<u>Martin Raymond Real Return Fund</u> – October 2004 monthly report

NAV/unit rose by 2.26% during October. The fund underperformed the booming Australian market, which rose 3.14% during the month, but outperformed the world index, which fell 0.4% in $A terms. The main reason for this was the fund's 40% cash weighting, which is kept in $A.

The fund is now one year old. During this time it has gained 17.95%. It has underperformed the Australian market, which rose 20.1%, but outperformed the world index, which rose 7.2% in $A terms. I regard this outcome as satisfactory, in that I have generated a return in excess of my target of 10% p.a., but it is not a spectacular outcome, particularly in an Australian context.

In my defence, I point out that the fund has always had at least 40% cash, and has usually had more non-Australian than Australian equities. Most of the fund's gains are attributable to five companies, only one of which (Village Roadshow) is Australian. The only big loser has been MCI.

The main events that affected the fund during the month were:

Village Roadshow (4.5% of the fund) rose 10% during the month after the company bought back more shares. The fund sold some shares, partly in response to the price rise, but also because the controlling family sold 10m shares.

MCI (5.3% of the fund) rose 3% and I decided to reduce the fund's weighting in an effort to reduce risk. I still think MCI is very cheap relative to what it could earn, but the high uncertainty of the long-distance phone industry means that the weighting should not be much above 5%.

Australian Magnesium stapled securities rose 25% during the month. This was my cue to reduce the fund's weighting from 3% to 0.4%. The securities will convert to ordinary shares later this month.

The fund's investments in **Rio Tinto and Commonwealth Bank options** rose in value, but these "profits" could easily vanish. At month end, 0.7% of the fund was in these options.

The fund made three new investments during the month.

3.6% of the fund was invested in **Infomedia**, an Australian company that provides software for car dealers. It is an Australian success story with a history of fast growth in many countries. It generates high margins, lots of cash and requires little capital. The shares trade at an undemanding P/E ratio of 11-12 times, and pay a dividend yield of 5.5%. The company has good growth prospects in the next few years.

2.5% of the fund was invested in **Infracorp**, a small Australian property company which was bought at a 25-70% discount to its net asset value.

3.4% of the fund was invested in **Indosiar**, Indonesia's leading TV network. Indosiar averages 20% ratings, and its top rating show ("Indonesian Idol") is watched by over 60m people every Saturday night. Indosiar has the usual highly desirable financial characteristics of a leading TV station, i.e. high margins, a high return on equity and good cash generation. I had been fascinated by Indosiar for a while, but until last month, foreigners were not allowed to buy the shares.

What makes Indosiar exciting is the potential for growth. TV stations usually have fixed costs, which means that most of any increase in revenue flows through to an increase in profit. Indosiar has enormous potential for growth.

Most obviously, it could raise its advertising rates substantially if Indonesia's new president succeeds in his mission of improving Indonesia's economy. The country has been depressed for years, and as a result ad rates are much cheaper than elsewhere in the world.

Even on current earnings, the shares are not expensive. The EV/EBIT[1] ratio is around 7 times and its P/E ratio is 12 times. These ratios imply that the shares are priced at a substantial discount to comparable TV companies in other countries, yet I believe that Indosiar has much better growth prospects.

The reason I have such a small weighting is that Indosiar is risky. First, there are question marks over the integrity of the company's controlling shareholder. Second, there are obvious risks in Indonesia. I know some people would almost prefer to take a holiday in Iraq than invest in Indonesia, but if the potential upside is there, I am happy to have part of the portfolio in a risky country.

I gain a little comfort from the fact that Mark Carnegie and John Singleton, two of Australia's smartest media investors recently announced that they intend to buy 20% of another Indonesian TV station, SCTV.

Fred Woollard
4th November 2004

[1] The EV/EBIT ratio is the ratio of Enterprise Value (i.e. the Market Capitalisation of the shares, plus the net debt in the company) divided by the company's Earnings before Interest and Tax.