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

Dear Unitholders,

NAV/unit rose 1.64% during the month. The main event for the fund was that its size fell after a decision was taken not to accept an intended $20m investment from one investor. This shrinkage caused the Fund's weightings in its three largest holdings (Aust Magnesium, MCI and Village) to be much larger than I would prefer, a situation that is still being rectified.

Since its inception on 1st November, the NAV/unit has gained 2.47%. The fund added two new names to its portfolio and now owns securities in eight companies. 56.7% of the fund remains in cash.

The main events of note during the month were:

1) **MCI (formerly WorldCom)** shares fell 10% during February. There were four causes of this fall:
   - MCI has deferred the end of its bankruptcy until April 30 because it was not able to complete a clean set of accounts by the original target of February 29
   - MCI agreed to pay $120m to settle a lawsuit by AT&T, its largest competitor
   - MCI was banned from doing business with the state of New Jersey (AT&T's home state) because of the old frauds
   - MCI's December result was worse than people expected

   The above developments are all negatives, but do not justify a 10% share price fall. I still believe that MCI are too cheap on a P/E of 6-7x 2004 earnings, depending on how MCI's proposed share buy-back goes.

   At month-end MCI represented 12.2% of the Fund. I would prefer that the weighting was closer to 5%, where it was at the end of January. The reason for this is that the shares currently trade on a "when-issued" basis. Until the bankruptcy is complete MCI is free to change the number of shares it issues, which could dramatically alter the price of the shares. After the Fund size shrank, MCI represented over 23% of the portfolio. This presented me with two very risky choices:
   a) Sell down to a 5% weighting. This is what I would usually do, but because MCI was trading on a "when-issued" basis, there was a danger that if the company reduced the number of shares to be issued, the Fund would be short, and suffer huge losses
   b) Hold on to the shares. Although I really like MCI, I have learnt the hard way that companies in bankruptcy often generate surprises, sometimes nasty ones. A 23% weighting breaches the rules of the Fund and would be irresponsible.

   I decided to sell just under half the shares, in effect taking on a bit of each risk. It is not an ideal solution, but it is the least bad available.

2) **Village Roadshow**'s (7.8% of the Fund) proposed buy-back of all of its preference shares has now definitely ended, and been replaced by a $100m on-market share buy-back. I view this development as moderately positive for us. In late February Village released its half-year results, which were much as expected. At $1.07, the shares trade for around 7x earnings and less than half of their intrinsic value. Although there remain lots of reasons to dislike Village, most or all of these are already in the price.

   (On 1st March, I reduced the Village weighting to 5.2%.)

3) **Sansei Yusoki** (4.9% of the Fund) rose 30% during the month along with many other Japanese deep-value shares, in response to an American fund making a bid for two other deep-value companies. As the share price rose to above its cash backing (gasp!) I sold some, and will sell more if the price continues to rise.

4) The first of the Fund's new holdings is **Bangkok Land**, whose bonds are 4.2% of the Fund. The Fund paid 18% of face value for the bonds. The company defaulted on its debts in 1998, but has remained in business, buying back and repaying debt. In the last year the Thai property market has recovered, and the company has become solvent, assisted by a $100m share issue. The company has offered to buy back the bonds at 17% of face value, but I am gambling that if we wait long enough, we will receive closer to 100% of face value. There are obvious risks, but I think the risk/reward mix is very attractive.

5) The Fund is participating in a share issue by **Simon Gilbert Wines** (3.9% of the Fund) as part of a reconstruction of a nearly-insolvent wine maker and processor. The new company will be debt free, and we are buying into it at around half of the cost of developing the business. New management from the old Southcorp are investing their money on the same basis as the Fund, and receiving large incentives to lift the share price. If the wine industry recovers from its slump, or if the new management team can turn the company around, I believe we might double our money over the next few years on this one.

Fred Woollard
1st March 2004