

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 May 2007 edition of Leyland Lines.

Budget

From an equity market perspective, the budget proved to be relatively benign.

In what was definitely an election budget, we believe that the government was sensible in giving back some of the large surplus by way of tax cuts and allocations to sensitive areas such as childcare and the elderly, without compromising economic prosperity. It was interesting to note the Opposition's congratulatory response!

From an investment perspective, a conspicuous omission from the budget was any substantial commentary in relation to telecommunications infrastructure.

The government would be well aware of this pressing issue and it seems logical that they are probably looking for a solution away from the glare of publicity. We would expect an announcement in the not too distant future and this may have major ramifications for the telecommunications sector and Telstra in particular.

Contents

Budget

Superannuation – Investment performance is still key

Update – BHP Billiton & Rio Tinto

Indophil Resources

FlexiGroup

Bravara Solutions

Updates

- TLS, HGI, AUN, CXP, FXJ & NWS

Leyland Lines

Superannuation - *Investment performance is still the key.*

There is no doubt the Government has made it more attractive to contribute to one's own superfund and in addition there are significant tax concessions on earnings within superannuation funds.

The return from the fund is generally taxed at a relatively low rate of 15% and franking credits on dividends are often treated as a rebate to the fund.

All these tax advantages on earnings are academic if the fund's portfolio is not performing to its potential. For example a \$500,000 SMSF that returns 18% for 10 years will have a value \$2,616,917.78 vs. \$1,552,924.10 which returned 12%.

With all the publicity surrounding the improvements and tax concessions for Self Managed Superannuation, the fundamental issue of achieving investment performance can be forgotten in the noise.

The talk has been on the governments incentives to increase contributions, including the opportunity to make high contributions prior to June 30. All of these changes are real positives to SMSF's and not surprisingly we have received many calls from clients and accountants topping up their self managed funds.

In conjunction with their accountant, beneficiaries decide the level of any additional contributions each year. In the case of self managed funds, the trustees decide on the core investment strategy for the fund. This will take into account the timeframe until retirement and for many funds, this will result in a significant part of the assets being invested in the sharemarket. In consultation with a portfolio manager, an investment strategy will be devised, taking into account the need for growth and income over the life of the fund.

One of the key differences between self managed superannuation funds and large corporate funds is the flexibility to decide asset allocation and the transparency of what investments the fund actually owns.

The large corporate superannuation fund's trustees decide the mix between asset classes. For example they may have 30% invested in bonds, 20% invested in international shares, 40% invested in Australian equities and 10% in "other". The corporate funds then appoint expert managers to manage the investments within the sectors. For example they will appoint bond experts and Australian share experts. The corporate trustees are forced to adopt a highly diversified approach as they are trying to cater for a high number of diverse beneficiaries.

Self-Managed Super Funds

Improving Performance

At Leyland Private Asset Management we are witnessing 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."*

MARKET UPDATE

Leyland Lines

Superannuation - *Investment performance is still the key. cont'd*

In today's world, SMSF's have the added advantage of being tailored to the beneficiaries requirements and provide far greater ongoing flexibility. For example, a SMSF with 10 years until retirement will have a greater percentage in shares than an imminent retiree who may seek the relative safety of a higher cash proportion. Once the trustee of the SMSF has decided the breakdown ("the investment strategy"), the next issue is how the money within each sector is going to achieve the best results.

Trustees can execute the share investments themselves and do the ongoing portfolio management. Naturally this is appropriate for trustees with the expertise and the time each day to devote to the portfolio. On the other hand, the trustee can do their job by appointing a specific expert in the same manner as the corporate superannuation fund. Whether the trustee's manage the shares or it is outsourced, performance and appropriateness need to be reviewed from time to time.

Some clients who had previously decided the former (to manage the investments and administration themselves) have decided to pass

the responsibility to us. This does not preclude them from taking over again should they wish to in the future. i.e. the SMSF enables the trustee to change back and forth from managing the shares themselves and outsourcing depending on their situation.

Additional performance is achieved by appropriately addressing corporate actions such as buybacks (which often produce very high franking credits for superannuation funds), taking up rights issues (which are normally at a significant discount to the market value) and the right floats such as T3.

It is important to remember that over the long term the All Ords averages just over 12 % p.a and therefore in years to come achieving a reasonable return on share portfolios will get tougher and the incidence of underperforming super funds will become more prevalent.

With most people submitting their 2006 fund tax returns at this time of year, it is pertinent to consider whether execution of the investment strategies is actually working or whether there should be a change.

Update: BHP Billiton and Rio Tinto

We recently attended a presentation by BHP Billiton's ex-CFO and current head of carbon steel materials, Chris Lynch, where he discussed the company's resource base and future growth opportunities.

Lynch reaffirmed the company's positive outlook for the demand for commodities. He noted that most of the world's economic growth was metals intensive, citing the industrialization and urbanization of China and India as key drivers of demand. India was in an earlier phase of growth than China but more importantly both countries had many years of strong economic growth remaining. Furthermore, a possible slowdown in the US was not a major concern as direct consumption of commodities in the US was

much lower and had less influence on commodity prices.

BHP remains focused on exploiting high commodity prices by increasing volumes through organic growth and acquisitions. Lynch highlighted the company's proven ability to develop and execute new projects, with 32 projects completed over the last four years adding an average 42% volume growth in the commodities it produces. Given the current project pipeline, the company is well placed to deliver strong volume growth across all of its core business units over the next three years.

BHP and RIO remain our preferred exposure to the commodities boom. These are high quality

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Update: BHP Billiton and Rio Tinto cont'd

businesses that are trading on historically low PE and free cash flow multiples. However it needs to be emphasized that future earnings and share price performance will largely depend on the direction of commodity prices. Current valuations factor in a falloff in prices. Should commodity prices continue to significantly exceed the market's expectations, analysts will be forced to upgrade their earnings forecasts and discounted cash flow valuation (DCF) derived price targets for these stocks. A major re-rating would be on the cards.

Recent speculation concerning a BHP takeover of Rio Tinto highlights the dominant positions these companies have in commodity markets. Should a speculated merger or acquisition

eventuate, BHP and Rio will secure additional pricing power. This could alter the earnings outlook materially and place the combined entity in a highly enviable position should commodity prices indeed remain stronger for longer.

BHP Billiton	2007E	2008E
Price-to-earnings	10.8x	10.2x
Price-to-free cash flow	9x	7.9x
Return on Invested Capital (ROIC)	30%	28%

Rio Tinto	2007E	2008E
Price-to-earnings	10.5	10.8
Price-to-free cash flow	7.9x	8.3x
Return on Invested Capital (ROIC)	27%	26%

Indophil Resources

Price \$.89

MKT CAP A\$338 Million

Indophil Resources found the very large undeveloped copper/gold deposit known as the Tampakan Project in the Philippines.

In March 2007 Xstrata, one of the world's leading mining houses, exercised their option to acquire 62.5 % of the project and become the manager following the completion of the final feasibility study. Xstrata's involvement in the management brings greater certainty to the project and is a positive reinforcement of mining development in the Philippines. Other major world mining companies such as Phelps Dodge, Anglo American and BHP are also in the Philippines which emphasises the government's ongoing commitment to mining.

The project at this stage has a resource of some 11.6 million tonnes of copper and 14.6 million ounces of Gold; this is world class and worth around A\$100 billion in the ground at current metal prices. Indophil will end up with 37.5% of the project after securing further interest from its Filipino partner.

The pre feasibility studies have been completed at a cost of \$27 million. The project has had a history of challenges as to ownership in the highest courts but this is now been resolved. Indophil with 37.5% of the project is positioned as a very significant shareholder in one of the world's potentially most cost competitive copper – gold deposits.

Indophil is in a healthy financial position, having raised equity to assist in the financing of the Tampakan project. They now have approximately A\$110 million in the bank. This cash will assist with the commitments to the Tampakan project but will also allow some expansion into some exciting projects in the region which can be underpinned by the healthy balance sheet.

Those investors who are prepared to take a medium term view and wait for the final approval for mining (which includes substantial environmental requirements) are likely to be rewarded. We feel however that the copper price has had a very good run of late and as world wide supplies increase, price pressures will also increase. On the other hand, the gold in the ground looks extremely valuable and in the future the gold price movements will be extremely important. We still feel the gold price has some substantial catch up to most of the industrial commodities.

With a market capitalisation of A\$338 million and with \$110 million in the bank, the price you are paying for a very large undeveloped low cost gold/copper resource managed by a world class company in Xstrata looks cheap if one is prepared for the political risk of the country and the development and environmental approval process.

MARKET UPDATE

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FlexiGroup Limited (FXL)

FlexiGroup provides finance at the point of sale for many household goods including furniture, whitegoods, appliances, electrical and IT equipment. FlexiGroup operates under many banners but their prime 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 is until 2015. FlexiGroup also have a distribution arrangement with Noel Leeming until 2011.

FlexiGroup listed in December 2006 and after an initial flurry of activity and increase in share price, has now settled back to more realistic levels.

The FlexiGroup story is just as promising as outlined in their prospectus, however the market has become disappointed by the lack of information coming from the company – even though this was flagged by the company as being due to a very short initial reporting period. The full year results are due to be released in August at which time we would expect FlexiGroup to be re-rated by the market.

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.

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.

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 with net debt/EBITDA of 9.6 times. Earnings growth forecasts below are looking for EPS growth of over 15% p.a. in line with historic results.

Code FXL				
Share Price	\$2.80			
	2006	2007(F)	2008(F)	2009(F)
EPS (cps)	10.00	13.60	16.90	19.5
EPS Growth (%)	0.00	36.00	24.26	15.38
P/E	28.00	20.59	16.57	14.36
PEG (x)	0.00	0.57	0.68	0.93
DPS (cps)	0.00	5.50	10.50	12.50
Franking (%)	0.00	100.00	100.00	100.00
Yield (%)	0.00	1.96	3.75	4.46

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 remains attractive.



MARKET UPDATE

Leyland Lines

Bravura Solutions Limited (BVA)

Bravura is an IT company which provides administrative and reporting software for the financial services industry. By way of example, they own and then licence software to Industry Super funds allowing the funds to record and administer member's super contributions and performance. The software in turn allows the industry fund members to enquire online as to the updated value. There is considerable demand from the industry as most institutions have underinvested in IT for years and are now finding customers demand such services.

When meeting with Bravura recently they said they currently have 150 institutional customers. Nearly all of these clients have an arrangement which required an upfront payment and ongoing licence and maintenance fees for the software. A licence can be up to \$5m upfront with \$1m ongoing. Analysts forecast that for the 2008 year revenue will be between \$150 - \$170m, with locked in revenue from existing contracts accounting for 85% of the total forecasts.

Like Computershare and IRIS in their markets, Bravura is a clear leader in its own niche market of software and administration provision in the financial services sector.

Managing Director of Bravura, Ian Dunstan has a stated ambition of emulating the global growth of Computershare. Computershare has used its Australian expertise in running share registries and applied the know how to the US and UK with amazing success. Dunstan has similar ambitions for his software company. This ambition has been supported by acquisitions and new contracts in the US and the UK. In both these markets there are numerous opportunities to pick up contracts that are much larger than their Australian counterparts.

An investment in Bravura is not without risk as it is a relatively new company and going through a massive expansion stage both in terms of business and the markets it is doing the business in. Dunstan's personal ownership of 24% of the company provides us some confidence.

After a spectacular run up to over \$3 per share late last year, Bravura has settled down around \$2.15. We note that CSFB's analysts has a worst case valuation of \$2.08 and a target price of

\$5.00. It would appear that Bravura only has to pick up 2 new contracts in 2008 in either the US or UK, to exceed the analysts forecasts which in turn would lead to further upgrades. So for those prepared to accept the risk of a rapidly expanding company there would appear to be plenty of upside.

Highlights (A\$m)	06/07E	06/08E	06/09E
Revenues	99.80	161.20	188.10
EBIT	8.40	21.40	29.50
Net Income	4.10	12.80	19.80
EPS	0.03	0.09	0.13
Net DPS	0.02	0.03	0.04

Profitability & Valuation	06/07E	06/08E	06/09E
EV/EBITDA x	21.20	10.10	-
PE x	76.70	27.40	17.70
Net dividend yield %	0.70	1.10	1.70

* Estimates provided by UBS

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.

MARKET UPDATE

Leyland Lines

In Brief

In recent times some of our more favoured stocks have been the subject of various announcements etc. which are worthy of mention:

TLS

Has been performing very well since T3 and the outlook remains optimistic. With expected growth in broadband, wireless and 3G, restructuring and system rationalization and a possible change to the FTTN landscape, TLS still has many growth options. As a bonus TLS could be attractive to a potential corporate buyer. The T3 prospectus mandated May 20th as the first date that an individual buyer could purchase the stake from the future fund.

Henderson (HGI)

Continues to increase their funds under management, particularly in high margin retail funds. Takeover rumors have come and gone but the company continues to grow nicely.

Austar (AUN)

Has had a very good run of late as a result of potential takeover and restructuring of rural telecommunication. We are holding for our IMA clients.

Corporate Express (CXP)

We recently met up with Managing Director Grant Harrod and are happy to report that CXP's "one source focus" last year is paying dividends. We expect EPS growth to continue at historic levels of 10-15% per annum.

Fairfax Media (FXJ)

This company has had a run recently after speculation of a takeover in light of changes to the media ownership laws. FXJ consummated the purchase of Rural Press recently, leading to News Corporation selling their blocking stake. News Corp has stated that FXJ no longer needs their protection. We would be surprised to see a bid in the very short term but acknowledge that changes are inevitable as the media landscape changes, particularly in the nature of delivery and source of content. Rupert Murdoch wrote a very succinct article on this point in this month's Forbes magazine which is recommended reading.

News Corporation (NWS)

News Corporation reported a solid 3rd quarter result which was overshadowed by the news that it made an offer for the Dow Jones, the company that publishes the Wall Street Journal. The market initially reacted negatively sensing that the price paid was too great and following information that the major shareholder family of Dow Jones were not prepared to sell. There is still a watching brief on the outcome though the content acquisition would be a very good long term strategic fit with the other media assets.

The company had a very strong film performance but most other divisions also had very good results including Cable Networks Sky Italia and Fox interactive Media (which includes My Space which had very strong advertising growth).

News Corporation still looks cheap when measured against other entertainment peers. The stock price has been a notable laggard in the market particularly in the last two months.

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MARKET UPDATE