

# Annual Report

SEPTEMBER

# 2007



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Chief Executive's Review
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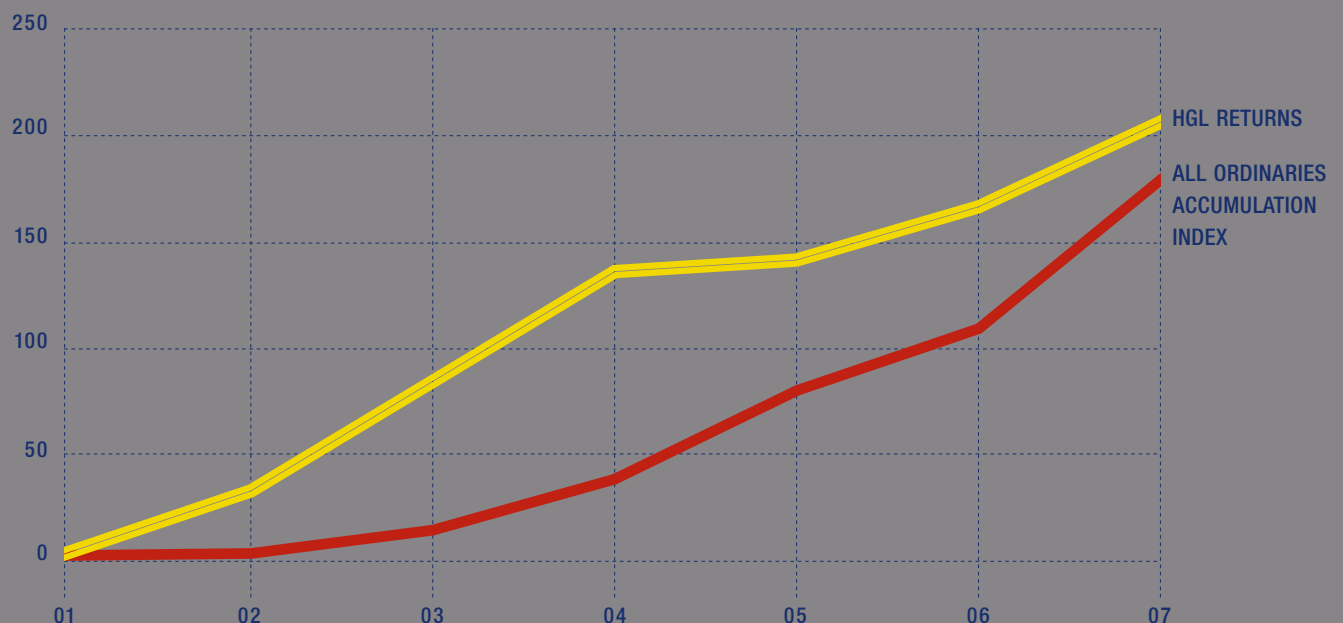
## HGL INVESTS IN AND DEVELOPS THE POTENTIAL OF SMALL AND MEDIUM SIZED BUSINESSES.

HISTORICALLY HGL ACQUIRED BUSINESSES THROUGH LISTED COMPANY TAKEOVERS AND PRIVATE COMPANY ACQUISITIONS. THIS HAS LED HGL TO FOCUS ON IMPORTERS AND DISTRIBUTORS OF BRANDED GOODS, FUND MANAGEMENT COMPANIES AND A SMALL LISTED SHARE PORTFOLIO.

GENERALLY HGL ENTERS INTO **PARTNERSHIPS** WITH THE PEOPLE WHO RUN THE BUSINESSES IN WHICH IT INVESTS. THROUGH THIS APPROACH THE PEOPLE RUNNING EACH BUSINESS HAVE A SUBSTANTIAL INCENTIVE TO ENSURE THEIR BUSINESS PROSPERS. THIS EQUITY PARTICIPATION PHILOSOPHY IS MIRRORED AT HGL WITH JUST UNDER 10% OF THE CAPITAL BEING HELD BY HEAD OFFICE MANAGEMENT.

## HGL INVESTS FOR THE LONG TERM AND DOES NOT PLAN TO SELL BUSINESSES.

HGL CONTRIBUTES WIDER BUSINESS EXPERIENCE AND ASSISTS THE PEOPLE RUNNING EACH BUSINESS TO MANAGE GROWTH AND RISK AND PLAN FOR MANAGEMENT SUCCESSION. THIS APPROACH PROVIDES LONG TERM SECURITY FOR SHAREHOLDERS, CUSTOMERS, SUPPLIERS AND STAFF. **HGL IS WELL PLACED** TO CONTINUE DEVELOPING ITS BUSINESSES AND PURSUING FURTHER ACQUISITIONS.



# REVIEW

**EARNINGS PER SHARE INCREASED BY 71% TO 32.4 CENTS (2006: 18.9 CENTS), CORE EARNINGS PER SHARE INCREASED BY 24% TO 19.2 CENTS (2006: 15.5 CENTS). DIVIDENDS PER SHARE INCREASED 24% TO 14.4 CENTS (2006: 11.6 CENTS). THE FINAL DIVIDEND WILL BE INCREASED BY 32% TO 8.2 CENTS PER SHARE (2006: 6.2 CENTS).**

## Overview

It is pleasing to report on another successful year for HGL. Profit after tax was \$15.6 million (2006: \$9.1 million) while core profit increased by 24% to \$9.3 million (2006: \$7.5 million). A significant non core item is the profit after tax of \$6.7 million from the sale of our 37% equity interest in MMC Asset Management Limited and the cancellation of our management agreement with MMC Contrarian Limited (ASX code: MMA). The results are described in more detail on page 7.

## Import and distribution businesses

The earnings before interest and tax (EBIT) from our import and distribution businesses increased by 15% to \$14.9 million (2006: \$13.0 million), excluding the \$0.7 million contribution of Biante which was acquired in April 2007.

We are continuing to search for additional businesses to acquire. Our acquisition criteria are set out on page 9.

## Return on capital

The total return on shareholders funds excluding the \$6.7 million profit from the disposal of MMC was 25% (2006: 21%). Including the \$6.7 million profit the return on shareholders' funds was 34%.

## Listed shares

From 1 October 2003 when the Company adopted its current strategy, realised and unrealised profits on our listed shares have averaged 11.6 cents per share per annum. This return is in addition to our core earnings which this year were 19.2 cents.

This year realised after tax gains from our listed shares were \$2.6 million (2006: \$1.1 million) this is included within non core profits. Our listed shares also increased in value by \$8.1 million after tax (2006: \$4.6 million). As required by Australian Accounting Standards, this unrealised profit is recognised directly into reserves and not included within profit after tax.

## People, health and safety

At 30 September 2007 the group employed 455 people (2006: 477). Our businesses mainly operate in low risk workplace environments however management of each business is aware of their occupational health and safety obligations and strive to ensure each workplace remains safe.

Both the impressive results and the positive outlook for the future arise from the efforts of our employees and joint venture partners. The board thanks them for their continuing effort and contribution.

## PROFITS AND GAINS

	2007 \$millions	2006 \$millions
Core profit	9.3	7.5
Non core profit	6.3	1.6
Profit after tax	15.6	9.1
Unrealised gains	8.1	4.6
Profits and gains	23.7	13.7

	cents per share	cents per share
Core profit	19.2	15.5
Non core profit	13.2	3.4
Profit after tax	32.4	18.9
Unrealised gains	16.8	9.6
Profits and gains	49.2	28.5

## DIVIDENDS

	cents per share	cents per share
Interim	6.2	5.4
Final	8.2	6.2
Total	14.4	11.6

\$68m

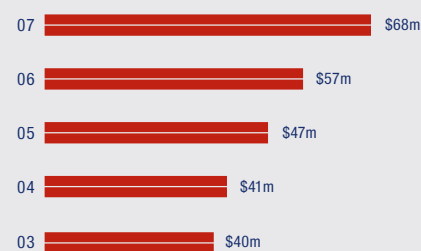
› invested in 12 import and distribution businesses

› EBIT to capital employed return of in 2007 25%

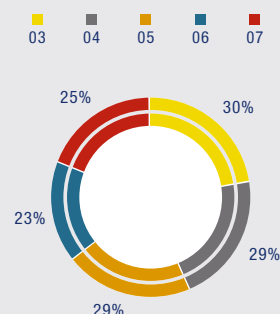
### Import and distribution businesses

The earnings before interest and tax (EBIT) of the businesses owned throughout both the current and prior year increased by 15%.

Our businesses are described on page 62.



At 30 September 2007 \$68 million (2006: \$57 million) was invested in 12 (2006: 11) import and distribution businesses. The return from the import and distribution businesses exceeds the target return of 20% as illustrated.



### Fund management interests

Our investment in fund management is \$57 million (2006: \$19 million), the increase is due to the acquisition of MMC Contrarian (ASX code: MMA) shares and the 68% increase in the value of Hunter Hall (ASX code: HHL).

### MMC Contrarian

As previously described, during the year we sold our 37% equity interest in MMC Asset Management and cancelled our management agreement with MMC Contrarian in return for \$15.3 million of equity in MMC Contrarian.

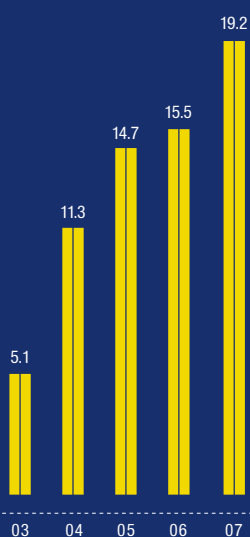
The benefit of this rearrangement is the investment is now largely supported by cash and assets that can be easily turned into cash rather than being mainly goodwill. An additional \$19 million has been invested to increase our shareholding to 13%.

### Hunter Hall

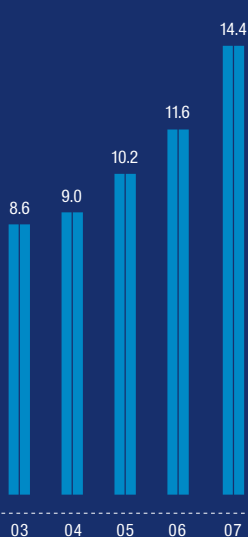
We own 6% of Hunter Hall with a market value of \$23 million (2006: \$14 million). Hunter Hall was established in 1993 by HGL and Peter Hall, and listed on the ASX in 2001.

During the year its funds under management increased by 54% to \$2.7 billion (2006: \$1.7 billion) and its earnings per share increased by 44%. Hunter Hall is cementing its position as a leading Australian domiciled global equities manager. Hunter Hall anticipate that 2008 should see solid growth.

CORE EARNINGS PER SHARE



DIVIDENDS PER SHARE



› Core earnings per share increased by 24% to 19.2 cents

› Dividends per share increased by 24% to 14.4 cents

### Dividends

The final dividend will be increased by 32% to 8.2 cents fully franked per share (2006: 6.2 cents fully franked) and will be paid on 18 December 2007. The total dividend for the year is 14.4 cents per share (2006: 11.6 cents fully franked) an increase of 24%. The full year dividend represents a dividend payout ratio of 75% (2006: 75%) of core profits. The Board policy is to distribute between 70% and 80% of core profits as dividends.

### Shareholder return

Dividend income grossed up for franking credits combined with share price growth for the year was 18%. The All Ordinaries Accumulation Index (AOAI) increased by 33% in the year. Since 2001 our total shareholder return being dividend income and share price growth, has been 20% compared to the AOAI which increased by 19% over the same period.

### Listed shares

We manage our listed share investments with the aim of exceeding a 15% per annum return over the medium term.

This year our listed shares produced a return of 45%. Over the last three years our listed shares have generated a 19% per annum return.

### HGL Strategy

HGL typically invests in both import and distribution businesses and fund management activities in conjunction with the people who run these businesses. For twenty years we have invested on the Australian Stock Exchange and acquired import and distribution businesses through takeover offers and by acquiring privately owned businesses.

HGL shareholders access a diversified portfolio of investments in small and medium sized unlisted businesses and a select number of listed companies identified by an experienced head office team. This diversified mix of investments mitigates the risk that we have in a single industry sector and underpins the robustness of our earnings.

### Significant developments during the year

**In October 2006** the Chief Executive of J Leutenegger became a 20% owner of the business. This is consistent with our strategy of enabling the senior management of the businesses we own to have an equity stake in the business they manage. While the nature of the equity participation varies from business to business they are all structured to provide management with the financial incentive to grow their business while managing the risks.

**In February 2007** we disposed of our 37% equity interest in MMC Asset Management and cancelled our management agreement with MMC Contrarian Limited in return for \$15.3 million of equity in MMC Contrarian. In addition, a further \$19 million has been invested in MMC Contrarian. Currently HGL owns 13% of MMC Contrarian and is one of the largest shareholders. Kevin Eley, our Chief Executive Officer, has recently accepted the position as the Chairman of MMC Contrarian.

**In April 2007** J Leutenegger acquired 100% of Biante, Australia's leading importer and distributor of collector model cars for \$8 million. During our initial period of ownership Biante has performed well and we expect significant growth from this business in 2008.

**In July 2007** we increased our equity stake in Amcla from 80% to 92% and strengthened the management team by the introduction of additional executives experienced in improving businesses. Management believe these changes will lead to the improved performance of the business. This business, which we acquired in April 2005 for \$5 million, has not performed as we would have wished and a \$2 million goodwill impairment expense was recognised this year.

### Other developments:

- The value of our 6% investment in Hunter Hall increased by 68% to \$23 million (2006: \$14 million).
- JSB which was acquired during 2006 and distributes specialist lighting equipment, increased its profitability by 53%. A long term incentive and retention plan has been implemented for JSB's senior management team which we believe will assist in ensuring JSB continues to prosper.
- Aarque Graphics New Zealand's leading digital print business increased its profits by 47% and we expect additional growth in 2008 as new products become available.
- SPOS which was acquired during 2004 and is Australia's leading point-of-purchase solutions business increased its profitability by 53%. 2008 is forecast to be another excellent year due in part to the focus of the company on providing sustainable and environmentally sound solutions to its customers.
- Amcla reported a loss of \$0.4 million due largely to restructuring costs.
- In aggregate the profitability of our other businesses was at the same level as the previous year. These businesses generated an excellent EBIT to capital employed return of 25%.

### Foreign exchange

To varying degrees our businesses have benefited from the strength of the Australian dollar. However, as the competitors to our businesses have received the same benefit market forces tend to result in the majority of these foreign exchange gains being passed onto consumers or retained by suppliers. Likewise when the Australian dollar weakens market forces trend to allow price increases to occur.

### Funding and balance sheet

The balance sheet remains strong with a conservative level of debt.

- › Total assets have increased by 46% to \$188 million (2006: \$129 million);
- › Shareholders funds have increased by 26% to \$93 million (2006: \$74 million); and
- › Net debt has increased to \$27 million (2006: \$1 million) with gearing at 20%.

The increase in total assets is mainly due to the purchase of Biante and MMC Contrarian together with the increase in value of Hunter Hall. The increase in net debt is mainly due to the purchase of MMC Contrarian shares and the acquisition of Biante.

### Outlook

Our strategy combined with the successful year just ended gives the board and management confidence that the company will continue to deliver results that will reward shareholders over the long term. Next year, with stable economic conditions, the Board anticipates a further increase in both core profitability and dividends.

### Goals for 2008

Our goals for next year include:

- increasing core earnings and dividends per share;
- ensuring borrowings remain conservative;
- developing our fund management interests;
- increasing the amount invested in businesses whilst ensuring the return exceeds 20%; and
- generating a return in excess of 15% from our listed securities.



**Peter Miller**  
Chairman



**Kevin Eley**  
Director and Chief Executive Officer

27 November 2007

HGL invests in businesses with most of the following characteristics:

- › Expected maintainable returns in excess of 20% calculated by reference to earnings before interest and tax (EBIT) to capital employed;
- › A track record of robust past profitability with either growth or growth potential;
- › A capable management team that can grow the business;
- › Equity participation of management team to bind key employees to the business and to encourage decision making that properly reflects risk and return; and
- › Diversification across suppliers and/or customers.

HGL invests in businesses for the long term. We do not buy a business with an intent to sell.

### Equity partnership

Our way of doing business is to enter into equity partnerships with the people who run the businesses in which we invest. This is achieved through either bringing in an equity partner on acquisition or structuring an arrangement with the current owners that enables us to gradually invite management to become part owners over time. Through this approach the people running each business have a substantial incentive to ensure the business prospers.

Generally we find management with equity or quasi equity assists in enhancing returns and in creating structures that will also build value over the medium to long term through properly managing opportunities and risk.

### Business approach

HGL develops the potential of Australian businesses. We build businesses for the long term benefit of our shareholders, customers, suppliers, staff and joint venture partners. With our long term investment strategy we do not anticipate to sell businesses. The management team of each business, led by its chief executive, are specialists in their market while HGL contributes wider business experience and a detachment from the day to day operation of the business.

HGL provides the majority of the finance to our businesses and ensures there are proper financial and business processes in place. We support each chief executive in ensuring the business is run in a manner that should lead to increased long term value. We act as a sounding board for the chief executive of each business and our involvement is formally through monthly board meetings and informally on a more frequent basis.

Our businesses recognise the importance of building the value of the brands they import. This is achieved through developing a rapport with customers that inspires them to trust and rely on our products, brands and first class service. All the HGL businesses aim to provide both their customers and suppliers with trouble free and profitable transactions. We support this process through encouraging appropriate training, advertising, marketing and promotions.

HGL builds the Australian sales of brands and tends to enter into medium to long term distribution agreements with suppliers which give the supplier comfort that we are prepared to make a long term commitment to their brand.

› \$68m  
invested in twelve  
import and distribution  
businesses

› 20%  
Total Shareholder  
Return since 2001

## SUMMARY OF RESULTS

YEAR ENDED 30 SEPTEMBER 2007

	NOTE	Earnings 2007 \$'000	Capital employed 2007 \$'000	Earnings 2006 \$'000	Capital Employed 2006 \$'000
Import and distribution businesses	1	15,563	67,838	12,956	57,437
Fund management businesses	2	4,236	57,272	3,291	19,191
Central items	3	(2,412)	875	(1,589)	(772)
Borrowings		(1,414)	(27,486)	(386)	(1,240)
Profit before tax		15,973	98,499	14,272	74,616
Tax	4	(4,002)	(8,640)	(4,365)	(2,893)
Partners' equity interests		(2,662)	(13,363)	(2,469)	(13,106)
<b>Core profit</b>		<b>9,309</b>	<b>76,496</b>	7,438	58,617
Non core profit	5	6,344	16,217	1,613	15,542
<b>Profit after tax</b>		<b>15,653</b>	<b>92,713</b>	9,051	74,159
Revaluation gains recognised in equity	6	8,134		4,696	
Other equity movements		94		(89)	
Profits and gains after tax		23,881	92,713	13,658	74,159
Core earnings per share (cents)	7	19.2		15.5	
Dividend per share (cents) - fully franked		14.4		11.6	
Reported earnings per share (cents)	7	32.4		18.9	
Profits and gains per share (cents)	7	49.2		28.5	

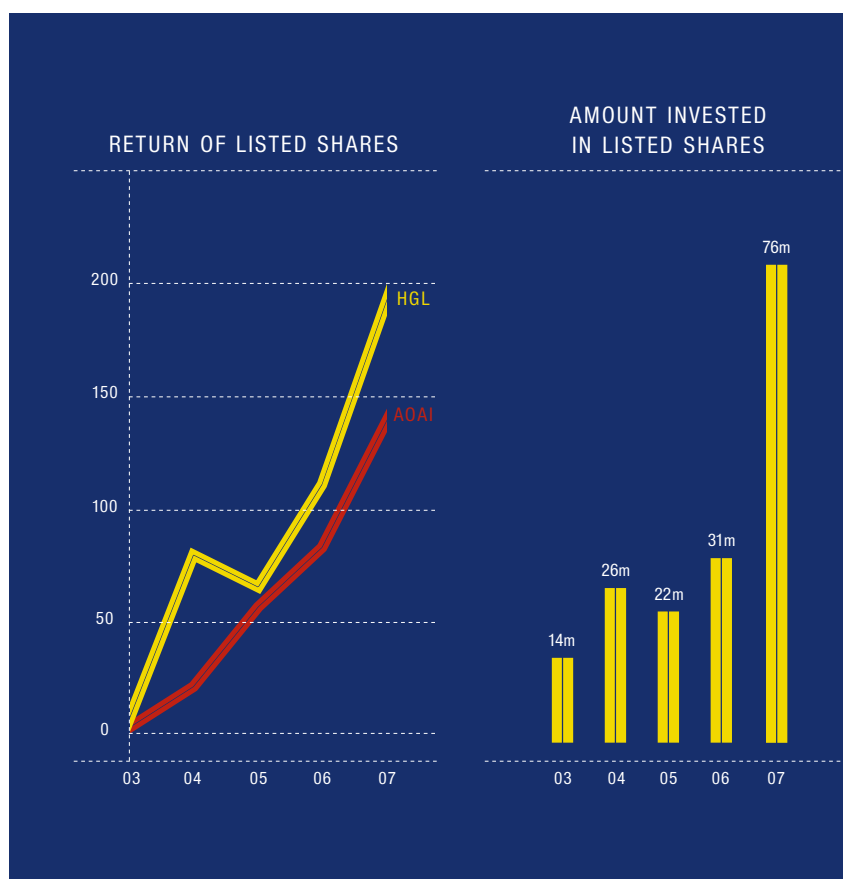
1. Biante was acquired in April 2007 and contributed an EBIT of \$0.7 million and has capital employed of \$8.3 million.
2. In February 2007 MMC Asset Management was sold and the management contract with MMC Contrarian was cancelled in return for \$15.3 million of equity in MMC Contrarian. Earnings comprise our share of the pre tax profit of MMC Asset Management of \$0.7 million (2006: \$1.6 million) and the management fee income from MMC Contrarian of \$0.3 million (2006: \$0.9 million) together with fully franked dividend income from Hunter Hall of \$1.0 million (2006: \$0.7 million) and MMC Contrarian of \$2.2 million (2006: \$nil). Capital employed comprises the market value of the investments in Hunter Hall and MMC Contrarian, the comparative figure also includes the value of the investment in MMC Asset Management.
3. These costs mainly comprise head office expenses and salaries. The main constituents of capital employed are property of \$4.9 million (2006: \$4.6 million), deferred consideration of \$4.1 million (2006: \$5.3 million) for JSB, employee share scheme loans of \$1.7 million (2006: \$1.5 million) and the SPOS equity liability of \$1.6 million (2006: \$1.2 million).
4. The tax liability of \$8.6 million (2006: \$2.9 million) includes deferred tax on the unrealised revaluation surplus from Hunter Hall and MMC Contrarian of \$6.8 million (2006: \$4.0 million).
5. Non core items are:
  - \$6.7 million profit on the disposal of MMC Asset Management and the cancellation of the management contract (2006: \$nil)
  - \$2.6 million profit on the sale of listed securities (2006: \$1.1 million)
  - \$2.0 million goodwill impairment expense
  - \$0.4 million option expense on the grant of an equity settled option in J Leutenegger Pty Limited (2006: \$nil)
  - \$0.4 million expense to increase the value of the equity liability of SPOS (2006: decrease \$0.6 million)

Capital employed is the market value of our listed securities, excluding Hunter Hall and MMC Contrarian being \$19.2 million (2006: \$17.1 million) less deferred tax on the unrealised revaluation surplus of \$3.0 million (2006: \$1.6 million).
6. After tax revaluation gains mainly comprise Hunter Hall \$6.6 million (2006: \$3.4 million), Calliden \$1.7 million (2006: \$0.1 million) and Credit Corp \$0.7 million (2006: \$0.7 million).
7. The weighted average number of shares on issue is 48,366,000 (2006: 47,866,000).

## SUMMARY OF LISTED SHARES

**OUR INVESTMENT IN LISTED SHARES HAS INCREASED BY \$45 MILLION DURING THE YEAR DUE MAINLY TO THE \$34 MILLION INVESTMENT IN MMC CONTRARIAN SHARES AND THE \$9 MILLION INCREASE IN THE VALUE OF HUNTER HALL.**

1. MMC Contrarian (ASX code: MMA). HGL owns 13% of MMC Contrarian a boutique fund manager with \$570 million of funds under management. Market value of MMC Contrarian \$1.04 a share at 30 September 2007. \$15.3 million of equity issued in consideration for the sale of MMC Asset Management and the cancellation of the management agreement with MMC Contrarian and \$19 million acquired on market.
2. Hunter Hall (ASX code: HHL). HGL owns 6% of Hunter Hall a boutique fund manager with \$2.7 billion of funds under management. Market value of Hunter Hall \$15.90 a share at 30 September 2007 and \$9.45 a share at 30 September 2006.
3. Calliden Group (ASX code: CIX). HGL owns 7% of Calliden Group a general insurer. Market value of Calliden \$0.58 at 30 September 2007 and \$0.40 a share at 30 September 2006.
4. Credit Corp (ASX code: CCP). Market price of Credit Corp \$10.98 a share at 30 September 2007 and \$8.10 a share at 30 September 2006.
5. During the year the units in the MMC Small Companies Fund were sold and a pre tax profit of \$1.9 million was realised.
6. During the period \$7.4 million of shares were acquired and \$6.6 million were sold realising a pre tax profit of \$1.8 million.
7. The total increase in value of the portfolio was \$15.3 million before tax, \$3.7 million of profit was realised and recognised in the income statement, the balance of \$11.6 million is unrealised profit and is recognised directly into reserves after deducting deferred tax at 30%. At 30 September 2007 total unrealised gains are \$32.8 million (2006: \$21.2 million) and the deferred tax provided in respect of this future taxable gain is \$9.8 million (2006: \$6.4 million).



	Note	Market value Sept-07 \$'000	Acquisitions/ (disposals) \$'000	Increase in value \$'000	Market value Sept-06 \$'000
MMC Contrarian	1	34,183	34,188	(20)	15
Hunter Hall	2	23,089	-	9,367	13,722
Fund management interests		57,272	34,188	9,347	13,737
Calliden Group	3	9,080	324	2,751	6,005
Credit Corp	4	3,749	-	984	2,765
MMC Small Companies Fund	5	-	(4,977)	259	4,718
Others	6	6,012	402	1,996	3,614
		18,841	(4,251)	5,990	17,102
<b>Total</b>	7	<b>76,113</b>	<b>29,937</b>	<b>15,337</b>	<b>30,839</b>

### › **Pre-tax profit of \$2.0 million to \$10.0 million**

HGL is seeking established businesses with a track record of profitability. Businesses with less than \$2.0 million of pre tax profit are of interest where the business can be integrated into one of our existing operations. HGL does not invest in start-ups. HGL targets a return on capital employed of 20%.

### › **Business type**

HGL's existing equity partnerships include:

- importers and distributors of branded products; and
- light manufacturers.

HGL is most attracted to businesses that are not overly capital or labour intensive.

### › **Fees**

HGL will pay an appropriate fee where a successful transaction occurs.

## WHAT MAKES HGL AN IDEAL PARTNER

### › **Experience**

Over 15 years experience working with our partners to solve business problems and improve financial performance.

### › **Ownership by management**

HGL creates structures in each of its businesses enabling management to share in the value they help create.

### › **Long term focus**

HGL invests for the long term, this provides stability and confidence for staff, customers and suppliers.

### › **Profitable**

Strong profit history which mirrors the success of our equity partners.

### › **Capital**

Listed on the ASX with a significant and supportive shareholder base, strong balance sheet and long standing banking relationships.

Do you know of a business that meets HGL's acquisition criteria and may represent an investment opportunity?

If you do we would appreciate discussing it with you.

Please contact **Kevin Eley** or **Michael Mahoney** on (02) 9221 7155 or [kevineley@hgl.com.au](mailto:kevineley@hgl.com.au) or [michaelmahoney@hgl.com.au](mailto:michaelmahoney@hgl.com.au)

HGL will pay an appropriate fee where a successful transaction occurs.

In April 2007 we acquired Biante following an indirect introduction from an HGL shareholder. As a result of the acquisition an introductory fee of \$80,000 was paid to this shareholder.