

MMC
Contrarian
Limited

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Inaugural Quarterly Investment update—March 2004

Attached is the first quarterly investment update from MMC Asset Management Limited, the investment manager of MMC Contrarian Limited (MMA). The report covers the period from when MMA listed on 5th December 2003 to 31st March 2004.

The manager's quarterly report provides shareholders with more information than just the monthly NTA statement. It includes background information on the manager's investment philosophy and methodology, a summary of the investments held at 31st March 2004 and comments on some of these investments. It is published on MMA's website which is now operative (www.mmccontrarian.com.au) and also filed with the stock exchange for shareholders to access.

Simon Rowell
Chairman

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First Quarterly Investment update—March 2004

In this first quarterly update we explain what in our view constitutes a contrarian opportunity, why we consider Burns Philp Limited and PMP Limited to be long term contrarian investment opportunities and where we have invested the large proportion of cash currently held by MMC Contrarian Limited (MMA) at 31st March 2004.

In the forth coming quarterly reports we plan to explain our theory on “value investing” and how we implement our “disciplined” approach to investing. There will also be updates on other large investments held by MMA at that time.

This report has been prepared solely for the benefit of MMA and its shareholders.

The views expressed about each company in this update are solely ours, reflecting our judgement at this date and are subject to change. These views have been formed after

- Extensively researching and analysing each company and its financials
- Visiting the company’s management and operations to assess the company’s prospects
- Continuously monitoring announcements, articles and brokers’ reports on the company, its industry or competitors or suppliers and
- Verifying our findings with as many independent sources as possible

We do not believe it appropriate to table our valuation of each company or comment on its current share price. We do however continuously update our estimate of the “free cash flow” we expect a company to generate in the medium term in order to satisfy ourselves that such company is trading on a low multiple and at a discount to its fair value.

Since MMA listed on 5th December 2003 we have identified a total of thirty five Contrarian opportunities of which MMA had invested \$60.5 million in seven of these opportunities at 31st March 2004.

While we identify opportunities that comply with our contrarian investment philosophy we will hold large amounts of cash or we may trade in other securities to improve returns.



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A summary of MMA investments at the end of March 2004 is detailed below

<u>Summary of Investments valued at market</u>	31st March 2004	% of portfolio
	\$000	
<i>Equities</i>		
Burns Philp & Company Ltd (BPC)	18,065	9.0
PMP Limited (PMP)	16,854	8.4
Hunter Hall Global Value (HHV)	9,515	4.7
IOOF Holdings Limited (IFL)	7,394	3.7
Reinsurance Australia Corporation Ltd (RAC)	4,286	2.1
Other	4,398	2.1
	<u>60,512</u>	<u>30.0</u>
<i>Hybrids</i>		
ANZ Ltd 8½ % Steps Preferred Securities	10,140	5.0
Commonwealth Bank Pref shares	5,175	2.6
	<u>15,315</u>	<u>7.6</u>
Funds on deposit	<u>126,000</u>	<u>62.4</u>
Total capital employed	<u>201,827</u>	<u>100.0</u>
NTA per share before tax -cents	100.8	
MMA share price	93.0	
(Discount) Premium to NTA before tax-%	(8.4)	
NTA per share after tax- cents	100.2	
(Discount)Premium to NTA after Tax-%	(7.7)	
MMA option price -cents	3.4	

The NTA at the time of listing was 98.1 cents.



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What are Contrarian Investments:

Contrarian opportunities are defined as investments in companies that are either misunderstood or unloved or companies that are operating sub-optimally because of:

- Poor and ineffective management
- Poor corporate governance practices at board level
- A down turn in the industry the company operates in
- A catastrophic event that affected the industry the company operates in or
- A failed expansion or acquisition programme;

The market will tend to overreact to these situations. Similarly it can take the market considerable time to fully factor in the potential improvement when these matters are resolved or the company becomes better understood.

We believe that these situations when properly timed and thoroughly analysed provide ideal long term value investment opportunities.

Burns Philp Limited (BPC);

Market capitalisation-\$1.2bn Turnover-\$3.5bn

We consider BPC to be a classic out of favour company for reasons which appear to us to be short term and the product of a superficial and flawed analysis by the market.

BPC is a global food company involved in yeast, baking and consumer foods.

Yeast; BPC manufactures, distributes and markets a range of fresh and dry bakers yeast and baking ingredients for use in commercial bakeries around the world. BPC operates plants in over 20 countries and is the leading supplier of bakers yeast in North and South America, Europe and the Asia pacific.

Herbs and Spices; These products are for use in the home and by food service operators and are sold primarily through retail in North America. This division is



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currently earmarked for sale and we understand that A\$325m will be realised from its sale by the 30th June 2004.

Baking and consumer foods; Goodman has large or dominant positions in baking, and consumer foods in Australia and New Zealand with outstanding retail brand names such as Uncle Tobys, Meadow Lea, Le Snak, Buttercup, Helga's, Wonder White, Mighty Soft and Purina. The products include bread, baked goods, breakfast cereals, margarine, flour and snack foods.

There are a number of reasons for acquiring a large stake in BPC however the four key factors that we took into account were:

- The company's products and their position in the market
- The propensity for the company to generate a large amount of recurring "free cash flow" and its ability to service its high level of debt
- The strength and experience of the senior management team and
- The failure in our view for the market to analyse the company properly

Stable Products and Markets: BPC manufactures, distributes and markets products that people eat every day with customers more evenly split between retail consumers and large food processors. BPC operates globally in mature, stable markets such as Australia, New Zealand, North America and Europe, while enjoying higher organic growth in South America, China and India. It has a portfolio of strong brands and holds the number 1 or 2 position in almost all its market segments. The food business in Australia and the global yeast and bakery business is essentially an oligopoly and BPC is adept at managing this competitive environment. This is evidenced by BPC being able to manage the recent bread price war in Australia where the margins are now improving and the market shows signs of rationality.

Reliable Cash flow: The high level of debt at BPC appears to be a concern for the market. However yeast and food are stable basic products producing predictable recurring cash flows with a low level of volatility. This combined with the extraction of significant costs from the Goodman businesses and a progressive recovery in baking earnings will improve the company's cash flow. This provides us with comfort on our estimation of the company's overall "free cash flow" and its ability to service and subsequently reduce its current high level of debt in a timely fashion.



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Outstanding Senior Management: We view the current senior management team of Messrs Hart, Degnan and Hugli as one which has a strong “identifiable and successful” history in extracting returns from businesses, dealing with high debt levels and ultimately delivering value to shareholders. As always, it is also reassuring to back management that are significant owners in their own right in the business they manage for shareholders.

Analysis of the company: We believe that BPC is incorrectly analysed by the market. For some reason the market tends to focus on “accounting” earnings rather than “free” cash flow.

BPC has a large non cash goodwill amortisation expense, spends far less in capex than reflected in its depreciation charge and has a very large interest expense relating to “non-cash” amortisation of a loan facility. Therefore “accounting earnings” bear virtually no correlation to the free cash flow being generated by the business. In addition Goodman Fielder earnings continue to be compared with those previously reported without taking into account factors that significantly impact on any comparison. These include many items such as IT costs which are now fully expensed as opposed to capitalising them (a favourite of previous management and many other companies), GMF Asia division which is now reported as part of BPC’s Asian business and the treatment of other expenses on a far more conservative basis for accounting by current management.

The current circumstances pertaining to BPC are very similar to those that prevailed a few years ago at Metcash during its dark years. Ultimately the cash flows rose to the surface, debt was reduced at great speed, the market started to analyse and understand the company properly and the rest is history.

In our view as the above matters are recognised we would expect the stock to be re-rated by the market.



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PMP Limited (PMP):

Market capitalisation-\$458m Turnover-\$1.3bn

PMP is the largest heatset web printer in Australia and New Zealand with an unequalled geographic spread of presses and sales and service teams. PMP prints magazines, catalogues, books and other material for newspaper, book and magazine publishers, retailers, corporates and governments in Australia and New Zealand. It has a number of important associated media services which include; distribution of printed material to 96% of the household letterboxes in Australia and New Zealand; digital image capture; targeted marketing and through Gordon and Gotch the distribution of around 2900 publications to newsagents and supermarkets in Australia.

In recent years PMP had a very poor performance record with margins crumbling in its core printing business, high levels of debt and a lacklustre management team. This resulted in profit downgrades, a reduced credit rating, the suspension of dividends, the divestiture and closure of non core operations and a disastrous share price.

Regardless of the above set backs we believe PMP to be fundamentally a sound business. In addition there are a few key factors which attracted us to this investment which include:

- The market's sentiment towards the company
- The strength of the company's management and Board
- The large competitive position the company holds in its markets
- The ability for the company to offer a comprehensive range of services throughout Australia and New Zealand and
- The ability for the company to generate a large amount of "free cash flow"



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Negative market sentiment: The market continues to have a very negative attitude towards the company which in our view will improve as investors become aware of the company's growing strength.

Strong Management and a proactive Chairman: We have been impressed with the new Chairman Graham Reaney. Graham instigated a strategic review of the company which led to a detailed profit improvement program, the strengthening of the board and the appointment of a new CEO David Kirk who has a strong record of driving change through all levels of business. Both David and the Finance Director, Richard Allerley, have impressed us with their hands on approach to the business, the achievement of the goals and benchmarks that have been transparently communicated to the market, the significant reduction in debt that has been achieved since their arrival and the commensurate impact these factors have had upon the earnings and cash flow generation of this business.

Improved competitiveness: PMP recently announced a \$124 million capital investment program. The business is therefore being progressively modernised and updated with the overriding objective to be the lowest cost, highest quality producer of magazine and catalogue printing and distribution business in Australia and New Zealand. Significant progress towards this objective has already been achieved and the recent capital expenditure initiative should make a major contribution.

Reduction in interest cost: PMP has also announced a debt restructure which involves a new \$330 million facility. We understand that this facility is not required for the capital investment program as the company will be cash flow positive for the foreseeable future. A recent Standard and Poor's assessment strongly supports this view. We understand that the refinancing package will however significantly reduce interest expense from the '05 financial year onwards. In addition the Company will no longer have the legacy of its very expensive financing facility to amortise. This figure was previously included in most analysts' interest expense figure without any commensurate recognition of its "non-cash" status.



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Favourable Industry dynamics: The favourable industry dynamics, at this point in time, also suggest an increase in PMP's share of the growing magazine, catalogue and direct mail market segments. The company should benefit from progressively higher margins as the capex programme allows it to steer its business mix towards higher margin business, particularly during the peak December quarter. The new printing equipment should also allow for greater scalability whilst decreasing the fixed cost base which particularly impacts during seasonally quieter periods, i.e. costs become increasingly marginalised.

Further Cost Reductions: In the '05 financial year we are expecting a considerable overlap from the run-rate on cost savings achieved during the course of the '04 financial year. In addition a second wave of cost cutting initiatives is due to be introduced. These savings together with an improved performance from the recently outsourced logistics function of Gordon and Gotch should contribute to higher levels of "free cash flow" in '05 financial year.

Alignment of Management incentives: The management incentives have been aligned with the interests of shareholders. These are based on stretch targets which relate to the profitability of the business. Salaries, particularly that of David Kirk, include a very large component "at risk" compared to the remuneration culture which previously existed at PMP.

In summary we are very cognisant of the competitive and capital intensive nature of the printing industry, however we believe that the many initiatives already undertaken as well as those recently announced place PMP in a very strong competitive position going forward. This will potentially produce high levels of free cash flow relative to the current market capitalisation of the Company.



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Cash and hybrid securities:

At the end of March 2004 MMA held investments of \$125m in cash and a further \$15m in hybrid securities.

Approximately \$50m is held on short term deposit with the Adelaide bank, \$75m held on deposit at call with the ANZ bank and we have invested \$15m in ANZ STEPS and Commonwealth Bank Preference shares. The investment in hybrid securities generally provides an additional margin over cash held on deposit.

While MMA holds substantial amounts of cash we continuously look for opportunities to improve returns.

The next quarterly investment update will be issued in July 2004.

Erik Metanomski
Executive Director
MMC Asset Management Limited

Kevin Eley
Director
MMC Asset Management Limited

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