



fatprophets australia fund limited

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14 June 2005

Net Tangible Asset Backing as of 31 May 2005	
Before Tax	\$.981
After Tax	\$.980
Cash Holdings	40.8 %

Dear Fat Fund Shareholders,

The Fat Fund's investment portfolio underperformed its benchmark S&P/ASX 300 Accumulation Index for the period 1 May to 31 May 2005 by -2.70%. In dollar terms, the net tangible asset backing rose 0.51% for a **gain of \$.005** per stapled security.

This relative under-performance was primarily the result of a significant portion of the portfolio being held in cash while the market rose strongly. In industry parlance this effect is known as "cash drag".

The portion of cash held within the portfolio has fallen from 72% at the end of April 2005 to 41% at the end of May 2005.

**Commentary:**

The Australian Equity market moved sideways in the first half of May before rebounding strongly in the second half to finish the month up 3.21% despite the trickle of profit warnings in April becoming a torrent in May.

In regard to the portfolio's short term under-performance, we remain focussed on investing the proceeds of the IPO in undervalued companies. At the smaller end of the market where we are currently finding value, liquidity and volume constraints prevent us from constructing the portfolio too quickly – or our buying pressure will move the market. During this period we are exposed to the cash drag effect, but we believe that patience will be amply rewarded by longer term out-performance.

Already, we've managed to find a number of small stocks that represent good value and are presently trading up to 50% below recent highs.

Typically such stocks suffer additional price weakness in May and June as some shareholders sell stock to crystallise capital losses ahead of year end. Some of these positions hurt the portfolio's performance during May 2005.

The short term bad news is that the positions being built may continue to under perform in the face of such selling. The long term good news is such selling provides share price weakness and volume allowing us to build a position – a process that can take 1-3 months, and sometimes longer.

### **Australian Worldwide Exploration (AWE)**

Value Investing 101: The market sometimes over penalises bad news.

AWE is a medium sized oil & gas explorer and producer. It has a number of projects in the development phase that will provide a major boost to ongoing cash flows. In recognition of this future AWE hit highs of \$2.10 in October 2004.

Delays in the start-up of the Bass Gas project (offshore between Tasmania and Victoria) resulted in the share price being punished by 21%.

Mathematically, the change in the net present value of future cash flows as a result of delay simply did not warrant the magnitude of this decline. The market likely over reacted.

We visited AWE management and modelled the company in detail – confirming in our minds the selling was overdone.

We purchased AWE in early May 2005 at \$1.65. At close of market 11 June 2005 AWE was \$1.96 – having regained most of what it had lost (up 19%).

AWE was a classic value investor's stock pick.

### **Ending Notes**

We remind you that the share and option that make up each stapled security can not be traded separately, until after the unstapling date of 20 April 2006.

Again, on behalf of the Board we thank you for your support and look forward to updating you next month.

Kindest Regards

Your Board of Directors and  
the Fat Prophets Funds Management\* Team

**\*Fat Prophets Funds Management (Australia) Pty Ltd is the Manager of the Fat Prophets Australia Fund Limited investment portfolio.**

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