NORTHWARD CAPITAL

Northward Capital Australian Equity Composite
Quarterly Investment Report
31 March 2011

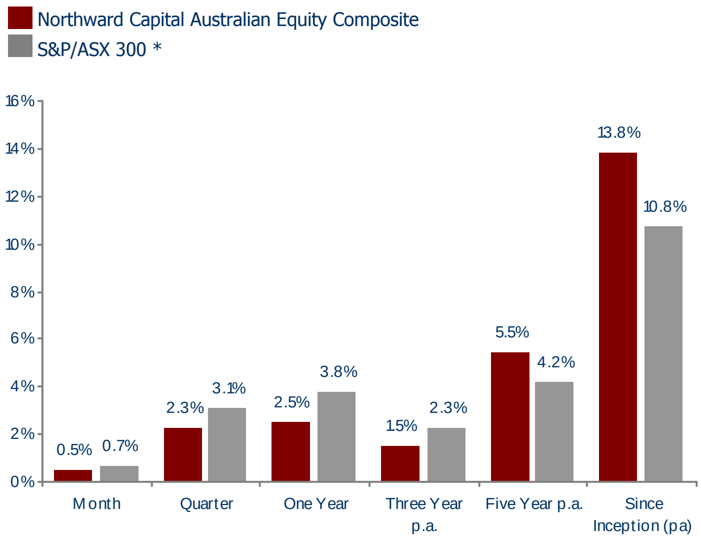
Fund Results

Portfolio Results	Quarter
Northward Capital Australian Equity Composite	2.26%
S&P/ASX 300 *	3.12%
Value Added	**-0.86%**

Stock Contributors	Overweight (+) Underweight (-)
Henderson Group	+
News Corp	+
Western Areas	+
Lend Lease	+
Asciano Group	+

Stock Detractors	Overweight (+) Underweight (-)
Sims Group Ltd	+
Energy Resources Aus	+
Resmed	+
Gloucester Coal Ltd	+
IAG	+

Risk Information	
Standard Deviation	17.3%
Tracking Error	3.6%
Information Ratio	-0.2



(1) Market value of the investment as at month end was $2,883.67 Million
(2) Inception return is calculated from 1 June 2004
(3) Returns are calculated gross - before taxes, before fees
(4) * Benchmark was S&P/ASX 300 ex LPTs prior to 1 May 2009
(5) Composite of accounts with similar benchmark (10 accounts in current month)
(6) Risk stats (where applic) based on mthly returns over rolling 3 year periods

Market Review

The ASX 200 Accumulation Index's 3.23% rise in Q1 marked its third consecutive quarterly gain, but left the index firmly within the trading range that it has occupied since September 2009. Measured by the gap between high and low, this has been the narrowest 18-month range since 2000-01. The earnings season was relatively calm in terms of large share price moves, but did highlight the softness of domestic conditions. Many companies cited sluggish domestic trading conditions as well as a negative impact from the strong $A. Insurance and airline companies were hit by a series of events – severe flooding in Queensland and Victoria and earthquakes in Christchurch and Japan.

The ASX200 Resources index lagged the market (+1.7%) as Mining shares were held back by weaker metals prices and concerns over policy tightening in China. One offsetting positive was the announcement of an A$5bn buy-back by BHP Billiton. By contrast, the Energy sector (+5.3%) finally revived thanks to three supportive themes – higher oil prices due to unrest in the MENA region; serious problems at Japan's nuclear power plants following the earthquake which strengthened the prospects of Australian gas projects; and lastly strong speculation that Woodside was about to be bid for. Banks (+5.4%) recovered from a poor 4Q as concerns over policy risk eased.

In terms of the US corporate sector, 66% of S&P 500 companies that have reported results topped sales forecasts last quarter, up from 62% in the previous period, a sign that demand may be taking over from cost-cutting as a driver of profits. Revenue has surprised to the upside in the past two quarters, while S&P 500 profits in aggregate have topped analysts' average forecasts for eight straight quarters now.

In terms of economic news, The Reserve Bank of Australia kept its cash rate target unchanged at 4.75% through the quarter. Although the RBA continued to stress the capacity pressures that it sees arising from the commodity sector, market expectations of rate increases retreated. Employment and capex data were mostly positive but credit and housing sector signals were soft.

US releases mostly indicated firming economic momentum, though towards the end of the quarter there were mixed signals from the consumer and housing sectors.

The People's Bank of China continued to tighten policy through the quarter, raising its policy rates once and the bank reserve requirement ratio three times.

Performance Review

Over the quarter Northward's portfolio returned 2.26% versus the ASX300 index return of 3.12%, resulting in an underperformance of 86bps versus the market.

Contributors to performance included Henderson Group, News Corporation, Western Areas, Lend Lease and Asciano.

Detractors from performance included Santos (not held), Gloucester Coal, Resmed, Energy Resources Australia and Sims Metal Management.

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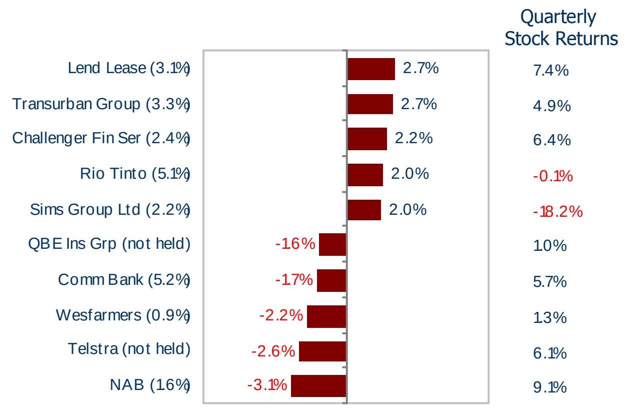
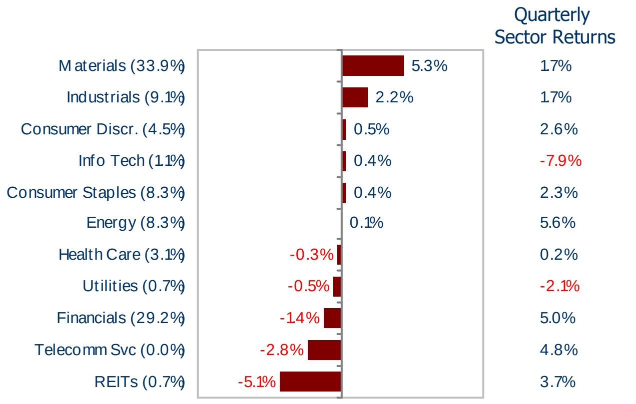
Fund Composition

Active Stock Positions
Underweights / Overweights versus benchmark



Sector Diversification
Underweights / Overweights versus benchmark



Portfolio Strategy

Despite the unrest in the Middle East and the tragic New Zealand and Japanese earthquakes, the key drivers of our equity market remain the Chinese and US economies – which we expect to provide the major leverage across our economy from both a demand and sentiment perspective. Domestic operating conditions, outside of resources, agriculture and online internet companies, remain somewhat challenging. The AUD continues its rise, consumers remain in consolidation mode, non-discretionary costs (power, water and health) are all rising, while interest rates are unlikely to be cut given the resources boom. While the economy remains strong overall with robust employment trends, there appears to have been a decline in productivity and we are facing rising union activity across a number of sectors.

As highlighted in our December report, a strengthening oil price remains a major risk to the positive macro backdrop for global growth – particularly the US recovery and domestic consumption themes. History shows that it is the rate of change in the oil price, rather than the absolute level that we need to focus on with respect to broader earnings risk. Goldman Sachs has calculated that an 80% or greater increase in the oil price within a 12-month period has usually resulted in a negative impact on equity markets within the subsequent one to two years. To date, the recent oil price moves are well below this level, providing some level of comfort.

The recovery of the US economy this year is expected to be a significant driver of global growth and the Australian equity market. We expect the recovery profile to remain somewhat uneven during 2011, but feel the upside is considerable given the starting point and the excess capacity that exists in the US economy. Certainly the economic data and corporate profit results so far this year remain encouraging.

The Chinese economy appears to be slowing in line with tighter financial conditions against a backdrop of increasing inflation. China's economy is expected to reaccelerate during 2H 2011 after inflation pressures begin to decline. We recently spent a week travelling in China meeting with Chinese corporations, local Govt corporations and companies such as Rio Tinto and Iluka. The cities we visited included Baotau, Ordos, Taiyuan, Beijing and Shanghai. We were also fortunate enough to be in the country the same week the 12th Five Year Plan was released. Current areas of concern for China's government include inflation, the widening gap between urban and rural incomes, a property bubble (1st tier coastal cities), potential food shortages and copy-cat demonstrations from MENA's unrest.

China's 12th Five Year Plan (12FYP) places emphasis on quality of growth, with environment, education, social welfare and energy efficiency all assuming greater importance. The lower GDP growth target of 7% (vs. 7.5% previously) is primarily intended to reinforce the message that quality of growth is important.

Environment merits a new sub-chapter, with emphasis on climate change and hydro power.

The 12FYP talks of the need to "restrain" energy-intensive industries. If China continues to grow unrestrained, its energy requirement and CO2 emissions will soon reach unsustainable levels. We continue to believe that nuclear development is very important for China as wind and solar power cannot contribute a meaningful amount to energy needs in the future.

There is no specific inflation target in the 12FYP because inflation is seen as a short-term issue. However, China's economic development policy recognises "inflation pressures" including rising labour costs, the cost of imported commodities and the fact that RMB appreciation will attract "hot money".

Overall, the meetings reinforced our confidence that China's demand for raw materials will continue to grow this year, albeit at lower percentage rates than in 2010. The new GDP growth target is 7% annually, but most economists in China expect the outcome to be more like 9% p.a.

In terms of portfolio strategy our positioning and thoughts from the start of the year are basically unchanged. The market's 8% decline and 9% rebound were due to exogenous events in the form of Middle East tensions and the Japanese tsunami and ensuing nuclear event. Our main portfolio changes over the last quarter have been to sell down our position in Asciano and buy a position in QR National after QRN's very strong interim result. The other major change has been to significantly upweight Woodside Petroleum in early January and exit our position in Qantas. This was due to our view in December that crude oil fundamentals appear to be firming as inventories in the US declined for the first time in many months driven by demand and a very cold winter snap, while China's 2010E apparent demand for oil may have grown 13.6% to 8.57 mm b/d versus previous estimates of 6%. We also upweighted BHP to overweight for the first time in the fund's history and significantly up weighted our Transurban position.

Portfolio Activity

Position Change	Holding	Start %	End %	Activity
Sold	Leighton Holdings	0.4%	0.0%	The small portfolio position in Leightons was sold to fund further investment in BHP Billiton.
Sold	Qantas Airways	1.8%	0.0%	Our position in QAN was sold at the beginning of the year for a couple of reasons. Firstly, we became more concerned in December 2010 about the potential for higher oil prices in 2011 given declining global stockpiles, which led us to increase our investment in the energy sector via Woodside. We also viewed a higher oil price as being indirectly beneficial for Incitec Pivot (purchase funded by sale of QAN) given that gas is a key ingredient for fertilizers and explosives.
Sold	Westfield Retail Trust	0.5%	0.0%	The fund sold a residual position in WRT that was generated as part of the Westfield Group's partial spin-off of its Australian shopping centre assets. The resulting position in WRT was materially below what is considered a minimum for any stock holding in the fund.
Purchased	Incitec Pivot	0.0%	1.4%	The rationale for buying IPL is a more positive view on fertiliser prices driven by tighter global supply conditions, solid demand prospects and rising farmer incomes. As such, it is likely we will see significantly higher fertiliser (DAP and urea) prices once more.
Purchased	QR National Ltd	0.0%	1.6%	We bought into QRN at $3.19 after it stunned the market with an interim result running well ahead of prospectus forecasts. QRN has an important regulated below rail infrastructure asset, growth and reform potential from the unregulated above rail businesses; the benefits of greater commercial focus following privatisation; and a conservatively geared balance sheet. We have concluded that QRN has potential to deliver material cost efficiencies from trimming its huge 9,400 workforce, significant capital management potential from its very undergeared balance sheet and contract re-pricing value uplift as only 28% of current above-rail coal contracts are currently commercial take-or-pay.
Increased	BHP Billiton	12.3%	14.4%	We added more BHP to the portfolio during the period as we consider the company to represent good value relative to other resource stocks. The large cash generation of the company, continued capital management, exposure to strong oil, gas, coal and iron ore prices, a large growth pipeline and ability to acquire assets makes BHP attractive at current prices.
Increased	ANZ Banking	1.5%	4.2%	The ANZ position was increased on the expectation of a positive quarterly earnings update. Positive EPS surprise was expected to come from further improvement in the business segment lending margin and also from the New Zealand business where ANZ has a relatively large market share. The New Zealand margin improvement is being driven by a switch from fixed home loans to variable where the margin is higher for the lender. Good growth is also expected from the Asian business where the company is focussed on assisting Australian corporate access funding from the strong Asian deposit base.
Increased	Transurban Group	2.6%	3.3%	The overweight position in TCL has been increased as the benefits to earnings of the Citylink and M2 expansions become clear. Further cost opportunities are also expected to be delivered from the management team. The 2H11 distribution is expected to exceed the consensus forecast of 13.5cps and strong distribution growth of around 14% pa is anticipated to 2013.
Increased	Woodside Petroleum	0.5%	3.7%	We increased our holding in Woodside during the quarter. Along with a more positive view on the oil price and the LNG market, we also have become more confident in the company's aggressive drilling campaign in order to obtain sufficient gas for the expansion of the Pluto LNG project in Western Australia. In addition Woodside continues discussion with third parties to provide gas to the Pluto project. We also have more confidence that a positive outcome will be achieved from the sale of the remaining 24% stake of the company that Shell owns.
Decreased	Asciano Group	2.0%	0.5%	We reduced in our position in AIO after a solid rally in the shares over the qtr to fund an investment into QRN. The stock has been a good performer since we first acquired it at $1.09, but the interim result fell short of our expectations, due mainly to lower than expected growth in the Coal division as a result of weather and congestion impacts. Positives are the lower than anticipated capex, the recommencement of dividends, and the much improved balance sheet, but the outlook statement by management remain subdued.
Decreased	Resmed	1.4%	1.1%	The gradual release of the new S9 respiratory aid product range has been problematic. Announcing the pending release of the S9 has resulted in a delay in sales in anticipation of the new product. In the December quarter the machine sales in the US slowed to 2% as sales of bilevel machines (which are the highest priced and gross margin machine) halted pending the release of the new S9 model, which is to be released very shortly. Mask and ROW machines sales remain strong. The bilevel is the last in the S9 portfolio to be released. Sales should revert to a more normal pattern in FY12.
Decreased	NAB	4.1%	1.6%	The reduction in the NAB position largely funded the increased ANZ position. NAB is seen as trading near fair value at the moment with positive mark to market benefits from the Specialised Group Assets division. Risks remain for the UK business as the recent austerity package impacts economic growth across the country.

Stock in Focus

Henderson Group PLC (HGG) Current Market Price: $2.65
XKO 4,849
Target Price $3.10

Henderson Group is an independent global funds management firm, with core competencies in equities, fixed interest, property and private equity. As at Dec 2010, funds under management totalled $53bn. Based in the UK, they offer a diverse range of investment products and have a creditable performance track record.

In January, Henderson Group made a friendly bid for Gartmore Funds Management, which shareholders have just voted to approve. Gartmore's exposure is concentrated in the UK retail space and nicely complements HGG's exposure. The combined group will move from the 14th to the 6th largest manager of high margin UK retail funds. Assuming 15% attrition of the Gartmore FUM, the acquisition would be approximately 15% NPAT accretive if synergy targets are met.

Henderson acquired New Star Funds Management in April 2009. New Star, another UK retail business, was under great financial pressure with a poor performance track record. Henderson achieved attrition levels and synergy savings in line with assumptions and ahead of schedule. The New Star experience bodes well for their latest acquisition, with a very similar integration plan. Gartmore is less risky given the portfolio managers responsible for 85% of FUM intend to move across and accept Henderson scrip, with plans for the rest of the FUM to be merged by August 2011, which is a more stable transition compared to the portfolio manager departures and fund outflows experienced in the lead up to the New Star acquisition.

The underlying drivers of the Henderson business are the direction of financial markets and funds flows. Obviously, with market volatility, funds flows have not returned to the steady state enjoyed pre GFC. Approximately 50% of Henderson FUM has a performance fee component, many of which depend on absolute as well as relative returns – so market levels have a meaningful impact on the likelihood of performance fees as well as the underlying management fee.

Management have proved themselves to be astute cost managers, as evidenced through the GFC downturn. The remuneration model is partly a profit share model which provides a buffer during downturns, and somewhat reduces upside leverage. However, during FY09 and FY10 the compensation ratio has been restored to about 45% of revenue, a level at which management believe positive leverage is possible as the top line grows.

The business will continue to be transformed from a low margin institutional business into a higher margin revenue stream through product mix and greater retail exposure. To this end, post bedding down the Gartmore acquisition, Henderson desire local expertise in the US and a number of Asian markets to better balance their UK/Europe exposure.

With regulatory approval of the acquisition pending, market forecasts are yet to incorporate the accretive Gartmore acquisition which will be a source of earnings upgrades. Incorporating our base case assumptions, the combined Henderson group would be trading on 11x FY12 PE vs UK and Aust peers at 11x-12.5x PE and 12x-16x PE respectively.

Traditionally Henderson has traded at a discount to peers partly due to inferior margins (being a mix issue) and weaker inflows. These issues are being addressed. Even without a rerating, based on EPS growth 25% and 28% for FY11 and FY12 we have a $3.10 price target. The two dominant risks are obviously negative overall market returns and, as an Australian investor, the strength of the AUDGBP.

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