SELECTOR AUSTRALIAN EQUITIES FUND (Ex 50)

Additional Information Guide

This Additional Information Guide (Guide) provides important additional information that forms part of the PDS.

Issue Date: 10 September 2012

This Guide is issued by DDH Graham Limited ABN 28 010 639 219, AFSL 226319 (DDH), the responsible entity of the Selector Australian Equities Fund. **Information in this Guide forms part of the Product Disclosure Statement, and the DDH Managed Funds Additional Information Guide and you should read it before making a decision to invest in the Fund**

1. ABOUT SELECTOR – THE INVESTMENT MANAGER

1.1 Who is Selector?

Selector Funds Management Limited is a boutique specialist manager of Australian equities. Selector was established to deliver superior medium to long-term investment performance through specialist stock selection coupled with a concentrated approach. Selector was founded by the existing management team in 2002.The management team have built up an extensive knowledge bank in the Australian equities market and have a significant combined experience. Selector is 100% owned by the management team who has invested their own funds alongside clients.

1.2 People

Martin Greenberg
Non Executive Chairman and Founder

Martin is Chairman and Managing Director of Apollan Investments Group (AFSL) and has continuous experience in financial markets since 1972. From 1986 – 1999 Martin was a Director of Babcock & Brown Limited, and Babcock & Brown Funds Management Limited and AIDC Limited. Martin left B&B pre IPO to pursue his own business interests. Martin is a Director of ERM Power, Liquid Capital and a ComEx member of the CSIRO. Martin holds a Bachelor of Business (UTS), Diploma of Commerce (UTS) and is a Fellow CPA. Martin is also Chairman of the Selector Funds Management Limited Compliance Committee.

Tony Scenna
Founding Director and Portfolio Manager

Tony is one of Australia's most experienced fund managers with continuous experience in the Australian funds management industry since 1983. In 1988 Tony was a founder of Harper Bernays Funds Management and was the Managing Director from 1994 to April 2002. Prior to this Tony spent five years as an investment analyst and then portfolio manager at Perpetual Trustees Australia Limited with joint responsibility for the common fund, Perpetuals flagship product. Tony has a Bachelor of Economics degree from the University of Sydney.

Corey Vincent
Founding Director and Portfolio Manager

Corey has experience as an analyst and portfolio manager since 2002 and prior to this 10 years experience in sell side stock broking. In 2001 Corey founded VBM Capital Limited and completed a sell down to staff in 2006 to focus on the operations of Selector Funds Management Limited. Corey was an affiliate of the Australian Stock Exchange, an Affiliate of the Newcastle Stock Exchange, a Fellow of the Australian Institute of Company Directors and has a Diploma of Financial Advising and a Post Graduate Diploma of Business.

George Giovas
Executive Director (since 2011)

George has extensive experience in finance, banking, property, funds management, risk and credit analysis. George joined ANZ Banking Corporation as a graduate in 1987. In 23 years at ANZ George developed analytical expertise across many industries and in particular Telco, Media, Entertainment, Real Estate and Financial sectors. His most recent position was Global Head of Property ANZ. George has a Bachelor of Economics and Masters of Commerce, Accounting and Public Administration. George is a Fellow of FINSIA. George is Chairman of Selector's investment committee and is a founding principal of Axius Partners who specialise in Capital Advisory Solutions, Third Party marketing and FM advisory.

John Maragiannis
Executive Director (since 2011)

John has extensive experience in institutional distribution with leading International and Australian and Funds Management houses. As head of distribution John was instrumental in the success of business growth at Credit Suisse, Schroder's and Zurich Scudder. His most recent role was Director of Distribution at Credit Agricole Asset Management from. John also worked at National Mutual and at AMP. John has a Bachelor of Commerce, Masters of Commerce. John heads Selector's distribution capability and is a founding principal of Axius Partners who specialise who specialise in Capital Advisory Solutions, Third Party marketing and FM advisory.

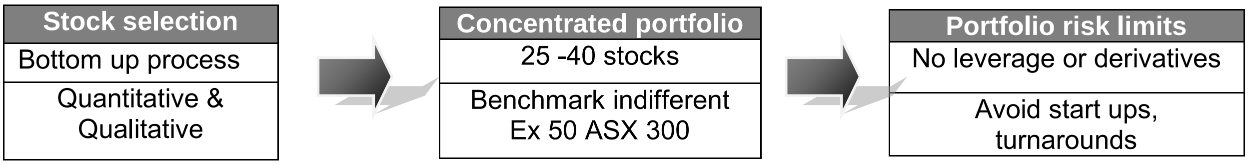
Robert Lapsley
Analyst

Robert has a Bachelor of Economics and is an Associate of Axius Partners (since 2012).

2. The Fund Investments

2.1 Investment Strategy

Selector's strategy is to invest sensibly for the long term. To achieve this Selector applies bottom up stock selection to identify good businesses selling at a fair price with the view to holding them over the long run.



As a good business evolves into a great business its underlying real earnings per share grows. Selector aims to capture as much of this earnings growth as possible over time, since it is real earnings growth that translates into share price appreciation.

The consistent **bottom up** process employed by Selector looks at a combination of the **quantitative** and **qualitative** attributes of a business. No "black box" methodology is employed. In short, Selector's competitive advantage is the ability of the portfolio managers to gain access to the people managing a business and assess the sustainability of its business model. Selector's 4 step stock selection process is outlined in section 2.3 on page 4.

Selector manages a **concentrated portfolio** of shareholdings in ASX listed Australian businesses. The portfolio will generally consist of 25 – 40 investments. As such, individual investments may represent up to 8% of the total investment portfolio. If selected correctly, individual stocks in a concentrated portfolio will have a meaningful impact on performance by growing well beyond the initial 4% level.

Selector is **benchmark indifferent**. In essence Selector is backing its consistent investment process and the portfolio manager's deep industry experience, rather than benchmarking against an index. Selector believes indexing limits returns to investors over the long run. Selector's long-term investment horizon aims to capture real earnings per share growth, reduce volatility and provide attractive taxation implications for the Fund and its investors.

Selector invests in Australian equities, **does not use leverage or derivatives** and **avoids start ups and turnaround** situations. Experience has taught Selector that these simple constraints when combined with Selector's hard risk limits provide significant protection to the portfolio with limited impact on the performance of the fund.

2.2 Investment style

A value based growth (VBG) approach is employed. Selector seeks superior business franchises where growth and value exists rather than being mutually exclusive; this also provides a margin of safety. Selector targets VBG through the combination of the three key elements of our investment style set out below.

i. VALUE BASED GROWTH (VBG)

- Management
- Business
  - Durable and transparent with a wide economic moat
  - A sustainable competitive advantage
  - Opportunities to grow and reinvest capital at high rates of return
- Balance sheet
- Capital management

ii. BUYOUT

- EBITA / Enterprise Value

The 3 year rolling buyout is a quantitative ratio generated through the process of modeling a business. This is Selector's key valuation ratio. Originally used by private equity managers, this tool provides a whole of business valuation, taking into account all debt and equity. It provides a guide to the earnings yield generated by the business after capital expenditure requirements. It can be compared to a risk free rate. The theory is that a premium over a risk free rate is required to compensate for the equity risk in the investment. As an example Conviction D, the lowest level of conviction requires a minimum buyout of 10% compared to a risk free rate of 5%.

The numerator is Earnings Before Interest Tax and Amortization (EBITA) is used rather than Earnings Before Interest Tax and Amortization and Depreciation (EBITDA) as Selector wants to view the business excluding any capital expenditure requirements. On the denominator, Selector assumes that all the debt and equity of the business is acquired, this is achieved using the enterprise value.

iii. ROAD MAP

The Road Map score is a combination of qualitative outcomes from the modeling process (income statement, balance sheet, cash flow statement) and quantitative observations generated from management meetings over time.

Qualitative			Quantitative		
Management Qualities	**Owner Qualities**	**Focus**	**Growth**	**Business Franchise**	**Balance Sheet**
Individuals we can trust	Material equity holding	Niche or franchise	Reinvesting in business	Businesses we understand	Low debt levels
Drive to take business forward	Common bond ordinary shareholder	Adapt to business conditions	Capacity to grow EPS	Well positioned in industry Inc ESG	Simple structure
Clear articulation business strategy	Track record Inc ESG	not react to share market pressure	Free cash flow	ROCE	Maintenance Cap Ex

A score of one or zero is awarded. A combined total score is then generated for each company. The process is seeking minimum scores of 10, 12, and 14 out of 18.
When combined with the buyout ratio each of these scores coincides with a different conviction level that drives the appropriate portfolio weighting, section 2.4.

2.3 Stock selection

Selector's stock selection process is sensible and consistent. The foundation for this common sense approach is the considerable industry experience of the portfolio managers. The stock selection process is termed "bottom up", Selector focuses on the business first, ensuring that investments are selected based on their individual merit. The portfolio is built stock by stock as each business is subjected to Selector's rigorous stock selection process.

There are 4 steps in the stock selection process;

- Quantitative Screen
- Ideas Shortlist
- Detailed Qualitative Research
- Portfolio Construction

Quantitative Screen			
Return on capital	Earnings quality	Financial leverage	Capital management

Ideas Shortlist
50 – 80 stocks principally from Ex 50 ASX 300

Detailed Qualitative Research
Confirmation via due diligence & market experience

Portfolio Construction		
25 – 40 stocks	Fundamentals, valuation & manager's market experience	Hard portfolio risk limits

Each of these 4 steps in Selectors stock selection process are outlined below.

i) Quantitative Screen

Selector initially applies a quantitative screen to a diverse range of companies across many sectors of the Australian share market. The deep industry experience of the portfolio managers provides a comprehensive in house research capability. Selector has a detailed historic knowledge of the bulk of the Ex 50 ASX Top 300 businesses (ASX Top 300 excluding the Top 50) and their management teams. The quantitative screen is a common sense model that has evolved over many years. It designed to screen for 4 quantitative factors that the managers deem to be of vital importance to the health of a business.

Firstly, Selector seeks to measure the **return on capital employed** (ROCE) over a multi-year horizon. This ratio forms the core of Selector's process for the simple reason that it reflects how well a company is utilising its capital to generate earnings, i.e. its franchise quality. Here Selector focuses on the ungeared return on total capital. The ROCE should be higher than a business's total cost of capital; otherwise any additional capital invested in the business will reduce shareholder returns.

Secondly, Selector seeks to assess various measures of **earnings quality** of a business such as its cash flow quality. High earnings are not as important as high-quality earnings. High quality earnings are transparent, repeatable, controllable and importantly bankable. Earnings that are the result of large one off events may not be repeatable and are of low quality. Importantly, those businesses that generate earnings but not cash may not be sustainable. When Selector invests, Selector makes sure the company is taking its earnings to the bank.

Thirdly, Selector seeks to measure the **financial leverage** of any given business. This is essentially a risk management tool. Selector's focus is debt. Debt may sit on or off the balance sheet. Examples of off balance sheet debt are the operating leases that the business is contracted to. The main output is a coverage ratio which measures the multiple that earnings before interest, tax and depreciation (EBITDA) covers the total financing costs of the business. The higher the level of cover the more robust a business is to operational or economic setbacks.

The fourth quantitative screen Selector focuses on is the **capital management** of a business. This is a measure of management as "stewards of the capital" in the business. This includes share capital issued or bought back by the company, capital required to maintain the operating business and capital required to grow. This factor has a significant influence on the level of returns provided to shareholders.

The 4 measures of Selector's quantitative screen dovetail. Simply put, a business with a high ROCE and high quality earnings can fund their activities internally from cash flows without aggressive use of debt or ongoing issuance of new equity, convertible notes and other derivative instruments.

ii) Ideas Shortlist

The quantitative screen produces Selector's ideas shortlist from a wide range and variety of businesses. The shortlist is typically 50 to 80 stocks principally from the Ex 50 ASX300 universe. Detailed qualitative research or "due diligence" is then undertaken on the ideas shortlist.

iii) Detailed qualitative research

The portfolio managers undertake detailed qualitative research on each of the businesses on the ideas shortlist. This starts with researching the business, its industry, channel checks of the competitive landscape and importantly **management interviews**. This is where the experience of the portfolio manager becomes the key advantage and where Selector wears out the shoe leather visiting companies. Section 2.4 outlines the process of detailed research.

iv) Portfolio construction

As a result of detailed research on the ideas shortlist, a selection of 25 to 40 businesses is developed and reviewed for inclusion in the portfolio. Portfolio inclusion is based on a quantitative valuation, qualitative attributes, and the portfolio manager's assessment of relative value and present opportunity.

As a result portfolio construction relies on the extensive experience of the portfolio managers. Here, it is important to note that, it is the portfolio managers, rather than investment analysts, who have undertaken the detailed research ensuring that high quality information is transmitted through the entire investment process. The portfolio is subjected to hard risk limits outlined in section 2.6 on page 6.

2.4 Detailed Research

A key feature distinguishing Selector's research is the consistent application of Selector's **"Road Map"** checklist. The Road Map is a drill down into the 4 quantitative factors measured in the initial stock screening process. It focuses on business and management qualities that Selector believes are the foundation of all good businesses. These factors are both quantitative and qualitative in nature.

Selector adopts a bottom up approach to stock selection because no two companies are alike and not all companies possess each element of the Road Map.

The Road Map is used as a checklist to assess changes within a business. It allows Selector to monitor each company's individual "milestones", which are monitored on an ongoing basis.

Achieving milestones on a consistent and timely basis is an important test of a business and management team. By measuring a company against milestones, the portfolio manager seeks to separate business fundamentals from share price performance.

One of the **most important** parts of Selector's stock selection process is meeting with management. Selector aims to meet with senior management when undertaking detailed research. This includes one on one meeting in Selector's offices, site visits, annual general meetings and also industry sponsored meetings.

Selector's investment strategy and stock selection process enables the portfolio managers, to identify companies with either strong sustainable growth in real earnings per share or the capacity to return high levels of excess cash back to shareholders. Selector knows that the market's recognition of value may take time to emerge. The Fund is therefore ideally suited to investors with a longer term investment horizon.

2.5 Construction Process

Tier 1	3 Year Buyout	Road Map Scorecard	Weighting
Conviction A	> = 12%	> = 14/18	4%
Conviction B	> = 10%	> = 12/18	3%
Conviction C	> = 9%	> = 10/18	2%
Tier 2	**3 Year Buyout**	**Road Map Scorecard**	**Weighting**
Conviction D	> = 15%	> = 10/18	3%

The process has 4 levels of conviction. Each level of conviction generates the appropriate portfolio weightings for that conviction. The 4 convictions make up two overall tiers of the portfolio construction.

Conviction A, B and C ideas in aggregate make up approximately 80% or more of the portfolio and are considered medium term opportunities that are expected to have improving franchise quality in the future. Conviction D makes up the balance of up to 20% of the portfolio. The two tiers are outlined briefly below.

Tier 1

Over 80% of Selector's investments comprise the core stocks expected to outperform in medium to long term. This part of the portfolio is made up of stocks of Conviction A to Conviction C.

Tier 2

Under 20% of Selector's investments comprise medium term opportunities that are expected to have improving franchise quality in the future. These stocks may represent earlier stage opportunities that have a transparent pathway to achieving the quantitative and qualitative business characteristics of the Road Map. This part of the portfolio represents Conviction D. Tier 2 may also consist of Ex 50 stocks outside the S&P ASX 300 due to free float constraints. Subset can be provided on request.

Four levels of conviction:

1. A stock that meets the requirements of Conviction A has a Buyout in excess of 12% and has achieved a minimum Road Map score or 14 out of 18. A conviction A idea generates a weighting between 3 and 4%.
2. A stock that meets the requirements of Conviction B has a Buyout in excess of 10% and has achieved a minimum Road Map score or 12 out of 18. A conviction B idea generates a weighting between 2 and 3%.
3. A stock that meets the requirements of Conviction C has a Buyout in excess of 9% and has achieved a minimum Road Map score or 10 out of 18. A conviction C idea generates a weighting between 1 and 2%.
4. A stock that meets the minimum requirements, Conviction D, of the process has a Buyout in excess of 15% and has achieved a minimum Road Map score or 10 out of 18. A Conviction D idea generates a weighting between 1 and 3%. Conviction D ideas make up approximately 20% or less of the portfolio and are considered medium term opportunities that are expected to have improving franchise quality in the future.

2.6 Portfolio risk limits

The portfolio management process is highly risk averse. Hard risk limits have been established to ensure this is adhered to consistently. Selector's uses a targeted process to screen for key business attributes: return on capital / earnings quality / low gearing / capital management. Selector's portfolio maintains a high level of portfolio liquidity and seeks to limit the maximum sector concentration of the portfolio. Selector further reduces portfolio risk by avoiding the inclusion of risky start-up businesses.

Portfolio hard risk limits include:

- Ex 50 ASX 300 universe: 4% position at cost of portfolio; max 8% through performance;
- Not more than 30% portfolio in single sector; and
- Avoiding start-ups and turnarounds.