<u>Samuel Terry Absolute Return Fund</u> – June 2008 monthly report

The Fund's performance, compared to that of Australian All Ordinaries Accumulation Index and the MSCI World Equities Index, follows:

To 30 June 2008	STAR	All Ords	MSCI ($A)
1 month	-9.27%	-7.32%	-8.24%
3 months	-5.58%	-0.63%	-6.32%
1 year	-20.94%	-12.12%	-20.86%
2 years	-4.84%	7.00%	-7.54%
Since inception on 1 November 2003 (%p.a.)	5.08%	16.44%	3.67%

"Buy when there's blood in the streets, even when it's your own." (Baron Rothschild)

<u>The Fund had its worst ever month.</u> There was no single cause of this result, but several of our smaller and more illiquid shares had large falls, often for no obvious reason. Large falls were common across small-cap Australian shares, mainly (according to brokers) because of tax loss selling, and some selling from funds needing cash to fund redemptions.

Some of the larger falls to hit the Fund included shale oil hopeful **Esperance Minerals** (1.2% of the Fund) down 56%, medical supplier **ITL** (3.5% of the Fund), down 26%, timber plantation owner **RuralAus Investments** (21% of the Fund) down 5%, fund manager **Hunter Hall** (5.7% of the Fund) down 16% and Japanese property fund manager **J-Rep** (2.7% of the Fund) down 33%.

Fundamentally, there appeared to be no obvious explanation for any of these falls, and the Fund bought more shares of several of these companies.

My penchant for obscure value stocks, and the Fund's lack of exposure to the large cap resources sector have caused the Fund to woefully underperform.

Despite (well actually, partly because of) the terrible performance of many of our shares, I am feeling very positive about the Fund and its holdings. Bear markets are the kind of environment in which I have tended to do well in past cycles. To illustrate why I feel so positive, I have decided to update you on our largest holdings and why we own them:

RuralAus Investments is an Australian timber plantation owner (21% of the Fund). RuralAus owns 8,000 hectares of land and has almost no debt. The shares trade at about half of net asset value and the company has stated that it intends to slowly sell its assets and distribute the proceeds to shareholders. I am a director of the company, and the Fund is the largest shareholder. As I have stated publicly, I will try to ensure that maximum value is returned to shareholders via this process.

Timbercorp is a large Australian owner/manager of forestry and agricultural assets. 6.0% of the Fund is in secured debt and 3.6% in convertible preference shares issued by Timbercorp.

The secured debt trades at a yield of over 20% and is protected by a first mortgage over properties probably worth more than the face value of the debt.

The preference shares mature in September 2009. At that time one of two things will happen. If Timbercorp ordinary shares (now $0.78) are above $0.50, we will receive $2.00 worth of cash or shares, a yield from the current price ($1.30) of about 60% p.a. If Timbercorp shares are below $0.50 at maturity, each preference share will convert into four ordinary shares. At $0.50 per share, Timbercorp would be valued at half of its tangible book value, and 3-7x earnings. Bears on Timbercorp worry about its high debts, but the company is profitable and excluding the compulsorily convertible debt, Timbercorp's assets are about twice its debt. In short, I believe Timbercorp's debt securities are too cheap.

Willmott Forests is an Australian pine plantation owner/manager. 8.3% of the Fund is invested in Willmott's preference shares. Like the Timbercorp preference shares, they mature in September 2009. If Willmott ordinary shares (now $1.43) are above $0.70 at maturity, we will receive $100 worth of cash or shares, a yield from the current price ($80) of about 33% p.a. If Willmott shares are below $0.70, the preference shares will convert into ordinary shares at $0.70 per share. At that price, I'd love to own the ordinary shares as Willmott would be valued at half of its tangible book value, and around 6x earnings.

Willmott has hard assets (mostly land and receivables) worth around three times its debts.

Hunter Hall is an Australian fund manager (5.7% of the Fund). This is a superb business run by quality people, with strong long term growth potential and almost no debt. The P/E is around 15x, the dividend yield around 7%. I regard this as much too cheap for such a good company.

NIB is an Australian health insurer (5.0% of the Fund). NIB has a good business, with a solid balance sheet and no debt. The shares trade at a 15% discount to tangible book value and the P/E is less than 10x. NIB has an open share register and if it were to be taken over (which I regard as a real possibility) the takeover price is likely to be well above current levels. If there is no takeover bid, the asset backing and earnings protect our downside.

Surya Citra Media is Indonesia's leading TV network (4.6% of the Fund). Like TV companies elsewhere in the world, SCM has attractive qualities as a business, but unlike them, it has strong growth potential, mainly because ad rates in Indonesia are very low. Debt is modest at less than 1x EBIT. The P/E of around 11x is inexpensive for a growth company, even if it is in Indonesia.

Calliden is an Australian general insurer (4.4% of the Fund). The shares trade for around 12x 2008 earnings, 8x 2009 earnings (my estimates) and 40% above tangible book value. Calliden has large tax losses and franking credits, both of which have significant value, now that Calliden is profitable again. Debt is around one third of equity.

900 Degrees is a small Australian trade publisher (4.3% of the Fund). This has been our worst performer, but has recently merged with a competitor and appears to be on the road to recovery. Our most recent investment followed large buying by the company's chairman. Based on 2008 earnings, the shares are on a P/E of less than 4x. Debt is around 3x EBIT.

Neteller is a UK company that is the world's leading payment system for internet gaming (4.2% of the Fund). The industry is growing at 20-40% pa. Neteller has had a tough two years because of US legal problems, but these have now been resolved and Neteller is now profitable. The business has large fixed costs, meaning it has high leverage to growth. Neteller also benefits from network effects, giving it a buffer against competitors. Our upside is difficult to quantify, but is potentially large. Net cash of 35p per share provides some downside protection compared to the current price of 60p.

Domino's Pizza is an Australian company making delicious pizzas in Australia and Europe (4.1% of the Fund). Domino's is a high-quality growth company, trading at around 17x earnings. The attraction of Domino's is that the Australian business alone underpins most of the share price. The European business, bought in 2006, is barely profitable, but is growing fast. If the European business can grow to the size of Domino's UK (which is plausible, but not certain), then the European business could be worth a lot more than the Australian business in a few years. Debt is less than 2x EBIT.
Heads we win a lot, tails we don't lose much…

J-Rep is a Japanese industrial property funds management business (4.0% of the Fund[1]). The shares trade for less than half of tangible asset value, 11x P/E and less than a third of the price paid by Macquarie and Goodman (two smart and successful Australian groups) to buy control of J-Rep in May 2007. Debt is slightly larger than shareholders' funds, but this does not worry me because the assets are leased on long leases on yields of over 5%, and the debt costs around 2.4%. Additionally, J-Rep is trying to sell most of its property into a fund. If successful, this will leave J-Rep with almost no debt and a profitable funds management business with locked-in clients. The asset backing protects our downside and the funds management business provides potentially large upside.

Net asset value per unit was $0.9548 at the end of June, cum-distribution which I estimate will be around $ 0.0374 per unit. 4.1% of the Fund was in cash, of which 5.3% was in gold and 1.2% in $A liabilities. The Fund owned securities issued by 21 companies.

[1] Last week I visited J-Rep in Tokyo. After that meeting, the Fund bought some more J-Rep shares.

Fred Woollard
14 July 2008

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