



## Nine years of Consecutive Strong Positive Returns!

### SEEKING SUSTAINABLE CASH FLOW

#### 70 Years P/E ratio

The price per share over its earnings (P/E ratio) is one of the most widely used ratios in investment analysis. The ratio was first described as a stock valuation method in the 1930s. It sees a firm's earnings power as main value driver and tells us how much an investor is willing to pay per dollar of earnings. For example, a P/E ratio of 25 suggests that an investor is willing to pay \$25 for \$1 of earnings.

A stock with a prospective P/E ratio of 25x looks prime facie expensive compared to the current market average of 15x, which points to some limits to this form of analysis. Companies may have different business models or risk profiles. Some explanations as to why a company has a high or low P/E are:

- Earnings growth rate

A higher P/E ratio may mean that investors are expecting higher earnings growth over the next few years. Thus it is a reflection of the market's optimism concerning a company's growth prospects.

- Risk

A company perceived to be higher risk usually requires a higher rate of return than a company operating in a stable industry. If the risk is higher, the P/E ratio tends to be lower.

#### Cash Flow and Earnings

Besides the P/E ratio there are a number of other factors to look at. One of them is a company's capacity to generate cash. A company should not only show a growing earnings stream, but also generate cash flows which are sustainable.

An advantage of looking at cash rather than earnings is that cash is cash and not easy to distort. Firm's report statements of cash flow which show changes in cash over one period. It basically shows where the cash comes from and what the management spends it on.

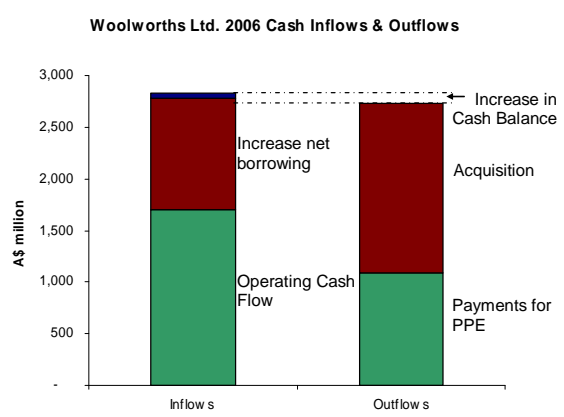
A cash flow statement is divided between operating, investing and financing amounts. The operating cash flow is derived from ongoing normal business activities. For example, included are sales and cash received from customers, cash payments to employees and suppliers and income tax paid.

Cash from investing activities include payments for property, equipment, money spent on acquisitions and proceeds from sale of equipment. The third part is cash flow from financing activities, which includes proceeds from issuance of shares, payments of dividends and changes in borrowings.

Unlike investing or financing, operating cash flow (OCF) comes from a renewable resource—a company's ongoing operations. The OCF provides management with discretionary resources that can be used for purchase of machinery and equipment, repayment of bank loans or pay dividends.

#### Where has the cash gone?

For example, in the 2006 financial year Woolworths (WOW) received almost \$40 billion as receipts from customers (about 18% of all retail sales in Australia).

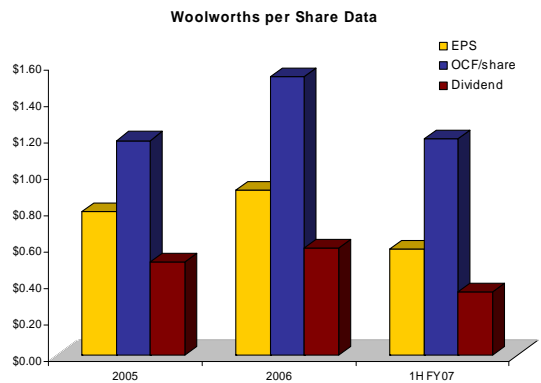


The company paid about \$37.5 billion to its suppliers and employees and almost \$500 million income tax. The net operating cash flow was \$1.7 billion - or approximately \$33 million per week.

Woolworths used this amount primarily for purchase of property and equipment of \$1.1 billion and \$1.6 billion for the acquisition of Progressive Enterprises in New Zealand. But the OCF was not enough to fund the acquisition, so the gap was filled by increasing bank borrowings by \$1 billion.

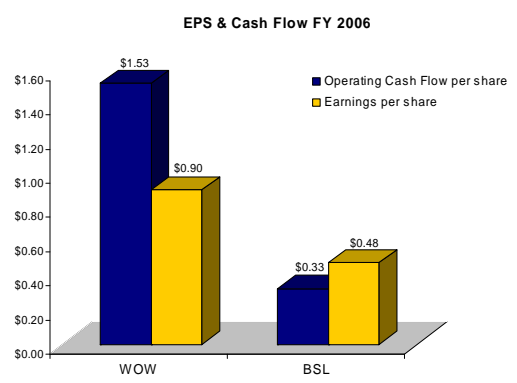
#### Sustainable Cash Flow

Breaking the operating cash flow down on a per share (OCFPS) basis we can see that the amount has increased in 2005/06 from \$1.18 to \$1.53 (an impressive 30% increase and higher than the EPS growth of 14%). OCFPS was much higher than the \$0.90 EPS.



Source: Company Data

In contrast, the relation EPS and OCFPS was quite different for BlueScope Steel (BSL) last year. Reported EPS were \$0.48 last year while OCFPS was only \$0.33. The lower cash flow vis-a-vis earnings was partly due to changes in working capital.



The comparison is somewhat limited but used as an example to illustrate the importance of cash flows. Woolworths' OCFPS has increased over the last 2 years. Rising earnings in the absence of rising operating cash flow triggers further examination about financial strength of the underlying business and prospects. But it also highlights different industries demonstrate different cash flow and earning characteristics.

#### Cash is cash

In summary, cash flow is a strong indicator of the quality of the business over the long term. The usual drivers to increase cash flow are business margins and better management of a firm's inventory, debtors and payables. In using different comparison methods, one tries to gain a better insight into the businesses and investment opportunities.

"Unlike some items that can be clouded with financial reporting issues, cash is real, finite, and measurable. Cash is cash."<sup>1</sup>

<sup>1</sup> (Harrison D, February 2002, Business Valuation Made Simple, Strategic Finance, p.46)

# PRIME VALUE GROWTH FUND

The Growth Fund (PVGF) aims to provide superior medium to long term capital growth, with some income, by managing portfolio of predominantly Australian assets.

For the six months ended 30 June 2007 the fund outperformed the benchmark S&P/ASX Accumulation Index by 2.6%. The fund achieved a return of 15.6% compared with the benchmark return of 13.0%.

At a sectoral level, the PVGF benefited from an overweight position in the materials and energy sectors and an underweight position in the financial and consumer sectors. We have maintained our cautious stance throughout the period due to expectations of sustained volatility. While the market reached another all-time high in June and pulled-back towards the end of the month, the cash holding of the Fund detracted from

the performance for the financial year.

At a stock level, the positive contributors to performance included holdings in BHP Billiton, WorleyParsons, Watpac and mining services group Monadelphous. The main detractors from performance included Lion Selection, Newcrest Mining and medical equipment producer Resmed.

Average annual returns for 1, 3, 5 and 7 years are now 30.8% (benchmark 29.2%), 33.8% p.a. (benchmark 26.4% p.a.), 28.4% p.a. (benchmark 19.3% p.a.) and 22.9% p.a. (benchmark 14.1%) respectively.

## Portfolio Outlook

While the Price/Earnings ratio for the resources sector has expanded substantially over the last six months, the financials sector Price/Earnings ratio has retracted.

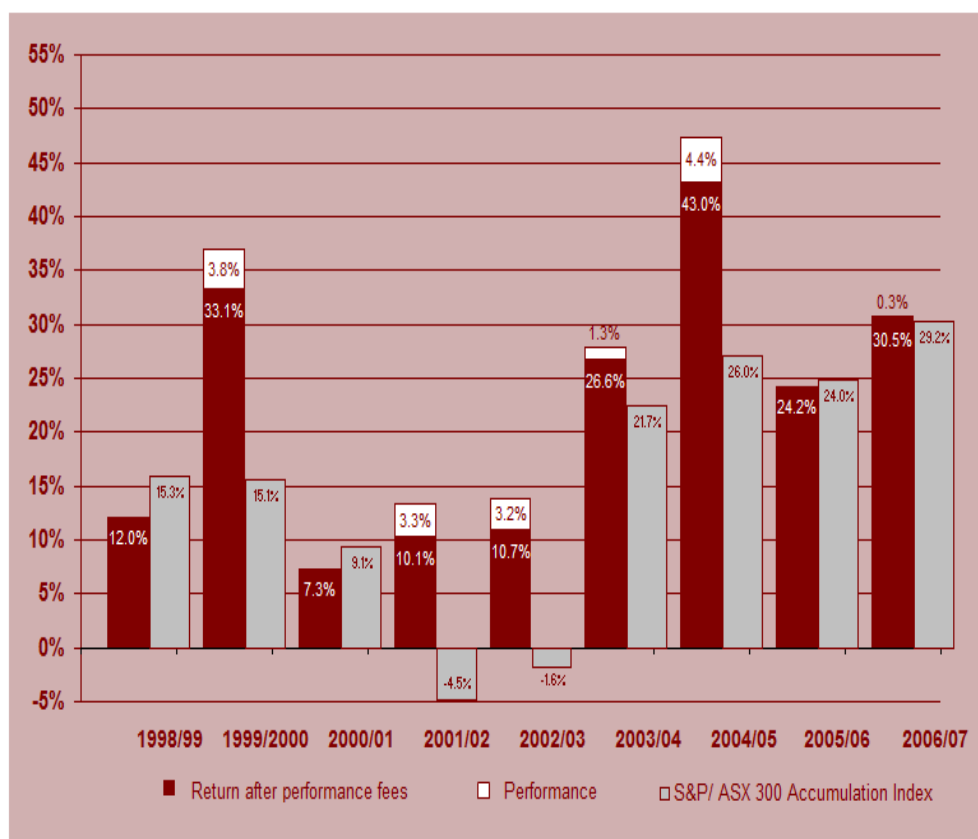
The resources sector is no longer as compelling as it once was on a valuation basis, but further upgrades to earnings expectations are likely.

We still consider diversified miners offer reasonable value; hence continue our positive stance towards this sector. Additionally, we are still keen on those companies servicing the mining industry and will also monitor sectors which we believe are poised for growth including some financial services companies and healthcare stocks.

The defensive nature of the portfolio will be retained as we are mindful of the need to balance the protection of capital while still achieving reasonable gains if the market rises.

## Historical Performance (Class A Units)\*

Annual Return of PVGF and S&P/ASX Accumulation Index by Financial Year. This shows the performance of the PVGF for each discrete financial year, demonstrating consistently positive & attractive returns. The Fund out-performed in 7 out of the last 9 financial years.



\*Past performance is not necessarily an indicator of future performance.

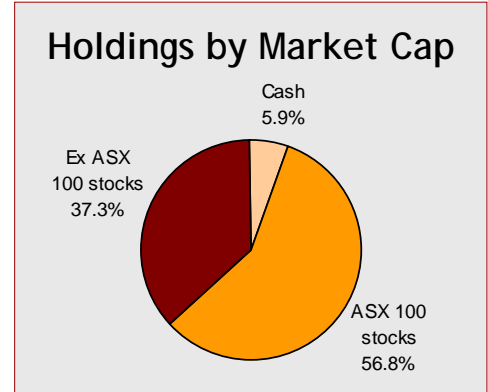
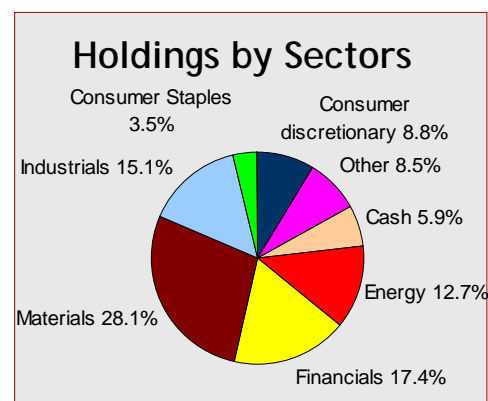
## Distributions (Class A Units)

Distributions	2004/05	2005/06	2006/07
Distribution (per unit)	\$0.1586	\$0.1097	\$0.1632
Distribution (% of Unit Price)	7.2%	4.4%	5.4%
Imputation Credit (per unit)	\$0.0128	\$0.0143	\$0.0226
Franking Level (%)#	18.8%	30.4%	32.3%

# The "level of franking" is a measure of the grossed-up imputation credit relative to the total distribution made. Unlike the franking level of a company's dividend however, the "denominator" includes not just dividends, but realised capital gains as well. In times where capital growth is strong, distributions are like to be higher, and the "level of franking" will be proportionately lower. This does not necessarily mean that dividends received were low or that they were not highly franked.

## Portfolio Holdings

The charts below provide a breakdown of the stocks in the Growth Fund as at 30 June 2007. The portfolio is overweight in the energy and materials sectors, and underweight in the financial sector, particularly commercial banks. The level of small cap stocks (outside the ASX 100) is approximately 37.3%.



## TOP FIVE HOLDINGS

Name	Sector
BHP Billiton	Materials
Monadelphous Group	Industrials
Orica	Materials
Rio Tinto	Materials
Woodside Petroleum	Energy

Note: The portfolio is generally comprised of 30 - 60 stocks.

# PRIME VALUE IMPUTATION FUND

The Imputation Fund (PVIF) aims to provide capital growth over the medium to long term, combined with regular, tax-effective income, by managing a portfolio of assets comprised mainly of Australian equities.

For the six months ended 30 June 2007 the fund outperformed the benchmark S&P/ASX Accumulation Index by 1.6%. The fund achieved a return of 14.6% over the six months period compared with the benchmark return of 13.0%. We are very pleased with the performance especially for a more defensive portfolio.

At a sectoral level, the fund benefited from an overweight position in energy and industrials sectors and an underweight position in financials and health-care. Main detractors include an underweight position in materials and the cash holding in a strongly rising mar-

ket. We have maintained our cautious stance throughout the period due to expectations of sustained volatility.

At a stock level, the major contributors to performance included mining service companies Monadelphous, Nomad Building Solutions, Coote Industrial and utility group Alinta. The positions which detracted from performance included Allco Finance Group, Ten Networks and Concept Hire.

Average annual returns for 1, 3, and 5 years are now 31.5% (benchmark 29.2%), 26.0% p.a. (benchmark 26.4% p.a.) and 30.8% p.a. (benchmark 19.3% p.a.) respectively.

## Portfolio Outlook

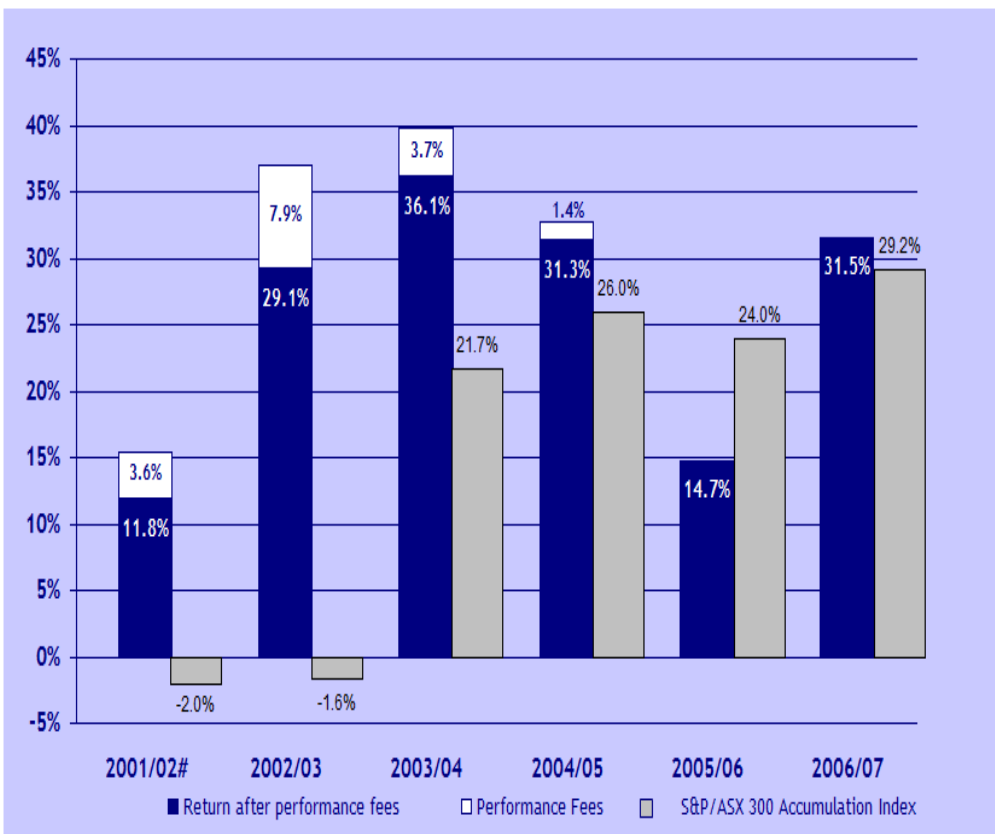
The portfolio will continue to focus on stocks offering a degree of both earnings certainty

and dividend income certainty, with a bias towards a higher stream of tax effective income. The domestic orientated component of the portfolio will favour industrial companies with strong pricing power and competitive strength. We are cautious about stocks exposed to rising costs, margin pressure and the rising A\$.

We will continue to monitor and seek out high quality small cap stocks over coming months, particularly those high-yielding and value industrial companies which have lagged the market with strong business and underlying fundamentals.

## Historical Performance (Class A Units)\*

Annual Return of PVIF and S&P/ASX 300 Accumulation Index by Financial Year. This shows the performance of the PVIF for each discrete financial year and demonstrates the PVIF has consistently delivered superior, positive returns. The Fund outperformed in 4 out of the last 5 financial years.



\*Past performance is not necessarily an indicator of future performance.

# The return for 2001/02 is for the period from 20 Dec 01 to 30 Jun 02

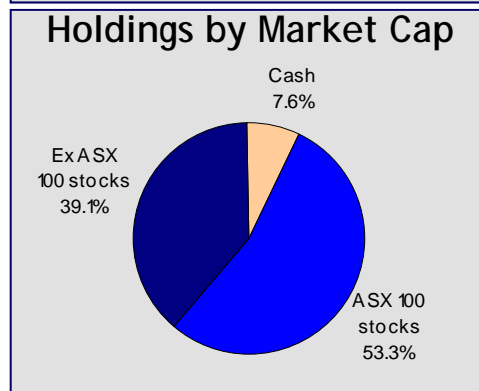
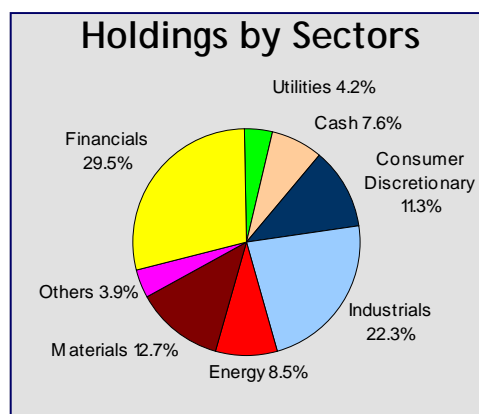
## Distributions (Class A Units)

Distributions	2004/05	2005/06	2006/07
Distribution (per unit)	\$0.1238	\$0.1536	\$0.1849
Distribution (% of Unit Price)	5.1%	5.9%	6.0%
Imputation Credit (per unit)	\$0.0247	\$0.0273	\$0.0427
Franking Level (%)#	46.6%	41.5%	53.9%

# The "level of franking" is a measure of the grossed-up imputation credit relative to the total distribution made. Unlike the franking level of a company's dividend however, the "denominator" includes not just dividends, but realised capital gains as well. In times where capital growth is strong, distributions are like to be higher, and the "level of franking" will be proportionately lower. This does not necessarily mean that dividends received were low or that they were not highly franked.

## Portfolio Holdings

The charts below provide a breakdown of the stocks in the Imputation Fund as at 30 June 2007. The portfolio has a lower weighting in energy and resources stocks, and is overweight in industrial and consumer stocks. The proportion of small cap companies (outside the ASX 100 stocks) is approximately 39.1%.



## TOP FIVE HOLDINGS

Name	Sector
Monadelphous Group	Industrials
National Australia Bank	Financials
Wesfarmers	Industrials
Westfield Group	Financials
Westpac	Financials

Note: The portfolio is generally comprised of 30 - 60 stocks.

Dear Investor,

2006/2007 was another very strong year for Australian equities. We are pleased to announce another strong and positive returns for our Funds.

The Prime Value Growth Fund (PVGf) has achieved a positive return in each of the last 9 financial years and has out-performed its benchmark in 7 out of the past 9 financial years.

The Prime Value Imputation Funds (PVIF) has achieved a positive return in each of the last 5 financial years and has outperformed its benchmark in 4 out of the last 5 financial years.

### Further strengthening of the Team

We are pleased to welcome three additional members to the team over the last twelve months:

Andreas Rosenau (BA MBA) joined us as a Senior Equity Analyst. His primary role is to provide fundamental bottom-up research, financial analysis and modelling of companies. Andreas was the Financial Controller for Wella AG (Asia Pacific Region), and held various senior financial and business positions in Europe and Asia.

Victoria Scholz joined the firm as the Client Services Officer. Victoria is responsible for client service along with operation and general administration matters. Victoria holds a Certificate IV in Financial Services and a Certificate III in Sport and Recreation Administration. Previously she was an administration support officer at AXA and has customer service and administration experience in a variety of industries.

Celeste Tsay (BA MB (Accounting) CPA) joined Prime Value as a Fund Accountant. She is jointly responsible for the accounting and taxation function of Prime Value and the Funds. Prior to joining Prime Value, Celeste worked for Mercer Consulting, Merrill Lynch, ANZ and Computershare.

### "Minimisation of mistakes": what is our track record?

Despite significant out-performance over the medium and longer time periods of 3, 5 and 7 years, reporting on Fund performance on a monthly basis can tend to shift the focus to monthly numbers. We recommend that investments in equity markets, including managed investments such as the Prime Value Funds, be made for the medium to long term and are cautious about this focus on shorter-term results. We decided to have another look at monthly returns in more detail; to see how often the market has produced positive and negative returns on a monthly basis, and how the Prime Value Growth Fund (PVGf) and Prime Value Imputation Fund (PVIF) performs in both positive and negative market conditions. The results of the analysis are below.

#### Prime Value Growth Fund

In the 111 months analysed since the Fund started, PVGf experienced positive returns in 78 months, compared with the S&P/ASX 300 Accumulation Index (benchmark), which experienced positive returns in 74 months. The PVGf outperformed the market in 66 months.

Positive Markets (74 months)		Negative Markets (37 months)	
PVGf outperforms	PVGf underperforms	PVGf outperforms	PVGf underperforms
44	30	22	15

#### Prime Value Imputation Fund

In the 67 months analysed, PVIF experienced positive returns in 54 months, compared to the S&P/ASX 300 Accumulation Index (benchmark), which experienced 49 months of positive returns. The PVIF outperformed the market in 40 out of 67 months.

Positive Markets (49 months)		Negative Markets (18 months)	
PVIF outperforms	PVIF underperforms	PVIF outperforms	PVIF underperforms
26	23	14	4

What can we learn from this analysis? Although past performance is not necessarily an indicator of future performance, the following summary points can be made:

- It would not be unusual to achieve a negative return, 1 in every 3 months on average.
- The PVGf and PVIF outperforms 3 in 5 months on average.

- In negative markets, the PVIF has been less volatile and more likely to outperform.

**Our key investment philosophy is to minimise mistakes; however it is impossible to avoid mistakes entirely. Historically, the funds have outperformed approximately 60% of the time, and has remained so. The key is performance over longer periods and it is important not to focus on the results of a few months only.**

### Investment Outlook

The key positive features of the global economy, especially from an Australian perspective, is that China's industrialisation is a powerful source of demand for commodities and this is unlikely to change for many years.

Globalisation means cheaper manufactured goods supplied world wide. However, the disinflation afforded by the integration of the Chinese economy into the global supply chain appears to be passing. There has been an acceleration in inflation in recent months for consumer items whose manufacture China dominates. Some inflation risks are emerging in developed economies, including Australia.

The IMF has revised its global growth forecast from 4.9% to 5.2% over the next 18 months. China is expected to grow by 11.2% in 2007 and 10.5% in 2008, and the US economy by 2.6% and 2.8 respectively. But they also warned that Central Banks may need to raise interest rates amid signs of accelerating global growth.

Easy credit has not only been the US economy's lifeblood in recent times, but - to a certain extent, also that of financial markets. It fuels take-over of companies in the US, Australia and elsewhere, resulting in massive rises in international share markets and supporting prices of many other assets.

But the situation is changing now. Investors are much more reluctant to lend money to Wall Street at low rates and easy terms. The current sell-off in global markets infused by news related to problems associated with the US mortgages market, should be seen against this backdrop.

The strong performance of the share market over the last four years or so has mainly been driven by two factors: global economic growth and financial engineering. The global growth story is still intact, but "financial engineering" may well become another dirty word and it is reasonable to expect market leadership to narrow to the global growth theme.

A recent study by Citi Smith Barney noted that the Australian Market 12 month forward P/E was 15.5x, not particularly high compared with previous peaks of > 20x, but high compared with recent years. For most of the last three years, earnings growth has been the market driver, not P/E expansion. Ample global liquidity (feeding takeovers) has been helping push P/E higher.

Amid signs that the days of cheap and easy debt for private equity firms and the takeover boom may be coming to an end, the mood of the market has swung from euphoria to extreme caution.

Australian share market investors have been extremely well rewarded during the last few years, with the S&P/ASX 300 Accumulation Index returning an annual compound growth rate of 19.3% for the last 5 years. The per annum performance of Prime Value Growth Fund for the same period was 28.4%, and the Prime Value Imputation Fund recorded a return of 30.8%.

We have been arguing for many years that Australia, with a long term GDP growth rate of 3 - 4% per annum, and an inflation rate of another 3-4%, can most likely support a sustainable share market rise of approximately 8 - 10% p.a. Prime Value has been aiming for a target return of somewhere between 10-15% p.a., but instead managed to deliver close to 30% p.a. for the last 5 years.

We do not believe that the current sell-off is a signal that "the sky is falling", as world economic growth is likely to be supported by the economic renaissance of China and India. However, we would like to remind investors that a 30% rate of return per annum should not be regarded as a norm in Australia. The important objective of achieving high returns on investment should be counter balanced with the equally important objective of preserving capital and maintaining an acceptable risk profile.

Han K Lee  
Managing Director

Y Yong Quek  
Executive Director