

**MMC**  
**Contrarian**  
**Limited**

ABN 83 106 248 248

Level 5, 34 Hunter Street  
Sydney NSW 2000  
GPO Box 4406  
Sydney NSW 2001

Phone: +612 9221 7155  
Fax: +612 9233 2713  
Email: enquiries@mmccontrarian.com.au  
Web: www.mmccontrarian.com.au

20 April 2005

Dear Fellow Shareholder and/or Option Holder

**Quarterly investment update and dividend**

I enclose the March 2005 investment update from MMC Asset Management Limited, the investment manager of MMC Contrarian Limited.

The Board's policy is to distribute a growing stream of franked dividends to shareholders every six months. The interim dividend, paid on 24 March 2005, was 1.5 cents per share (fully franked). Based on the current performance of the company and provided there is no major deterioration in its portfolio the Company will pay an increased final dividend of at least 2.0 cents per share (fully franked) for the year ending 30 June 2005. The dividend will be paid during October 2005.

If you are an option holder I will also be writing to you in late May to remind you that your options will expire on Thursday 30 June 2005. Any options not exercised before 30 June 2005 will automatically lapse.

On behalf of the Board

Yours sincerely



**Simon Rowell**

**Chairman**

MMC Contrarian Limited (MMA) is a listed investment company. MMA's investments are managed by MMC Asset Management (MMC). HGL Limited has made available the services of several of its key executives to assist MMC with providing the management services. Both HGL and MMC are experienced investors with an outstanding long term record of wealth creation.

MMA's investment philosophy is aimed at preserving and growing shareholders' capital **over the long term**. This is achieved by acquiring a concentrated portfolio of companies primarily listed on the Australian Stock Exchange that are trading at a discount to their fair value (**value investing**), by thinking independently and not following the herd (**Contrarianism**), and by having structured and methodical approach to investing (**discipline**). An MMA share therefore offers its shareholders exposure to a distinct investment strategy that is not widely available in the investment markets.

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MMC ASSET MANAGEMENT LTD  
ABN 37 071 807 684  
AFS Licence number: 230920  
Toll Free: 1 300 888 904  
www.mmcfunds.com.au

Level 8, 34 Hunter St  
GPO Box 4963 Sydney NSW 2001  
Phone: (02) 9233 2250  
Fax: (02) 9233 2275

## MMC Contrarian Limited (MMC Contrarian) March 2005 quarterly investment update

This is your manager's fifth quarterly investment update since MMC Contrarian listed in December 2003 and is the final update before the 2005 financial year end. In this report we deal with the following issues:

- your company's dividend philosophy and outlook
- recent changes to your company's capital structure
- the expansion of our investment management team
- the performance and composition of the investment portfolio for the previous 3 months and for the period since listing and
- the reason for holding large amounts of cash

We recognise that we have discussed some of the above issues in the past but believe them to be important enough to bring to your attention once again.

### Contrarianism

An important matter which is dealt with in detail under the performance and composition of the portfolio at the end of this report is MMC Contrarian's performance. Since inception the portfolio has achieved 15% per annum in a phase of the market cycle that has provided few attractive contrarian opportunities.

Although we do not place undue emphasis on short term performance, as we base our investment decisions on the long term, we are satisfied with our performance. On average, approximately 67% of your portfolio was invested in cash and cash equivalents / hybrids earning a rate of around 5.5% while around 33% was invested in equities, which returned in excess of 30% per annum. You may argue that we should have invested more in equities over this short period; however this ignores the long term risk of investing in an overvalued market.

We are not market followers but instead we exercise independent and contrary thought, which can make us look foolish at times. This does not perturb us as we are acting in your best long term interests.

We cannot state with certainty when there will be more contrarian opportunities, however, there appears to be a number of early signals indicating that the market may be facing a correction or downturn. When this does occur we feel confident of investing your cash including cash introduced through the exercise of the remaining options.



MMC ASSET MANAGEMENT LTD  
ABN 37 071 807 684  
AFS Licence number: 230920  
Toll Free: 1 300 888 904  
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### **Interim Dividend:**

The board of MMC Contrarian declared a fully franked interim dividend of one and a half cents per share for the six month period to December 2004 which was paid on 24<sup>th</sup> March 2005.

Your company's policy is to distribute a growing stream of fully franked dividends to shareholders twice a year. Based on the current performance of the company and provided there is no major deterioration in the portfolio the board of MMC Contrarian will pay an increased final fully franked dividend of at least 2.0 cents per share for the period to June 2005.

### **MMC Contrarian Options:**

An option was issued with each ordinary MMC Contrarian share for nil consideration at the time of listing (ASX code MMAO) on 11<sup>th</sup> December 2003. The holder is entitled to subscribe for one share in MMC Contrarian anytime up to 30<sup>th</sup> June 2005 for each option held, at a fixed price of \$1.00. At the 31<sup>st</sup> March 2005 24.3 million options had been exercised. If all the remaining options are exercised the capital of your company will be expanded by a further \$175.7m.

In May 2005 MMC Contrarian will send all option holders a letter with information on the exercise of options which will also highlight the important fact that these options expire on 30<sup>th</sup> June 2005. Option holders who exercise their options before 30<sup>th</sup> June 2005 will participate in the final dividend for the year to 30<sup>th</sup> June 2005.

### **Capital Management:**

On 16<sup>th</sup> December 2003, the Directors of MMC Contrarian introduced a share buy back scheme in order to buy MMC Contrarian shares on the ASX in the event that they consistently traded at a substantial discount to the NTA of the company. Up to 31<sup>st</sup> March 2005 5.9 million shares had been acquired at prices between 93 cents and 105 cents under the scheme and subsequently cancelled.

### **Investment Management team:**

During the quarter two new analysts Daniel Mueller and Rosemary Tan joined MMC Asset Management increasing our investment management professionals to seven. Both Daniel and Rosemary are enthusiastic, highly qualified and welcome additional resources especially in times like these when value opportunities are few and far between and we find that we have to work even harder than normal to research and identify investment opportunities that meet our strict criteria.



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**An unaudited summary of MMC Contrarian investments at 31<sup>st</sup> December 2004 and 31<sup>st</sup> March 2005 is detailed below:**

| <u>Summary of Investments valued at market</u> | 31 <sup>st</sup> December<br>2004 | % of portfolio | 31 <sup>st</sup> March<br>2005 | % of portfolio |
|--|-----------------------------------|----------------|--------------------------------|----------------|
| <i>Equities</i>                                |                                   |                |                                |                |
| Burns Philp & Company Ltd (BPC)                | 23,445                            | 9.8            | 27,175                         | 10.8           |
| PMP Ltd (PMP)                                  | 27,480                            | 11.5           | 25,500                         | 10.1           |
| Prime Infrastructure Ltd(PIF)                  | 5,068                             | 2.1            | 9,781                          | 3.9            |
| Abacus Property Group Ltd (ABP)                | 7,777                             | 3.3            | 7,500                          | 3.0            |
| IOOF Holdings Ltd (IFL)                        | 9,043                             | 3.8            | 6,947                          | 2.7            |
| Hunter Hall Global Value Ltd (HHV)             | 6,293                             | 2.6            | 6,053                          | 2.4            |
| Babcock & Brown Japan Property Trust (BJT)     | -                                 | -              | 4,234                          | 1.7            |
| Flight Centre Limited (FLT)                    | 4,230                             | 1.8            | -                              | -              |
| Reinsurance Australia Corporation Ltd (RAC)    | 3,848                             | 1.6            | -                              | -              |
| Other  | 5,065                             | 2.1            | 8,576                          | 3.4            |
|  | 92,249                            | 38.6           | 95,766                         | 38.0           |
| <i>Hybrids</i>                                 |                                   |                |                                |                |
| Allco Hybrid Investment Trust (PoDS)           | 8,950                             | 3.7            | 8,726                          | 3.5            |
| ANZ Ltd 8½ % Preferred Shares (StEP)           | 10,238                            | 4.3            | -                              | -              |
| Commonwealth Bank Preferred Shares (PERLS)     | 5,138                             | 2.2            | -                              | -              |
|  | 24,326                            | 10.2           | 8,726                          | 3.5            |
| Funds on deposit                               | 122,480                           | 51.2           | 147,279                        | 58.5           |
| Total capital employed                         | 239,055                           | 100.0          | 251,771                        | 100.0          |
| NTA per share before tax –cents                | 115                               |                | 113                            |                |
| MMA share price - cents                        | 106.0                             |                | 100.0                          |                |
| (Discount) Premium to NTA before tax-%         | (8.5)                             |                | (13.0)                         |                |
| NTA per share after tax- cents                 | 111                               |                | 110                            |                |
| (Discount)Premium to NTA after tax-%           | (4.7)                             |                | (10.0)                         |                |
| MMA option price –cents                        | 6.0                               |                | 1.5                            |                |



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### **Review of the portfolio over the previous 3 months**

As a result of our continuous review of the investment portfolio, we bring the following matters to your attention.

#### **Movements in the portfolio:**

As can be seen from the summary of investments on page three, 41.5% of the portfolio at 31<sup>st</sup> March is invested in equities and hybrids compared with 48.8% at 31<sup>st</sup> December 2004. During this three month period we completely sold Flight Centre Limited and Calliden Group Limited (Reinsurance Australia Corporation Limited). New investments included Babcock & Brown Japan Property Trust (which listed on 4 April). We sold approximately 9% of the IOOF Holdings Limited shares and increased the investment in Prime Infrastructure Limited by approximately 73%.

Credit spreads (margin above the bank bill rate) had contracted considerably over the past 18 months. Although we do not anticipate a large correction in credit spreads, we have sold all bank hybrids as in our view the credit spreads do not justify the additional risk when compared to bank deposits.

The NTA for the quarter has increased after adjusting for the effects of the payment of the interim dividend (1.5 cents) and the exercise of 23 million options (1.0 cent).

#### **Half Year Results:**

##### **PMP Limited (PMP)**

The half year result was sound and in line with our expectations. PMP flagged in the interim results that capacity shortages during the second quarter had constrained gross margin expansion. As a result, the company decided to accelerate the installation of the new equipment under its previously announced capital investment program (Project Emerald). This initiative will adversely affect second half year results with the company expecting to deliver at the bottom end of the market guidance range. Due to the lower profit guidance, the share price has fallen from \$2.30 to \$1.85.

We continue to have a positive view on the stock and see it as a contrarian opportunity. We believe that significant tangible benefits should accrue in 12 – 18 months time as a direct result of Project Emerald. The biggest concern for PMP is a possible downturn in advertising, however, PMP has positioned itself in more defensive, higher margin segments of the market and is well placed to generate a considerable amount of free cash flow over the next three years.



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#### Burns Philp & Company Limited (BPC)

A strong half year result was underpinned by cost savings in the Goodman Fielder (GF) businesses as well as more stable competitive conditions particularly in baking. Management have demonstrated that since taking over GF it has been able to cut costs while increasing sales and improving profits beyond market expectations. We believe that management will maintain sustainable growth from the GF businesses and the company will continue to generate a substantial amount of free cash flow.

#### Abacus Property Group Limited (ABP)

ABP reported a strong half year result with increased profits to security holders, reduced gearing and an increase in NTA backing. Distributions for the half year were up with Directors confirming that the distribution to security holders would increase further in the second half of the year.

Total assets under management have increased by 25% to \$850m reflecting the growing strength of the company and its ability to meet ongoing distributions to security holders from the increase in the annualised net rental income.

Although ABP is in the property sector, which is showing signs of continued weakness, we are comfortable with this investment. In our view, Abacus management tend to operate better in this sort of property environment.

#### IOOF Holdings Limited (IFL)

IFL delivered a solid but slightly disappointing half year profit result to 31<sup>st</sup> December 2004. We reduced the position in IFL, which has had a strong share price run since listing in December 2003, selling down part of the portfolio's holdings at a significant profit.

#### Portfolio Activity:

##### Investment in the Babcock & Brown Japan Property Trust (BJT)

BJT is a diversified trust focused on investing in the Japanese property market. The initial portfolio will include a combination of 8 office and 4 retail properties located in the central and greater Tokyo area. The trust has secured low cost fixed funding of around 1.5% with 90% of interest bearing debt being fixed for a term of five years. We believe that the Japanese property market is reaching the bottom of its 14 year cycle and is showing positive signs of turning around. Including foreign tax credits, the trust is initially expected to yield 10.1%.



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#### Increased Holding in Prime Infrastructure Limited (PIF)

We increased the holding in PIF following the acquisition of Powerco. The Powerco business complements PIF's existing business providing further stability and cash flow growth. This will ensure that earnings are further diversified across asset sectors while reducing volatility by industry and geographic segments. We also believe that PIF's expansion into global wind farms, an imminent pricing decision on the Dalrymple Bay Coal Terminal issue and the potential acquisition of International Energy Group may provide further positive reasons for increasing the position in PIF.

#### Sale of Flight Centre Limited (FLT)

We sold the holding in FLT amid on going profit downgrade concerns through which we saw further downside risk in the share price. We exited the position at a small loss well above current prices.

#### Review of the portfolio since listing

The All Ordinaries Accumulation Index has had a very strong run since MMC Contrarian's listing in December 2003 returning over 24% per annum. During this 15 month period the All Ordinaries Index has not returned a negative quarter and 12 of these months have produced positive returns, including 10 in a row from May 2004 to February 2005. Obviously these returns cannot continue indefinitely. The market has clearly become overvalued with stock prices generally being expensive.

A quarterly summary of the composition of the portfolio since listing and the NTA and share and option price at the relevant dates are shown below for your information.



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**Quarterly summary of portfolio composition**

\$ Million

|                                       | 31 March<br>2004 | 30 June<br>2004 | 30 September<br>2004 | 31 December<br>2004 | 31 March<br>2005 |
|---------------------------------------|------------------|-----------------|----------------------|---------------------|------------------|
| Equities                              | 61               | 74              | 85                   | 92                  | 95               |
| Hybrids                               | 15               | 15              | 15                   | 24                  | 9                |
| Cash on deposit                       | 126              | 122             | 122                  | 123                 | 147              |
| Total Capital Employed                | 202              | 211             | 222                  | 239                 | 251              |
| NTA Per Share                         |                  |                 |                      |                     |                  |
| Before Tax on unrealised gains- cents | 100.8            | 105.4           | 109.1*               | 115*                | 113+             |
| MMA Share price- cents                | 93.0             | 97.0            | 101.0                | 106.0               | 100.0            |
| MMA Option price- cents               | 3.4              | 4.0             | 4.7                  | 6.0                 | 1.5              |

\* After payment of a 1.0 cent fully franked dividend

+ After payment of a 1.0 and 1.5 cent fully franked dividends

Since listing MMC Contrarian's NTA has increased from 98.1 cents to 113 cents before tax on unrealised gains, after paying 2.5 cents of fully franked dividends, and after the effect of the Dividend Reinvestment Plan, the exercise of options, and the buy back. Adjusting for these factors your company returned over 15% per annum. We are comfortable with this performance especially considering the large amount of cash held in the portfolio when the equity markets have risen strongly. However it is very important to realise that we do not place undue emphasis on short term performance. We base our investment decisions on the long term outlook for companies and therefore performance in our view should be measured over a similar length of time.

The equity portion of your capital has been invested in a concentrated portfolio of companies based in Australia. In line with our disciplined approach to investing we researched a significant number of Contrarian opportunities and invested in no more than 15 of these companies. We invested a large portion of your funds in Burns Philp and PMP and a smaller amount in other good companies such as Prime Infrastructure, Abacus Property and IOOF Holdings all of which appreciated substantially in value. In fact the equity component of your portfolio increased in value by a rate in excess of 30% per annum.



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Your company has held a minimum of 60% of its assets in cash and cash equivalents / hybrids since listing where we received a return of approximately 5.5%. This is in accordance with the company's disciplined investment philosophy of maintaining large cash holdings if attractive, low risk investments cannot be found.

While it may be argued that the equities weighting should have been higher over the short term (in order to increase the return of the portfolio), this ignores the long term risk of investing in an overvalued market. The current market has a high degree of investment risk from a contrarian perspective. There is an abundance of overvalued stocks, which are highly 'in favour' with the market amid little regard for quality or fundamentals. This may be ideal for short term, speculative, momentum investors but it represents a riskier environment for contrarian investment. Accordingly, the high allocation to cash is a function of managing risk in the current environment.

It is often in a fund manager's interest to be a market follower (although they may believe it to be wrong) rather than a market leader. If the market collapses they are likely to perform in line with the rest. On the other hand if they exercise independent and contrary thought, they are likely to look foolish for periods, but will be acting in the best long term interests of unitholders or shareholders.

This is very much our dictum at MMC, as we will not choose investment risk (for our clients) over career risk (for ourselves). We are far less concerned with catching the top of a wave than being wiped out.

Erik Metanomski  
Executive Director  
MMC Asset Management Limited

Kevin Eley  
Director  
MMC Asset Management Limited

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