

**PREMIUM**  
INVESTORS LIMITED

**SHAREHOLDER NEWSLETTER**  
Strategic Vision - September 2010



# QUALITY HIGH YIELDING LIC'S BACK ON TRACK!

## Summary of Key Points

Today, post the disruption of a Global Financial Crisis and a predatory induced off market buy-back exercise during 2009, we are pleased to report that your company is in excellent shape and providing shareholders with sound returns.

Post the 2009 buy-back, your Board has implemented significant cost cutting and efficiency measures to restore a sound and competitive expense base. The underlying assets of the company are well diversified and are now spread across six successful boutique managers within the Treasury Group's team.

Significant new Top 20 shareholders have emerged on the share register during the past six months providing good support within the market and assisting in reducing the magnitude of the discount of share price to net asset value.

Treasury Group Limited has supported the PRV share price recovery by investing during the past six months. Statements from the company regarding their investment are that they see PRV as a high quality, undervalued long term investment opportunity and are keen to provide ongoing support.

During the past financial year shareholders will have received 8.5c in fully franked dividends which represents a cash yield of 11.9% at current share prices. This level of dividend was a catch-up payment reflecting the inability of being able to pay a dividend in the 2009 year as a consequence of the then draconian accounting standards. Going forward your Board sees PRV as a unique investment with low risk and low asset volatility, high quality and well diversified management which has the potential to provide existing shareholders and new investors a sustainable average 6c to 7.5c fully franked dividend potential throughout a full economic cycle.

Based on this dividend potential, the shares at current prices reflect a prospective full cycle investment yield range of between 7.0% to 10.5%, fully franked which is an attractive return relative to alternative opportunities.

**Your Board's mission is to maintain the company's well established and successful long term investment philosophy whilst continuing to seek further efficiencies in management through both technology and innovation.**

## BACKGROUND

This newsletter has been prepared for PRV shareholders to highlight the positive changes to the company's outlook post the significant off market buy-back imposed upon the company during late 2009. As a consequence of this event the majority of institutional investors departed the share register and 4,000 loyal retail investors chose to remain and support the well established unique diversified, low-risk investment philosophies adopted by the company and the Treasury Group team of boutique managers.

Whilst the share price has continued to trade at a significant discount to the underlying assets during the past six months, your Board has focused on restructuring the company to manage your company's smaller asset base (\$80mil) smarter and more efficiently. These actions were undertaken to ensure that the recurring cost structure on the smaller company were contained and the investment process more flexible to enhance shareholder returns. Our aims were to ensure that the loyal shareholders who stood by the company would be fully rewarded and that the emerging smaller company would be focused on servicing this important quality market niche.

The off-market buy-back could not have been more poorly timed and was executed during the latter stages of the Global Financial Crises after a massive erosion of market value. This was an exercise, in hindsight, of short-term speculative opportunism. The promoters of the proposal aggressively purchased a large number of shares prior to and during negotiations to force the buy-back, and sold at a significant profit when the buy-back was executed.

We are pleased to announce to our shareholders who supported the company during this event and the not insignificant new shareholders, who over the past six months have recognized the unique undervalued status of the share price, that the company has emerged from this set back, in a substantially stronger position than it was prior to the event.

## Summary of Key Points (cont'd)

### WHAT ACTIONS HAVE THE BOARD UNDERTAKEN TO RESTRUCTURE THE COMPANY TO RESTORE ITS MARKET STATUS?

#### 1. Cost Reductions

The Board implemented a process to identify all avenues for cost reduction to ensure that the smaller entity was not burdened with the fixed costs of running what was a much larger portfolio. The legal and associated costs of undertaking the buy-back were \$618,000. Consequently total expenses for the year to 30 June 2010 were \$2.987 million compared with \$2.793 million in the previous year. Such an expense represents 3.5% of underlying assets and is an unacceptable burden on an investment vehicle.

The smaller portfolios have been restructured from five individually managed mandates with in excess of 230 individual securities to administer into six wholesale unitised holdings with the original five managers and one new one providing the same investment philosophy and strategies. The base fee rate of these unitised holdings are the same as the fee levels charged on individual mandates, but the administration cost savings for Premium of holding six holdings in unitized trusts, which are valued daily, as opposed to 230 shares in five individual mandates, is significant. The outcome is greater efficiency and a significantly lower cost structure.

Cost savings are under ongoing review and 2011 expenses are expected to be more than 40% lower than 2010, restoring the company's expense ratio to a more attractive and competitive level

#### 2. Rebuilding the Company's Strategic Vision to pre GFC Credibility

All peer group LIC's were severely affected during the GFC. Premium suffered a double blow with a 60% off market buy-back prior to the 2010 recovery. Whilst the buy-back was unpalatable, the events created substantial realised tax loss benefits and significant franked credit accruals which are now available to the remaining shareholder in the smaller structure. This will enable management to maintain a more attractive dividend policy for years to come, possibly during subdued investment conditions, whilst at the same time participating fully in the ultimate recovery cycle down the track.

PRV is a unique and special investment vehicle relative to all other LIC's.

- It is the only diversified "fund of Funds" vehicle with a strategic asset allocation of 50% global equities/50% domestic equities.
- It is the only LIC which does not have a "single manager" risk.
- It has the contractual management and administration of Australia's most successful boutique aggregator", Treasury Group Limited, with the \$15 billion of assets represented in its funds management operations. Hence PRV shares the efficiencies, compliance and governance of a major institutional investor and the ability to participate in higher performance profiles of smaller and emerging quality boutique managers. No other peer group LIC has a structure with this depth of financial integrity.
- It has by far the lowest risk factor of peer group LIC's through wider diversification and targets a long term full cycle benchmark objective of the 5 year bond rate + 3%pa. Consequently, its asset base is less volatile than pure equity LIC's.
- It is an excellent vehicle for retiree income investors providing a balance of regular fully franked income, discounted dividend reinvestment plans and discounted share purchase plans to reward loyal long term investors.
- It has transparency in investment philosophy and a Board with a mission to ensure that shareholders have an open communication with the company and are fully informed.

#### 3. Restoring a Transparent and Achievable High Dividend Policy.

During the 2009 financial year, PRV, along with every other LIC was unable to pay a dividend due to unrealistic Corporations Law and Australian Accounting Standards which precluded investment companies from distributing their income and reserves as dividends, whilst unrealised losses in the underlying assets were negative.

Consequently, whilst PRV aggregated investment income during the Global Financial Crises (GFC) it was not permitted to distribute this. This draconian rule has now been repealed and in future market reversals there will be scope to pay dividends in difficult times.

## Summary of Key Points (cont'd)

The 2010 financial year marked a return to profitability and PRV paid two interim dividends (1.5c and 3.5c) and a final of 3.5c totalling 8.5c fully franked. PRV's investment benchmark of 5 year bond rate + 3% throughout a full market cycle can support an attractive dividend policy, however, the 8.5c paid in 2010 is not sustainable in the short term as it incorporated a "catch up" payment for investors for dividends foregone during 2009.

Based on the large pool of realised losses and surplus franking credits, given the likelihood of more normal investment conditions emerging in coming years as the market recovers from the worst crash since 1929, a fully franked dividend of 6c to 7.5c pa is possible during the medium term with scope to grow from that level in later years as we enter the next cycle of world growth.

The dividend level will naturally fluctuate from time to time (up and down) when market cycles experience significant

volatility. During the 4 years pre GFC from 30 June 2004 – 2008, PRV distributed 30.5c of fully franked dividends averaging 7.6c per annum. Over the past six years (incorporating GFC) PRV's total fully franked dividends have totaled 39c, representing an average of 6.5c per annum.

What does this mean to the 3900 PRV long term retail investors? It means that based on the current price of 71.5c:

- The stock is providing a yield of 11.9% fully franked on the 8.5c distribution paid during the past financial year.
- Based on the past six years average dividend payment (6.5c pa including GFC impact) the stock price reflects a yield of 9.1% fully franked
- Based on normalized conditions for the four years pre GFC, the average 7.6c distribution would equate to a yield of 10.6 % fully franked.

### PRV DIVIDEND YIELD PROFILE

<b>Current Price: 71.5 cents</b>	<b>Dividend per share cents</b>	<b>Fully Franked Yield % @ Current Price</b>	<b>Pre-tax yield % equivalent on non franked investment (assume 30% tax rate)</b>
Historical average: 6 yrs to 30/6/10	6.5	9.1	13.0
Pre GFC average: 4 years to 30/6/08	7.6	10.6	15.1
Financial year to 30/6/10	8.5	11.9	17.0
Expected Medium Term Projection	6.0 - 7.5	8.4 - 10.5	12.0 - 15.0

## What about the share price discount to assets problem. Why hasn't there been a more aggressive buy-back by the Board?

There is a perception amongst some shareholders and broker commentators, that an aggressive on market buy-back will bridge the discount gap by absorbing selling pressure on the stock by and underpinning the market price. Some commentators are using this argument to suggest that LIC Boards are not pro-active in capital management and the market discount to asset value is the Board's fault for not "propping" or intentionally seeking to manipulate the market up when there is no sustained buying support.

The share price discount of newer contemporary LIC issues has been a structural issue since their inception. It is a difficult phenomenon to explain, other than it is consistent in varying degrees amongst all LIC's issued in the past seven years. Many of these affected LIC's have been very well managed, achieved and exceeded targeted investment objectives and communicated well with their shareholders.

The fact is that, despite numerous market buy-back activities undertaken by several LIC's over time, none have ever achieved any meaningful permanent elimination of the discount factor. Some have had the affect of temporarily manipulating the share price up modestly to narrow the discount, only to see the discount revert to former or worse levels, once the buy-back exercise is over.

The only exceptions appear to be where the intention is to ultimately destroy the company's long term investment philosophy by aggressively buying back the majority of shares, and the last shareholders standing, and the Board have control of a cashed up shell company.

The concept of an on-market buy-back as a capital management tool was designed for high cash flow and cash rich companies with limited market growth, to enhance their earnings per share base by reducing the number of shares on issue and eliminating a lower return asset (cash). This is a rational and transparent activity for cash rich industrial companies. However, the concept promoted by some broker or advisory groups to aggressively apply on market buy-backs to LIC investment vehicles which are not cash rich, and are fully invested in long term assets in accord with their declared mandates, is a futile and potentially destructive exercise particularly when undertaken in depressed markets.

This activity is not "smart" capital management. It forces the manager to sell depressed assets in weak markets and buy their own undervalued shares in the expectation that the fund will achieve a "positive value arbitrage" which will have a very modest impact on the company's Net Asset Value.

The arithmetic simply does not stack-up as being a strategic long term dynamic exercise. If you buy 5% of the company's shares back at a 20% discount you will hypothetically add 1% to the underlying asset value of the Balance Sheet. After selling quality long term investments to buy your own stock you have incurred double brokerage costs on the sell/buy exercise and increased the company's fixed cost expense ratio by 5% as well as in the current climate, created realized losses in your accounts. It can hardly be deemed dynamic capital management for a specialist LIC company to be involved in a disassociated strategy of short term buy-back activity exercises in an endeavour to manipulate the share price.

Most LIC's have a transparent mandate and a mission from their shareholders to run a business focused on achieving long term investment goals in a specific specialist asset class, or in PRV's case, a quality well diversified global and domestic fund of funds investment philosophy.

There is a perception by many well intentioned, but uninformed commentators, that the on market buy-back is a means of increasing the share price to reduce the discount to Net Asset Value. i.e it is overtly portrayed as a mechanism that management can use to manipulate the share price higher when there is insufficient demand or will on the market to do so. However, the reality is that such activity is illegal. In addition the ASX has rules in relation to the conduct of share market buy-backs which inhibit a manager undertaking a buy-back to lead the market price. There is also another ASX guideline which restricts the buy-back activity to one third of the markets turnover.

Thus to undertake a 5% buy-back the stock would have to turnover 15% which is one of the reasons that LIC buy-back activity cannot be sustained in large quantities, unless the aim of the exercise is to ultimately reduce the size of the company to a position where it is no longer a viable entity. In that case the predators can pick on the carcass until there is nothing left. They make short term gains and the long term shareholders lose their high yielding, tax effective investment company.

Ultimately, it is our view that the structural LIC discount problem will dissipate as long term market fundamentals dictate. A stock which is actively traded with quality and sustainable management in the current economic climate, will ultimately be recognised. Based on the past six years average distribution, PRV at its current price is providing shareholders with a fully franked yield of 9.1% and on medium expectations, a range of 8.4% to 10.5% yield. This makes PRV's shares on basic investment fundamentals, a very attractive investment. As these expectations are achieved it is not unreasonable to expect that the discount will ultimately dissipate.

Using an excerpt from correspondence received from one of PRV's supportive top 20 shareholders he reminded us of the words of Warren Buffet in his Chairman's letter in 1987 ( the previous major financial crisis). Buffet stated:

*"The speed at which a company's success is recognized is not that important, as long as its intrinsic value is increasing at a satisfactory rate. In fact, delayed recognition can be an advantage: it may give (active investors) the chance to buy more of a good thing at a bargain price."*

## What about the possibility of another predatory off market buy-back closing down the Company?

This is always a risk in an open market. At the end of the day it is the shareholders who decide the outcome and it is the Board's responsibility to be cognisant of the shareholder wishes. During the past year PRV was subject to a predatory action which resulted in 60% of shares being bought back. The principals and many staff of promoters of this exercise commenced buying once they announced their intention and continued to buy heavily during the period of negotiations with PRV. None of these people held shares in PRV previously and all sold into the buy-back realising significant short term profits.

There apparently is nothing illegal about this activity and it could happen again at any time if shareholders allow it. At the end of the day it is the majority shareholder vote

which enables such short term exercises to succeed. It was successful last year because around one third of the shareholders were institutional investors and a very large number of smaller non-institutional shareholders were tied to financial advisory networks. It provided the opportunity in the back-end of the GFC to achieve a short term value added outcome which otherwise would not have been available.

Approximately 37% of shareholder sold their shares in the buy-back offer leaving around 3,900 shareholders (or 63%) of total shareholders committed to the long term investment goals of PRV.

With the removal of the institutional block of shareholders, the post buy-back share register has no significant or dominant block of shareholders. The largest remaining shareholder group held 2.5% of capital and the top 20 collectively 12%. During the past six months the stock has experienced robust buying support with five new "top 20" shareholders appearing on the share register. Collectively these new shareholder have acquired around 7 million shares or 7.8% of capital. The largest new shareholder is Treasury Group Limited with 2.8%. The support of these new shareholders, together with the support of some now 3,900 loyal shareholders, who have already demonstrated faith in PRV's future, provides us with confidence that the vast majority of our shareholders support the PRV's vision to provide shareholders with a unique, a well diversified and secure attractive investment.

### CHANGE ON SHAREHOLDER SPREAD PRE BUYBACK (30 JUNE 2009) AND AUGUST 2010

Premium Investors	Pre Buy-back Aug 2009	Post buy-back June 2010	% Change
Number of shares on issue 000's	224,346	89,770	(60)
Number of Shareholders	6,617	3,953	(40)
Top 20 holdings shares held 000's	72,105	15,272	(79)
% of total equity	32	17	(47)

It is possible that some new shareholders may have acquired shares to seek to initiate predatory activities for short term gain. We have no way of knowing this and can only address such matters if they arise.

Your Board's focus is on ensuring that the vast majority of current holders get what they sought when they initially invested and reinforced that investment by remaining committed to the long term vision of achieving the benefits of a well diversified, unique and well managed Domestic/global investment LIC product.

It is only your individual support and resolve which can prevent predatory action. You are the shareholder and you have the voice and the vote. Should predatory action emerge it cannot succeed if sufficient loyal long TERM shareholders vote against it.

Such predatory activity usually commences with a letter to shareholders questioning the Board's integrity and seeking to undermine confidence in the Company. The letter usually will contain unsubstantiated allegations of mismanagement by allowing a share price discount to prevail and inability to manage costs in a difficult time, conflicts of interests within the Board, Treasury Group ripping off unrealistic fees etc. to support a case for a resolution to remove the Board and take control of the company. The ultimate goal usually is to close the business down and to realize a significant short term

profit at the expense of the aspiration of committed loyal long term investors.

We have a great company and look forward to ensuring that you can view it as a "jewel" in your portfolio. But the future in predatory actions is in your hands and your vote.

## What would I get back if the company was wound up?

From time to time shareholders and financial commentators will comment on the share price discount and proffer the question: "Why don't you just wind the company up and return the net assets to shareholders?" The answer is simple:

1. The company is a quality viable investment entity providing long term growth and significant fully franked income to its shareholders. It has no debt and very significant realised tax losses to support a strong growth and income profile during recovering markets. The share probably is the highest yielding asset in most shareholders' portfolios and has the ability to continue to be the jewel in their portfolio in coming years.
2. In a wind-up you would immediately destroy around 10% of the shares underlying value. Using the latest Net Tangible Asset data the position is as follows:

### PRV ESTIMATED WIND-UP VALUE 31 AUGUST 2010

Net Asset Value per Share after tax on realized losses	90.3 cents
Value of realised tax losses foregone on wind-up	6.1 cents
Gross wind-up value pre costs	84.2 cents
Less admin, legal and liquidation costs Est.	3.1cents
Estimated net value on wind-up	81.1 cents
Share Price 10 September 2010	71.5 cents

It can be seen from this data the share price discount to the wind-up value is 11.8% and, if a wind up was implemented, shareholders would effectively be selling an asset which is yielding 10% fully franked and has the ability to sustain that yield during the medium term and further enhance it in the longer term.

The question you would need to ask in such a situation is "where would you be able to reinvest these funds to replace a sustainable 10% fully franked yield in a quality low risk, tax effective security?"