

K2 Australian Absolute Return Fund

ARSN 106 882 302

Interim report - 31 December 2011

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Directors' report

The directors of K2 Asset Management Ltd (ABN 95 085 445 094), the Responsible Entity of K2 Australian Absolute Return Fund, present their report together with the financial report of the K2 Australian Absolute Return Fund (the "Fund") for the half-year ended 31 December 2011 and the auditor's review report thereon.

Principal activities

The Fund continued to invest funds in accordance with target asset allocations as set out in the current Product Disclosure Statement and in accordance with the provisions of the Fund's Constitution.

The Fund did not have any employees during the half-year.

There were no significant changes in the nature of the Fund's activities during the half-year.

Directors

The following persons held office as directors of K2 Asset Management Ltd during the half-year or since the end of the half-year and up to the date of this report:

Campbell W Neal
 Mark S Newman
 Robert C Hand
 Hollie A Wight

Service providers

The Responsible Entity and Investment Manager of the Fund is K2 Asset Management Ltd.

The Custodian of the Fund is Morgan Stanley & Co International plc.

The Administrator of the Fund is State Street Australia Limited.

The Unit Registry service provider of the Fund is Computershare Fund Services Pty Limited.

Review and results of operations

The Fund maintains its long/short investment strategy in listed equities and other investment instruments in Australia and New Zealand permitted by the Fund's Constitution. It aims to preserve capital over the medium term and generate a 15% per annum return after fees over a three to five year investment cycle.

The investment policy of the Fund continues to be that detailed in the current Product Disclosure Statement and in accordance with the provisions of the governing documents of the Fund.

Results

The performance of the Fund, as represented by the results of its operations, was as follows:

	Half-year ended	
	31 December	31 December
	2011	2010
	\$'000	\$'000
Operating profit/(loss) before finance costs attributable to unitholders	(48,752)	60,083
Distributions		
Distributions payable	-	1,211
Distribution (dollars per unit)	-	0.408

Directors' report (continued)

Unit redemption prices

Unit redemption prices are shown as follows:

	2011 \$	2010 \$
At 31 December	<u>158.00</u>	<u>184.11</u>

Significant changes in state of affairs

In the opinion of the directors, except as disclosed below, there were no other significant changes in the state of affairs of the Fund that occurred during the financial half-year under review.

Likely developments and expected results of operations

The results of the Fund's operations will be affected by a number of factors, including the performance of investment markets in which the Fund invests. Investment performance is not guaranteed and future returns may differ from past returns. As investment conditions change over time, past returns should not be used to predict future returns.

Further information on likely developments in the operations of the Fund and the expected results of those operations have not been included in this report because the Responsible Entity believes it would be likely to result in unreasonable prejudice to the Fund.

Rounding of amounts to the nearest thousand dollars

The Fund is an entity of the kind referred to in Class Order 98/0100 (as amended) issued by the Australian Securities and Investments Commission relating to the "rounding off" of amounts in the directors' report and financial report. Amounts in the directors' report and financial report have been rounded to the nearest thousand dollars in accordance with that Class Order, unless otherwise indicated.

Lead Auditor's Independence Declaration

A copy of the Lead Auditor's Independence Declaration as required under section 307C of the *Corporations Act 2001* is set out on page 4.

This report is made in accordance with a resolution of the directors.



Hollie A Wight
Director

Melbourne
7 February 2012



Lead Auditor's Independence Declaration under Section 307C of the Corporations Act 2001

To: the directors of K2 Australian Absolute Return Fund

I declare that, to the best of my knowledge and belief, in relation to the review for the half-year ended 31 December 2011 there have been:

- (i) no contraventions of the auditor independence requirements as set out in the Corporations Act 2001 in relation to the review; and
- (ii) no contraventions of any applicable code of professional conduct in relation to the review.

KPMG

Michelle Hinchliffe
Partner

Melbourne

7 February 2012

Statement of comprehensive income

	Half-year ended	
Notes	31 December 2011 \$'000	31 December 2010 \$'000
Investment income		
Dividend income	9,536	7,665
Interest income	2,178	1,632
Net gains/(losses) on financial instruments held at fair value through profit or loss	(54,191)	71,459
Other operating income	1	7
Net investment income/(loss)	(42,476)	80,763
Expenses		
Interest expense	-	271
Responsible Entity's fees	136	130
Management fees	3,579	3,866
Auditor's remuneration	21	17
Transaction costs	1,478	2,021
Performance fees	-	13,834
Administrative expenses	200	219
Short dividend expense	647	48
Other operating expenses	215	274
Operating expenses before finance costs	6,276	20,680
Profit/(loss) from operating activities	(48,752)	60,083
Finance costs attributable to unitholders		
Distributions to unitholders	4 -	(1,211)
(Increase)/decrease in net assets attributable to unitholders	3 48,752	(58,872)
Change in net assets attributable to unitholders/Total Comprehensive income	-	-

The above statement of comprehensive income should be read in conjunction with the accompanying notes to the interim financial statements.

Statement of financial position

		As at	
	Notes	31 December 2011 \$'000	30 June 2011 \$'000
Assets			
Cash at bank	5	78,650	49,787
Receivables		313	3,463
Due from brokers - receivable for securities sold		47,008	8,539
Financial assets held at fair value through profit or loss	6	333,538	462,766
Total assets		459,509	524,555
Liabilities			
Distributions payable	4	-	9,825
Payables		954	1,669
Due to brokers - payable for securities purchased		3,196	16,715
Financial liabilities held at fair value through profit or loss	7	2,271	20,838
Total liabilities (excluding net assets attributable to unitholders)		6,421	49,047
Net assets attributable to unitholders	3	453,088	475,508

The above statement of financial position should be read in conjunction with the accompanying notes to the interim financial statements.

Statement of changes in equity

The Fund's net assets attributable to unitholders are classified as a liability under AASB 132 Financial instruments: Presentation. As the Fund has no equity, the Fund has not presented any items of changes in equity for the current or comparative half-year.

Statement of cash flows

	Half-year ended	
	31 December 2011 \$'000	31 December 2010 \$'000
	Notes	
Cash flows from operating activities		
Dividends received	12,349	8,058
Interest received	2,405	1,585
Other income received	111	234
Management fees paid	(3,591)	(3,734)
Performance fees paid	-	(3,070)
Payment of other operating expenses	(3,128)	(3,312)
Net cash inflow/(outflow) from operating activities	<u>8,146</u>	<u>(239)</u>
Cash flows from investing activities		
Proceeds from sale of financial instruments held at fair value through profit or loss	1,128,562	1,096,287
Purchase of financial instruments held at fair value through profit or loss	(1,124,067)	(1,156,193)
Net cash inflow/(outflow) from investing activities	<u>4,495</u>	<u>(59,906)</u>
Cash flows from financing activities		
Proceeds from applications by unitholders	58,063	61,371
Payments for redemptions by unitholders	(36,978)	(14,534)
Distributions paid	(4,850)	(15,518)
Net cash inflow/(outflow) from financing activities	<u>16,235</u>	<u>31,319</u>
Net increase/(decrease) in cash and cash equivalents	28,876	(28,826)
Cash at bank at the beginning of the half-year	49,787	87,356
Effects of foreign currency exchange rate changes on cash at bank	(13)	353
Cash at bank at the end of the half-year	5 <u>78,650</u>	<u>58,883</u>

The above statement of cash flows should be read in conjunction with the accompanying notes to the interim financial statements.

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1 Basis of preparation of interim report

This interim financial report covers K2 Australian Absolute Return Fund (the "Fund") as an individual entity which is a registered managed investment scheme under the *Corporations Act 2001*. The Fund was registered with ASIC as a registered managed investment scheme on 13 November 2003 and began operations on 1 October 1999. The Fund will terminate on 16 August 2079 unless terminated earlier in accordance with the provisions of the Fund's Constitution.

The Responsible Entity of the Fund was K2 Asset Management Ltd (the "Responsible Entity"). K2 Asset Management Ltd's registered office is Level 32, 101 Collins Street, Melbourne, VIC 3000. The financial report is presented in Australian currency.

This general purpose financial report for the interim half-year ended 31 December 2011 has been prepared in accordance with the *Corporations Act 2001*, and Australian Accounting Standard AASB 134 *Interim Financial Reporting*.

This interim financial report does not include all the notes of the type normally included in an annual financial report. Accordingly, this report is to be read in conjunction with the annual report for the year ended 30 June 2011 and any public announcements made in respect of K2 Australian Absolute Return Fund during the interim reporting period in accordance with the continuous disclosure requirements of the *Corporations Act 2001*.

The interim financial report was authorised for issue by the directors on 7 February 2012.

2 Summary of significant accounting policies

The accounting policies applied by the Fund in this interim financial report are the same as those applied by the Fund for the year ended 30 June 2011.

3 Net assets attributable to unitholders

Movements in number of units and net assets attributable to unitholders during the half-year were as follows:

	31 December 2011 No. '000	Half-year /year ended		30 June 2011 \$'000
		30 June 2011 No. '000	31 December 2011 \$'000	
Opening balance	2,711	2,549	475,508	416,454
Applications	350	634	58,063	113,251
Redemptions	(225)	(626)	(36,706)	(111,889)
Units issued upon reinvestment of distributions	29	154	4,975	25,250
Changes in net assets attributable to unitholders	-	-	(48,752)	32,442
Closing balance	<u>2,865</u>	<u>2,711</u>	<u>453,088</u>	<u>475,508</u>

As stipulated within the Fund's constitution, each unit represents a right to an individual share in the Fund and does not extend to a right to the underlying assets of the Fund. There are no separate classes of units and each unit has the same rights attaching to it as all other units of the Fund.

4 Distributions to unitholders

The distributions paid/payable for the half-year were as follows:

	31 December 2011 \$'000	Half-year ended		31 December 2010 \$'000	31 December 2010 \$PU
		31 December 2011 \$PU			
Distributions payable	-	-	1,211	0.408	
	<u>-</u>	<u>-</u>	<u>1,211</u>	<u>0.408</u>	

5 Cash at bank

	As at	
	31 December 2011 \$'000	30 June 2011 \$'000
Cash at bank	<u>78,650</u>	<u>49,787</u>

6 Financial assets held at fair value through profit or loss

	As at	
	31 December 2011 Fair value \$'000	30 June 2011 Fair value \$'000
Designated at fair value through profit or loss		
Australian equity securities	306,778	459,496
New Zealand equity securities	<u>26,760</u>	<u>3,270</u>
Total designated at fair value through profit or loss	<u>333,538</u>	<u>462,766</u>
Total financial assets held at fair value through profit or loss	<u>333,538</u>	<u>462,766</u>

7 Financial liabilities held at fair value through profit or loss

	As at	
	31 December 2011	30 June 2011
	Fair value \$'000	Fair value \$'000
Designated at fair value through profit or loss		
Listed equity securities sold short	2,271	20,838
Total designated at fair value through profit or loss	2,271	20,838
Total financial liabilities held at fair value through profit or loss	2,271	20,838

8 Events occurring after the reporting date

No significant events have occurred since the end of the reporting date which would impact on the financial position of the Fund disclosed in the statement of financial position as at 31 December 2011 or on the results and cash flows of the Fund for the half-year ended on that date.

9 Related parties

The performance fee expense paid or payable to K2 Asset Management Ltd relating to the half-year ended 31 December 2011 is \$356 (2010: \$13,833,752). The performance fee is calculated and accrued daily based on the net asset value (before performance fee) of the Fund and is paid in arrears on a semi-annual basis as at the last Business Day in December and June. Performance fees are paid where applicable from redemptions throughout the financial year on a pro-rata calculation.

For further information please refer to the Product Disclosure Statement.

There have been no significant changes to the related parties transactions disclosed in the annual report for the year ended 30 June 2011.

10 Contingent assets and liabilities and commitments

There are no outstanding contingent assets and liabilities or commitments as at 31 December 2011.

Directors' declaration

In the opinion of the directors of the Responsible Entity:

- (a) the financial report and notes set out on pages 5 to 12 are in accordance with the *Corporations Act 2001*, including:
 - (i) complying with Australian Accounting Standard AASB 134: *Interim Financial Reporting*, the *Corporations Regulations 2001* and other mandatory professional reporting requirements; and
 - (ii) giving a true and fair view of the Fund's financial position as at 31 December 2011 and of its performance, as represented by the results of its operations, changes in equity and its cash flows, for the half-year ended on that date; and
- (b) there are reasonable grounds to believe that the Fund will be able to pay its debts as and when they become due and payable.

This declaration is made in accordance with a resolution of the directors.



Hollie A Wight
Director

Melbourne
7 February 2012



Independent auditor's review report to the unitholders of K2 Australian Absolute Return Fund

Report on the financial report

We have reviewed the accompanying interim financial report of the K2 Australian Absolute Return Fund, (the Scheme) which comprises the statement of financial position as at 31 December 2011, the statement of comprehensive income, statement of changes in equity and statement of cash flows for the half-year ended on that date, notes 1 to 10 comprising a summary of accounting policies and other explanatory information and the directors' declaration.

Directors' responsibility for the financial report

The directors of K2 Asset Management Ltd (the Responsible Entity) are responsible for the preparation of the interim financial report that gives a true and fair view in accordance with Australian Accounting Standards and the *Corporations Act 2001* and for such internal control as the directors determine is necessary to enable the preparation of the interim financial report that is free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express a conclusion on the interim financial report based on our review. We conducted our review in accordance with Auditing Standard on Review Engagements ASRE 2410 *Review of a Financial Report Performed by the Independent Auditor of the Entity*, in order to state whether, on the basis of the procedures described, we have become aware of any matter that makes us believe that the interim financial report is not in accordance with the *Corporations Act 2001* including: giving a true and fair view of the Scheme's financial position as at 31 December 2011 and its performance for the half-year ended on that date; and complying with Australian Accounting Standard AASB 134 *Interim Financial Reporting* and the *Corporations Regulations 2001*. As auditor of K2 Australian Absolute Return Fund, ASRE 2410 requires that we comply with the ethical requirements relevant to the audit of the annual financial report.

A review of an interim financial report consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with Australian Auditing Standards and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.



Independence

In conducting our review, we have complied with the independence requirements of the *Corporations Act 2001*.

Conclusion

Based on our review, which is not an audit, we have not become aware of any matter that makes us believe that the interim financial report of K2 Australian Absolute Return Fund is not in accordance with the *Corporations Act 2001* including:

- (a) giving a true and fair view of the Scheme's financial position as at 31 December 2011 and of its performance for the half-year ended on that date; and
- (b) complying with Australian Accounting Standard AASB 134 *Interim Financial Reporting* and the *Corporations Regulations 2001*.

KPMG

KPMG

A handwritten signature in black ink, appearing to read 'Michelle Hinchliffe'.

Michelle Hinchliffe
Partner

Melbourne

7 February 2012