Leyland Lines

February 2007

MARKET UPDATE

Subscription $20 per month

Leyland Lines is our monthly newsletter providing investors with our insights on the overall market, individual companies and other relevant issues. All the information contained in this newsletter is for general reading only and should not be taken as a personal recommendation. We encourage you to call Leyland Private Asset Management for specific advice in relation to your portfolio.

Welcome to the February 2007 edition of Leyland Lines.

We are well into the reporting season and the results so far have impressed the market. Cost cutting has been a feature of many results, with organic growth starting to slow down. Headline growth still remains strong with additional growth coming from acquisitions.

In this edition we look at the growing supply/demand imbalance and outline why a p/e premium is likely to remain in the market in the medium term. We also look at NWS which has performed strongly for many of our IMA's in the last 2 years, and looks set to continue this outperformance.

We look at dairy minnow Warrnambool cheese company, revisit Transurban which has undergone changes since our last review and also discuss our impressions of the Jim Rogers lunch which we recently attended.

Retail Food Group is up 70% since our recommendation and we discuss whether it is still value and we review Coca-Cola results.

Finally, some of our clients hold shares in Agincourt which is under offer from Oxiana. We discuss the details of the offer.

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MARKET UPDATE

Lunch with Jim Rogers

We recently attended a lunch with Jim Rogers where he provided his long term outlook for investment assets.

You might be asking... who is Jim Rogers?

A graduate of Yale and Oxford, he co-founded the Quantum Fund with George Soros in 1970. During the following ten years, the fund gained 3,300% while the Dow Jones Industrial Index advanced a meagre 20%. Quantum was one of the first truly international hedge funds. In 1980 Rogers decided to "retire" at the age of thirty seven.

Since then, he has been a media commentator and guest professor of finance at Columbia University. He has traveled around the world on a motorcycle and a Mercedes Benz, chronicling his travel adventures and worldwide investments in the books Investment Biker (1995) and Adventure Capitalist (2003). His most recent book is Hot Commodities (2004).

He is renowned for his bullish view of commodities and the Chinese economy and has plans to sell his mansion in Manhattan, New York and move his family to Shanghai.

So what did Jim have to say over lunch?

- Commodity prices will remain stronger for longer. The shortest bull market in commodities lasted 15 years while the longest lasted 23 years. We are still in the early stages of a secular uptrend in commodities
- There has not been a major oil discovery for 30 years. All of the world's major oilfields are suffering declining reserves. Supply and demand forces will drive oil prices higher. Geopolitical and supply shocks could easily cause oil prices to hit US$100 a barrel or more.
- Soft commodities such as sugar, wheat and coffee beans will experience their own long term bull market.
- The scarcity of water will be a major problem worldwide. Water will become a highly valuable commodity and water infrastructure assets should be good investments.
- The US has $13 trillion in foreign debt and this is increasing by $1 trillion every 15 months. The Federal Reserve continues to print more money and debase the currency. The US dollar is in demise and will eventually lose its status as the international currency of choice, just as the Great British Pound had done previously. This will be bullish for precious metals, gold, silver and platinum.
- Bonds experienced a long term bull market in the 1980s and 1990s. Bond prices have hit a peak and will perform poorly over the next 10-15 years. Only short term bonds or special situation bonds (junks etc.) should be considered as investments.
- Australia has a bright future and is truly a lucky country because of our proximity to Asia and our abundance of natural resources.

Rogers believes that the 21st century belongs to China. It's a rocky road ahead and there will be setbacks along the way, but he believes China is destined for economic greatness and will overtake the US as the world's dominant economy in the not too distant future. His best single piece of advice to us was to make sure that our children and grandchildren learn the language of Chinese!

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MARKET UPDATE

Liquidity – Is a PE Premium Justified?

The 'liquidity' and 'super inflows' that have occurred recently are unprecedented.

With the increase in demand (funds available for investment) and decrease in supply (good quality companies for sale), some argue that the price of the market should be at a premium to the historical average during this period of supply/demand imbalance.

What is driving the increased demand?

There are three primary culprits driving the infow of funds into the Australian market; Superannuation Changes, the Future Fund and proceeds from takeovers/mergers/buybacks etc.

The market is trading at a p/e of 17 times which is above its historical average of 12-14 times but still well below the highs of over 20 times seen in 2003. Until now this has been justified by earnings growth of approximately 15% per annum (putting the market at a pe / growth multiple of approximately one which is reasonable value). However, with organic EPS growth slowing to approximately 10% the PEG multiple starts to look a bit expensive, but not overstretched.

However, it is conceivable that the current p/e premium may even increase and could stay in the market in the short to medium term due to the following factors:

1. Future Fund

The Australian government is (sensibly) trying to ensure that the pension benefits of public servants are fully funded and have therefore set up the future fund. The total value of the future fund is forecast to be $43bn in the short term, rising to $80-90bn within 4-5 years. Estimates of the total amount to be invested in equities range from 10% - 30%. At the mid-range of 20%, the total investable funds which need to find a home is $8.6bn.

2. Superannuation and recent changes to super laws

Recent government changes to superannuation laws have triggered a massive inflow into superannuation funds (both institutional and self managed). In a recent note, Credit Suisse forecast that in 2007 this change could contribute an additional $2.7bn to the share market.

In addition, generic growth of superannuation continues unabated with annual growth of approximately 17%. This translates into an extra $3bn of inflows in 2007.

Anecdotally, this is bad for the investment property market with recent news that borrowing for investment properties has fallen 30% since June 2006. This makes sense for many investors as the benefits of selling their investment property and transferring money into superannuation often outweighs negative gearing. The relative differences are magnified in a flat property market.

3. Private Equity

There is a prognosis that investors can't find value in the share market so they are investing in "alternative equity classes" such as private equity. Ironically, the private equity firms are pushing the price of many companies to historic highs e.g. QAN, CGJ etc. (we often surmise why investors would invest in private equity for the funds to just invest in the market – it seems to make more sense to avoid the middle man and invest directly themselves!!)

Private equity firms have funds which they have to put to work. We wouldn't be surprised to see more aggressive moves over the next twelve months.

Supply

Whilst the demand for equities is increasing from various quarters the supply of available quality investments is diminishing; leading to higher prices being paid for existing available assets.

The supply of shares is drying up predominantly due to companies leaving the market as a result of takeovers (whether by way of private equity, MBO or straight takeover). Examples over the past few years include CML (now relisted ex myer and a target itself), WMC, QAN (under offer), RIN (under offer), FLT (under offer), PRK, DVC, etc.

The inordinate number of buybacks at the moment is also reducing the number of shares on issue. Eg. BHP is buying back 10% of their capital.

Will it last?

We believe this is a short-mid term phenomenon which will disappear from whence it came; baby boomers will reach the stage where they will want to withdraw their super in order to fund retirement. This should slowly bring the market back to historical averages; but it is unlikely to occur in the immediate future. Additionally, new people will enter the workforce as the retirees are leaving – all contributing at least 9% of their income to the super pool each year.

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Warrnambool Cheese & Butter Factory (WCB)

Warrnambool Cheese & Butter Factory (WCB) listed on the ASX in May 2004. The company is the fourth largest dairy manufacturer in Australia with an 8.4% market share. The main contributor to sales is commodity dairy (cheddar cheese, skim milk powder, whey protein) with 96% while the remainder is branded drinking milk.

WCB reported an adjusted net profit after tax (NPAT) of $7.6 million for the financial year ended 30 June 2006. This was in line with the previous corresponding period and can be considered a satisfactory result given the prevailing industry conditions. Profit margins were negatively impacted by factors such as softening dairy product prices, an increase in milk prices paid to suppliers, the appreciation of the Australian dollar and reduced milk intake levels due to dry climatic conditions.

An increase in milk prices paid to suppliers came amid aggressive milk pricing by major commodity processors and drinking milk processors. These pressures should ease once the current period of restructuring and rationalization of the dairy processor industry is complete. Analysts see WCB as a “two year” recovery story, with expectations for flat profit growth in 2007 followed by much higher profits in the subsequent two years.

The company has a number of important competitive advantages in its favour. These include a strong supply franchise in the Southeast Victoria and South Australia regions (with an ability to grow milk intake faster than anyone else in Australia), a centralized plant which operates at full capacity (versus 60% to 80% for competitors) with a strong quality control and cost containment culture, and continuing brand strength development.

As a listed company with an undergeared balance sheet, WCB has access to a range of equity and debt funding options to enable it to take advantage of any profitable acquisition or organic growth opportunities that may arise in an industry undergoing significant change.

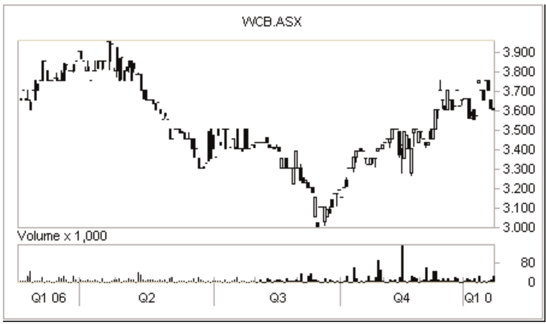
The stock is currently trading on a prospective price-to-earnings multiple for 2007 of 18x, falling to 11x in 2008. Given its undemanding price-to-earnings and ability to generate strong free cash flow, WCB represents a solid medium-term value play for investors.

Investment Fundamentals

	2006A	2007F	2008F
Net Profit After Tax ($ mil)	7.6	12.6	12.9
Free Cash Flow ($ mil)	12.6	14.6	15.2
EPS (c)	19.5	19.6	32.3
Price / EPS (x)	18.5	18.3	11.1
Price / FCF (x)	10.9	9.4	9.0
Dividend Yield (%)	2.5	2.5	4.2

Source: Consensus estimates

Share Price Graph



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Retail Food Group (RFG)

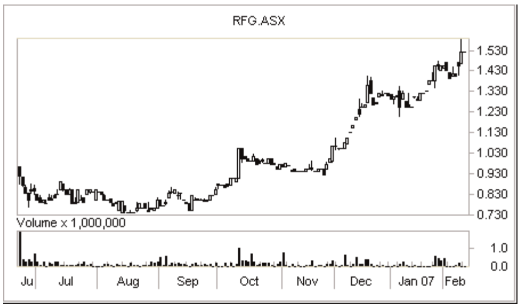
We last wrote about Retail Food Group (RFG), the franchisor and intellectual property owner of the Donut King and bb's café systems, in the November edition of Leyland Lines. Since then, the share price has risen 62% on the back of strong trading conditions and potential corporate activity.

RFG recently announced that earnings before interest and tax (EBIT) for the six months ended 31 Dec 2006 will be at least 22% ahead of the previous corresponding period. This exceeds previous management guidance and supports our growth outlook which is based on store expansion plans, low and largely fixed expenses and the minimal capital intensive nature of the business. We remain of the view that double-digit earnings growth for the company is sustainable over the medium term.

RFG also recently unveiled plans to purchase Brumby's Bakeries Holdings. This would add 316 bakery franchise system to the company's existing network and be of a sufficient scale and maturity to significantly bolster the company's growth profile. If the acquisition is successful, it will allow RFG to apply its proven expertise in managing franchise systems to another high profile Australian brand and provide opportunities for cross-selling, collaborative marketing, co-branding and supply economies.

RFG is forecasting 2007 NPAT of $7.4 million (EPS 10.3 cents) and a fully franked dividend of 6.25 cents, which places the stock on a PE ratio of 14.8x and a dividend yield of 4.1%. Management is confident of meeting these targets and there is scope for the company to over deliver as trading conditions remain strong, store expansion plans run ahead of schedule and the new coffee roasting facility starts contributing to earnings.

We continue to believe that RFG is an attractive business and despite recent share price performance is trading on an undemanding valuation given the earnings growth and free cash flow generation potential.



Self-Managed Super Funds

Improving Performance

At Leyland Private Asset Management we are experiencing more and more clients choosing to invest their self-managed super fund (SMSF) via an Individually Managed Account (IMA).

Bill established a SMSF to realise the numerous tax benefits available and to have control over where and how his monies are invested. In his late 40s, Bill believed he would have the time to manage his SMSF; however he soon realised the challenges in finding the time to execute, manage and administer a share portfolio effectively.

"I knew I wanted to invest the majority of the super fund assets in shares, but found I did not have the time to analyse which shares to buy and when to take profits. When I managed the shares myself, the fund underperformed due to my inability to act on opportunities as I could not watch the market closely enough. I also found I was missing out on offers like buy backs and rights issues as I was getting behind on my paperwork."

Bill approached Leyland Private Asset Management six months ago. We discussed his preferred share portfolio profile for his SMSF, which included reasonable diversification, capital growth and an exclusion from investing in property due to other investments in that sector. *"When you consider the time I was allocating trying to find the right shares to invest in, or divest of, combined with the time I spent on administration. Leyland's fees are minimal and they have so far out performed my investments in every sector."*

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Coca – Cola Amatil (CCL)

CCL reported its FY06 results on 15 February. With a FY06 NPAT of $323m, CCL has improved upon its 1H performance, and delivered at the top end of management's guidance. This result was underpinned primarily by a strong growth in Australia, and rapid recovery in Indonesia. Despite the momentum of 2H results, CCL still faces many business challenges.

CCL's share price has increased by approximately 15% since October 2006. The underlying driver for this upward trend are easing commodity costs, in particular aluminum and sugar, expansion of product range in Australia, and strategic expansion into the alcoholic beverage market. At the current share price of $8.19 we believe that CCL is fully priced, and it may be an opportune time for investors with a large exposure to reduce their holdings in order to diversify their portfolio.

In this article we hope to concisely outline the key factors influencing CCL's operations.

Input Costs

Commodity prices have eased over the past few months. Whilst this is advantageous to CCL's input costs, given the company's forward hedging profile, the effect is likely to be felt in FY08. Cost of Goods Sold (COGS) in FY07 is still expected to increase by 6%.

Lower Petrol Prices

The recent downward movement in oil price will have an effect on customer's discretionary spending at the petrol station; customers more likely to impulse spend given a lower petrol bill.

Weather

CCL benefits from normal summer weather (i.e. above 28C) with limited rain. This year has been unseasonably cool and wet in parts, and this may affect consumption volumes in Australia.

Asia

The South Korean operation is still experiencing hardship after the extortion threat last July. Volumes have decreased, and consumer confidence is low. Whilst management has not yet decided whether it will divest South Korea, it has engaged an investment bank for assistance.

CCL's Indonesian performance is extremely unpredictable due to the volatile macroeconomic conditions of the country. The business has done well in 2H with improving consumer confidence on the back of falling inflation / interest rates.

Coke Zero

This was the saving grace for CCL in FY06, as the sale volumes exceeded all expectations. The challenge in FY07 is for the product to deliver the same proportional contribution.

Summary

At the current price range of $8.00 - $8.20 we believe that CCL is fully priced, and that all positive developments/news have been taken into consideration.

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News Corporation Limited (NWS)

We have been believers in the NWS story for three years and the latest set of results gives us no reason to change our mind.

NWS has now settled down into six distinct divisions, providing geographical, industrial and technical diversification. They are:

1. *Filmed Entertainment*

Revenue driven from NWS movie division. Revenue comes from movies at the cinema augmented with ongoing sales of DVD's etc. This division was the largest contributor of NWS' earnings last quarter with 31%. Due to the volatility in hit movies this can be a volatile part of NWS' business.

2. *Television*

Television revenues around the world are driven by advertising revenue which itself is cyclical and also driven by ratings. Ratings can vary depending upon programming and NWS Television had a reasonably subdued quarter due to lower than expected baseball ratings. NWS expects this to pick up and this is a reasonably defensive sector of NWS' earnings.

3. *Satellite Broadcast Cable*

Cable and satellite businesses need a critical mass of subscriber numbers to break even, and after breakeven there is generally significant upside as every new subscriber is high margin. Like television, the number of subscribers is driven partly by content. This division is trading reasonably well but had a cost overrun in the last quarter. Satellite provides a defensive earnings stream for NWS.

4. *Newspapers*

Newspapers around the globe are slowly losing their classified advertising revenues to the internet. Fortunately, many of NWS' papers are not as reliant upon advertising as some of their competitors and are sold on content and attract more display advertising. Newspapers are likely to remain a low growth area for NWS in the foreseeable future and are likely to form a smaller percentage of net revenue as the other divisions grow.

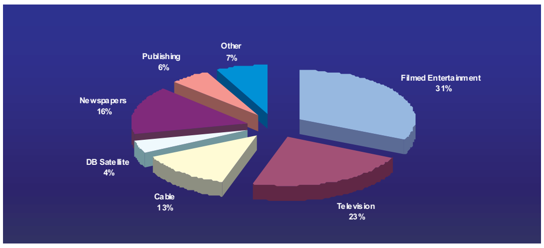
5. *Publishing*

The book publishing business hit the headlines recently when they decided not to publish the mooted OJ Simpson book. A small but important part of NWS' business.

6. *Other*

"Other" would normally be considered an inconsequential part of a business, however, this is where NWS' wildcard really lies. This division is responsible for most of NWS' ever growing internet business and we would expect this to become a significant part of NWS' revenues in the coming years.

The revenue breakdown can be illustrated as follows:



NWS has undertaken several major acquisitions in the last 9 months. We believe they will be able to use their geographical and content muscle to drive this division above market expectations.

NWS is likely to exceed their full year EBIT growth forecasts of 14%-16% with possible surprises from their online division (fox interactive media).

NWS provides fantastic exposure to the global media industry with potential upside provided by new age assets complimented by defensive old style income streams. Debt is becoming less of an issue for NWS and the key risk remains succession planning however it is unwise to preclude investing in a quality company on this basis.

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Transurban Group

The main reason to consider investing in Transurban is for its low risk tax effective distributions coupled with some capital growth. The current yield is approximately 7.05% which is expected to grow at 8% p.a. The distributions are 75% tax deferred, meaning generally tax is not payable on 75% of each distribution until the shares are sold.

By way of background, Transurban is the owner and operator of the following tollways:

1. Citylink, which connects Tullarmarine airport to the Melbourne CBD
2. M2, which connects North Western Sydney with the city.
3. 47.5 % of Sydney's Westlink M7, which runs at around the outskirts of Sydney and connects to the other tollways.
4. a US tollway called Pocahontas

In December, Transurban made a takeover offer for Sydney Roads and subject to ACCC approval (due in early March) will add the following Sydney roads to its portfolio – The Eastern distributor, the M4 and M5 motorways. The only objection seems to revolve around Transurban's 50% ownership of the Etag administration system.

Whenever a driver subscribes and uses an Etag, regardless of which tollway, a payment goes to this Etag operator. Even for example when someone drives over the bridge. In the worst case Transurban may have to sell down some of this holding to a minority level to appease the ACCC.

The Sydney Roads takeover will mean that Transurban will basically own and operate all of Sydney's major roads. This will provide Transurban with an extraordinary amount of data on traffic flows which allows Transurban to maximize their Tollway returns. For example where to put on/off ramps, where to improve bottlenecks by adding lanes. It will also give them a huge advantage when tendering for new roads

Transurban Sydney Road network post the SRG takeover

Transurban have publically stated that they have numerous opportunities in the US where privately owned tollways is a relatively new concept. Transurban is working on establishing a new company to facilitate these opportunities. The new company will be funded by the US institutions with Transurban (Australia) retaining a significant shareholding. Transurban will also benefit by charging the US company management fees in a similar model to Macquarie Bank.

An investment in Transurban is generally considered to be defensive and low risk. The media beat ups last year about the debt levels of such companies and the recent failure of the cross city tunnel do not apply to Transurban. Most of Transurban's tollways are mature and have an established traffic history, which produce highly reliable income streams. After allowing for the cost of a successful takeover of Sydney Roads Transurban interest cover is 2.2 times, which compares extremely favorably with other infrastructure companies. Please refer to the table.

Over the next 6 months there a series of positive events which may well act as catalysts to lift the share price. These include:

1. Completion of the Sydney Roads takeover and any announcements on efficiencies.
2. The opening of the Lane Cover tunnel in March which will add to the traffic on the M2.

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3. Continued ramp up in traffic numbers on the M7 which only opened last year.
4. Establishing the US Infrastructure company.
5. Transfer of the Pocahontas tollway from Transurban to the US entity.

In summary, an investment in Transurban is defensive in nature and will produce solid tax effective distributions with the potential for capital gain over the next six months.

Infrastructure Stock Comparison

		TCL	MIG	SPN	SKI	ENV	DUE	APA	BBI
Price	A$	7.66	3.7	1.4	1.39	1.23	3.15	4.25	1.91
Mkt Cap	A$m	6666	9907	2793	1781	924	1418	1789	2691
DPS	Ac	54	20	11.4	17.2	9.5	25.65	28	15
Franked	%	0	0	9	0	0	7	40	0
Tax Deferred	%	75	0	64	20	0	10	0	100
Yeild	%	7.05	5.4	8.1	6.5	7.7	8.1	6.7	7.8
5 Year CAGR	%	8	4	3	3.5	0	3	5	7
Net Interest Cover	x	2.2	1.4	2.54	2.77	1.99	1.96	1.71	1.77

TCL: Transurban – Tollways

MIG: Macquarie Infrastructure Group– Tollways

SPN: SB Ausnet – Owner of Victorian Gas and Electricity distribution infrastructure

SKI: Spark Infrastructure – Energy Infrastructure, with $1.20 installment to be paid in March

ENV: Envestra is the largest distributor of gas

DUE: Duet gas and electricity pipelines managed by Macquarie

APA: Australia Pipeline – gas transmission pipelines

BBI: Babcock infrastructure owns diversified infrastructure assets including Port at Dalrymple Bay QLD and gas and electricity assets in NZ and Europe.

Is it time to consider an Individually Managed Account?

In a busy and time poor world it is difficult to properly monitor your investments. Leyland Private Asset Management has its complete focus on managing and making the investment decisions for share portfolios on behalf of Australian and international clients.

Our senior management has proven track records over many years managing and advising private portfolios.

Individually Managed Accounts provide the following benefits

- Direct Share Ownership
- Day-to-day Portfolio Management
- No Hidden Fees
- Detailed Performance Reporting
- Tax Benefits
- No Entry or Exit fees

If you understand that direct share ownership is a key to wealth, please contact Leyland Private Asset Management.

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MARKET UPDATE

Update on Agincourt Resources Takeover by Oxiana

Current Price $1.80

Oxiana has made a scrip takeover offer for Agincourt which has been one of our favored producing gold stocks. The offer is .65 worth of Oxiana shares for every one share in Agincourt. The offer valued Agincourt at $1.92 on the day of the offer.

In spite of the fact that the gold price has increased over 10% since the start of the year

Oxiana's share price has lagged the market mainly on the back of falls in copper and zinc prices.

Agincourt is a quality gold company that has a considerable upside with the Martabe gold project in Indonesia which they bought from Newmont for $US 100 million

The gold resource in Indonesia is currently at 5.8 million ounces with exploration continuing to find further resources.

We would hold the Agincourt shares at the moment whilst the gold price is moving. The shares will rise and fall on the back of the gold price and on the back of the Oxiana share price movements. As the Gold Price is hovering around the $US670 mark there is a reasonable chance that we could see a breakout to the upside target of the old highs around $US730 in the short term. The success of the takeover should be monitored over the next month. The directors of Agincourt have recommended the takeover.

For those investors who do not have any gold shares and would like to roll their investment into Oxiana there is the advantage of having shares in a large diversified miner that will be capitalised at over $3 billion dollars. Oxiana is also one of the major resource companies that the institutions focus on as the gold price rises. The diversification into Oxiana will spread the risk of Agincourt's Martabe project in Indonesia should Oxiana's takeover be successful.

In summary we recommend holding your shares until the likelihood of the success of the takeover emerges over the next month or so. If you have any further queries please contact your adviser.

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