

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 January 2008 edition of Leyland Lines

In this edition of Leyland Lines we provide a market outlook, revisit some of the companies which have been inordinately sold off recently, including IAG, FXL and RFG. We review the gold sector in light of our US\$1,000 prediction for the gold price and also revisit the agricultural sector as demand for soft commodities continues amidst some recent healthy rainfall and increased global demand.

Austofix to Close Prospectus at the end of January

As we described last month, Leyland Private Asset Management is acting as the corporate adviser for the float of Austofix. The prospectus is scheduled to close at the end of January.

Copies of the prospectus can be obtained by calling Leyland Private Asset Management.

Contents

Market Outlook
FlexiGroup Limited
Retail Food Group
Gold Update
Agricultural Stocks
Insurance Australia Group

Leyland Lines

Market Outlook

The downturn in the market has to a large extent factored in a US recession and the uncertainty that still exists is the severity of any downturn. It is clear that the Federal Reserve and Bush administration will devise various rescue packages including lowering interest rates, tax cuts and other measures in an effort to avoid a more severe downturn.

The property market in the US has been falling for over two years and there are now signs that some type of bottom will emerge this year, though any sustained recovery will take a considerable amount of time. The concern for many economists is that any stimulus packages will ultimately fuel inflation. This has been one of the reasons the gold price has surged.

In contrast to the United States, Australia already sees signs of inflation emerging particularly on the labour front in Queensland and Western Australia, and the Reserve Bank is currently contemplating the need for another interest rate rise. With the international pressures and evidence of strain on homeowners from previous increases in interest rates and the rise in petrol prices, it will be no surprise if the Reserve Bank maintains a watching brief for a little longer.

Australia continues to be a major beneficiary from the boom in China, India, the Middle East, Brazil and Eastern Europe and is likely to be somewhat more protected from a US downturn than in previous recessions. There has been some concern that a US recession will dramatically affect China's exports to the US.

The Economist Magazine recently wrote an article pointing out that not only did the 2000 US recession have a limited impact on China's GDP growth (estimated at around 1% of GDP) at that point in time, but the export markets for China including Japan, Korea and the rest of Asia together with Europe still provides a huge market for China's exports to a much greater extent than in 2000.

The development of the internal economy in China since 2000 is also another factor that will allow growth to continue apace. The economist actually argues that a slowdown in the order of 1% of GDP for China would be healthy as inflationary pressures have been building there.

In essence we see some more volatility particularly until the end of the March quarter but believe that as commodity prices stabilise investor confidence will return to those companies that will continue to benefit from the growth in China, India Middle East Brazil and Eastern Europe for many years to come.

Good quality well managed industrial companies will attract a premium as badly run companies flounder. We also see a much greater focus on soft commodities and the agricultural sector generally.

The overriding pessimism that currently exists reinforces the old adage that bull markets climb a "wall of worry".

Leyland Lines

FlexiGroup Limited (FXL)

Price \$1.59 Market Cap \$359m

In the current downturn we are attempting to identify opportunities in which the market has sold good quality companies due to perception of risk, rather than reality.

We have followed FlexiGroup in the past and believe this represents one such opportunity.

FlexiGroup provides finance at the point of sale for many household goods including furniture, white-goods, electrical appliances and IT equipment.

When a customer uses the FlexiGroup service to finance their purchase at point of sale, the result is effectively a win for everybody except the consumer! The retailer is able to increase the value of goods sold and receive payment within 48 hours, the salesperson receives a higher level of incentive (commission) and FlexiGroup acquires a new customer to whom they may later cross sell additional services such as insurance, personal loans etc.

FlexiGroup operates under many banners, including Flexirent, Smartway, Easylease and Flexipak among others. However, Flexigroup's primary source of distribution is via long term agreements with retailers, predominantly **Harvey Norman for whom they have provided financing since 1995**. FlexiGroup's current agreement with Harvey Norman extends until 2015, while FlexiGroup also have a distribution arrangement with Noel Leeming until 2011.

In light of the recent international issues, the share price has retreated from a high of \$3.24 to current levels of \$1.59. We believe this is an outstanding opportunity to purchase additional shares.



On December 19th Flexigroup provided a market update regarding their funding arrangements, stating that "FlexiGroup does not rely on the global capital markets to source any of its funding requirements nor does it have any securitisation programmes in place. Based on current projections for new business volumes and anticipated principal repayments, our committed undrawn facilities are expected to be sufficient to cover the projected net increase in borrowings through to June 2009.

On current valuations FlexiGroup appears to be good value with largely predictable and sustainable earnings augmented by further growth potential via a generic increase in the sale of consumer goods (plasma TV's etc) and an increase in the number and type of products against which FlexiGroup will lend funds.

The biggest risk to FlexiGroup is regulation. At the moment FlexiGroup is exempt from the Uniform Consumer Credit Code (UCCC) as they are effectively leasing the product to the consumer. If greater disclosure is mandated it may adversely affect the perceived competitiveness of FlexiGroup's offering. Other risks are non-renewal of distribution agreements, downturn in consumer demand and increase in bad debts. We believe these are all adequately compensated for in the current share price.

FlexiGroup has an experienced and well credentialed board of directors and senior management team, led by Chairwoman Margaret Jackson.

FlexiGroup has a very conservative balance sheet. Earnings growth forecasts anticipate EPS growth of over 15% p.a. in line with long term historic trends.

Code FXL

Share Price \$1.65

	2006 (A)	2007(F)	2008(F)	2009(F)
EPS (cps)	10	13.6	16.9	19.5
EPS Growth (%)	0	36	24.26	15.38
P/E (x)	16.50	12.13	9.76	8.46
PEG (x)	0	0.34	0.40	0.55
DPS (cps)	0	5.5	10.5	12.5
Franking (%)	0	100	100	100
Yield (%)	0.00%	3.33%	6.36%	7.58%

Source - Consensus Figures

FlexiGroup provides investors with exposure to a company with a sound operating history, entrenched earnings and distribution profile, conservative organic growth and blue sky opportunities via additional products and geographic mix. FlexiGroup also has a strong balance sheet and sound management and the medium to long term outlook still remains attractive.

Leyland Lines

Retail Food Group (RFG)

Price \$1.55 Market Cap \$149m

We recently spoke with Nigel Nixon, executive director of Retail Food Group (RFG), to discuss company prospects and gain an update on the business.

There have been some concerns raised recently regarding RFG's exposure to the rise in commodity prices, namely coffee, wheat and sugar. Nigel pointed out that the company does not have a direct exposure, as third party manufacturers' invoice and supply the franchisees directly. Moreover, management anticipated these cost increases and sought to recover them for franchisees by raising retail prices for bread and donut items by circa 20% in November last year. Similar rises in retail prices were seen elsewhere as all players have been feeling the same pressures. Nigel believes these cost increases can continue to be passed on to consumers as has been the case in the past.

Following the acquisition of Michele's Patisserie and the private placement in November, RFG has a debt to assets ratio of 58%. Although this gearing level is relatively high, the company's franchise model produces strong and reliable cash flows with which to service this debt. Nigel informs us that debt was recently refinanced on favourable terms. The new bank debt facility of \$120 million has a maturity of three years, with \$100 million on a fixed rate of 6.85% and the remainder on variable. This is particularly reassuring given rising interest rates, the current state of the debt market and the perceived refinancing risks many companies are exposed to.

The current focus of the company is the bedding down and integration of the Michele's Patisseries and Brumby's businesses, realisation of synergies across these franchise systems and organic growth from menu improvement and continued store rollout. In the longer term, a key growth avenue for RFG will be expansion into Asian markets under a master franchise arrangement. Management is looking into China and Japan in particular, with a search ongoing to find partners with the requisite knowledge and experience in the franchised food business.

When asked to comment on the important Christmas and New Year period trading conditions, Nigel replied that he was "happy" with the level of business across the franchise systems during that period. Of particular note was a stronger result from the Donut King stores in South East Queensland, where favourable weather conditions led to an improvement on the softer trading conditions experienced in the previous year. We will have to wait for the 1H2008 financial results to be released for the full details.

NO TIME TO RUN YOUR SELF MANAGED SUPER FUND?

Leave the worry to us Leyland Individually Managed Accounts

One of the biggest challenges for those people with Self-Managed Super Funds (SMSF) is finding the time to manage investments wisely to gain the best possible return on those investments. So, many of our clients choose Leyland Private Asset Management to manage the equities portion of their personal super fund. Most investors want to maintain overall control, but recognise that their time and market knowledge sometimes limits their investment returns.

Please contact Leyland Private asset Management if you would like to talk further about us managing your super fund equity investments.

Leyland Lines

Gold Update

At Leyland Private Asset Management we have been bullish gold for two and a half years (we refer you to our articles in Leyland Lines of the September '05 and April '06 editions). Although the price rise has taken longer than we anticipated, the dramatic recent price increases are examples of how in a bull market movements can be very rapid.

The fundamentals for gold still remain extremely attractive for all the reasons we enunciated in our original article including:

- Overall weakness in the US dollar
- Hedge against inflation
- Hedge against political turmoil
- Limited Central Bank sales
- Lack of exploration investment
- Lack of serious discoveries world wide
- Underweight position of reserves in countries such as China
- Underweight exposure of fund managers and retail investors compared to historical weightings in previous bull markets particularly with the major economic uncertainties at the moment.

Many will ask..... where to from here?

Gold is probably the hardest commodity to pick short term movements, but the fact that it has now convincingly broken the 1980 high of US\$850 and is also moving substantially higher in all currencies is indicative of much greater upside in the future. One has to bear in mind that the inflation adjusted price of the previous high 28 years ago is north of \$2000 in today's US dollars.

So which stocks still look reasonable assuming further upside in the gold price?

It is prudent to stick to the major stocks initially as they attract the most Fund management interest and we still believe this is in its infancy. While we have already seen some significant moves over the past few months, as the price rises further this will continue to be reflected in the stocks. Equally, short term downside moves will see the major stocks reflect this.

Newcrest is the largest gold stock in Australia and has been the most favoured by the

institutions; generally because of the quality assets with the majority of the producing mines are located in Australia, so avoiding political risk which dominates many of the gold stocks with interests overseas. Newcrest has performed very well recently though the one query we do have is the full extent of the unwinding of their hedge book. The company has unwound at least half of their hedge position but there is the possibility of at least 1.7million ounces still hedged. If that is the case this is a significant negative. Until the final hedge position is made clear we would look to avoid Newcrest.

Unlike Newcrest, Lihir timed their unwinding of the hedge book to perfection and is now the largest producer with no hedging. The negatives with Lihir remain in the fact that its major mine is in PNG with the inherent political and economic risks of that country. Nevertheless as the gold price improves, the value of the large resource/reserve position will be reflected in the share price.

We also like Oxiana and Oceana Gold for their resource position and growth profile over the next few years. As the gold price continues to be noticed by more investors there will be a filtering down affect to middle size producers/explorers and ultimately to the speculative explorers. We have just seen the first stage of what will be the most interesting gold market in 20 years.

Michael McCormick from Leyland Private Asset Management gave an interview on Bloomberg TV prior to Christmas and predicted US\$1000 gold by the end of 2008. There were also comments on the possible merger between BHP and RIO.



To access the interview please go to: <http://www.leyland.com.au/media/mcbbnov2007.mpg>

Leyland Lines

Agricultural stocks

In November 2006 and in June last year we recommended buying agricultural stocks as they were discounted at that time due to the drought. Recently inland NSW and Victoria have received a significant amount of rainfall. From the anecdotal evidence we are hearing there is a significant confidence in the outlook for next years crops and that should further benefit the agricultural listed businesses.

The companies we highlighted have done very well and in a few cases we think they will go further. Our confidence in the sector is based on the following:

1. Soft commodities historically have followed increases in hard commodity prices and this is now emerging in wheat and sugar.
2. Australian agricultural produce is high quality and is sought after in many markets, particularly in international markets and often at a premium price.
3. The rising wealth in areas such as India and China will lead to increasing demand for many agricultural products in Australia.
4. The leverage agricultural companies have to seasonal conditions is significant and we haven't yet seen analysts upgrade profit expectations following the recent rains.

Futuris (FCL)

Price \$2.20 Market Cap \$1,656m

Futuris is the largest and most diversified listed agricultural share on the market. By way of background Futuris has the following divisions and investments in other companies:

1. Elders Branches- through its 280 rural branches Elders supplies a wide range of farm inputs and the marketing and sale of farm outputs including:
 - Meat and Livestock- Elders is the largest stock and station agent.
 - Wool- a global leader in the sale of greasy wool and one of the largest early stage processors.
 - Grain- Elders is growing its grain accumulation business.
 - Merchandise- one of the two largest suppliers of general rural merchandise.

- Real Estate- Australia's largest rural estate agents.
2. Elders Rural Bank provides loans and deposit facilities as well as insurance products. This is a 50% joint venture with Bendigo Bank and due to Elders long standing with the rural community has a significant edge in this market over the major banks.
 3. 43% of Australian Agricultural Company (AAC) - Australia's largest beef cattle owner and operator.
 4. 50% Shareholding in Hi Fert, one of Australia's leading fertiliser companies.
 5. 27% ownership of Webster- a diversified food and agribusiness.
 6. Forestry- following the takeover of ITC, this is now one of Australia's major timber operations incorporating the sale of MIS packages and the operation of the timber plantations.
 7. 47% interest in Amcom- an internet supplier and IT service company.

Futuris share price has done very little over the last 12 months. Futuris is currently trading on a consensus PE of 15 times, with considerable upside risk to the earning estimates- given the follow up rains experienced across a large part of Elders markets and the strength of its fertiliser and forestry business.

Australian Agricultural Company (AAC)

Price \$3.50 Market Cap \$888m

The company has a dominant position in beef cattle and rural land holdings over the last two years.

Asset Update: AAC revalue its significant herd based on market prices and logic would say that with the recent rains stock demand from southern states will increase the value of the herd and this will increase the asset value of AAco, leading to market upgrades.

Corporate Update: AAC major shareholder Futuris have signalled that they are considering selling their 43% shareholding. There is the real possibility that this could lead to a takeover offer or a break up of the assets.

Leyland Lines

Agricultural stocks cont'd

In addition, if the rains lead to a good crop season in Eastern Australia, AAcO will further benefit from the increased supply of grain later in 2008, which it requires to finish many of its beasts before sale.

AAcO continues to be well positioned and we would recommend holding the stock.

Incitec Pivot (IPL) Price \$124.04 Market Cap \$5,955m

Incitec's management emphasise that Incitec Pivot remains more exposed to fertiliser prices than sales volumes. The company is a price taker in the industry. DAP and urea prices are the key profit drivers for Incitec Pivot with every US\$10 per tonne change translating to 4% and 1.5% of EBIT respectively.

Fertiliser prices have gone up and will continue to remain in high demand following the Christmas rains. This is particularly so given Dyno Nobel's decision to pullout of their fertiliser expansion projects due to escalating construction costs.

Incitec is currently operating in a fantastic environment of low competition and high demand for its products. Not surprisingly IPL's share price has done extremely well.

Graincorp (GNC) Price \$11.11 Market Cap \$703m

Graincorp provides logistics and storage services to farmers on the east coast of Australia. As such it is highly geared to crop volumes. Since Christmas it has moved up slightly, however we still think there is further upside for Graincorp, as the analysts haven't significantly upgraded their outlook as yet.

The industry seems to be recognising the logic of merging the various regional providers, which is expected to lead to industry consolidation later in calendar 2008. The first step in the process is for each of the participants to unwind their restrictive shareholder structures. AWB, GNC and ABB are

all putting this simplification to a shareholder vote shortly. These proposals are logical, however, there is always the risk that they won't be successful.

Insurance Australia Group (IAG) Price \$3.90 Market Cap \$7,319m

After a series of external events, IAG has continued to under perform. Competition in the insurance industry has kept premiums down, their expansion into China was thwarted and their acquisition into the UK appears ill timed and expensive. The latter two has lead to many analysts questioning the current senior management. On top of these issues, IAG has just suffered from what the industry calls an extraordinary event in the storms in December, leading to short term earnings downgrades. This litany of events has seen the share price fall from above \$6 to below \$4.

Although we are disappointed with IAG and in hindsight our exposure, we certainly would not be selling now. There is little doubt that IAG has been one of the most disappointing stocks over the last few years and continues to be under pressure. However, now the damage is done, investors need to be rationale about what they do with their shares now the price is down.

Although it may take some time for IAG to regain the markets confidence the reality is:

1. Its balance sheet is extremely strong and retains an AA credit rating- this is one of the highest in Australia.
2. If, as management have suggested, it maintains its dividend it is on a fully franked yield of 8%.
3. Quality retail brands in Australia including NRMA. with significant market share.
4. Highly regarded new management has been hired.

This report is provided by Leyland Private Asset Management Pty Limited (ABN 75 081 890 799), which holds an Australian Financial Services Licence #223419. This is not an offer (or solicitation of an offer) to buy/sell the securities/instruments mentioned. Leyland Private Asset Management Pty Limited, its directors and/or employees may own securities/instruments in the companies mentioned in this report or may advise the issuers. The nature of investments necessarily involves the risk of loss. Leyland Private Asset Management Pty Limited is of the view that the information provided herein is accurate and complete, however, no warranty of accuracy, completeness or reliability is given, and no responsibility for loss or damage whatsoever or howsoever arising as a result of any representation, act or omission whether express or implied, is accepted by Leyland Private Asset Management Pty Limited, its directors or employees. Leyland Private Asset Management Pty Limited does not provide accountancy or tax advice and you should seek independent advice on these matters. Any advice is general advice only and does not take into account your personal financial position or objectives and therefore you should consider such advice accordingly. For additional information, research reports and important disclosures, contact us at info@lpam.com.au or see www.lpam.com.au.

If you no longer wish to receive Leyland Lines please email or call Leyland Private Asset Management.