

Impact of the Queensland Floods on our Australian Portfolio

As has been widely reported Queensland has suffered major flooding in January 2011. These floods are of sufficient magnitude to affect the near term outlook for a number of businesses. There are two key industry sectors that have borne the brunt of the economic impact of the floods which I comment on below before discussing the specific effects on the Australian Funds.

Queensland plays a major role in the Australia's coal industry, comprising ~50% of the coking coal export market. The impact on the industry is expected to be twofold. Firstly, there has been (and will continue to be) loss of coal production, currently equating to c\$1bn, according to JPM Morgan's economics team. This will be offset to some extent by an increase in pricing. Another problem for miners is that there are two main rail lines in Queensland which account for ~85% of coal haulage volumes. Currently the Goonyella system is operational, which represents ~53% of network capacity but the Blackwater system, ~31% of network capacity, is currently out of operation with at least 8km of track submerged.

Damage from flood/storms will also impact insurers who write home and contents insurance, property/fire/engineering policies, business interruption and motor vehicle insurance. Again using JP Morgan estimates they see a potential loss to the insurance industry from Queensland floods/storms of ~\$1bn.

Specifically in terms of the Australian Funds we have almost no direct exposure to either of these two sectors other than a small position in coal handling company Sedgman. In the case of Sedgman this is an internationally diversified business so the impact is relatively muted.

As well as direct impacts from the floods the portfolio has three primary indirect exposures:

The largest of these is the currency. The kiwi dollar has rallied strongly against the Aussie dollar on the back of the floods. Given that we had been concerned about the level of the currency anyway we have hedged a significant portion of the Fund's currency exposure, in fact just prior to Christmas we had lifted the proportion of the portfolio hedged against currency movements to 75%. This move has paid off heavily as the kiwi rallied strongly against the Aussie as the rains fell.

Toxfree Solutions, a material portfolio position, with its East Coast presence will be a likely beneficiary of the floods as significant remediation work will be required. In particular Tox has expertise in cleaning drains and sumps and in managing chemical spills. All of these skills will be in strong demand as the clean up effort from the floods gets into gear.

Austbrokers owns a network of Insurance brokers throughout Australia. The company is simply a broker taking no insurance risk itself so is not directly exposed

to the cost of flood clean up. Perversely though, the company will benefit from the floods to the extent that insurance premiums are likely to rise (a major global reinsurer has already commented that they expect to increase reinsurance rates). Given that Austbrokers derives a commission based on premiums this should feed through into higher revenues.

Lastly on a more personal level it was interesting to get feedback from some of our Queensland contacts who note the incredible support the community has provided to helping each other out in these difficult times. One comment in particular resonated "I spent the last couple of days digging mud in some of the affected areas and was humbled by the number and willingness of people to just turn up and start working like trojans."