



WAM Capital Limited (WAM)

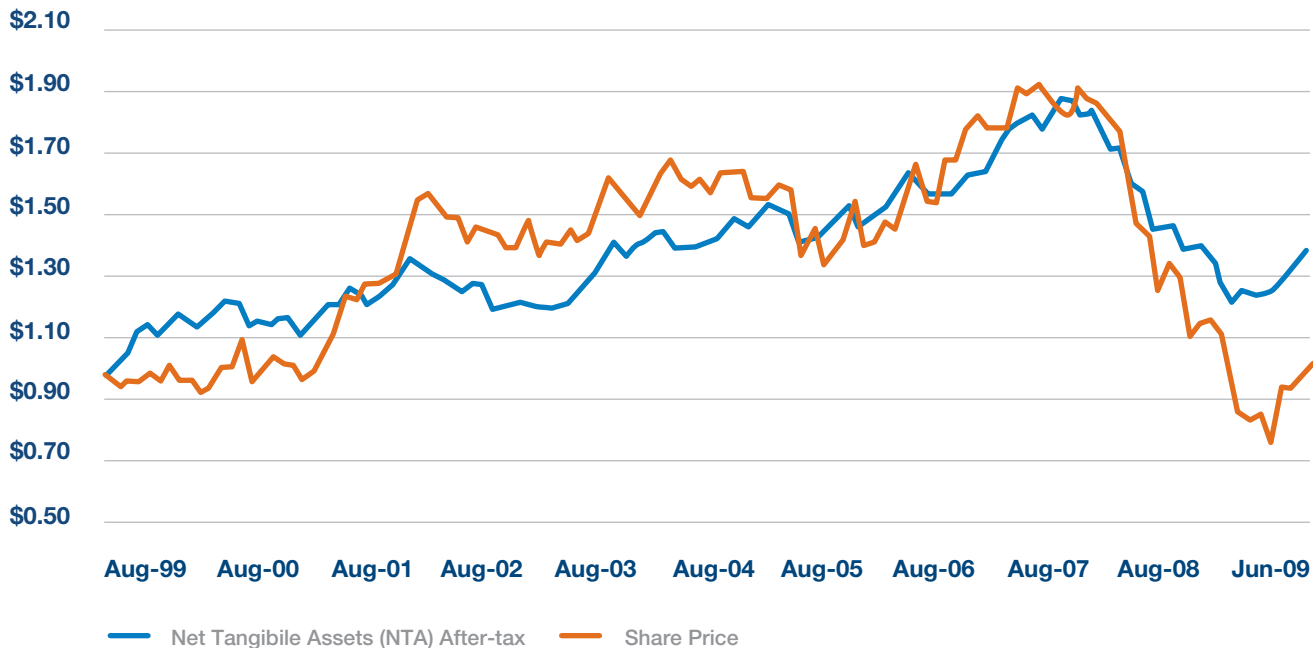
Investor Report 30 June 2009

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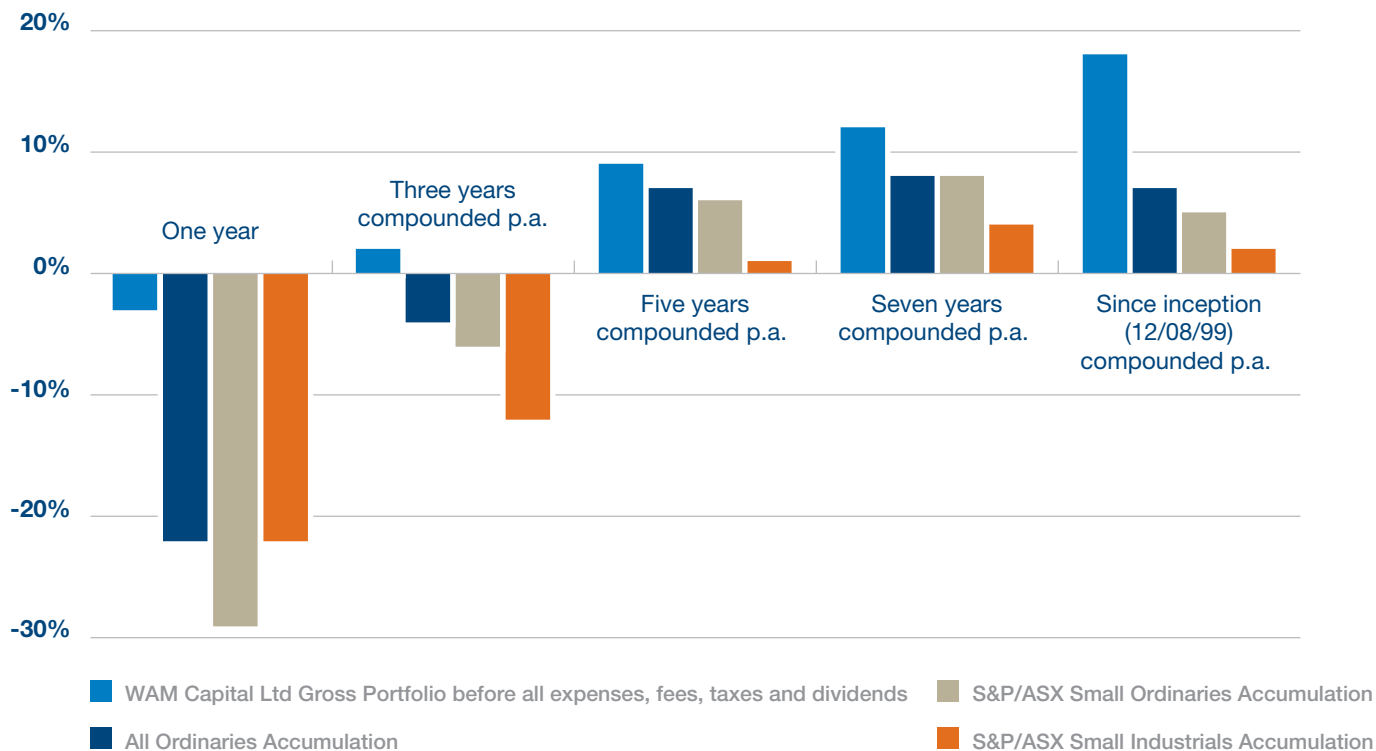
Contents

- 01** Investment Objectives and Process
- 02** Performance
- 04** Portfolio Summary as at 30 June 2009
- 06** Dividends
- 08** The world has changed forever
- 12** A closer look at two of our Research Driven stocks
 - 12** McPherson's Limited
 - 14** RCG Corporation Limited
- 15** A closer look at two of our Market Driven stocks
 - 15** Pacific Brands Limited
 - 16** RHG Limited
- 17** What is a Listed Investment Company?
- 19** Contact Us

WAM Capital Ltd NTA & Share Price History



WAM Capital Ltd's Gross Portfolio versus All Ordinaries Accumulation Index, S&P/ASX Small Ordinaries Accumulation Index and S&P/ASX Small Industrials Accumulation Index to 30 June 2009



Investment Objectives and Process

Our investment objectives are to achieve a high real rate of return, comprising both income and capital growth, within risk parameters acceptable to the Directors and to preserve the capital of the Company.

Our investment process focuses on:

(a) Research Driven investing,

where we undertake extensive research, rating the company's management, earnings growth potential, valuation, industry position, generation of free cashflow and identifying a catalyst that will change the valuation the market gives to the company, and

(b) Market Driven investing,

where we scour the market for trading opportunities. These could include participating in initial public offerings, placements, block trades, rights issues, corporate transactions (such as takeovers, mergers, schemes of arrangements, corporate spin-offs, restructurings), arbitrage opportunities, LIC discount arbitrages or relative value arbitrages. This part of the portfolio is traded actively.

In the Research Driven part of the portfolio we do not favour investing in mining companies due to the high risk nature of mining businesses and the volatility of revenues. This does not apply to the Market Driven part of the portfolio where we are looking for trading opportunities.

Performance

WAM Capital Limited's (WAM) results for the year saw a decline in our after-tax net tangible asset backing (NTA) by 2.8% while the overall stockmarket fell 22.2%. This performance was a result of a number of factors which we will now discuss.

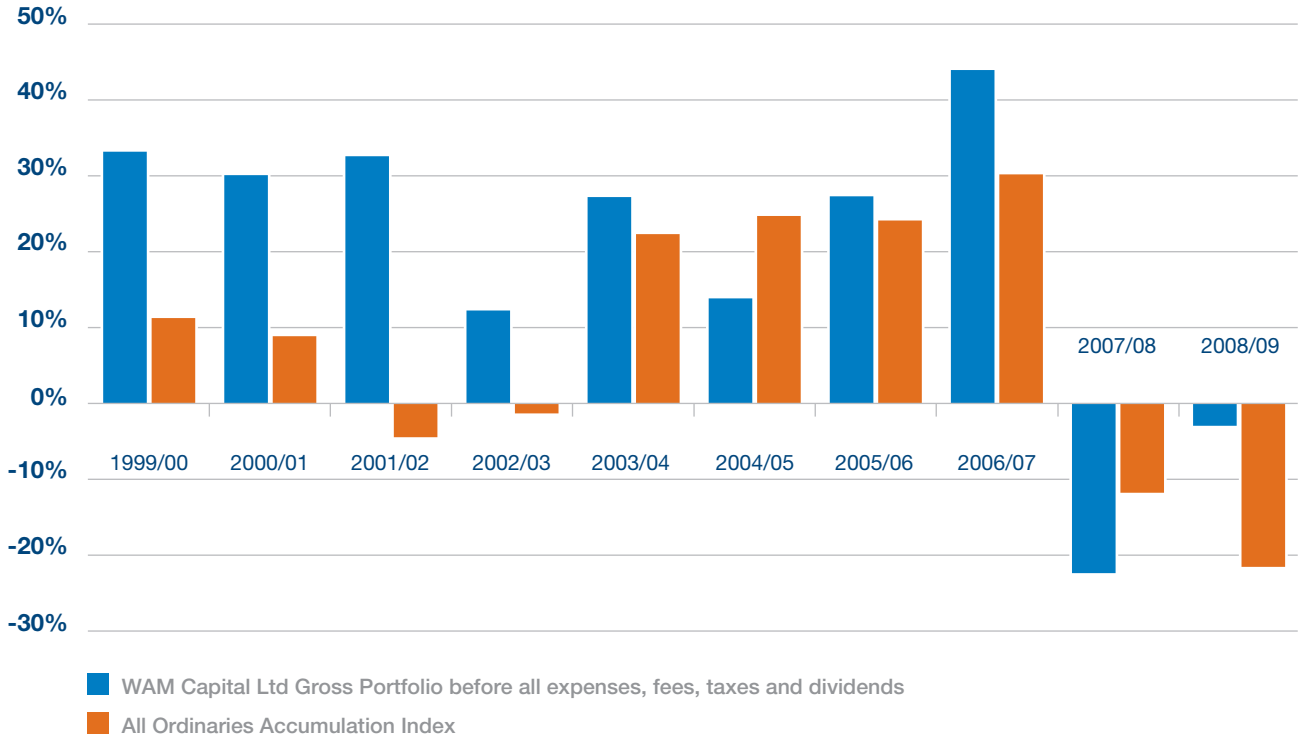
WAM's performance can be broken down into three categories – cash, research stocks and trading stocks. The funds cash levels averaged 54% over the course of the year and contributed approximately +3.1% to the overall performance.

The trading portion of the portfolio is where we take advantage of short term opportunities that arise in the market. Examples of this are capital raisings offered at a discount, block lines of stock and takeover arbitrages. This portion of the portfolio was impacted negatively in the period between July 2008 and March 2009 when the sharemarket was falling sharply. Since March, the trading opportunities increased dramatically with an improving market and a slew of capital raisings at significant discounts. We looked to judiciously take advantage of as many opportunities as possible.

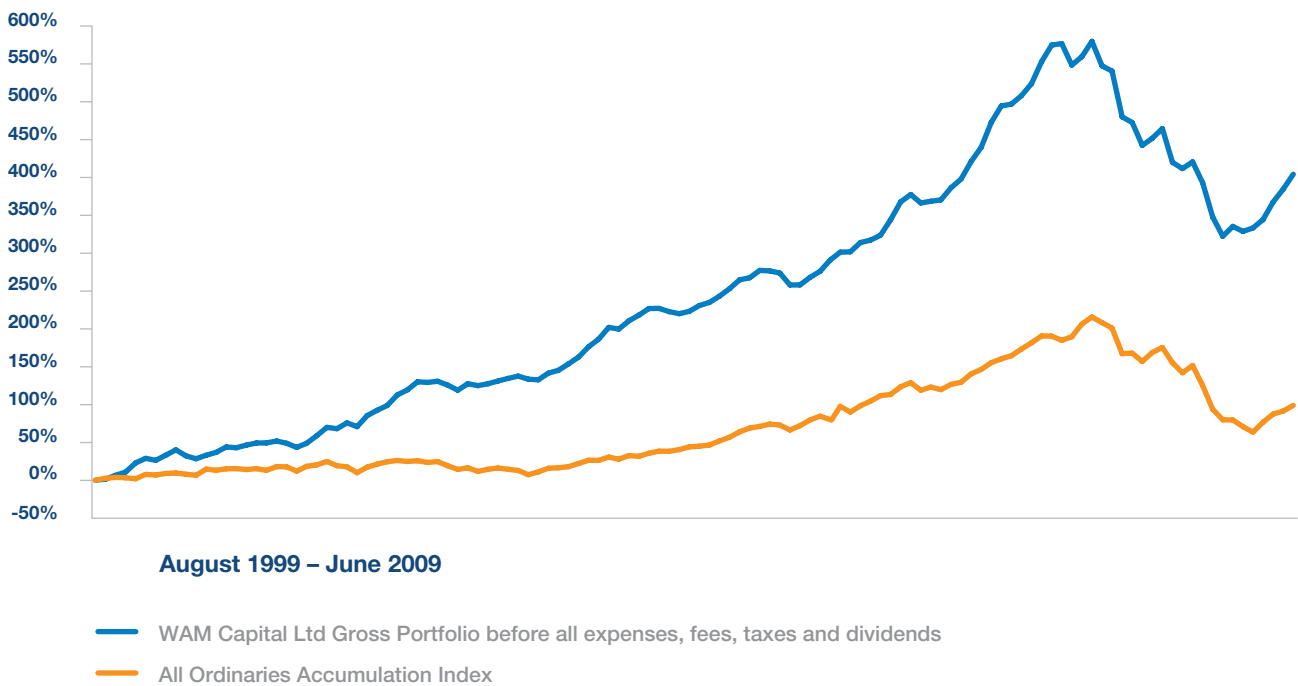
The research portion of the portfolio performed soundly during the 12 months. These stocks managed to weather the downturn and then responded well when the market bounced. It was particularly difficult to identify quality research stocks in the calendar year 2008 due to a lack of earnings growth. However, the rebound in earnings in 2010 and 2011 is providing many opportunities of which we are taking advantage.

WAM has a large exposure to medium to small capitalisation industrial companies. During the 12 months to June 30, 2009, the Small Ordinaries Index fell approximately 31.8%. At this date the index was still 50% below its all time high recorded on November 1, 2007. With interest rates low and an earnings rebound in 2010 and 2011, we still see good opportunities in this area. The next major hurdle for industrial stocks will be the eventual increase in official interest rates which we anticipate will take place in 2010.

Annualised Relative Gross Performance: WAM Capital Ltd versus All Ordinaries Accumulation Index

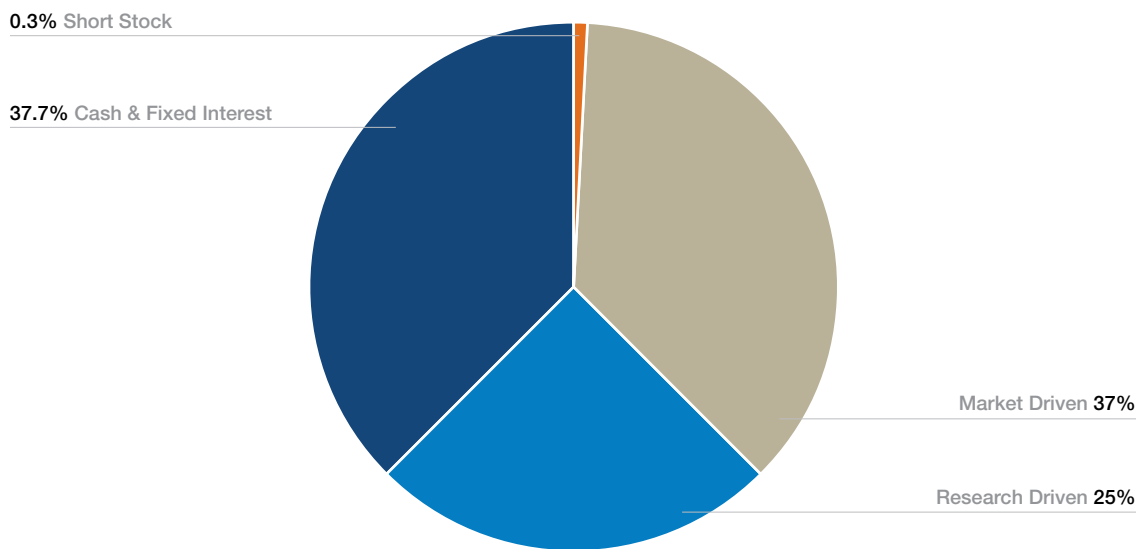


WAM Capital Ltd Gross Portfolio versus All Ordinaries Accumulation Index

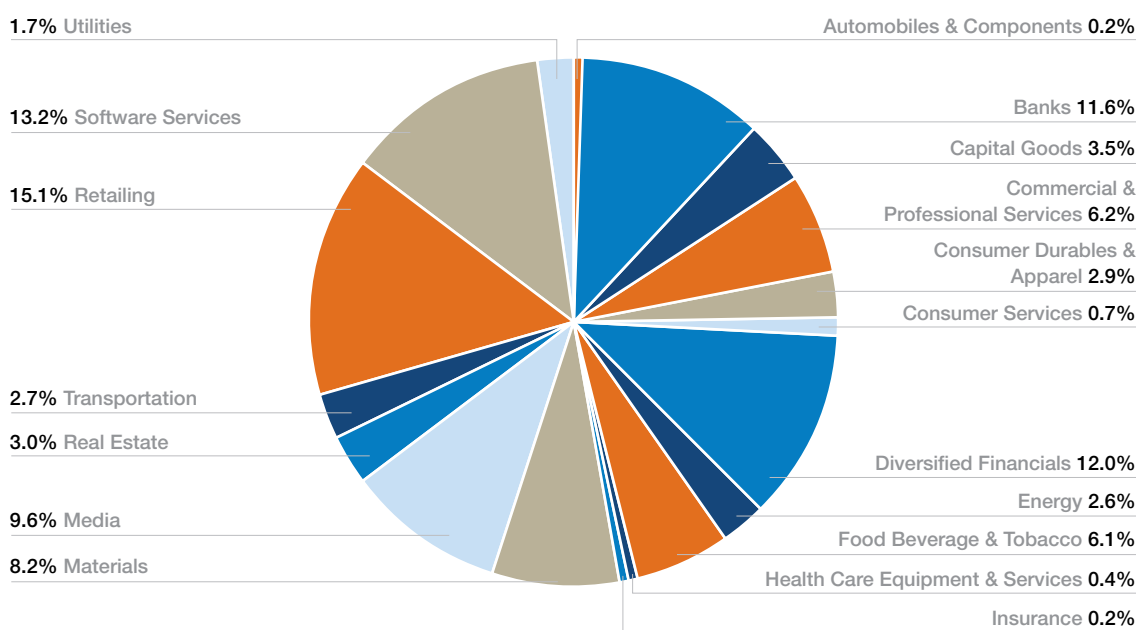


Portfolio Summary as at 30 June 2009

Asset Allocation



Sector Allocation



Top 10 Research Stocks as at 30 June 2009

ASX Code	Company Name	Sector	Market Value \$m	% of Gross Assets
RKN	Reckon Limited	Software & Services	5.2	3.8%
MMS	McMillan Shakespeare Limited	Commercial & Professional Services	3.4	2.5%
RRA	RR Australia Limited	Retailing	2.3	1.7%
MCP	McPherson's Limited	Consumer Durables & Apparel	2.3	1.7%
MLE	Macquarie Leisure Trust Group	Real Estate	2.1	1.5%
MLB	Melbourne IT Limited	Software & Services	2.0	1.5%
MCU	Mitchell Communications Group Limited	Media	1.9	1.4%
RCG	RCG Corporation Limited	Retailing	1.8	1.3%
AHE	Automotive Holdings Group Limited	Retailing	1.7	1.2%
OKN	Oakton Limited	Software & Services	1.5	1.1%

Top 10 Trading Stocks as at 30 June 2009

ASX Code	Company Name	Sector	Market Value \$m	% of Gross Assets
LNN	Lion Nathan Limited	Food Beverage & Tobacco	5.1	3.8%
NAB	National Australia Bank Limited	Banks	3.1	2.3%
PBG	Pacific Brands Limited	Retailing	2.5	1.9%
RHG	RHG Limited	Banks	2.1	1.5%
EFG	Everest Financial Group Limited	Diversified Financials	2.0	1.5%
WBC	Westpac Banking Corporation	Banks	1.9	1.4%
FBU	Fletcher Building Limited	Materials	1.8	1.3%
ANZ	Australia & New Zealand Banking Group Limited	Banks	1.6	1.2%
PGA	Photon Group Limited	Media	1.6	1.2%
AIO	Asciano Group	Railroads	1.6	1.2%

Best Performing Stocks FY2009

ASX Code	Company Name	Sector	Unrealised/ Realised Gains
MCP	McPherson's Limited	Consumer Durables & Apparel	\$1,688,782
RHG	RHG Limited	Banks	\$1,271,549
PBG	Pacific Brands Limited	Retailing	\$978,075
EFG	Everest Financial Group Limited	Diversified Financials	\$847,227
MMS	McMillan Shakespeare Limited	Commercial & Professional Services	\$656,331

Worst Performing Stocks FY2009

ASX Code	Company Name	Sector	Unrealised/ Realised Losses
HFA	HFA Holdings Limited	Diversified Financials	(\$2,746,059)
HAP	HFA Accelerator Plus Limited	Diversified Financials	(\$1,655,456)
MLB	Melbourne IT Limited	Software & Services	(\$1,431,882)
IDM	Industrial Minerals Corporation Limited	Materials	(\$1,131,384)
NOD	Nomad Building Solutions Limited	Capital Goods	(\$1,095,557)

Dividends

On the 17 August 2009, WAM paid a fully franked dividends of 4.0 cents per ordinary share, reflecting positive retained earnings in the current financial year.

WAM derives its profits from the gains, dividends and interest income it receives from the investments held in its portfolio. Both realised and unrealised gains on investments flow through the profit and loss account of the company due to WAM being classified as a trader for tax purposes.

WAM is required to pay dividends from profits made in any year or from retained earnings.

A trader's retained earnings and profit will go up and down with the movements in its portfolio of investments. For example, WAM may buy a company's share for \$1.00 a share. That company's share price may rise to \$2.00 in the first year of ownership. A profit will be booked regardless of whether the shares are sold or not. The following year the shares fall back to \$1.00 and a loss is recorded whether the share is sold or not. This scenario would wipe out any retained earnings, preventing a trader from paying any dividends.

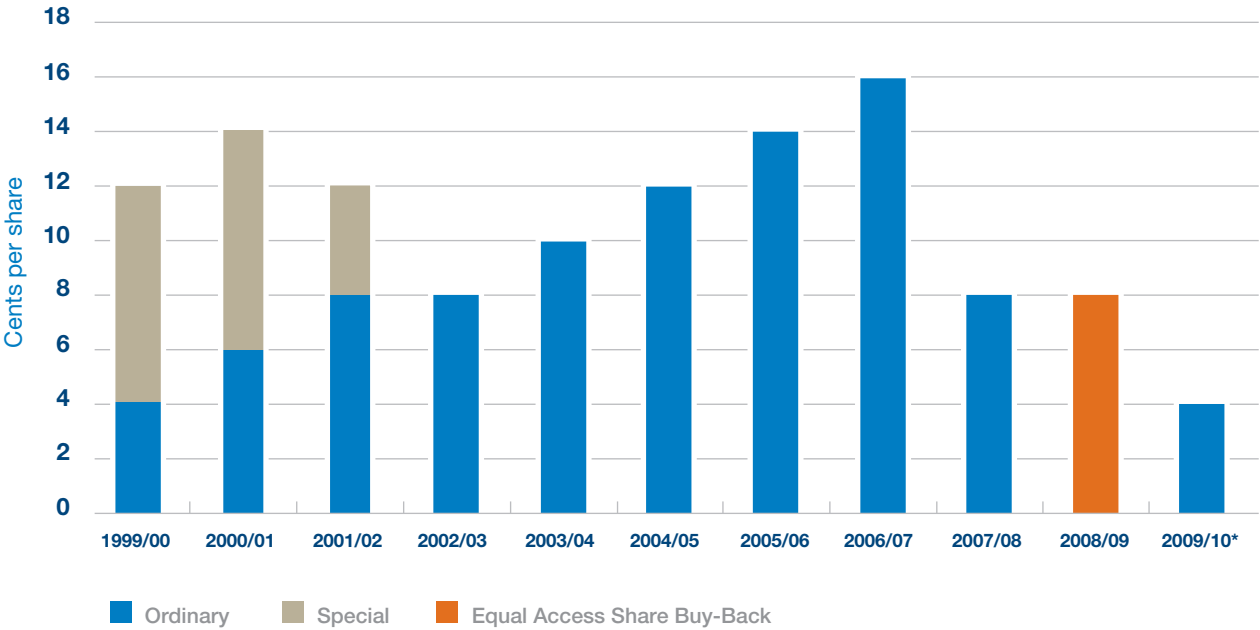
Applying this example to WAM, if retained earnings are wiped out because of a drop in the portfolio value, then the Funds ability to pay a dividend is removed in that period. As was the case in the prior year, at 30 June 2009 WAM had negative retained earnings and as such did not pay a dividend.

In the new financial year, WAM's portfolio increased strongly in July thus resulting in a profit being made which was partially paid to shareholders as a 4.0 cent fully franked dividend on 17 August 2009.

A trader like WAM may enjoy profits for many years and in that time has the ability to pay dividends. One or two years of a bear market and poor fund performance when the portfolio drops in value may see no dividend paid.

WAM will continue to pay dividends from profits to the extent permitted by law and prudent business practices. Dividends will be franked to the extent that available imputation credits permit. The Board is committed to paying an increasing stream of fully franked dividends to shareholders over time. This policy is dependent on the profitability, retained earnings and availability of franking credits of the Company.

Dividends



*to date

The world has changed forever

Is it time to unlock the pen and let the bulls roam freely in the paddock to enjoy themselves?
Is it time to sink the slipper into the bears and hunt them back into the cave?

While it is still too early to answer these questions it is worthwhile investigating what markets do following a severe bear market. In last year's Investor Report we penned an article on bear markets over the last century, analysing how long they last and how far they usually fall. What we didn't know back then was that US investment bank Lehman Brothers would collapse in September 2008, resulting in a global credit crisis and the second worst bear market of all time. The broad based S&P 500 Index in the United States fell 56 per cent in 17 months only to be matched stride for stride by the Australian All Ordinaries Index that fell 55 per

cent in 16 months. The pain in the Australian market was felt most acutely by the small industrials sector which experienced a 70 per cent crew cut. At the time of writing this report (June 30) it has been 116 days since the US and Australian share markets hit their respective lows on March 6. This is the longest and strongest rally since the bear market was unleashed back in late 2007. But when things change there is usually a level of scepticism and a state of disbelief sets in. The consensus view that still pervades the market is that the world has changed permanently and a recovery is still many years away.

The financial crisis claimed many victims on Wall Street including Bear Stearns, Lehman Brothers, Merrill Lynch and insurance group AIG. The catch cry has been that Wall Street and the financial world as a whole has changed forever. Investors should no longer expect the same returns they have enjoyed in recent years. What people should never lose sight of is that things do change and a crisis normally accelerates the change. The table below shows the Dow Jones Industrial Index and its original 12 stocks back in 1896.

Table of the Dow Jones Index in 1896

Company	What Became of It
American Cotton Oil	Distant ancestor of Bestfoods
American Sugar	Evolved into Amstar Holdings
American Tobacco	Broken up in 1911 antitrust action
Chicago Gas	Absorbed by Peoples Gas, 1897
Distilling & Cattle Feeding	Whiskey trust evolved into Millennium Chemical
General Electric	Going strong and still in the DJIA – In 1892, GE was formed via a merger of famed inventor Thomas Edison's Edison General Electric Company and a competitor, Thomson-Houston Company.
Laclede Gas	Active, removed from DJIA in 1899
National Lead	Today's NL Industries removed from DJIA in 1916
North American	Utility combine broken up in 1940s
Tennessee Coal & Iron	Absorbed by U.S. Steel in 1907
U.S. Leather (preferred)	Dissolved in 1952
U.S. Rubber	Became Uniroyal, now part of Michelin

Source: www.finfacts.com

Of the original 12 stocks only General Electric has survived. The remaining 11, which represented the US economy of the day, have been merged, taken over or shut down. GE has proven amazingly nimble, morphing an electricity company into a conglomerate that includes financial, medical and engineering divisions.

The much hackneyed phrase “the world has changed forever,” is a truism but not one we should all fear. No one can doubt the US consumer, the engine for above average economic growth for the world in recent years, is in for a period

of hibernation. In simple terms the average person in the US and other western countries, including Australia, borrowed too much money over the last decade to bring forward their ambitious life style. New houses and cars, overseas holidays and private schools have become the norm rather than the exception.

This change though does not automatically result in the share market falling into a Japanese like funk that has lasted the best part of two decades. The US and other western countries have continually changed and this has resulted in the share market rising more than 170

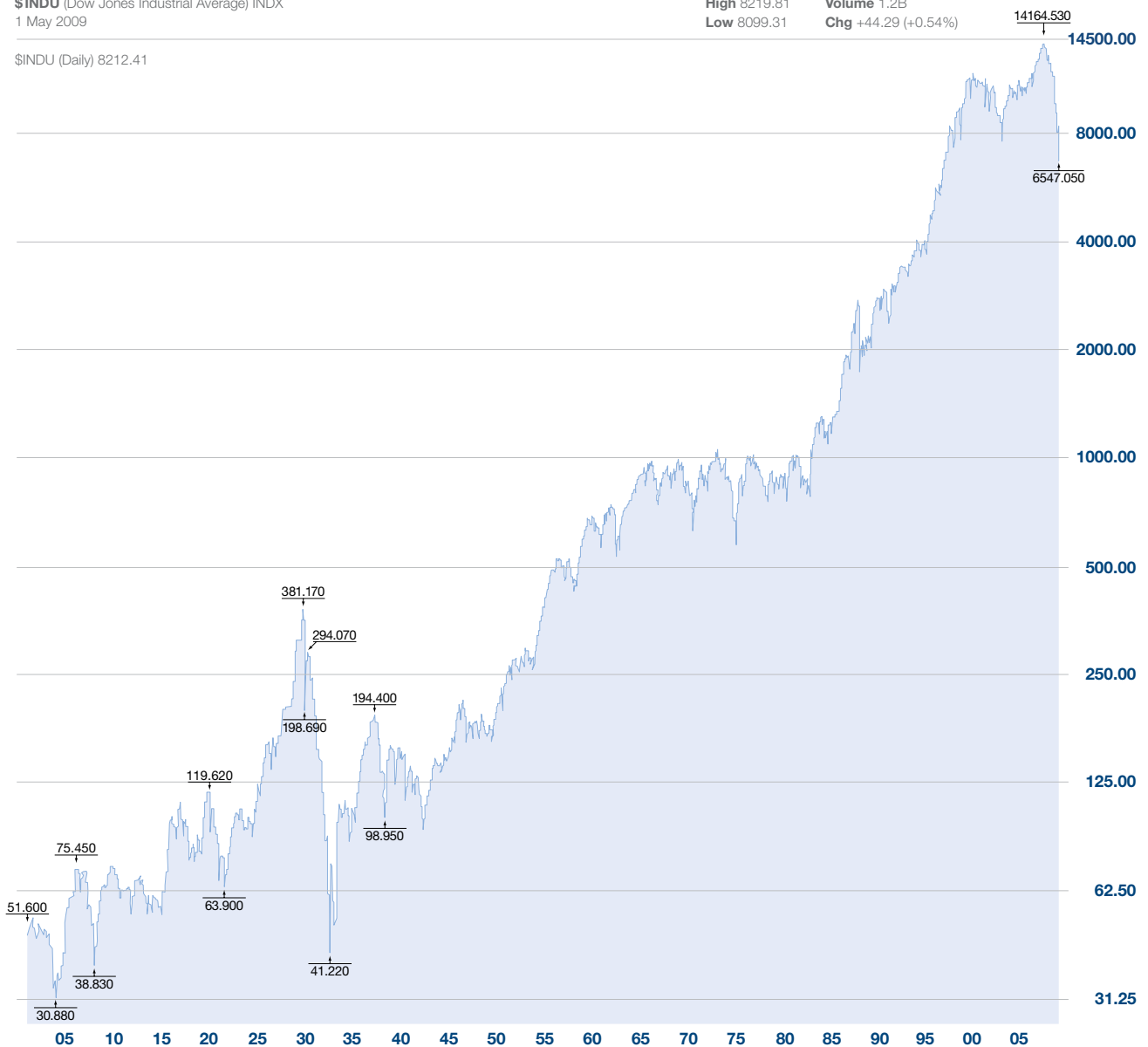
times over the last 100 years. In other words, if you were to put \$100,000 in the US share market in 1909 it would now be worth \$17 million and this does not include dividends. All bear and bull markets behave similarly with bear markets averaging approximately 15 months in duration and falling about 33 per cent. The bull markets last about 3 times as long and average a return of around 100 per cent. For every 10 years, on average 7 are up and 3 are down. This decade the US market has already managed 4 down years and we still have a year to go.

Dow Jones Industrial Average (1900 – Present Monthly)

\$INDU (Dow Jones Industrial Average) INDX
1 May 2009

Open 8167.41 Close 8212.41
High 8219.81 Volume 1.2B
Low 8099.31 Chg +44.29 (+0.54%)

\$INDU (Daily) 8212.41



Source: www.stockcharts.com

1900–Present Monthly

Every boom and bust has its leaders and things change over time. During the run in the 1960's the nifty fifty stocks rose to enormous price to earnings multiples as they took their American businesses around the globe. In the 1990's it was the technical revolution that was lead by Cisco, Microsoft and a slew of internet based companies. Back in the 1880's the railway stocks paved the way for above average returns.

As we sit here in 2009, no one is quite sure what sectors will lead us forward but the chances are they are not the same organisations that have done so in the past. It may well be the emergence of the Asian economic miracle that proves the way forward. History tells us that after a major correction in prices following an extended period of above average returns, life changes and the world moves on. Change usually proves to be a good thing, rather than a nasty end.

How do markets perform in the long term

The belief that investors can no longer enjoy the returns of recent times is an interesting comment given the US market has delivered a negative absolute return over the last decade. At June 30 1999, the Dow Jones Industrials Index was trading at 10,971, or about 23 per cent higher than where it closed one decade later on June 30, 2009 (the time of writing

this article). At the current bottom of the market on March 6, the Dow Jones Index was trading at a 32.7 per cent discount to the close 10 years earlier. These appalling returns are the direct result of a significant bull market that effectively began in late 1974, but really gathered a head of steam in 1983, ending with the tech wreck in early 2000. From 1983 to 2000 the Dow Jones Index managed to post gains of more than 13 per cent per annum, almost double the long term average of just over 7 per cent. (These numbers are purely share price movements and do not include dividends). It could be argued the massive underperformance of the past decade is a correction that will take returns back to or close to long term averages.

1970s

There are striking similarities between the last decade and what unfolded from the years 1966 to 1983. In these 17 years the Dow Jones Industrial Index attempted to break through 1,000 point mark on four occasions but effectively failed each time. There were five bear and five bull markets during the period. This indigestion, or as some term it, secular bear market, was the end of a staggering upward surge that went from 1932 to 1966 and saw the Dow move 2,400 per cent higher.

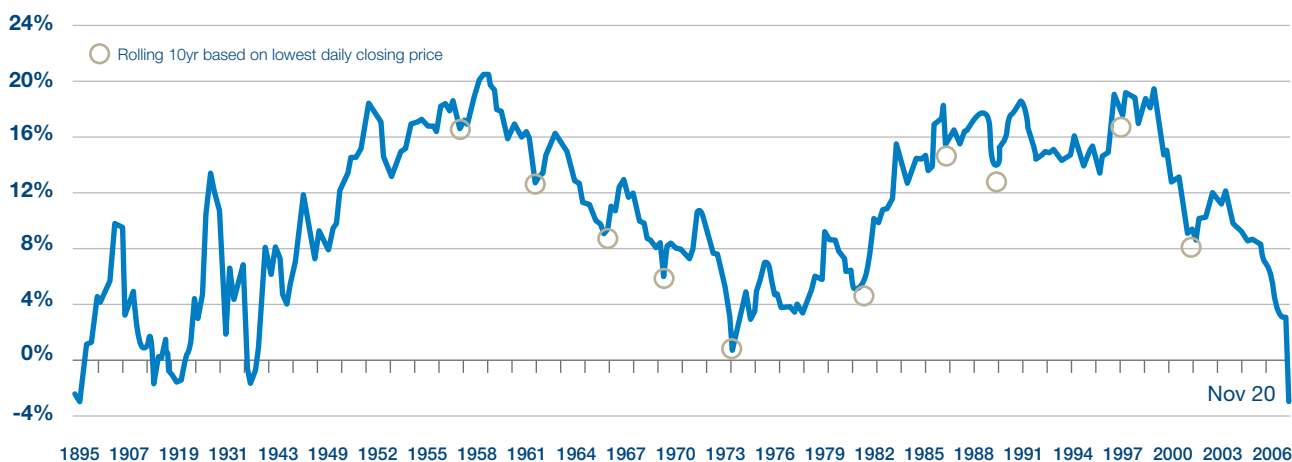
While the market did not surge into new territory until 1983 the ultimate low in the 1970s bear market was in

the September quarter of 1974 when the Dow hit 577. This was about half way through the secular bear market that had begun 8 years earlier. Between the low in 1974 and the end of the bear market in 1983 the share market doubled, which is a return of about 8 per cent annually (excluding dividends).

Overlaying this on the current day situation, things look quite interesting. If the market bottomed on March 6, 2009, some nine years after the end of the bull market in 2000, it will take some 10 years for the Dow to reach a new high based on an 8 per cent return per annum. Alternatively it may only take 8 years to reach the high if the duration of the secular bear market is the same length as the one experienced in the 1970's. That would mean an annual return of about 10 per cent before dividends. Unfortunately, the 1970's also show us that just because you hit a bottom in terms of share prices, it does not necessarily mean that it is a smooth rise to the next bull market.

The following chart suggests that the worst may be behind us and a recovery has started. The chart tracks the 10 year rolling average of the broad based S&P 500 Index. It shows that when the 10 year average return falls below zero this is a very opportune time to buy. The chart also shows that the 10 year rolling return to December 2008 was the worst experienced in 115 years.

S&P 500 Rolling 10yr compounded total returns (1895–now) – worst in 100+ years



Note: 1895–1946 based on year-end prices, 1947 onwards based on quarter end prices. Circles show rolling 10yr based on lowest closing during 1962, 1966, 1970, 1974, 1982, 1987, 1990, 1998, 2002 bear market. Source: UBS Research

The Australian experience

Like its US cousin, the Australian share market has delivered on average just over 7.4 per cent per annum over the last 100 years. This jumps to over 12 per cent once dividends are added in.

The Australian share market fell approximately 55 per cent from its peak on November 1, 2007 until the current bottom on March 6, 2009. This was the second worst bear market the country has ever experienced, and only 4 per cent shy of the 1973/74 bear market and worse than the market during the Great Depression back in 1929.

Despite a recession free period from 1991 to 2009 the share market has managed to underperform its long term average. In fact, from the bottom of the market in 1991 to the March 6 low in 2009 the share market only managed to deliver returns of 5.5 per cent per annum. If it had delivered its long term average, the All Ordinaries Share Index would currently be sitting at around 4550 (written at June 30). Not one to be outdone, the Small Industrials Index failed to register any gains over the same period.

This underperformance is all the more surprising when we take into consideration that between the market peak in September 1987 and the bottom in 1991 the Australian share market halved.

If the market manages to resume average returns over the next 8 years, it will manage to break through the old historical high. However, as mentioned above, the market does not normally recover in a straight line. If we look at the seven bear markets after WWII and not including the current one, the average return experienced over the first 12 months following the bear market is 32 per cent. Some are much greater but most recovery years enjoy rises of at least 20 per cent. Not all of these recoveries though necessarily result in the beginning in a multi-year bull market. There were several bear

markets in the 1970s before the recovery in 1982 saw the market shoot to new highs and keep on powering. The crash of 1987 saw a recovery during 1988 and 1989 before another bear market of more than 30 per cent during 1990/91 which in turn was followed by another bear market in 1994.

So history tells us while the first year after a bear market is usually a good one, the period following that recovery can be quite volatile, but overall profitable.

Humans though never change

While investors can enjoy the opportunity that change brings, there are some aspects of human life that never seem to change. The father of value investing Benjamin Graham taught the world, including his student Warren Buffet, about market psychology. He invented a character called Mr Market who turned up at your door each day to buy or sell shares to you at various prices. Graham believed Mr Market's moods would swing wildly from euphoria in bull markets and severe depression in bear markets. In bull markets Mr Market would arrive at your door, euphoric and willing to pay high prices for the shares you own. In bear markets the same Mr Market would arrive at your door willing to sell you his shares at very low prices. This philosophy was first articulated by Graham when he started teaching about investing at Columbia University in 1928.

During 2008 Mr Market became very depressed and can't see any good times in the future. Highly paid experts around the globe are happy telling everyone the world has changed forever and investors can't expect to receive the same investment returns they have enjoyed in the past. Only when share prices are much higher and the world economy has recovered will Mr Market start to enjoy himself again.

Despite a recession free period from 1991 to 2009 the share market has managed to underperform its long term average.

A closer look at two of our Research Driven stocks

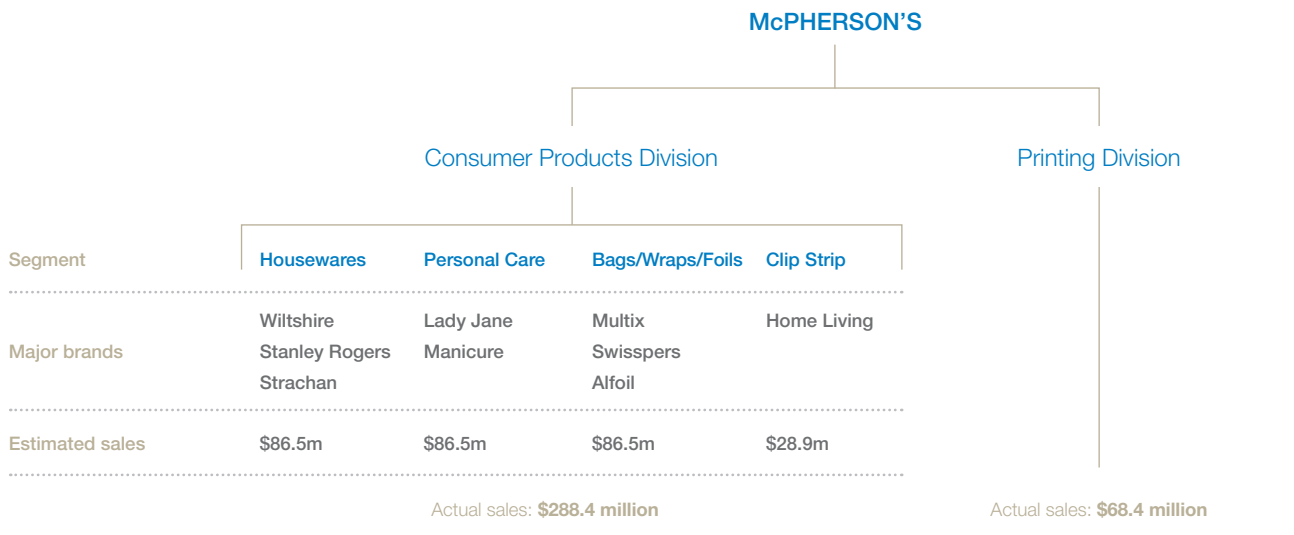


McPherson's

McPherson's Limited

McPherson's Limited (ASX code: MCP) distributes and markets (mostly to supermarkets) a wide range of kitchenware, utensils, glassware, gardenware, homewares and bathroom products together with household bags, wraps and foils, beauty, hair and personal care products. The company also has a printing division that provides products including books, loose-leaf printing, greeting cards, stamps and catalogues.

Figure 1: McPherson's Businesses and Major Brands



McPherson's was initially part of the Market Driven portion of the WAM portfolio. With earnings growth (a major factor in our research ratings template) returning in 2010 the company has now made the transition to the Research Driven part of the portfolio.

McPherson's is a turnaround story following a disastrous 2008, where the company was on the brink of collapse due to extremely high debt levels and falling earnings due to a sharp depreciation of the \$AUD against the \$USD. McPherson's imports many of its products from offshore and pays for them in \$USD. At its worst, the weak currency meant McPherson's was paying 50% more for its goods. During this period the company unsuccessfully tried to raise equity via a rights issue at \$1 and subsequently the share price collapsed to \$0.27 in February 2009.

The management team led by David Allman have been with the company for many years with the market having mixed views on their ability and execution. It has not been a "sexy" business for fund managers to own with low historical growth rates of around 5% p.a.

From a valuation perspective the stock looks compelling. When the stock traded below \$0.35 (when WAM starting buying shares in February 2009) it was on a price to earnings ratio of less than 1 times. Major sellers exiting the stock at the time weighed negatively on the price with the illiquid nature of the company's shares. McPherson's shares (at the time of writing) are trading at \$1.80 putting the company on a price to earnings ratio of 4.5 times which is favourable compared

to listed competitors Breville Group 8 times and GUD 12 times FY2010 earnings.

The company has undergone a cost cutting exercise saving around \$5m p.a. We believe there is more scope for further cost reductions in the future. This should improve EBIT margins dramatically in the next few years. In addition, there is more certainty in place around currency hedges being established, thus neutralising McPherson's exposure to the \$USD.

The company has become increasingly confident that earnings growth will return in FY2010. This view was assisted by the announcement made by the company in April 2009 that McPherson's would earn 30 cents Earnings Per Share (EPS) for FY2009. The catalysts going forward for the stock are earnings surprises and a return to paying dividends. Other attractions for us were the lack of institutional investors on the share register and the consumer products division being "less discretionary" in tougher economic times. We forecast the company can generate high levels of free cash flow which will enable debt reduction to 50% debt to equity at 30/06/10 (from an estimated 70% at 30/6/09). We expect the company to have an ability to resume paying dividends in the short to medium term.



RCG Corporation Limited

RCG Corporation Limited (ASX code: RCG) is an investment holding company for specialty retail businesses.

RCG currently owns just one asset, The Athlete's Foot Australia (TAF). TAF is a specialty footwear retailer offering mostly athletic footwear operating 135 stores in Australia. The business operates in Australia under licence from the parent company based in Atlanta USA where it pays 1% p.a of gross product sales to the licensor.

RCG has recently announced it intends to buy out this licensing agreement to secure the brand name long term.

RCG rates as a buy on our Research Rating template and we have identified a number of catalysts which we believe will re-rate the stock.

RCG listed on the ASX in July 2004 and since that date has divested two loss making businesses which were considered non-core to continuing operations. Near the top of the share market in September 2007, the company raised \$15m of equity at \$0.23 cents per share from institutional shareholders to fund acquisition opportunities. To date, the company has not bought a new business due to the environment in the retail sector along with vendor price expectations being too high. We believe management's decision to be patient on the acquisition front, to preserve capital and maintain a strong balance sheet, is sound in the current environment. The company had a net cash position of \$27m as at 31 December 2008 as a result of the capital raised back in 2007 and the strong free cash flow that TAF has produced over that period.

TAF's growth over the next few years will predominately come from its new format stores (which are a larger store layout by square metre) as well as offering new products such as school shoes. After visiting one of these new format stores at Macquarie Centre NSW, we were impressed by the layout and the personalised customer service approach. We believe this is a key differentiating feature when

compared to its major competitors such as Rebel Sport. These new store layouts to date have produced great results registering 17% growth for the six months to June 2009.

The investment rationale behind RCG was due to a number of factors driven by our Research Rating template ranking earnings growth, valuation, industry position and management. We visited the company three times during our research process including a site visit at Macquarie Centre NSW. During this process we became more familiar with the management team led by Ivan Hammerslag. Ivan, who has over 20 years experience in retail, most notably grew and sold Freedom Furniture in the 1990's.

RCG had \$0.14 cash when we bought shares at \$0.27 placing the company on a fully diluted price to earnings ratio of 6.8 times FY10 ex cash. This compares favourably to listed peers which historically trade on multiples between 10-15 times. We initiated a position in RCG in April 2009 via a vendor sell down and continue to like the company's prospects. Major catalysts for the stock include acquisitions of retail businesses, payment of regular and special dividends (which the company has announced it will commence in August 2009) and the new format stores driving comparative store sales growth.

A closer look at two of our Market Driven stocks



Pacific Brands Limited

Pacific Brands Limited (ASX Code: PBG) is a leading manager of everyday essential brands. PBG is headquartered in Melbourne, employing over 9000 staff with operations in Australia, New Zealand, United Kingdom, Malaysia, China and Indonesia.

The company owns a stable of brands including Bonds, Dunlop Sport, Berlei, King Gee, Sleepmaker and Holeproof. These brands are predominately sold through Australian retailers.

Pacific Brands' share price traded at \$3.00 in January 2008 before falling significantly. The business was operating with a highly geared balance sheet, and debt covenants were breached. The market viewed the company as being in the hands of the banks (via the debt covenant breaches) and the stock was priced for the company to fail, trading down to \$0.13 in March 2009. Despite the share price action, the company's underlying earnings were relatively stable as shown at the half year result in February 2009. By this time, most institutions had left the register as they did not view Pacific Brands to be of investment grade and were concerned about the companies insolvency. This negativity was compounded by the company's decision to lay off 1,850 local manufacturing workers and move those jobs offshore, in an attempt to reduce operating costs.

In April 2009, Pacific Brands refinanced its debt – the first sign of confidence from the banks. We visited the company management on 23 April (two days after the debt refinancing), with PBG trading at \$0.40. At this level the P/E (price to earnings) ratio was 2-3 times FY2010 earnings, and the EV/EBIT (enterprise value to earnings before interest and tax) was 5 times FY2010 earnings.

We believed the company had been oversold. Cost reduction initiatives were being implemented, earnings remained relatively flat in a recessionary environment and management were looking at divesting non-core brands. We also saw scope for margin expansion.

Pacific Brands then came to market, raising \$256 million in equity at \$0.60 a share in May 2009. The issue was aimed at alleviating the company's debt concerns and was extremely well supported by existing and new institutional shareholders. At the time of writing, the stock is trading above \$1.25.

We see further catalysts for share price improvement. These include the divestment of the non-core brands and significant cost cutting. We also expect the company to resume paying dividends within the next couple of years. Pacific Brands is currently trading on a P/E of 7 times FY2010 and EV/EBIT of 6.4 times FY2010.

R H G

RHG Limited

RHG Limited (ASX Code: RHG) was founded in 1991 as a wholesale provider of funds to lenders initially in the commercial and investment property markets, sourcing loans from external parties.

The company was formerly known as RAMS Mortgage Corporation Ltd until the brand name and approximately 50 shop fronts were sold to Westpac in late 2007. Rams Home Loans listed in July 2007 (near the top of the market) at \$2.50 per share. Its major shareholder, Chairman John Kinghorn sold 80% of his holding for \$640 million into the float. Then came the credit crisis and the companies share price fell to a low of 4.6 cents in June 2008.

When RHG floated, the business operated by sourcing the wholesale markets for funding and taking the spread against what it charged the retail customer. When the debt markets collapsed in 2008, the RHG business model came under serious pressure as the cost of funding increased dramatically and RHG could not fund its loan book. This coupled with a large debt profile, sent the share price into a tail spin. To survive, RHG sold its operating business to Westpac for \$140 million and paid off the company's debt, and was left a \$13 billion mortgage book in run-off.

At the lows in the RHG stock price, the market capitalisation was only \$50 million. Institutional investors had exited the register because of the debt concerns, even though the existing mortgages remained profitable. In February 2009, the Company announced its results to December 2008, giving profit guidance of \$65 million to \$70 million. This number was greater than the RHG market capitalisation at the time,

and the cash on the balance sheet was mounting. When we decided to start buying the shares at \$0.13 a share there was \$0.40 a share of cash on the balance sheet and a mortgage book of more than \$9 billion that was profitable and being liquidated.

RHG's mortgage book now stands at approximately \$8 billion and we value the company at approximately \$1.00 per share once all the mortgages run-off. RHG's margins have also benefited from the Reserve Banks cuts to interest rates as not all the reduction has been passed on to their customers. RHG has also engaged in an on-market buyback of stock to close the gap on the \$0.55 net tangible asset backing at 31 December 2008. We view the main risk for the stock to be how the Company's Board uses its current large cash holdings. The Fund's average entry price is \$0.21.

What is a Listed Investment Company?

A Listed Investment Company (LIC) is a closed end pool of capital that invests in the stock market.

By closed end we mean that if an investor wants to leave the fund, he or she sells shares to another investor coming into the company rather than withdrawing money from the fund. Effectively, no money leaves the fund and only the shareholding changes.

We believe that a closed end fund is a superior structure to managed fund/unit trust structures. With closed end funds or LIC's, the manager of the fund does not have to sell stocks in the portfolio to raise cash for a departing investor. That means investment decisions are based on the fundamentals of the companies the manager invests in, rather than money flow via redemptions.

Most other funds, like managed funds and mutual funds, are open ended. This means that when an investor wants to leave the fund the manager is forced to liquidate stocks to finance the redemption. This places pressure on the manager who has to put fundamental investing to the side while he or she manages the cash flows.

Invariably, most investors depart a fund when stocks have fallen significantly, which historically has proven to be the best time to buy. This means the manager may have to sell companies which they believe represent good value.

At the other end of the scale, most money pours into the market and open end funds, when stock prices are soaring in a bull market. The manager may then be forced to buy companies at inflated prices. As has proven the case recently, this type of momentum investing can cause a serious destruction of capital when the bull market ends and is replaced by a bear market.

As a LIC is a closed end fund it does not have any of these problems which can be of significant advantage and benefit to the investor.

LIC's are unique investment vehicles because they can trade at a discount or premium to the assets that they own. When investors want to take their money out of LIC's, selling may result in the share price falling below the value of its assets (or NTA). We refer to this as trading at a discount to NTA. This can provide a great buying opportunity. On the other hand, when investors are buying shares in LIC's, the share price may trade higher than the value of the assets it owns (or NTA). This is referred to as trading at a premium to NTA. This can provide a selling opportunity.





WILSON

ASSET MANAGEMENT

Wilson Asset Management is an independently owned boutique investment manager established in November 1997 by Geoff Wilson and joined by Matthew Kidman in mid 1998. Wilson Asset Management is based in Sydney, Australia.

The Wilson Asset Management Group (WAM Group) employs four investment professionals who have a total investment experience of over 40 years. The members of the WAM Group include Chris Stott, Paul O'Halloran, Kate Thorley, Deanne Gray and Zahidi Agar.

At June 2009, the WAM Group was the manager of three listed investment companies with funds under management of approximately \$270 million. The group also manages an unlisted fund.

In August 1999 the first of the three listed companies, WAM Capital Limited (WAM), was established and has grown from \$21.5 million to approximately \$145 million today. WAM focusses on investing in small to medium sized companies listed on the Australian Securities Exchange for the short to medium term.

In August 2003 the second listed investment company, Wilson Investment Fund Limited (WIL), was established

with approximately \$161.3 million raised. WIL focusses on investing in small to medium sized companies listed on the Australian Securities Exchange for the long term.

WAM Active Limited (WAA) is the most recent addition to the group which was listed on 10 January 2008 with approximately \$15 million raised. WAA is an active investor with high turnover and individual stocks may not be held for extended periods.

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