The Rock
INVESTMENT PLANNING LIMITED

Investment Market Update No. 26

March 2006

Editorial

The stockmarket continues to show strength, but on most measures does not seem overvalued. We continue to look to invest in stocks that are currently out of favour, and the recent re-weighting into infrastructure stocks vindicates this position.

In this issue we cover:

1. New contact details;
2. What we've been doing for you;
3. Stock research initiatives;
4. Investment outlook;
5. Investment briefs.

David French
Managing Director and Head of Financial Planning

New contact details

Following our de-merger from The Rock Building Society Limited, we now have new contact details. These are listed on the attached sheet for your reference.

Importantly, client portfolios are now held on our own network. While you can still access the portfolios through The Rock's website, it's probably more convenient to go directly to our secure site – https://www.capinvest.com.au. Make sure you include the "s" on the end of http, or you will not benefit from the data encryption used to protect your internet session.

We have protected your information on our systems using industry best practice combinations of firewall hardware, Microsoft ISA server and the Verisign data encryption. Further, external consultants have checked all settings.

For those who log in directly, the website looks quite bare. We have contracted out the process of redeveloping it, a task that is expected to take four to six weeks. This will coincide with the launch of our new name and logo.

If you have any problems with logging into your portfolio please contact us so that we can assist you.

What we've been doing for you

At The Rock Investment Planning we aim to offer superior client service. Notwithstanding the distractions of the change in the business we have been able to make significant contributions to many client portfolios.

Over January, February and March we completed the administration of a large number of Self Managed Superannuation funds, for an all-up price of $900 each, including fund auditing. This was a 10 per cent reduction on what we had charged previously, and is considerably lower than alternative providers.

Clients holding BHP in superannuation funds were also contacted to ascertain whether they would like to sell their shares into the BHP share buy back. Reducing the number of shares on issue is one way of increasing earnings (profit) per share. Companies sometimes undertake buy-backs to achieve that goal. Through negotiations with the tax department, the shares are often bought back with a very small capital component, and a large fully franked dividend. In the recent BHP example, the capital component is $2.10 and the dividend component is expected to be around $19.00. Adding tax credits to the $19.00 dividend gives a total value of over $29.00. With the stock price trading at about $25.00, there is a windfall gain of about $4.00 per share.

The real value of this to investors depends on the investor's tax rate. Investors paying no tax receive full value from the transaction, while those on tax rates of 15 per cent or lower still stand to gain.

Clients with the first series of Amcor convertible notes were offered the opportunity to sell these instruments back to Amcor for cash. At maturity, most companies generally convert these notes to ordinary shares, and then the shareholders can decide whether to sell the ordinary shares or keep them. Offering a cash buy-back option means that there is no brokerage payable, and there is no risk that the value of the ordinary shares can fall in value after conversion.

Coincident to the Amcor reset preference shares being bought back, we were able to secure a line of Futuris Limited unsecured notes (Futuris is the company that owns Elders). These yield 7.8 per cent. For most clients we were able to swap the maturing Amcor notes for Futuris notes, maintaining a low risk, high income exposure.

The money from the Amcor notes is not due to be received until 28th April and the Futuris notes settle on 3rd April. Consistent with our approach over the past 5 years we advanced the money at no charge to those clients who we felt should undertake the Amcor/Futuris Swap, but who did not have the cash available at the time.

March also saw many clients offered an allocation in Dyno Nobel Limited, a large explosives company. It was very difficult to secure a meaningful allocation in this float, nevertheless we distributed more that half a million dollars worth to clients.

More mundane but nevertheless important tasks included visits to Centrelink on behalf of clients, discussions with the ATO, organizing building valuations and all the general financial planning activities.

Stock research initiatives

While most of our investment choices perform well, we are only human and sometimes get one wrong. Rather than putting our head in the sand, we try to ascertain what is affecting the stock price, so that we can make a decision as to whether our original reasons for purchasing the investment still hold.

Clients who hold FIELDS hybrids (a more risky instrument offering a high yield secured by Cooper Basin gas assets), will know that the price has fallen substantially over the past 6 months or so. Since January, I have spoken to the company twice to form a view as to whether the wheels were really falling off. These discussions suggested that the market had not correctly assessed the true position of the company. The company and other interested parties subsequently released an information memorandum, that provided much needed clarity as to the company's position. Following that FIELDS have begin to appreciate in value.

We have also spoken to Telstra executives to gain an impression as to what is going on in that company. We believe that the company is being sold down ahead of the float of the final tranch of the company, and that it is trying to bully the government into setting favourable regulatory terms. While it is tempting to agree the stock is a dog, it's worth remembering that Commonwealth Bank was in a similar position in the early 1990's, and no-one wanted it at $5.00. Now everyone wants it at $44.00. Only a few years ago Orica's price fell from $13.00 to $6.00. Now people can't get enough at $23.00.

People sold CSL all the way from $60.00 to $12.00. Now its nearly $60.00 again.

Our main reasons for not recommending that Telstra be sold is that the company has an unequaled presence in the community (a line into almost every home for instance – even if you use a competing carrier), and the efficiencies that we believe will be realized once the Government sells its stake.

Wesfarmers, AMP and BHP are other stocks that have fallen out of favour from time to time. Unless something about the stock fundamentally changes, history shows it's generally better to hold on for the ride.

While we prefer not to have any investments fall in value, it is the overall performance of the portfolio that is most important. We are always careful not to over-expose portfolios to any one stock. For example, the largest holding of FIELDS in any portfolio is 8 per cent. This means there are plenty of other investments to take up the slack if one falls in value. Further, we seek to include assets that behave differently to each other. Clients who were with us over September 11th, 2001 will remember that while the value of equities fell, the value of the hybrids increased. This is the basis of modern portfolio theory, and every day we use it to manage your portfolio.

Investment outlook

The latest increase in US interest rates brings the official overnight cash rate in that country to 4.75 per cent, just 0.75 per cent below the Australian rate. This, and an expected softening in commodity prices is putting pressure on the $US value of the $A. This is consistent with our economic outlook and the comments we made in the previous newsletter regarding the attractiveness of certain international investments. The weaker $A also bodes well for earnings of companies with substantial offshore assets – Amcor, Paperlinx, Orica and Dyno come to mind.
The past month or so has also seen money begin to flow back into boring utilities and infrastructure stocks,

of which we are fond. These stocks generate attractive yields with earnings certainty. Their prices generally respond well to stable or falling interest rates. The fact that many of these stocks have increased substantially in value suggest that the market is beginning to embrace our view that interest rates in Australia are unlikely to increase further.

Our investment view continues to suggest purchasing out-of favour investments, selected international investments and the few hybrids that remain good value.

Investment Briefs

Here are some trading ideas for non-portfolio clients:

David Jones Limited (DJS)
The company reported net profit after tax of $54.5 million for the first half of 2006 – an increase of 14.7 per cent. This was a solid result against a backdrop of weaker consumer sentiment. The interim dividend increased 16.7 per cent to 7 cents per share.

Tighter inventory management saw an increase in gross margins, cost reduction initiatives were ahead of schedule and free cash flow reached $70 million. DJS is currently trading at about $2.89 and is yielding 4.84 per cent fully franked.

QBE Insurance Limited (QBE)
Despite cyclones and hurricanes, QBE was able to produce a record profit for the first half of 2006. Net profit after tax increased by 27.3 per cent to $1,091 million, and the company declared a dividend of 38 cents per share, 50 per cent franked. This was an excellent result that demonstrates management's expertise in limiting exposure to large loss situations. Continued strong growth in premium income is expected to underpin future profit increases, complemented by selective acquisitions.

Woolworths Limited (WOW)
First half earnings increased by 22 per cent, underpinned by a strong result from it's supermarket business. Despite costs associated with changes to its distribution network, this division increased earnings by 23 per cent. Analysts are expecting a 35 per cent increase in earnings between financial year 2006 and financial year 2008, making the stock still reasonable value despite being at almost $20.00 per share.

Goodman Fielder Limited (GFL)
In the first half trading update since listing, the company reassured investors that earnings are in line with forecasts, despite a weaker $NZ. GFF has highlighted several strategic initiatives for the future, including expanding distribution, developing new products and making acquisitions. The company seems relatively cheap, trading on 2007 P/E projections of 12.9X and a 6.2 per cent fully franked yield. We would like to see more track record before committing ourselves further.

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