

About this Review

Sector reviewed	Small Cap Australian Equities
Total Funds rated	31
Date of this Sector Review	June 2010

About this Fund

Fund reviewed	OC Funds Management Premium Equity Fund
Fund Size (\$M)	23
Responsible Entity	OC Funds Management Limited
Fund Commenced	December 2000
Retail Fee (p.a.)	1.54% + Performance Fee
Structure Availability	Platforms, Wholesale, Retail

About the Fund Manager

Fund Manager	OC Funds Management
Ownership	55% by investment team, 35% by directors, 10% by external private investors

Assets Managed this Sector (\$M)	65
Years Managing this Asset Class	9

Investment Team

Team Size Dedicated to this Fund	5
Portfolio Manager	Robert Frost
Number of Analysts	5
Departures/Team Ratio (past 2 yrs)	25%

Investment Process

Style	Style Neutral, Absolute Return
Targeted Absolute Return (p.a.)	10% - 15% (over rolling three year periods)
Typical Tracking Error (p.a.)	N/A
Typical Stock Numbers	30-50
Typical Capitalisation bias	6%-10% Large/Mid caps, 40%-60% Small Caps, 20%-45% Micro Caps
Franking Level (FY09)	41%
Tax efficiency - Income in total distribution (FY09)	100%
Discount Gains as in Total Capital Gains (FY09)	0%
Maximum of Portfolio in any One Stock	11%
Maximum of Portfolio in any One Sector	No Hard Limits
Maximum of Issued Capital of any One Stock	7.5%
Minimum Capitalisation (\$M)	30 ('Soft' Limit)
Maximum Size Limit of Fund (\$M)	400 (Across all small cap funds)

Rating history

June 2010	Investment Grade
January 2010	Fund Watch
April 2009	Investment Grade

What this Rating means

➤ The Investment Grade rating indicates that Lonsec believes that the fund or product can achieve its objectives and, if applicable, outperform some of its peers over an appropriate investment timeframe. However, compared to higher rated managers / funds, this manager has fewer competitive advantages in people, process or product design. If available, higher rated funds or products giving access to this asset class or strategy are expected to provide better long term investment outcomes

Fund Risk Characteristics

	Low	Moderate	High
Capital Volatility			▲
Corporate Risk			▲

Risk categories are based on Lonsec's qualitative opinion of the risks inherent in the product's asset class and the risks relative to other products in the relevant Lonsec sector universe.

Using this Fund

This is General Advice only and should be read in conjunction with the Disclaimer, Disclosure and Warning on the final page.

➤ Small cap funds invest in a market that is less liquid and more volatile than the large cap Australian equity market. This Fund should be used to complement large cap exposure in clients' portfolios, rather than replace it, with up to 8% of the total portfolio depending on client risk preferences. Lonsec's model portfolio asset allocations (traditional assets only) are 6% within the 'Growth', and 8% within the 'High Growth' risk profiles respectively

➤ The Fund is subject to equity market risk and movements (both positive and negative) in the share prices of the underlying securities in the portfolio. Investors should therefore be aware that the Fund may experience periods of negative returns and that there is a risk of potential capital losses being incurred on their investment

Changes since last review

➤ Co-portfolio manager Dean Fergie departed the firm in January 2010.

➤ Following Fergie's departure, OC Funds Management elevated Robert Frost to the new role of Head of Small to Mid Cap Investments. Frost also takes on lead portfolio management responsibilities for the Fund. Previously the manager used a co-portfolio manager structure.

➤ OC Funds Management acquired Patriot Managed Accounts, an SMA/IMA business in May 2010. As part of the acquisition, Stephen Sedgman and Stephen Evans join the OC Funds Management team.

➤ OC Funds Management has established a risk management committee to review and provide oversight to all of the funds managed by the team. The risk management committee comprises all of the portfolio managers and is chaired by Stephen Sedgman.

- James Casey, portfolio manager of the large cap strategies departed the firm in April 2010.
- Peter Barnett has stepped down from the Board of OC Funds Management. Barnett has been replaced by Graham Cunningham.

Lonsec Opinion of this Fund

Philosophy/Style

- The OC Funds Management (OCFM) Premium Equity Fund is a relatively differentiated offering in the Lonsec small cap sector, being absolute return focussed and more concentrated than the typical fund assessed by Lonsec. Advisers should note that at times the Fund may have a substantial exposure to cash, does not hold resource stocks, is not restrained by sector exposure limits, and as such the performance of this Fund may at times differ significantly from the small cap market. The Fund aims to achieve a return of 10%-15% pa (over rolling three year periods), regardless of prevailing market conditions.

People and Resources

- The OCFM investment team comprises five investment professionals and is led by Robert Frost, Head of Small and Mid Cap Investments. After a long period of stability, the team has undergone major change since the last Lonsec review, with the departure of portfolio manager Dean Fergie, the integration of the investment team from Patriot Managed Accounts and a change in the decision making structure from a co-portfolio manager structure to a single portfolio manager structure under Frost.
- The departure of Fergie saw the team lose its most experienced investor. However, Lonsec notes that the addition of Stephen Sedgman and Stephen Evans from Patriot Managed Accounts means that the average investment experience across the team increases to 18 years, above average amongst Lonsec assessed peers. Sedgman in particular is a strong appointment, with over 35 years of investment experience.
- Lonsec considers the addition of Sedgman and Evans to be potentially a strong complement to the team of Robert Frost, Sam Baillieu and Rob Calnon. Sedgman will chair a new Risk Management Committee which will review and provide portfolio oversight. Whilst Sedgman brings broad market experience to the team, Lonsec believes his top down macro and thematic views (which were part of the investment process at Patriot Funds Management) will add another dimension to the OCFM investment process. In Lonsec's observations, a number of boutique small cap managers are strong in terms of "bottom up" stock analysis but relatively few supplement this with any "top down" analysis.
- In contrast to peers assessed by Lonsec, Robert Frost is relatively less experienced as a lead portfolio manager. However, he does have 13 years of investment experience, largely in the small caps sector, and has been involved in the management of this Fund since September 2001. Lonsec considers Frost to be a solid investment professional.

- Lonsec considers the change to a single portfolio manager to potentially be an enhancement in terms of increasing accountability. That said, the structure has only been in place for five months and remains relatively untested.
- One of the standout features of OCFM is the investment team's very high alignment of interest with external investors. A performance fee structure, material co-investment in the Fund (including compulsory reinvestment of annual bonuses) and considerable equity stakes held in OCFM by key members of the investment team contribute to this view.
- Relative to other managers assessed by Lonsec in this sector, business risk remains higher than peers due to the manager's relative low level of funds under management (FUM). As at the time of this report, the manager's total FUM (excluding the Patriot Managed Accounts business) had increased to \$83m (from \$70m at the last review) although this remains significantly below the \$276m in FUM as at the 2007 review. That being said, the addition of the Patriot Managed Accounts business increases FUM to \$180m and widens the revenue base of the firm (albeit with the additional cost of two investment professionals, some support staff and systems costs). OCFM is profitable at this level of FUM. Lonsec's previous reservations about the manager's business viability are lessened in this review.

Research and Portfolio Construction

- Lonsec considers OCFM's investment process to be well developed and reasonably comprehensive. OCFM's fundamental research is focussed on an Operational Risk Assessment (ORA) encompassing six broad areas, being company management, business model, operating history, industry structure, financial analysis, and corporate structure.
- The assessment and score for each of the six areas is encapsulated in a template, thus making the peer review process more efficient. That said, Lonsec notes that a standard template has not been used for all stocks researched, and the level of detail differs significantly between stocks. Lonsec would prefer to see a formal standardised template adopted, which should strengthen the overall integrity of the research process.
- In stock valuations, OCFM is one of the few small cap managers that formally recognise a 'low case' valuation, or an assumed limit to how low the stock could fall. While this is likely to be in the minds of all small cap fund managers, Lonsec considers this a positive aspect of the process as it compels the team to quantify downside risk, rather than simply assume it as part of the process.
- OCFM does not use a standardised valuation methodology, preferring to tailor methodologies for different sectors, and typically look at secondary valuation methodologies to support the primary valuation. Lonsec considers this appropriate, provided that there is a robust peer review.
- The portfolio construction process is well structured. A proprietary matrix is used to determine active stock weights, driven by the ORA score and the valuation upside (referred to as the Equalised Equity Return).

Risk Management

- Risk management at the stock level is embedded in the research process, given OCFM’s focus on quality companies with strong management teams and sustainable business models.
- At the portfolio level, the maximum individual stock position (11%) is above that imposed by most small cap managers reviewed by Lonsec. Generally a high conviction position would not exceed a 7% weighting in the portfolio.
- Since the last Lonsec review, OCFM has instituted a Risk Management Committee to review portfolios and portfolio positions. The RMC comprises the various lead portfolio managers at OCFM and is chaired by Stephen Sedgman. Lonsec considers this a strong positive enhancement to the process and an effective way of leveraging Sedgman’s broad investment experience.

Capacity

- OCFM currently manages \$65m in small cap strategies and has a target capacity of \$400m across its two small cap products. Lonsec does not believe the manager has any capacity constraints at this time and considers OCFM’s capacity discipline to be a key strength for the manager

Performance

- The Fund’s longer term performance profile has been poor, underperforming peers and failing to achieve its stated return objective over the three and five year time periods assessed to April 2010. The Fund has also failed to outperform the sector benchmark (S&P/ASX Small Ordinaries) over the three and five year periods assessed. The underperformance is disappointing as Lonsec expected that the Fund would be able to outperform peers in more difficult markets due to the ability to hold higher levels of cash. In particular, a Worst Drawdown of -68.4% compares poorly to the peer average -55.3%.
- That said, the Fund’s more recent one year performance has been strong; an Excess Return of 22.3% compares favourably with the peer average of 11.7%. More importantly, Lonsec believes the stock selection over this period is a marked improvement over previous years.

Overall

- Lonsec has upgraded the Fund's rating to "Investment Grade" from "Fund Watch". In Lonsec’s view, OCFM has now addressed the issues that led to the Fund being placed on "Fund Watch". The addition of Stephen Sedgman and Stephen Evans more than addresses the loss of investment experience following the departure of Dean Fergie.
- While Lonsec believes OCFM’s investment process and philosophy is sound, a number of individual holdings in past years have resulted in disappointment. Lonsec believes the addition of a risk management committee will add a level of rigour to the investment process. The change to a single lead portfolio manager structure also increases the level of accountability within OCFM’s investment process.
- Lonsec believes the changes since Dean Fergie’s departure have been positive for the Fund. However, it remains “early days”; Lonsec would prefer to see the changes to the team and process “bedded down” before reconsidering the Fund’s rating.

People & Resources

Size and Experience

The OCFM investment team comprises five members; Robert Frost, Sam Baillieu, and Rob Calnon, with Stephen Sedgman and Stephen Evans joining from Patriot Managed Accounts.

Robert Frost has been with OCFM since September 2001 and has been Head of Small and Mid Cap Investments since January 2010. Prior to joining OCFM, Frost covered small and mid cap stocks as a research analyst at Austock Stockbrokers.

Sam Baillieu is one of the co-founders of OCFM and has 13 years of investment experience. Prior to joining OC Funds, Baillieu was an analyst in the research department at EL&C Baillieu. His previous employment included experience in both corporate finance and venture capital projects. Baillieu covers both small and large cap research at OCFM.

Rob Calnon joined OCFM in 2007 as an analyst/dealer and was promoted to portfolio manager in 2009. Calnon’s experience encompasses chartered accounting and corporate finance at Ernst and Young.

Stephen Sedgman has over 35 years of investment experience. Prior to joining OCFM, he founded Patriot Managed Accounts, an IMA/SMA business, as well as Patriot Asset Management (Patriot) which operated as a sister company to Patriot Managed Accounts. At Patriot, Sedgman led the investment team in both large and small cap strategies.

Stephen Evans has 9 years of investment experience including 6 years at Patriot Managed Accounts. His prior experience includes two years at Man Investments in London. Evans commenced his career as a research assistant at brokerage firm EL&C Baillieu.

Frost and Baillieu are currently executive directors of OCFM. The non-executive directors on the OCFM Board include Charles Baillieu, Sidney Myer, Graham Cunningham, and Michael Hamson. Charles Baillieu has been in the investment industry for 28 years including as a director of institutional equities at Deutsche Bank. Hamson and Myer each have 17 years investment experience, whilst Cunningham brings to the table his broad commercial experience from investment banking/advisory. Lonsec considers the Board to be of impressive strength, and an important resource for the investment team to leverage.

The majority of back-office functions have been outsourced to the Fund’s custodian, National Custodian Services.

Team Structure

Name	Position	Years at OCFM	Years Industry Experience
Robert Frost	Head of Small and Mid Cap Investments	8	13
Stephen Sedgman	Head of Investment Risk Committee/Portfolio Manager	0	37
Sam Baillieu	Portfolio Manager	9	13
Rob Calnon	Portfolio Manager	3	3
Stephen Evans	Portfolio Manager	0	9

OCFM have changed their portfolio management structure from co-portfolio managers to a single portfolio manager for each product. For the small cap strategies, Robert Frost is now the lead portfolio manager. The remaining members of the investment team will continue to perform investment research, but may have additional portfolio management responsibilities for OCFM's other products (ASX200 and Concentrated funds, SMA/IMA accounts).

In addition to his investment management responsibilities, Sam Baillieu is responsible for corporate strategy while day to day responsibility for many of the non-investment functions lies with Sam Cole.

Turnover

Over the past two years there have been two appointments and two departures from the investment team. Dean Fergie departed in January 2010 whilst James Casey (who managed the large cap portfolios) departed in May 2010. Stephen Sedgman and Stephen Evans have joined the team following the acquisition of Patriot Managed Accounts.

Key Person Risk

Lonsec considers key person risk to have reduced somewhat due to the addition of Stephen Sedgman to the team, which brings an experienced investor to complement Frost and Baillieu. Risk is also to a large degree mitigated by the ownership and remuneration structure in place. That being said, Lonsec would view the departure of Frost, Baillieu or Sedgman most negatively.

Remuneration / Alignment of Interests

Each member of the investment team (except for recent appointee Stephen Evans) has an equity stake in the OCFM business and in aggregate the investment team currently owns >50% of the firm's capital. A performance fee structure is in place with the manager entitled to 20% of net returns above 15% p.a., with a high watermark. The performance fee is re-invested back into the Fund for at least a 12 month period. The investment team's variable remuneration is determined by the OCFM remuneration committee, which consists of the Chairman and one non-executive director. On a yearly basis the bonus pool consists of 25% of the business' profit and 25% of the performance fee generated (if applicable). Pleasingly, all executive and non-executive directors of OCFM are co-invested in the OCFM funds.

Investment Style

Style and Philosophy

OCFM adopts an absolute return investment style with an emphasis on preserving investor capital. The manager is indifferent to 'growth' or 'value' orientated stocks and thus at different points in time the portfolio may display significant 'value' or 'growth' tilts. Being absolute return focussed, OCFM is completely benchmark unaware with no sector constraints or requirement to hold stocks for 'risk management' purposes. The Fund targets an absolute return of 10%-15% pa (over rolling three year periods), regardless of prevailing market conditions. Unlike most absolute return focussed managers, OCFM elects not to include stock shorting as part of its investment process.

Research Approach

Overview

Investment Style	Style Neutral
No. of stocks in universe	190
No. of stocks fully modelled	120 (40-50 active)
Key Screens	Profitability, positive cash flow, ROE > 7%, Debt/EBITDA > 4x, Excluded: Resources, biotechs, listed investment companies, listed property trusts, businesses with embryonic or unproven business models, companies with management rated poor, Market cap: min \$30m,
Top-Down	0%
Bottom-Up	100%
Qualitative Analysis	Operational Risk Assessment (company management, business model, operating history, industry structure, financial analysis, and corporate structure)
Research Inputs	Site visits – companies, suppliers & competitors (400+ pa),
Use of broker research	General research, financial data, some financial models

Valuation Approach

Primary	DCF, PE relative, EV/EBITDA, Sum of parts, Dividend Yield (varies with sector)
Secondary	As above (varies with sector)

Portfolio Construction

Overview

Portfolio construction is undertaken jointly by the investment team, with the objective of building a portfolio of three categories of stocks, including 'long-term fundamental investments' (comprised of 15-25 stocks), 'prospective long-term holdings' (5-15 stocks), and 'catalysts for re-rating' (0-10 stocks). The portfolio construction process is guided by both OCFM's proprietary weightings matrix and stock weighting restrictions based on the phase of the research process that has been completed. The final portfolio is reasonably concentrated, typically containing between 30-50 stocks. Where the manager cannot identify sufficient opportunities, a significant portion (up to 100%) of the Fund may be held in cash.

Stock weightings are guided by a proprietary weightings matrix that incorporates the proprietary Operational Risk Assessment (ORA) (qualitative research) and Equalised Equity Return scores (valuation) determined during the research phase (both factors rated 1-5). In addition, maximum weightings are determined by the extent of the research process completed. For example if a face-to-face meeting with company management and a basic valuation (utilising system forecasts) has been undertaken then a weighting of up to 2.0% is permitted (this 'minimum' level of research is, however, said to be rare). In order to invest the

maximum weight (11%) the investment team must have completed a full ORA, a detailed valuation model, and a face-to-face management meeting (with at least 2 of the team attending) and site visit. The rationale for this approach is that the manager wants the flexibility to be able to move quickly in response to an opportunity.

Weightings are also subject to liquidity considerations, with OCFM not wanting to acquire more than 7.5% of a company's issued capital. A 'liquidity scaleback factor' is utilised for all positions where the target weighting exceeds 1.5% of the company's issued capital.

On occasion the Fund will hold a small number of 'trading' stocks, such as IPOs where the manager has not yet determined whether the stock will become a long-term hold. As such, for accounting and tax purposes the Fund is split into a 'holding' and 'trading' portfolio.

OCFM will sell a holding if they consider it has become overvalued, a better opportunity is identified, or it becomes evident that an error in the team's rationale for initially investing in the stock has occurred.

Risk Monitoring

On a monthly basis OCFM undertakes attribution to assess each stock's marginal contribution to the overall Fund return. In addition, for core holdings OCFM aims to have quarterly contact with company management.

Individual stock positions are limited to 11% of the portfolio, and the maximum holding in any one company is limited to 7.5% of their issued capital. Whilst not a 'hard' limit, OCFM will generally not invest in companies with a market capitalisation < \$30 million. The maximum exposure to large cap stocks is 30% of the overall portfolio. As a result of the manager's absolute return focus there is no maximum cash weighting imposed.

Since the last Lonsec review, OCFM has introduced a risk management committee chaired by Stephen Sedgman and comprising all of the portfolio managers. The role of the risk management committee is to provide a high level review of the portfolio and to consider any underlying thematic or macro biases. The risk management committee is separate from the regular investment team meetings which are held to review stock research.

Funds Under Management

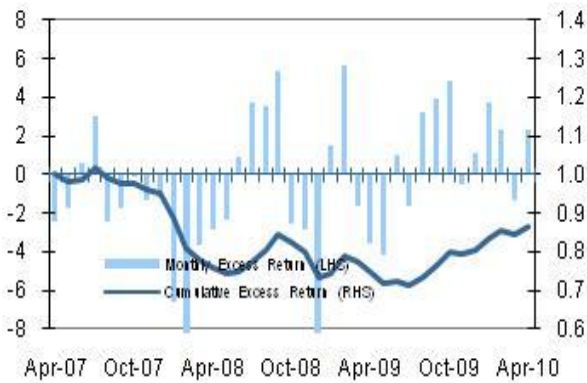
OCFM managed \$65 million in small cap strategies as at the time of this report. This is a relatively small amount compared with major industry peers and Lonsec believes OCFM is less likely to be affected by size issues on a comparative basis. Pleasingly, the manager has predetermined a maximum FUM size (aggregate across all existing small cap products) of \$400M, upon which it will close to new inflows.

Quantitative Performance Analysis
Annualised after-fee % returns as at 30 April 2010

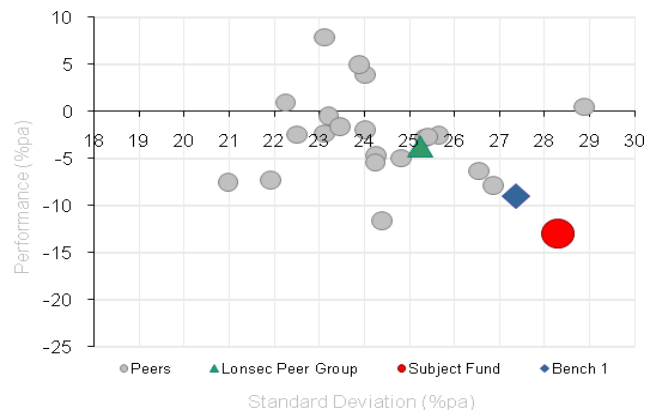
	1 Year		2 Years		3 Years		5 Years	
	Fund	Peer Group	Fund	Peer Group	Fund	Peer Group	Fund	Peer Group
Performance (% pa)	61.6	50.9	-2.0	0.5	-13.0	-3.7	1.9	10.6
Standard Deviation (% pa)	12.6	15.9	29.7	27.3	28.3	25.2	22.9	20.8
Excess Return (% pa)	22.3	11.7	7.0	9.5	-4.1	5.3	-5.2	3.4
Outperformance Ratio (%)	66.7	60.8	58.3	59.5	44.4	58.0	38.3	54.1
Worst Drawdown (%)	-3.7	-6.2	-51.0	-45.0	-68.4	-55.3	-68.4	-54.7
Time to Recovery (mths)	2.0	1.5	na	na	na	na	na	na
Sharpe Ratio	4.6	3.0	-0.2	-0.2	-0.7	-0.4	-0.2	0.2
Information Ratio	2.4	1.8	0.6	0.9	-0.3	0.6	-0.5	0.4
Tracking Error (% pa)	9.3	7.4	12.2	10.8	12.5	10.1	10.8	8.8

Fund: OC Funds Management Premium Equity Fund, Peer Group: Average among Lonsec Rated Australian Equity (Small Cap) Manager Universe Benchmark: S&P/ASX Small Ordinaries Accumulation Index

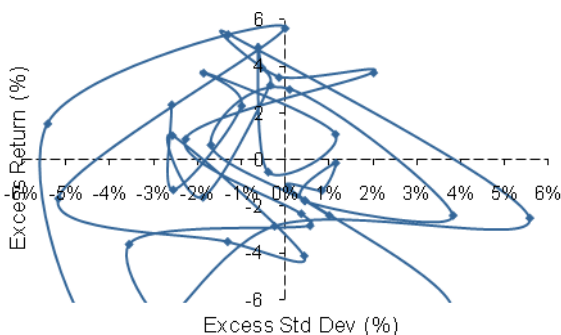
Cumulative Performance over three years



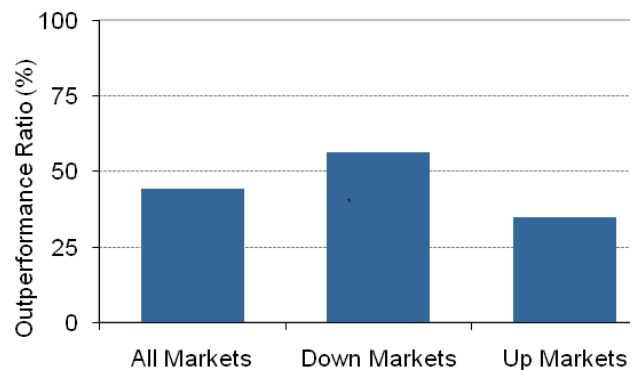
Risk-return Chart over three years



Snail Trail over three years



Outperformance Consistency over three years



Glossary

Absolute Return	'Top line' actual return, after fees
Excess Return	Return in excess of the benchmark return
Standard Deviation	Volatility of monthly Absolute Returns
Tracking Error	Volatility of monthly Excess Returns against the benchmark (the Standard Deviation of monthly Excess Returns)
Sharpe Ratio	Absolute reward for absolute risk taken (outperformance of the risk free return (Bank Bills) / Standard Deviation)
Information Ratio	Relative reward for relative risk taken (Excess Returns / Tracking Error)
Worst Drawdown	The worst cumulative loss ('peak to trough') experienced over the period assessed
Time to Recovery	The number of months taken to recover the Worst Drawdown

Analyst Disclosure & Certification

Analyst remuneration is not linked to the rating outcome. The Analyst(s) may hold the product(s) referred to in this document, but Lonsec considers such holdings not to be sufficiently material to compromise the rating or advice. Analyst(s) holdings may change during the life of this document. The Analyst(s) certify that the views expressed in this document accurately reflect their personal, professional opinion about the financial product(s) to which this document refers.

Date Prepared: June 2010
Analyst: Lin Ngin
Release Authorised by: Paul Pavlidis

IMPORTANT NOTICE: The following relate to this document published by Lonsec Limited ABN 56 061 751 102 ("Lonsec") and should be read before making any investment decision about the product(s).

Disclosure at the date of publication: Lonsec receives a fee from the fund manager for rating the product(s) using comprehensive and objective criteria. Lonsec's fee is not linked to the rating outcome. Costs incurred during the rating process of international funds, including travel and accommodation expenses are paid for by the fund manager to enable on-site reviews. Lonsec does not hold the product(s) referred to in this document. Lonsec's representatives and/or their associates may hold the product(s) referred to in this document, but detail of these holdings are not known to the Analyst(s).

Warnings: Past performance is not a reliable indicator of future performance. Any express or implied rating or advice presented in this document is limited to "General Advice" and based solely on consideration of the investment merits of the financial product(s) alone, without taking into account the investment objectives, financial situation and particular needs ('financial circumstances') of any particular person. Before making an investment decision based on the rating or advice, the reader must consider whether it is personally appropriate in light of his or her financial circumstances or should seek further advice on its appropriateness. If our General Advice relates to the acquisition or possible acquisition of particular financial product(s), the reader should obtain and consider the Product Disclosure Statement for each financial product before making any decision about whether to acquire a product.

Lonsec's rating process relies upon the participation of the fund manager. Should the fund manager no longer be an active participant in Lonsec rating process, Lonsec reserves the right to withdraw the document at any time and discontinue future coverage of the Fund(s).

Disclaimer: This document is for the exclusive use of the person to whom it is provided by Lonsec and must not be used or relied upon by any other person. No representation, warranty or undertaking is given or made in relation to the accuracy or completeness of the information presented in this document, which is drawn from public information not verified by Lonsec. Conclusions, ratings and advice are reasonably held at the time of completion but subject to change without notice. Lonsec assumes no obligation to update this document following publication. Except for any liability which cannot be excluded, Lonsec, its directors, employees and agents disclaim all liability for any error or inaccuracy in, or omission from, this document or any loss or damage suffered by the reader or any other person as a consequence of relying upon it.