cap equity fund.

Fees

The Management Fees for the Fund are 0.95% p.a. with a performance fee associated with the Fund. The Performance fee is 20% of outperformance over the ASX/S&P Small Ordinaries Accumulation Index, which is paid quarterly and accrued daily and is based on a high watermark (based on positive performance and recouped loss of performance). Zenith views the management and performance fees as competitive and in line with its asset class peers.

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