

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 November 2008 edition of Leyland Lines

The share market has now fallen from a high of 6740.9 which it reached on 30 October 2007 to it's current value of 3636.1 (46.06%). In percentage value this is greater than the 1987 crash in which the market retreated by 43%. More importantly is the chronological performance. In 1987 the market only gave back 6 months of gains. In other words, if one had purchased a unit of the index in January 1987, that person would still have been in profit after the crash, whereas the current market has returned to levels it was at four years ago, and many companies are at ten year lows – this has impacted significantly on many investors; even very conservative investors. With the increased use of gearing and increased percentage of the population with either direct or indirect exposure to the share market, this downturn has hurt more than most.



We have been champions of long term value investing and been reiterating this message over the past few months and continue to do so.

Many of Leyland's investors hold companies which have held up well in the recent market such as Telstra, IAG and QBE. Whilst these have been wonderful investments in the downturn, the strategy now changes slightly as opportunities to purchase companies with greater leverage to market recovery abound.

The question an investor must ask at the moment is 'what is going to happen to the company I am invested in over the next 5-10 years and how much money that business is going to make?' The second question is 'will the company in which I am invested be around in 10 years?' Once these questions have been answered, one can start choosing from the plethora of investment opportunities available. Our opinion is that investors are taking less risk by buying now with a long term perspective than at any other time in the past 20 years. Prices have more than factored in a significant economic downturn and now the proverbial 'man on the street' is discussing the poor share market – a classic sign.

In this month's newsletter we identify companies which are trading below their cash backing. We also discuss Telstra due to our client's large exposure to this company. In addition we look at Virgin Blue and Seven Network.

Please contact Leyland Private Asset Management should you wish to discuss your portfolio.

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Virgin Blue (VBA)

Price: \$0.335 Market Cap: \$330m

Virgin Blue is a company which falls under the 'what will this company earn over the next 10 years' philosophy.

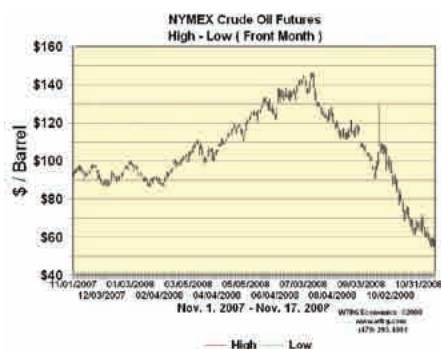
Earnings:

The current market capitalisation of Virgin is \$330m. In the 4 years since Virgin has been listed they have generated \$1.2b – approximately 4 times the current market capitalization. It would require a considerably bleak view of the world and the local airline industry to imagine that Virgin won't earn at least \$300m over the next 10 years. We believe they are likely to earn substantially more than \$300m over the next 10 years. If we are wrong and Virgin earns only \$300m over the next 10 years they are still on a very respectable p/e of 11x average earnings.

Net Tangible Assets:

Virgin Blue currently has an NTA backing of between 65-80 cps (depending on depreciation assumptions for their aircraft). Conservatively, 65cps is still approximately double the current share price. We have investigated the Boeing order book and are confident that this NTA level is eminently achievable given the long delay many airlines are facing for their new aircraft. We also discuss Virgin's NTA position elsewhere in this newsletter.

Oil:



Oil prices are the key variable in determining an airline's profitability. In the last 12 months oil prices have been extremely volatile, soaring above \$140 in March (with many analysts predicting \$200) and falling dramatically to its current price of \$55. None of this fall in oil price has been reflected in the share price of VBA. In a falling market, bad news tends to be amplified and good news is ignored.

Costs:

Virgin is an extremely low cost operator with a very young fleet, providing Virgin with a unique opportunity to outflank her rivals in a tough market.

Management:

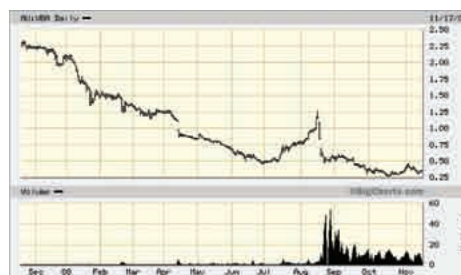
Virgin Blue has long term, proven management who have not been distracted by outside interests.

Toll selling

The recent perfect storm for VBA has been compounded by nearly 60% of the companies shares being distributed to Toll Shareholders who may not have been natural holders of Virgin – further altering the short term supply/demand equation for the shares (Buffet's short term 'voting machine' has been in play).

Summary:

Virgin Blue is a standout investment which has been overlooked by much of the market – which seems to have "given up" on this and many other companies. As the company is trading at a massive discount to future earnings we believe that Virgin Blue has the potential to be a "10 bagger" for investors.



Code VBA
Price \$0.335

	2007(a)	2008(a)	2009(f)	2010(f)	2011(f)
NPAT (\$m)	215.80	97.70	9.79	64.95	112.64
EPS (cps)	20.50	9.30	0.93	6.17	10.70
P/E (x)	1.63	3.60	36.02	5.43	3.13
DPS (cps)	4	2	0	0	0
Yield (%)	11.94	5.97	0.00	0.00	0.00
Franking (%)	100.00	100.00	0.00	0.00	0.00

Average estimates - Bell potter, ABN Amro, Etrade

MARKET UPDATE

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Telstra (TLS)

Price: \$4.21

Market Cap: \$52,385 million

Despite all the criticism directed towards the company over the past decade Telstra has performed reasonably well over the past 12 months and has considerably outperformed the ASX..

Telstra's share price has retained credibility by being down only 10 per cent in the 12 months prior to the time of this newsletters publication and it is significantly higher than it was two years ago.

Confidence towards the company has enabled it to be widely regarded as a defensive stock nowadays. This reputation can be largely attributed to Telstra's balance sheet.

TLS has \$758m in standby credit facilities and debt maturity in FY09 and FY10 accounts for only 3.8% and 7.7% of total interest bearing net debt respectively

The company has a relatively low credit default swap premium and 57% of interest bearing debt is fixed.

In times such as these investors often look towards stocks considered "safe" a secure dividend, a fully franked yield currently paying just short of 7% and a strong balance sheet TLS fits this category. As expected the company recently made no changes to FY09 and FY10 guidance, which cannot be said for many companies following the AGM season.

This guidance did assume Australia was not going to enter a recession, so there is a risk to these forecasts.

TLS made significant changes to its structure three years ago, when it decided to transform from priced-based to value-based competition with broadband being the driver behind the company's future.

With two years remaining in the five-year program there have been very few disruptions to its success to-date, though it will not be until 2010 that TLS can lay claim to free cash flow, which could mean they reach their cash flow target of \$6bn-\$7bn (\$3,855m in FY08).

TLS had as number of positives come out of the FY08 results including:

- mobile revenue grew 12.3%.
- roll out of the Next G network resulted in world-leading 3G penetration. This resulted in 3GSM customer numbers more than doubling from 2 to 4.35 million, representing 46.6% of the total mobile services in operation.
- the blended average revenue per user (ARPU) per month rose 7.8% to \$49.48, while the 3GSM ARPU increased by 0.9% to \$73.74.
- BigPond's market share increased 2% to 49%, retail subscribers rose by 36% to 3.27 million, while ARPU rose 2.9%.

Further encouragement for investors became evident when 1Q09 results proved that operating trends continued, including double-digit revenue growth in mobile and net additions in wireless broadband for the three months.

A concern for the market in the past, Yellow Pages metro directories outperformed the previous year and it can be expected to produce single digit earnings for FY09.

TLS has stayed ahead of its competition despite all the challenges they have thrown at them, in the form of opposing offers directed towards their customers. Much of this success can be attributed to the superior service BigPond provides and the migration to higher speed plans is driving ARPU. Close to 70% of customers are using high-speed "Liberty" plans following the investment in the roll-out of ADSL 2+ services in April.

In regards to the Fibre to the Node network (FTTN) Telstra's management recently outlined their concerns and may relinquish the opportunity to bid by the November 26 deadline. Further information in regards to TLS's position on the matter is expected shortly.

Telstra's conservative balance sheet, secure yield and strong market position has it well placed to defy an economic downturn, while its directional change from a traditional

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Telstra (TLS) cont'd

telecommunications business to a broadband and media-communications business could prove to be beneficial for investors in the long-term.

TLS (\$4.21)	2008	2009	2010	2011
EPS (cps)	29.7	30.3	36.2	42.4
P/E (x)	14.2	13.9	11.6	9.9
DPS (cps)	28	28	29	32
Yield (%)	6.7	6.7	6.9	7.6
Franking (%)	100	100	100	100



STW Communications (SGN)

Shares in advertising and diversified marketing services company STW Communications have been savaged in the past three months, falling 75% to near-record lows. The company has been heavily sold down amid fears that an economic downturn will prompt customers to slash advertising and marketing budgets.

Concerns about a slowdown may be overhyped as STW increasingly shifts its focus from traditional advertising to diversified marketing services. These services are higher-growth and less prone to cyclicality. Net profit after tax (NPAT) in the first half of 2008 was up only 3% and advertising was flat. However the diversified marketing division delivered an excellent result with earnings growing 32% and now representing the larger share of group profits (55%).

Demand for STW's diversified services should remain strong as companies seek to maintain revenues and generate sales in a weakening economy. Recent surveys show that companies are reallocating their budgets from traditional advertising to areas such as digital and direct marketing, website development, promotional marketing and public relations. These marketing channels are more targeted and cost effective, delivering readily quantifiable results.

STW's debt position may be another point of concern for investors. Currently bank debt stands at \$200 million. However the company has \$65 million cash in the bank which reduces the net debt balance significantly. The bank has also shown continued support for STW's business, granting the company new banking facilities in July 2008 and increasing available facilities from \$238 million to \$289 million. Earn-out due to vendors of acquired businesses amount to \$72 million, to be funded by a combination of cash and debt.

Assuming STW repeats the customary pattern of making 60% of its earnings in the second half, the company should make about \$40 million in financial year 2008. This would place the company on a comfortable net interest cover of at least five times. The company has also secured some major new business wins which will provide uplift to the advertising division in the second half.

Despite the pessimism hovering over the advertising and marketing sector, analysts are still expecting STW to make at least 20 cents per share in 2008. Investors are clearly looking ahead and anticipating a sharp downturn in business in 2009/2010. Should STW's earnings prove more resilient, there is strong potential for the share price to rise manifold from current extremely low valuation levels.

	FY07	FY08E	FY09E
Core Net Profit (m)	\$41.6	\$40.3	\$40.6
EPS (c)	21	21	21
DPS (c)	12	12	12
PE Ratio (x)	2.9	2.9	2.9
Dividend Yield (%) (100% fully franked)	19.5	19.5	19.5



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Seven Media Group (SEV)

Price: \$5.45 Market Cap: \$1.2 billion

"Every major media company has seen their share prices decline by 50 per cent... Times are uncertain and volatile. And, given the rapidly changing developments in the global economy it is challenging for all of us. We will all confront challenges over the coming twelve months."

Kerry Stokes, chairman (SEV).

Much has been made of the share price retracement of many of the world's largest media companies. In fact the chairman of Seven Network (SEV) recently noted that "major media companies have seen their share prices decline by 50 per cent". By creating an environment of negativity, many of the positives for businesses like Seven Network have been left unnoticed.

Balance sheet strength:

With a cash position greater than \$1.5 billion, liquid assets (equities) of around \$500 million and no debt to speak of, SEV currently has an enviably strong balance sheet. In fact, in a recent investor briefing Kerry Stokes pointed out that the company had great financial flexibility and was patiently looking to take advantage of opportunities as they arise.

As other media organisations continue to experience weakening earnings and overstretched balance sheets, Seven will be in a position to purchase distressed assets. And, while purchasing assets in a bear market is often frowned upon in the short term, there are few surer ways to grow a business than to buy quality, synergous assets at fire sale prices.

Broadcast Television:

Seven's television business is strong. In fact, more Australians watch Seven than any other network, making Seven the strongest player in the industry.

For the past four years Channel 7 has lead the market in providing news and current affairs. Today Tonight is currently in its fourth consecutive year of leadership in the public affairs category, while Sunrise has now lead its time slot for the past five years. In prime time, the channel has 8 of the top 10 most watched programs on television, and earlier this year set a new record during the Olympic Games when 17.2 million viewers tuned in to their broadcast. These outstanding results brought with it record advertising revenues.

The outlook for Channel 7 remains strong, with expectations that the channel can continue to push their advantage and expand their audience through digital TV.

Other assets:

Pacific Magazines currently owns 30% of the Australian magazine market (up from 24% last year), dominating readership in each of its key publishing categories. The business now publishes 1 in 4 of every magazine sold nation wide, and is able to reach 40% of all Australians.

Unwired is a wireless technology business which is currently trialing new technology which produces the fastest broadband speeds ever seen in the wireless industry (over 30 meg per second). Seven Media Group expects the technology to be ready for demonstration in the near term and is excited about the opportunities that such a technology will bring.

Company outlook:

While SEV is happy with their business, financial strength, and long term outlook for their company, they are aware of the macro industry factors which will force a short term slow down in their business and in advertising revenues. That said, with the company currently trading at less than liquid asset backing (cash and equities), the risks involved with an investment in SEV are substantially reduced. Buying SEV shares at current prices means an investor gets the Seven Media Group business and their equity investments for free. After all, investors are currently paying less for their shares than the company has cash in the bank.

Seven Media Group 6 month chart



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Deep Value Investing

There is no doubt that the stock market has recently been dragged through one of recent history's most severe corrections. With equities down over 40% from their 12 month highs, it's no wonder that investors are throwing in the towel and that despair is the new par for the course.

Still, historically the markets have taught us some very convincing lessons. Not the least of which is that if you can buy quality companies cheaply, you will eventually be rewarded.

The key question is; what is considered cheap?

MEASURES OF VALUE

Some would argue that Australian stocks have traditionally traded at PEs of around 15, so at less than 10 times there must be upside. Others will argue that based on technical indicators the global stock markets look oversold. While those statements may be true, there are some very basic indicators that if discovered are absolute in their objectivity, almost unaffected by economic conditions and widely accepted as genuine indicators of deep value.

Two such indicators are;

- companies trading at below asset backing, and
- businesses trading at less than their cash backing.

In the current environment there are more of these opportunities than you might think. Not surprisingly, many of those opportunities are in resource and energy companies – sectors which have received the brunt of the recent sell down.

STRIKE RESOURCES (SRK)

Without getting into the details of the companies (the idea is to point out that the situation exists, not recommend particular stocks), Strike is a coal, iron ore and mineral sands mining and exploration company with projects in Australia, Asia and South America. Currently the company is focused on bringing their Berau thermal coal project into production. As of September 30 the company

had \$73.5 million in cash – approximately 56 cents per share. In October, SRK's low was 33 cents. This means that for 33 cents, an investor could buy 56 cents worth of cash, and get the company's assets, management and projects for free.

Strike Resources 2 month chart



COOPER ENERGY (COE)

Similarly, Cooper energy reported cash equivalents of \$75.1 million (30 cents per share) as at September 30. At its October low COE traded for as low as 23 cents. So yet again, for 23 cents an investor could have bought 30 cents of cash, a diverse portfolio of oil projects, production of 100,000 barrels of oil per annum and sales of \$15million pa.

Cooper energy 2 month chart



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Deep Value Investing cont'd

VIRGIN BLUE AIRLINES (VBA)

Still, some conservative investors shy away from businesses that are reliant on commodity prices to maintain their profitability. For them there are industrial businesses such as Virgin Blue (VBA), which exhibit similar deep value at current prices. VBA currently has net tangible assets of between 65 and 85 cents per share. This means, that should the company liquidate its assets and pay them out to the share holders, each share holder would earn between 65 and 85cents per share. So, at October lows an investor could have paid 27cents for 65cents worth of assets. Not only that, but the 'business' of Virgin Blue would be thrown in for free.

Virgin Blue Airlines 2 month chart



THE OUTLOOK:

There is no doubt that a pessimistic investor could find reasons not to invest in any of the aforementioned stocks. After all, each of the above mentioned companies are out of favour with the market. They could also find reason to simply never invest in the stock market again. However, such an assertion is ultra myopic.

For those willing to take a longer term view, the markets have taught us that when investors buy quality businesses at cheap prices they are inevitably rewarded.

The only question is: when will value prevail and drive the markets higher?

I don't have an answer to that question (I haven't yet found a crystal ball that works). But, given the opportunity to invest today, I would certainly recommend that investors begin to retest the financial waters. After all, past experience has shown that the stock market to be a leading indicator for the economy - typically the stock market leads the real economy by about six months. So, while there is no certainty that we will see a recovery as of today, those people waiting to see the economic recovery before re-entering the stock market will find that by the time they have seen it the stock market will have left them behind.

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