

Sandhurst Professional IML Future Leaders Fund

Sharemarket commentary[#]

The mid and small cap market rose +10.2% over the December quarter, bringing the gains over the last 6 months to +25.7%. These gains more than reversed the losses recorded in the first 6 months of the year to bring the gain over the calendar year to +9.1%. The positive quarterly result reflected gains in international markets following moves by the Fed to commit to another round of Quantitative Easing and an improving tone to economic data. However weak bond markets, tensions in Korea and China's move to increase interest rates continued to play with the markets nerves. Domestically economic data indicated that the economy slowed significantly in the September quarter, with GDP growing only 0.2% qoq, however employment growth remained strong. The RBA raised the official cash rate 25bps during the quarter, to finish the year at 4.75% this combined with an increase in commodity prices saw the Australian dollar hit a post float high of 101.6 US cents.

The mid and small cap index rallied strongly over the quarter outperforming the large cap index purely on the back of strong gains in the Materials and Energy sectors. In fact over 80% of the index's gain was attributable to these two sectors. The Resource related sectors both rallied hard following several takeover bids and strength in most commodity prices, with iron ore, coal, copper, gold, silver, oil and mineral sands all posting increases, while 'rare earth' stocks rallied hard following news the Chinese had suspended exports of these commodities. In contrast most industrial sectors only registered small moves over the quarter with the Consumer Staples and Consumer Discretionary sectors actually declining.

In corporate news takeover activity returned to the fore with a bid for gold company Dominion Gold being received from Kingsgate Resources, Rio Tinto bidding \$3.9bn cash for coal company Riversdale, copper miner Equinox bidding for Citadel Resources, whilst US oil services company Oil States International showed that the strong AUD is no barrier for foreign predators by bidding \$650m cash for remote accommodation provider Mac Services (which equates to 16.2 times trailing EBITDA). Private equity group KKR put forward a takeover proposal for fund manager Perpetual Ltd at an indicative \$38-40 a share, a 23% premium to the pre-bid price, which was subsequently rejected by the Board, while Fletcher Building made a cash and scrip bid for Crane Group after amassing a 14.9% stake in the company (this bid has also been rejected by the Board).

The AGM's which occurred during the quarter saw most companies being cautious in their outlook, with trading conditions generally described as patchy. There were a number of profit warnings during the quarter, including Aristocrat which fell after downgrading profit expectations for the year due to a weak US market, a loss of market share and the strengthening Australian dollar, while Programmed was hurt by softness in their painting business and Hastie blamed delays in customer capex commitments and project delays because of wet weather. Retailers were particularly cautious with many describing trading conditions as very difficult due to the impact of higher interest rates, excessive discounting, abnormal weather and a generally cautious consumer. Retailers to warn included The Reject Shop, Billabong, Premier Investments (owner of Just Jeans), Noni B. and Harvey Norman.

Fund information

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Application (ex distribution)	\$0.6708
Redemption (ex distribution)	\$0.6675
December 2010 distribution (per unit)	\$0.0145
ICR (% p.a.) as at 31 December 2010	1.30%
Fund start date	1 June 2006
Fund size as at 31 December 2010	\$1.95 Million

Fund Performance

Performance period	Fund Return*	Benchmark**
1 month	+2.8%	+6.8%
3 months	+7.3%	+10.2%
1 year	+10.4%	+9.1%
3 years [^]	-1.8%	-5.6%

[^] % Performance per annum.

* Performance figures are calculated before tax and after fees and costs; using redemption prices and assumes distributions are reinvested. Past performance is not an indication of future performance.

** The benchmark for this Fund is the S&P/ASX 300 Accumulation Index (excluding S&P/ASX 50, excluding property trusts).

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Portfolio performance & summary[#]

The Future Leaders Fund gained +7.3% over the quarter, which was a pleasing result given its defensive positioning. The Fund benefited from many good performances including Campbell Bros, Cabcharge, Thorn Group, Salmat and Credit Corp. The Funds' low exposure to mining and mining services hurt the Fund as these sectors performed strongly over the quarter.

Late in the quarter Salmat announced the acquisition of four digital communication businesses from the distressed Photon Group for \$75m. This acquisition fits directly with the company's aspirations to grow their presence in the fast growing digital communication space and enables them to offer an enhanced range of services to their existing blue chip client base, such as self service SMS campaign management and the ability to offer advertising campaigns across mobile, online, social media and Interactive Voice Response ("IVR") channels. The acquisition makes Salmat the clear market leader in email, SMS messaging and IVR marketing in Australia and its earnings per share accretive in year one.

Metcash reported a first half EBITA of \$199.4m up 7.7% on sales growth of 5.8%, whilst underlying profit was \$115m, up 2.3% on the prior period. The key IGA Distribution business delivered like-for-like sales growth of 3.3% with EBITA up 5%, which was a good result in a difficult market. The company noted the difficult trading conditions for supermarket retailers, with continued food price deflation and cautious consumer behaviour impacting their ability to grow. These concerns led the company to warn that there were risks to achieving its earlier guidance of EPS growth of 6% - 8%. Despite the cautious outlook, we view the company as a high quality business which is attractively priced on a PE of 12.5 times and a dividend yield of 6%. Also during the month they announced they would pursue the Franklins acquisition and effectively challenge the ACCC's view of this transaction, this acquisition remains an attractive growth avenue for the company.

Campbell Brothers delivered a very strong first half profit of \$66m, up 73%. The outlook commentary was also very strong, with FY11 profit guidance of \$120m-130m provided. Campbell's has benefited from a strong recovery in the mining sector, with work levels reportedly approaching 2008 levels. The environmental division also showed margin improvement, benefiting from the trend of increased environmental regulation and testing. We see Campbell's as a quality, low risk play on resource sector strength, complemented by less cyclical divisions such as Environmental and Industrial.

We continue to skew our portfolio heavily towards companies that can continue to do well in what we believe will be a slow growth environment going forward. We continue to believe that earnings growth expectations are still too high for many cyclical companies and we continue to be cautious on these. We remain focused on companies with strong, sustainable cash flows and a strong market position and we continue to see opportunities to buy such stocks at favourable valuations.

For further information contact our Customer Service Centre on 1800 634 969 or visit our website:
www.sandhursttrustees.com.au/investments

Portfolio holdings	
Portfolio	% of Fund
Amalgamated Holdings	7.07%
Energy Developments	4.66%
Metcash	4.61%
Salmat	4.38%
Credit Corp Group Limited	4.14%
Spotless	3.92%
Cabcharge Australia Limited	3.86%
Goodman Fielder	3.74%
Tatts Group	3.51%
Sky City Entertainment	3.42%
Top 10 Stocks	43.31%
Other Stocks	47.37%
Cash	9.32%
Total	100.00%

Please note the portfolio information supplied above is based on the underlying managed investment scheme, in addition, the Fund may directly hold small amounts of cash.

The Sandhurst Professional IML Future Leaders Fund (Fund) is issued by Sandhurst Trustees Limited (Sandhurst) ABN 16 004 030 737 AFSL 237906, a subsidiary of Bendigo and Adelaide Bank Limited ABN 11 068 049 178 AFSL 237879. Each of these companies receive remuneration on the issue of the Fund or the service they provide, full details of which are contained in the Product Disclosure Statement (PDS). This update is provided by Sandhurst and contains general advice only. Please consider your personal circumstances and read the PDS, available at Bendigo Bank branches or by phoning 1800 634 969, before making an investment decision.

[#]Sharemarket commentary and Portfolio performance & strategy are provided by Investors Mutual Limited. (PQWFL1006)