



Inside the investment team...

Investing in the new 'real' economy

As we detailed in an article last July [\[click here to read the article\]](#), Hyperion maintained an optimistic view on select retail stocks despite gloomy statistics for the sector at the time that saw overall retail growth levels slump to 2.6% compared to the long-term average of 6%.

The retail news hasn't improved since then. According to the latest statistics issued by the Australian Bureau of Statistics (ABS), annual retail sales growth in 2011 fell to 2.4% – its lowest level in almost 30 years.

In particular, the December sales figures were dismal, falling 0.1% as against expectations of a 0.2% increase during the traditional peak time for retailers.

Yet the bleak overall picture obscures the successful performance of retailers who are adapting to the rapidly-evolving environment that, as we said last year, is "characterised by changing buying habits and the rise of online competition."

Those retailers who in the face of the online threat (or opportunity) can clearly define their value proposition, will have a stake in the future.

As investors, Hyperion looks for retail firms with strong organic growth prospects and the ability to cement their competitive position in an increasingly internet-driven industry.

Last year an ABS publication, 'Australian Social Trends,' highlighted how the internet is transforming our shopping habits. According to the ABS report, domestic online retail sales in 2009 amounted to between \$19-24 billion. As well, 64% of Australians made an online purchase over 2008/9, up from 61% in the preceding period – and undoubtedly the trend to online shopping has accelerated since then.

The anecdotal evidence strongly supports that case. While traditional retailers were bemoaning the 0.1% decline in December sales, it seems Australians were simply shopping online rather than cutting overall spending. A recent conversation with the CEO of a freight-forwarding company confirmed our view that Australian consumers are embracing the internet in greater numbers. The freight-forwarding chief told us his parcel volumes were up four-times over the Christmas period – a quadrupling in business that had to be matched with the installation of new automated systems and more staff.

As investors, we seek to capture the value of this online retailing phenomenon. Hyperion has always recognised the importance of the internet as a retail delivery mechanism and our portfolio reflects that. Our bottom-up process has filtered out mature retailers, like David Jones, and instead highlighted those firms that are growing from, or are adapting their businesses to, the online environment - stocks like Wotif.com or Realestate.com. But we're not investing in the internet dream: Hyperion focuses on the profitable first-runners that can demonstrate at least a 15% return on equity.

A recent addition to the Hyperion portfolio is a case in point. We bought into the float last November of New Zealand online auction firm TradeMe. Bought by Fairfax in 2006 for NZ\$700 million, TradeMe dominates the internet auction space in New Zealand – a spot left vacant as eBay ignored the country.

The firm has a strong earnings and profit history, solid dividend forecasts and a low level of debt: the numbers reflect a company primed to prosper in the new internet retail reality.

So while investors have been increasingly preoccupied by the search for 'safe havens' – including bond investors accepting negative yields for US Treasuries in 2011 – we see the much maligned retail sector having potential star performers in it yet.

Joel Gray appointed to Head of Australian Equities

Hyperion is delighted to announce the appointment of Joel Gray to the newly-created role of Head of Australian Equities. For some time Joel has been coordinating the research work on companies (existing or prospective) that the Team feels need additional analysis, as well as managing the interstate and international company visits. He was also heavily involved in the recruitment of the newest addition to the Investment Team, Jason Orthman, in 2008. His appointment to the new role is in recognition of these added responsibilities in the functioning of the Australian equities team.

According to Dr Manny Pohl, CEO and Managing Director of Hyperion, the expertise and commitment to Hyperion's unique investment philosophy displayed by Joel as Senior Portfolio Manager, were key factors when assigning his new position.

[Click here](#) to read the full press release.

Range bound PE ratio bode well for long-term performance

The portfolio continues to be well positioned over the medium to long-term. Two years ago the trailing PE ratio for the portfolio was approximately 22 times, 12 months ago it was 17 times and today the PE ratio is around 14 times – a decline of 36% over two years. However, the PE ratio for the portfolio is range bound and should mean reverting to higher levels over the long-term. We expect low double digit EPS growth over the next 12 months combined with a high dividend yield of around 6% suggesting the short-term outlook is reasonably positive, although there is always a wide range of potential return outcomes over short time horizons. The long-term return outlook for the portfolio remains attractive (and more predictable), based on an elevated five year IRR of 23%. This five year forecast return for the portfolio incorporates average EPS growth of 13% pa, a 6% dividend return and a 3% expansion in the portfolio's trailing PE ratio from current depressed levels.

Navitas hampered in the short-term by SAE acquisition

Both the Hyperion Australian Equities Composite and the Hyperion Australian Equities ASX 300 Composite underperformed the market during January. The Hyperion Australian Equities Composite returned 2.63% and the Hyperion Australian Equities ASX 300 Composite returned 2.92% while the S&P/ASX 300 Accumulation Index produced a 5.13% return.

For the Hyperion Australian Equities Composite the largest contributors to active performance during the month were Rio Tinto (+14.7%), JB Hi-Fi (+11.6%), Wotif.com (+9.5%) and Macquarie Group (+7.2%). The largest detractors from active performance were SEEK (-7.2%), Navitas (-17.7%), Cochlear (-4.2%) and Platinum Asset Management (-3.4%).

For the Hyperion Australian Equities ASX 300 Composite the largest contribution to active performance came from the portfolio's investments in Rio Tinto (+14.7%), JB Hi-Fi (+11.6%), Wotif.com (+9.5%) and Macquarie Group (+7.2%). The largest detractors from active performance were SEEK (-7.2%), Navitas (-17.7%), Cochlear (-4.2%) and Platinum Asset Management (-3.4%).

Navitas reported its profit result for the December 2011 half-year late in January. The bottom line profit was below both the market's and our expectations due to the acquisition of the SAE business in February 2011. The core university pathway business produced a reasonable profit result in difficult circumstances, and long-term growth potential remains substantial. The university pathways program in Australia has been adversely affected by international student visa and permanent residency requirements. However, some of the earlier regulation that has been acting as a head wind to attracting international students to Australian universities has recently been reversed. The loss making start-up operation in the USA is showing early signs of gaining traction and this business is expected to be a large profit contributor in the long-term. The stock's five year estimated IRR is 25%, the dividend yield is around 6% and the trailing PE ratio is 16 times.

Also during the month, Platinum Asset Management announced a half-year profit downgrade due to the lower level of funds under management (FUM) during the latest half-year. The negative growth in FUM has resulted from a combination of negative net fund flows, poor short-term performance relative to its benchmarks and the negative translation impact from the high level of the AUD. We still like the long-term outlook for Platinum given its long-term track record of producing high levels of alpha, its large global opportunity set (i.e. its FUM is not capacity constrained) and the long-term stability of its key fund managers.

Performance (%)	1 mth	6 mth	1 year	2 year	5 year	Since inception (Oct 96)
Hyperion Australian Equities Composite	2.63	-4.65	-9.96	-2.41	0.22	12.73
Excess Performance over S&P/ASX 300 Accumulation Index	-2.50	-3.22	-3.45	-3.22	2.00	4.30

Hyperion Australian Equities Composite Top 10 Stock Holdings		
Stock	Absolute Weight (%)	Active Weight (%)
BHP Billiton	7.39	-4.23
Rio Tinto	7.24	4.35
Cochlear	6.89	6.56
Commonwealth Bank of Australia	6.52	-1.22
SEEK	6.41	6.24
WorleyParsons	5.14	4.59
Sky Network Television	4.92	4.92
AMP	4.52	3.34
REA Group	4.41	4.34
Woolworths	4.36	1.50

Performance (%)	1 mth	6 mth	1 year	2 year	5 year	Since inception (May 03)
Hyperion Australian Equities ASX 300 Composite	2.92	-5.19	-10.88	-2.98	1.39	12.08
Excess Performance over S&P/ASX 300 Accumulation Index	-2.22	-3.76	-4.37	-3.80	3.17	3.47

Hyperion Australian Equities ASX 300 Composite Top 10 Stock Holdings		
Stock	Absolute Weight (%)	Active Weight (%)
BHP Billiton	7.62	-4.00
SEEK	7.25	7.09
Rio Tinto	6.89	4.00
Cochlear	6.88	6.55
Commonwealth Bank of Australia	6.59	-1.14
WorleyParsons	5.78	5.23
AMP	5.73	4.56
REA Group	5.73	5.67
Woolworths	5.73	2.87
Carsales.com	4.64	4.54

Platinum struggles on falling funds under management

The Hyperion Small Growth Companies Portfolio significantly underperformed its benchmark during January. The fund returned -0.35% compared with the S&P/ASX Small Ordinaries Accumulation Index return of 7.75%. Wotif.com made a positive contribution to active performance (+9.5%) during January. The biggest detractors from active performance during the month were Navitas (-17.7%), Dominos' Pizza Enterprises (-6.2%) and Sky Network Television (+0.5%).

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Performance (%)	1 mth	6 mth	1 year	2 year	5 year	Since inception (Oct 02)
High Conviction Small Growth Companies Portfolio	-0.35	1.02	-0.01	2.24	4.37	24.47
Excess Performance over S&P/ASX Small Ords Accumulation Index	-8.10	7.85	13.44	0.56	8.48	15.69

High Conviction Small Growth Companies Portfolio Top 10 Stock Holdings		
Stock	Absolute Weight (%)	Active Weight (%)
IRESS Market Technology	10.51	9.77
REA Group	10.41	9.68
Sky Network Television	10.40	10.40
Carsales.com	9.62	8.53
Wotif.com Holdings	8.36	7.86
Dominos Pizza	6.00	6.00
Platinum Asset Management	5.87	5.01
Trade Me	5.52	5.52
Navitas	5.07	4.37
Reckon	4.83	4.83

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