

Peters MacGregor Capital Management

Peters MacGregor Capital Management Pty Ltd (PMCM) is a boutique global investment management company based in Sydney. PMCM has traditionally constructed and managed portfolios for private investors by way of an Individual Management Agreement (IMA). PMCM brought a Listed Investment Company (LIC) to the market in April 2004 (Peters MacGregor Investments Limited (PET)).

PMCM is a specialist equity 'value' manager with an investment culture that has been strongly influenced by the investment philosophy of Warren Buffett and Professor Benjamin Graham. PMCM portfolios are characterised by their highly concentrated holdings to a maximum of 20 stocks and their willingness to sit in cash if no attractive 'value' investments can be found. Unusually for an Australian based boutique manager, PMCM's investment universe is not limited to Australia with investments skewed towards the United States as well as New Zealand. Lonsec Limited (Lonsec) has completed a review of Peters MacGregor's investment management capabilities. As a result of this review, Lonsec has maintained the view that Peters MacGregor is a Recommended manager.

Manager Overview

Peters MacGregor Capital Management was established in 1999 and has over \$130 million under management. The business is 100% owned by PMCM Chief Investment Officer, Wayne Peters, and has ten full time staff. Peters established PMCM after several years of running his own portfolio, based on wealth he had accumulated building up and selling a retail business (Kodak Express). Peters has been managing external mandates for eight years (three years prior to the establishment of PMCM).

Investment Objective

PMCM's objective is to achieve a 12% annual compound return (after fees) over the long term (5 years plus) through 'value' investing. PMCM's focus is on capital growth rather than income.

If PMCM believes there is no value to be found in its investment universe it will sit in cash and hence capital preservation is an important factor in the decision-making process. Portfolios consist of investments in a limited number of listed companies (maximum of 20) which PMCM understand and believe are currently undervalued by the market.

Resources

Over the past twelve months PMCM has expanded the investment team by two, with the appointment of Investment Analysts John Dowling and Mark Gardiner. Dowling joined PMCM nearly a year ago and is based in the United States where he is responsible for US stock research, with the aim of identifying additional candidates for inclusion on the Watch List. Gardiner is a recent appointment (May 2005) and is based in Sydney where he is responsible for contributing to the research effort on Australian stocks.

Key investment professionals;

Wayne Peters is the Chief Investment Officer (CIO) of Peters MacGregor Capital Management Pty Ltd. Peters' experience is primarily in retailing and for the last ten years investment markets. He commenced his undergraduate business studies at James Cook University, completed his Master of Business Administration at Bond University and has studied company valuation at Harvard. Peters guest lectures on value investing at Bond University and is a member of the Australian Institute of Company Directors and the Securities Institute of Australia. He is also a non-executive director of the New Zealand publicly listed company Michael Hill International Ltd.

James Craigie is the Chief Executive Officer of PMCM. Craigie has over 15 years of finance, management and corporate advisory experience. He spent 11 years at Hambros Australia (and SG Hambros) working in the corporate advisory area, providing a range of specialist services including IPOs, company valuations, mergers and acquisitions and company restructurings. He joined Peakhour Pty Ltd in 1999 as the CFO. Following the sale of Peakhour in 2002 he established Aggrandise Pty Ltd (a boutique corporate advisory firm).

Michael Haddad is an investment analyst at PMCM, based in New Zealand. Haddad graduated with first class honours from the University of Waikato, New Zealand, having attained a Bachelor of Management Studies and a Graduate Diploma in Accounting and Finance. He has previously worked for ABN AMRO Craigs, a major stockbroking company in New Zealand and Fisher Funds Management in Auckland as an Investment Analyst.

John Dowling is an investment analyst at PMCM, based in the US. Dowling is a Chartered Financial

Analyst and has a Bachelor of Arts Degree in Business Economics from the University of California at Santa Barbara. He has previously worked for Standard & Poors Corporate Value Consulting Group as a senior valuation associate in San Francisco and as a credit analyst at Wells Fargo Bank. He is a member of the CFA Institute and the Security Analysts of San Francisco.

Mark Gardiner is an investment analyst at PMCM. Mark has a Bachelor of Arts Degree with a Double Advanced Major in Economics and Spanish from Dalhousie University, Halifax Nova Scotia. He has successfully completed the CFA course and is currently fulfilling the work experience requirements. Mark previously worked for Fairwater Capital Corporation in Toronto Canada as an Investment Analyst prior to relocating to Australia.

Investment Philosophy

PMCM's investment philosophy is heavily influenced by the philosophies and strategies of Warren Buffett and Professor Benjamin Graham. PMCM views investing in shares as investing in a business. The manager is a long term investor and will not buy into a stock unless it is prepared to hold that stock for at least 10 years. PMCM will only invest in stocks that are priced with at least a 25% discount to its estimated value range. This is what PMCM refers to as its "margin of safety".

The core beliefs underpinning PMCM's philosophy include:

- Each business must demonstrate durable competitive advantage and be run by people who will maintain and improve that advantage over time - not necessarily in the next six or twelve months, but definitely over five and ten years. Net earnings must also hold the promise of substantial growth in the years ahead.
- PMCM treats each investment as if it was buying the business and key PMCM staff, (including CIO Wayne Peters), are significant investors in the same portfolio of companies as external investors.
- PMCM believes this focused approach enables the manager to thoroughly understand businesses. PMCM places a heavy weight on certainty and does not diversify share holdings into industries and companies that it does not understand.
- PMCM does not spend time trying to guess which way the market may move and is not an active trader.
- PMCM only invests in a small number of businesses (20 or less).

- PMCM will talk with and assess the management of each company held in the portfolio on both their operational and capital allocation track record.

Lonsec is impressed with the conviction that PMCM brings to its investment philosophy. Lonsec is confident that PMCM's investment decisions have been driven by adherence to the stated philosophy and expect this to be maintained going forward.

Investment Process

There are a number of distinct stages to the PMCM investment process. The manager is looking to identify stocks that meet the three key criteria of outstanding business, competent management and great price. In helping to identify stocks satisfying these criteria, PMCM initially screens the investment universe using return on capital (ROC). PMCM uses the US centric 'Value Line' research as a pivotal part of this screening process. Other factors considered at this primary filtering stage include whether the company; exhibits a stable and understandable business, can demonstrate a consistent operating history and offers favourable long term prospects.

This initial screening is followed by in-depth quantitative and qualitative analysis to assess and evaluate the factors of whether a company is 1) an outstanding business, and 2) has competent management. This analysis follows a broad template, where a consistent set of key questions are asked. All prospective stocks undergo in-depth analysis and are summarised in a one-page sheet explaining the merits of a stock. The third element of the process, price, is the final consideration in assessing a company and does not come into play until a company has fulfilled the criteria of 1 and 2 above.

Portfolio construction is based on each holding representing a minimum of 4% and up to a maximum of 20%. Holdings increase in 1% increments and the size of a position depends on the confidence in the stock derived from points 1 and 2 above as well as the margin of safety (price discount). Although conviction in stocks in the portfolio may vary, the key point is that the conviction in every stock in the portfolio is extremely high, to the point that the CIO would be prepared to "put 100% of his own money in it".

In regards to valuation, the primary valuation tool is discounted cash flow (DCF) and the approach tends to be quite conservative in terms of the discount rate applied. For each stock assessed, a valuation range will be ascertained and the margin of safety will be determined. PMCM currently has a Watch List of 150 companies from its investment universe and models all 150 of these stocks. This Watch List is of companies PMCM is happy to own but only if the stock can be purchased at the right price.

PMCM will not invest in a company that does not have six years of financial accounts. This stance will preclude PMCM from participating in some IPOs. The PMCM investment process is looking for companies where management has a long track record and has successfully managed the growth and capital allocation of the company. In addition, PMCM will not invest in industries subject to rapid change such as information technology. PMCM is looking to invest in 'stable' industries such as retail, insurance and services.

PMCM has a reasonably robust sell discipline. A stock will be sold if its price exceeds PMCM's estimated economic value by 110%, if the manager believes that the portfolio's price to value ratio can be substantially improved by replacing a business selling at full estimated value with another selling at 50% of its estimated value, or if there is a material deterioration in the industry or management relevant to that stock.

If PMCM can not find any 'value' the manager is prepared to sit in cash. By way of example, at present PMCM has 41% of its portfolio in cash and is holding only eight stocks (up from six a year ago). As evidence of the concentrated and long-term nature of the PMCM investment process, since PMCM started running external mandates in 1999 it has held only 21 stocks. It should also be noted that Berkshire Hathaway (Warren Buffett's investment vehicle) has been in and out of PMCM portfolios twice in the past five years. Cash holdings have been as high as 85% in August 2002 and as low as 15% in July 2003.

While the PMCM investment universe is global, historically investments has been limited to the United States, Australia and New Zealand, however, there are no hard mandate restrictions on investing outside of these markets. At the time of writing, of the eight stocks held in the portfolio, six are listed in the US, one is listed in Australia and one is listed in NZ. The portfolio is 100% hedged back to the A\$.

Risks

Key Person Risk

There is significant key person risk surrounding PMCM's CIO and founder Wayne Peters. If Peters' was to be hit by the mythical bus then Michael Haddad would take over the management of PMCM and PMCM's Board would be responsible for determining Peters' replacement. The ownership of the management company itself would pass to Peters' estate. Given PMCM is a long term investor and there are no 'trading' positions there should be no immediate panic (i.e. there is limited risk of short term underperformance due to a change in portfolio manager) as all the stocks in the portfolio are expected to be held for the long term. Nevertheless, Peters will be the primary driver of performance for

PMCM going forward.

Diversification Risk: Theory (R.A Brealey) suggests that a twelve stock portfolio can provide 90% of portfolio diversification benefit. However, this benefit reduces as the number of stocks reduces and reduces substantially if all the stocks are in the same industry. According to Brealey a five stock portfolio provides 77% of the benefit of diversification if each is in a different industry. Investors need to be aware that their portfolio may be more at risk if they hold a limited number of stocks which are concentrated in a limited number of industries.

General Market Risks: Investors returns may be adversely affected by market conditions, including market volatility, interest rates, economic variables, political events, war, natural events and changes in law which may occur globally or at a country, industry or asset class specific level.

Long-term investment: Investing with PMCM is a long-term investment. Investors should be aware that the performance of PMCM may show a greater degree of variation over a shorter term than it does for a medium to long-term.

Cash Dividends: PMCM does not guarantee that cash dividend distributions will be paid to investors.

Value of investment can be volatile: Investors should note that the value of their investment can be volatile, the value of the investment may decline as well as appreciate and there can be no assurance that the manager will be able to achieve its overall investment objective.

Changes in the law: Investors should note that they may be exposed to the risk of changes in laws, legislation or regulations or taxation during the life of their investment.

Taxation

Intending investors are advised to consult their own Tax Advisers.

Performance

Peters MacGregor Capital Management 'Average Weighted Portfolio' Performance

Financial Year	Gross Return	Net Return	MSCI Index	Relative Performance
6 mths to June 2000*	20.5	16.5	-0.4	16.9
FY 2001	28.6	23.0	-15.7	38.7
FY 2002	55.3	43.1	-19.1	62.2
FY 2003	19.7	16.8	-6.2	23.0
FY 2004	20.2	16.2	20.2	-4.0
FY 2005	17.1	13.2	10.1	3.2
Cumulative Performance to 30 June 2005 (% p.a.)	Gross Return	Net Return	MSCI Index	Relative Performance
1 year	17.1	13.2	10.1	3.2
3 years	19.0	15.3	7.5	7.8
5 years	27.5	21.7	-3.3	25.0
Since Inception**	29.0	22.9	-3.1	25.9

* not a full FY due to inception date, ** Inception date is 1/1/00

The above table summarises the audited historical average weighted returns over all the individually managed accounts ("IMA") managed by PMCM during the relevant periods. Each IMA will generate discrete returns depending on its portfolio structure from time to time. Gross returns include dividends and foreign exchange costs and are presented before taxes and fees. The net returns are net of management fees and before taxes. Relative performance is the difference between the net return and the MSCI Index.

When compared to the MSCI Index (net local) PMCM has performed very strongly since inception. The manager has comfortably achieved its investment objective of delivering a 12% p.a. return over five years and beyond. As PMCM's management style does not focus on investing relative to any Index, the Fund can be expected to have a significantly higher Tracking Error (variability of returns relative to the Index) than mainstream managers focused on global investing. This result is consistent with the manager's style but it is a characteristic that investors should be aware of. The potential for returns to vary significantly from the Index is evidenced in the table above. As PMCM portfolios are managed very differently than the Index, the Fund can provide significant diversification benefits when combined with other managers who place much greater emphasis on the benchmark when constructing portfolios.

Peters MacGregor Investments Limited 'Listed Investment Company' Performance

Performance timeframe (%)	Gross Return	Net Return	MSCI Index	Relative Performance
16 April to 30 June 2004	2.1	1.1	0.8	0.3
6 months to Dec-04	3.1	1.6	6.5	-5.0
Since Inception* to Dec-04	5.2	2.7	7.4	-4.7

* Inception date is 16/4/04 (260 day compound return)

** Note that the net returns of the LIC are net of both management fees and costs and taxes

(Performance data to 30 June 2005 will be available on the PMCM website from late August 2005 ... www.petersmacgregor.com)

The above table represents the performance of the listed investment company since its listing date of 16 April 2004. The timeframe of analysis is extremely

short and hence the earlier table (summarizing the performance of the 'Average Weighted Portfolio') provides a far better indication of PMCM's ability to achieve its investment objectives over the longer term. It should also be noted that the performance of the LIC has differed significantly to that of the 'Average Weighted Portfolio' since April 2004. The primary reason for this is that the LIC held a significantly higher cash weighting for most of 2004. The manager "treats every new portfolio as if it was their own" and was not prepared to purchase stocks for the LIC which, while held in other accounts, were trading outside the manager's 'buy range'. After an establishment period of nearly 12 months, the LIC portfolio now largely reflects PMCM's preferred stock structure. As such, it is expected that going forward, the performance of the LIC's NTA will be more aligned with that of the 'Average Weighted Portfolio'.

Overall Opinion

PMCM is an Australian manager that operates with a distinctive culture and approach to equity investing. PMCM provides an excellent opportunity to add value to an investor's portfolio over the longer-term, however, when considering exposure to this manager, investors need to be aware of the manager's non mainstream approach to investing. This includes an investment philosophy that places high reliance on the skills of individual team members and a commitment to 'value' investing and concentrated portfolios. In this regard, Lonsec believes that it may be appropriate to use this manager in conjunction with a more conventional equity manager, rather than in isolation.

The boutique structure of PMCM means that there is an extremely high commitment from the investment team to the future success of the business and ensures that there is a strong alignment of interests between the investment team and the end investor.

The CIO, Wayne Peters, has significant and overriding input at all stages of the investment process – including the structure of the process, the identification of investment ideas, the final investment decision regarding individual securities and portfolio construction. In its current structure, the process is therefore highly dependent upon the input of one individual. Lonsec recognises that the depth of the team has improved with the addition of resources over the past year however, key person risk remains high.

PMCM has an effective way of managing the investment universe. This is undertaken at two levels. Firstly, the manager does not profess to cover the entire universe (as represented by an Index such as the MSCI World), because portfolio construction is not undertaken with reference to any Index. Secondly, PMCM applies a quantitative screen and distinct qualitative criteria to filter the universe of potential candidates down to a much more manageable size.

PMCM does not operate with hard limits (either relative to an Index or absolute) in relation to stock,

industry, country, or currency positions and therefore has the scope to deviate significantly from the Index and from other global investment managers. These characteristics are consistent with the manager's investment approach, however, it is important that potential investors give them due consideration and decide whether such an investment style sits comfortably within their risk profile.

Investors must be aware that the performance of PMCM will be driven primarily by the skills of the manager rather than the performance of the underlying investment universe. Success is very much based on human skills and the ability to invest well. This is compounded by the reliance on Wayne Peters who is primarily responsible for the performance track record of PMCM over the past five years. The performance of PMCM may be adversely impacted by changes in management, trading strategies or key investment personnel (not that any of these are expected by Lonsec).

As mentioned, PMCM's unique management style, high reliance on the skills of individual team members and the absence of 'hard' risk constraints for portfolio construction suggest that it may be appropriate to use this manager in conjunction with more conventional global equity managers, rather than in isolation. This view is supported by the fact that PMCM can provide significant diversification benefits when combined with other global managers, who place much greater emphasis on the benchmark when constructing portfolios.

There is no doubt PMCM's CIO Wayne Peters is a passionate and committed 'value' investor. PMCM's policy of relying on stock selection to achieve excess returns has been very successful (... to date the manager has never sold a holding at a loss). However, the nature of PMCM's investment approach does introduce the possibility of over reliance (perceived or otherwise) on the stock picking and portfolio construction ability of the key portfolio manager.

Lonsec believes that PMCM is well placed to provide strong absolute returns over the longer-term and to achieve its stated investment objective, although these returns – particularly over the shorter-term – may look very different to those achieved by any Index or other globally focused investment manager.

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