

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 September 2007 edition of Leyland Lines

Last month we proposed that the correction had presented “very real value and a buying opportunity”. This has turned out to be correct with the market recovering most of its losses during the last month. Those brave enough to buy have done well over this month. The most recent news of Westpac successfully placing its bond issue in the US and KKR successfully financing its takeover of Boots signifies a significant improvement in the US credit markets.

In this month's edition, we revisit a few stocks we have previously covered and believe the correction has presented another opportunity to buy. Aristocrat Leisure, Emeco Holdings and Walter Diversified services all announced positive profit results and outlook statements during the month and are yet to perform in terms of share price appreciation. Therefore, there is still an opportunity to acquire these companies. For these reasons, we continue to hold these stocks and in many cases would recommend new portfolios buy them.

We have also identified a couple of emerging stocks with attractive fundamentals and growth outlooks—Allomak and SMS Technologies.

Finally, Newcrest has just announced a company changing event by raising sufficient funds to pay out their gold hedging positions. Newcrest will not only be Australia's largest gold producer, now any increase in the gold price will flow to the bottom line.

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A second chance to buy quality companies

Following are three companies which, despite positive profit results and outlook statements are yet to perform in terms of share price appreciation. For these reasons we continue to hold these stocks and in many cases would recommend new portfolios buy them.

Aristocrat Leisure (ALL)

Current price: \$14.00

In our July newsletter, we recommended Aristocrat at \$14.00, based on the fact that they had been sold down too heavily over the preceding couple of months. We suggested that the reason for the depressed share price was due to market concerns over their \$US earnings and their Japanese operating results. In our opinion, Aristocrat's profit results announced during the month of an increase of 20 percent is very solid (if not for the increase in the Aussie dollar over the last few months its operating results would have been closer to 30 percent). Further, management stated that they are confident on the outlook for each of the geographic businesses' operations (Australia, US, Japan and Macau) and expect to grow profits by at least a further 20% in 08. Post-results, we believe the Aristocrat risk has been lightened and yet for the moment the share price remains the same.

Aristocrat is the international leader in the design and supply of poker machines and it has recently been estimated that they will achieve over a 50 percent market share in the fastest growing gambling centre in the world, Macau. The Aristocrat business model of charging clients a set fee, means it is not dependent on how much people gamble, but rather the number of machines and how often they are updated. For these reasons, it will benefit from the emergence of casinos in Macau and other locations, as it is not dependent on the success of any one particular casino.

Management was positive with the outlook for 2008, citing an increase in the replacement cycle in the US and the growth of Macau specifically. The analysts' consensus is for profits to increase by a further 25 percent.



In our opinion, Aristocrat is an Australian company that is a true global leader in its field. Typically, a global industry leader will be priced at a premium to the growth outlook. Yet currently Aristocrat is trading a forward PE of 18, which is a discount to their 25 percent growth outlook.

Emeco Holdings Limited (EHL)

Current price: \$1.35

Emeco supplies the mining sector with large scale earth moving equipment. The majority of its business is done via rental and maintenance agreements with the larger mining companies for their open cut mines. Typically, a contract will consist of the supply of a series of \$1M plus vehicles for the period of 1-3 years. The margin on such contracts is over 20 percent and naturally the key to the business is to ensure the equipment utilisation is kept high. To offset its utilisation risk, Emeco negotiates the contracts with its clients before actually acquiring the machinery.

In its results announced in July, it exceeded NPAT expectations for the last year and provided very positive guidance of a 20 percent 2008 growth outlook. Despite these results Emeco share price has fallen significantly. Currently Emeco is trading on a PE of 10 times 2008 earnings versus a market PE of 15, or in relative terms a 33 percent discount to the market. This is despite having a growth outlook superior to the overall market.

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A second chance to buy quality companies cont'd

The only rationale for the current share price is the prospect of mining projects failing to continue, leading to the Emeco equipment not being rented. In our opinion, the strength in global demand for resources and in turn the number of mine expansions completely offsets this risk for the foreseeable future.

Archer Capital and PEP, the original private equity vendors, still hold just under 20 percent of the listed entity. Once their holdings are replaced with longer term institutional shareholders, any perceived overhang will be removed. When this occurs a rapid bounce in the share price will not be a surprise.

Once the market recognises the margins Emeco achieves and the continued high demand for the large scale equipment, Emeco is likely to move from a discount to a market premium. Coupled with growth in the underlying profits there is considerable upside in the share price.

As a precedent to what could happen to Emeco, another company which serves the resources sector, Bradken went through such a pricing transformation. Bradken supplies consumables to the mining and rail industry. When it first listed it traded for a significant period at a PE discount to market. Now, it trades on a premium of 18 times 2008 earnings.

If Emeco was to trade on the same multiple as Bradken, then the Emeco share price would be \$2.40.

Walter Diversified Services Limited (WDS)

Current price: \$2.20

Walter Diversified Services is an engineering company with two specialist divisions, which was floated on the ASX about 12 months ago. The first division, Walter Mining, services underground coal mines with both high level engineering services and medium level employment services. The second division, DCC, provides specialist water, pipe and infrastructure construction services.

We first recommended WDS at \$1.75 in April 2007, as we believed it was reasonably priced versus its current earnings and that the DCC division would benefit from the amount of Government and private monies being spent on water projects nationally. Subsequently, the share price reached over \$3.00 in July 2007.

Since then, the overall stock market correction has brought WDS back to \$2.20.

WDS' recent profit results disclosed a very healthy 35 percent increase over the previous year. In particular, the pipe and construction division, was outstanding. The Walter Mining division was somewhat disappointing as management explained that port bottlenecks had resulted in the divisions' clients delaying many projects which in turn hurt the short term performance of this line of business.

WDS stated that it is very confident with its 2008 and beyond outlook, with this confidence supported by record contract levels at July 2007.

They have also made two acquisitions of Engineering firms boosting their presence in WA and providing an entrée into the Middle East oil business.

At \$2.20, WDS is trading on around 10 times 2008 earnings with consensus analysts' forecasts predicting growth rates of 18 percent in profits (This is before taking into account the recent acquisitions). As WDS has a relatively small capitalisation, some discount to market is justified; however given the growth rates we can see significant capital appreciation in the share price.

Since our first recommendation we have remained in touch and impressed with the senior management of Walter Diversified Services. The current market presents an opportunity to acquire a well run engineering company whose services are in very short supply.

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Allomak (AMA) – Update

Current Price: \$0.70

Allomak released a pleasing FY07 financial result. The result was in-line with recent management guidance. Allomak achieved revenue of \$36 million, EBIT of \$5 million and a net profit after tax of \$3.8 million. This result came from a combination of base organic growth (70% of EBIT), value added growth (23%) and contributions from new acquisitions (7%).

Of particular note was the extent and success of value adding initiatives - the economies of scale, cost synergies and coordinated sales opportunities available from grouping complimentary businesses together. 15% of EBIT came as the result of two businesses in the Allomak group coordinating their efforts to win a major sales contract.

We met with Allomak CEO, Rob Allan, at a recent investor conference. Mr Allan re-affirmed his guidance for EBIT of \$10 million in FY08. This figure is based on current run rates (essentially the performance in the last quarter of FY07 annualized) and highlights continued improvement in the performance of the businesses as a result of operational initiatives implemented to date.

The recent acquisition of smash repair specialist Mr Gloss should add another \$8 million to FY08 revenue and \$1.5 million to EBIT. Further acquisitions are likely over the coming months and these should be immediately earnings accretive. Based on current management guidance, we estimate Allomak is trading on a FY08 PE ratio of only 8x despite recent share price appreciation.

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MARKET UPDATE

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Newcrest Mining (NCM)

Current Price \$22.40

Market Capitalisation 11 Billion

Newcrest Mining is Australia's largest gold company. It has been the subject of takeover speculation for many years by international peers such as Barrick Mining, Newmont and Anglo Gold.

One of the problems for Newcrest has been that they have had a large hedge position over their production which has limited the benefits of a rising gold price to the bottom line.

In order to remedy this situation and to accentuate the company's faith in the longer term prospects for the gold price, the company has announced one of the largest equity raisings in the last twelve months in order to neutralise the hedge book and expose the company to any rise in the gold market. They have bought some downside protection in the form of an \$800 Australian gold put option which will cost the company A\$80 million.

By eliminating the hedge book the company can now participate in the benefits of a rising gold price. Should the gold price follow some of the movements of the base metals prices over the next few years the resultant benefit to Newcrest will be substantial.

However, one of the biggest variables for Newcrest remains the Australian dollar and ironically as the US dollar falls, the gold price in US dollars tends to appreciate but there also tends to be an appreciation of the Australian dollar, which offsets much of the benefit of gold rising in US dollars. Many however argue that there will be a point where the gold price rises in all currencies.

Once the de-hedging is completed Newcrest becomes much more vulnerable to corporate activity as the international gold companies decide that it is much easier and more economic to buy reserves and potential reserves than to explore themselves.

Most analysts now argue that the de-hedging will be earnings accretive and lead to a re-rating to the upside on the Price Earnings ratio as earnings growth potential is now significantly increased (particularly if the Australian dollar gold price continues to appreciate).

There are issues with the accounting treatment of the hedge book for a couple more years which will hurt the headline profit but most analysts will focus on the operating earnings.

We would argue that Newcrest remains extremely well positioned from a reserve, production growth, cost control and exploration upside potential. Many of the past impediments including the debt levels and the hedge book will largely be removed with this share issue.

The gold assumptions that most analysts in the market have used are still extremely conservative and any similar movements as per the base metals movements over the last few years would see much higher prices over the medium term which would flow through to even larger valuation upside on Newcrest.

Newcrest does not have political risk as all its mines are in Australia; it is a relatively low cost producer and has excellent exploration potential. It is definitely a target for the large overseas gold companies as they seek stable countries with proven reserves. By neutralizing the hedge book, any worries on the debt levels and non-participation, the gold price upside has been largely eliminated. The put position offers some cheaper downside protection.

For those clients who want exposure to the gold price through a stable large Australian company that has almost full exposure to a rising gold price, an opportunity has arisen to buy at a price close to \$20 with the large capital raising.

MARKET UPDATE

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SMS Management & Technology (SMX)

Current Price: \$6.78

SMS Management & Technology (SMX) is a professional IT services company with offices in Adelaide, Brisbane, Canberra, Mackay, Sydney, Melbourne, Singapore and London.

SMX operates three complementary services in the IT consulting field: - Technology Services, M & T Resources and SMS Consulting.

Technology Services

The Technology Services division offers customised software development and systems integration services to large corporate and government clients. Services include data warehouse and reporting, web services, data quality, data conversion, systems integration and client server needs. This is a growing industry as many businesses need to integrate their software both internally (often due to legacy systems and acquisitions) and also integrate externally with suppliers and customers who are often operating on different software platforms.

In 2007 technology services contributed 14% to EBITDA; management has a stated aim of increasing this contribution to 26% by 2010.

M&T Resources

M&T Resources provides recruitment for the Information and Communication Technology (ICT) industry.

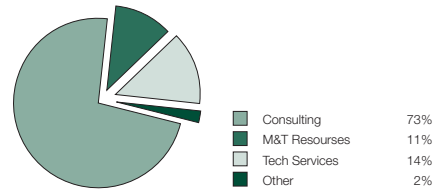
IT Recruitment is a very profitable industry at present and SMX has been able to leverage off their IT expertise and access to quality personnel to provide an adjunct to their traditional consulting style business model. M & T assists clients of SMX with finding suitable candidates for their clients across a broad range of positions.

SMX is in a very powerful position as they have a very large database of potential candidates and have an intimate knowledge of their customer's needs.

SMS Consulting

SMS Consulting is the key revenue driver for SMX and contributed over 70% of EBITDA in 2007. Staff levels and utilisation rates are an essential driver for this division. In 2007 SMS employed over 1300 contract staff and Credit Suisse forecasts this number to increase to approx 1500 in 2008 and 1770 in 2009. Operating off a relatively fixed cost base, the incremental contribution of each new contractor can be significant (depending upon the actual contract). SMS is also pursuing acquisitions which may accelerate their growth profile.

EBITDA breakdown - 2007



Financials

SMX had an exceptional year last year, with NPAT of \$18m up from \$11.8m in 2006. With good growth across all three divisions, an appetite for acquisition and a very strong balance sheet SMX is in an enviable position in a high growth sector of the market. Profit growth of over 40% p.a. has been forecast for the next two years which is relatively aggressive but management does have a proven track record. There are three businesses in the mid tier consulting space and we believe that consolidation is likely. With a 2008 forecast p/e of 15 times and significant growth profile, we believe that SMX looks to be relatively good value.

Risks

The risks for SMX are predominantly a slow down in spend on IT projects. This is closely linked to the economic cycle. All the evidence at the moment points to increased demand for IT services, particularly outsourced services in a full employment work force.

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