

under the radar SMALL CAPS

SMALL TALK

"I'll give you one reason small caps are better: "asymmetry"... the reason you can beat the market by owning small caps is that information is less available, which means you have an edge."
- Geoff Wilson of Wilson Asset Management

1 DECEMBER 2011

You Can Be My Lachlan Star

We've said this before, but Geoff Wilson of Wilson Asset Management, who makes a special appearance in this Issue, said what the team at Under the Radar Report can never repeat enough: "WE LOVE SMALL CAPS".

Other than our interview with Geoff, we also give you two other reasons why (we love small caps): Chilean gold producer Lachlan Star; and toot toot, it's Engenco (an engineering specialist with expertise in trains and large diesel engines).

These two stocks are fantastic opportunities to capitalise on management that have vision and are also able to control expectations.

Both are well positioned because the individuals that run the companies have big incentives to make it work, and they also have done it before.

Small caps, if nothing else, are about backing the vision of people like Dale Elphinstone, Chairman and 44 per cent holder of Engenco, and Mick McMullen of Lachlan Star.

Under the Radar Report is devoted to finding such people and it is our pleasure to tell you more about them and how you can profit as a result.

I am sure you will enjoy this Issue.



Best Wishes,

Richard Hemming
Editor

**99% of all financial news relates to the 40 to 50 biggest companies. So what about the rest?
They're Under the Radar**

ISSUE #6

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under the radar

**SHARE
TIP**

01

ENGENCO

The turnaround story that has the ability to deliver investors massive windfalls.

SHARE PRICE **\$1.00** MARKET CAPITALISATION **\$125 MILLION** ASX CODE **EGN**

BIG NEWS COMING UP

Under the Radar Report understands from the company's chief operating officer, Kevin Pallas, that the turnaround is on track to meet the profit expectations of the market for the year to 30 June 2012. House broker RBS Morgans is forecasting a net profit after tax of just under \$16 million. He also expects that it will sell a significant percentage of its train leasing business "Greentrain" by 30 June. This would allow the business to expand, which Engenco would benefit from, as the provider of maintenance services.

BACKTRACKING FOR A SECOND...WHAT IS ENGENCO?

The company has two divisions, one which services and manufactures large diesel engines ("Drivetrain"); and the other provides maintenance and repairs for trains, as well as leasing them out ("Gemco").

In the last financial year, Engenco's revenues were about \$200 million and were split evenly between the two divisions. Although, its Drivetrain business is more profitable, generating about 55 per cent of earnings, compared to the 45 per cent coming from Gemco.

Dale Elphinstone, the company's chairman, bought into the company in July last year and now holds 44 per cent. Big investors like the Pratt Family's Thorney Group, and the fund manager SG Hiscock believe that the success he has had as a franchisee for Caterpillar construction equipment will be translated into Engenco.

STILL TOOTING

So far the big achievement is that the company still exists. It has gone from making an operating loss of \$50 million (\$107 million if you include write-offs) and being insolvent with about \$110 million in debts as at 30 June 2010. One year later, Engenco showed a profit, albeit small (just under \$5 million) and net debt of just under \$40 million.

But looking at the share price, you might believe that these investors' faith is misplaced. After all, the stock is trading well below \$1.20, which is the price (after taking a share consolidation into account) at which it raised \$85 million.

Proponents of the stock will always tell you that management has consistently said that it's a "3 to 5 year turnaround story", but this doesn't give you the full picture. Another factor is that due to financial duress, the founder of the company, Mike Coote, has dumped most of his 11 per cent of stock onto the market.

GEMCO TURNAROUND ON TRACK

The company is in the process of reducing the costs and ramping up the activities of its Gemco rail business, which is where the short term gains will be made in earnings growth. Even if it doesn't sell part of its rail business in the short term, the demand for its services is increasing and the company is expanding its facilities to cope with this. Pallas says that the company is increasing its sales of wheelsets from 12,000 to 18,000 a year.

The company also intends to establish a presence on the east coast, attacking the dominant players Downer EDI and UGL.

Selling a significant part of the train leasing business "Greentrain", would however, be a big positive. It would free up capital for Engenco and allow a potential partner to expand the business, delivering Engenco valuable maintenance contracts.

MINING SERVICES DEMAND

On the Drivetrain side, the company is not expecting growth in profit margins, but demand for its services and products from the resources sector will ensure continued double-digit revenue growth.

Underground mining equipment is a big user of its gas compression technology, and the company is starting to increase its exposure to Asia. It also owns the intellectual property over the Swedish made Hedemora diesel turbo charger, which is used in the Collins Class submarines.

Wrapping your mind around Engenco is not easy. This accounts for part of the reason investors have not flocked to it. But its earnings are moving in the right direction and it won't be too long before dividends do too. ■

BULL POINTS

- Confident of making profit numbers
- Final leg of turnaround on track
- Strong demand for services
- East coast expansion

BEAR POINTS

- Complicated business
- Not committing to dividend

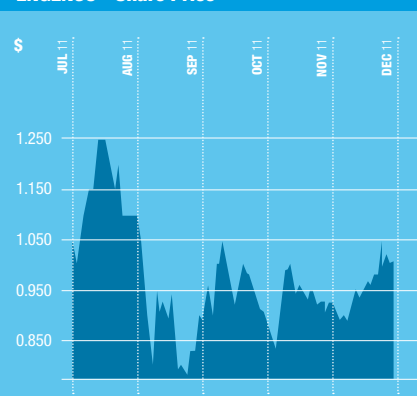
WHY WE LIKE IT

Since Tasmania's richest man, Dale Elphinstone, joined the company about a year and a half ago, it has gone through a massive transformation. Now shareholders are in a position to benefit from the turnaround. It is trading at a 40 per cent discount to its competitors, RCR Tomlinson, UGL and Downer EDI. If you reduce this by half, you would value Engenco at over \$1.20. And we believe it will reach this valuation in the next six months...

WHAT'S NEW?

The AGM in mid-November shows that the turnaround story remains on track. We also spoke to the chief operating officer, Kevin Pallas and we believe the company will beat the fiscal 2012 forecasts of its house broker RBS Morgans, and will complete its restructure, announcing the partial sale of its train leasing business.

ENGENCO - Share Price



SOURCE: ASX

RADAR CRITERIA: MANAGEMENT

MANAGEMENT IS (NEARLY) EVERYTHING FOR THE SMALL COMPANY

**IN THIS SECTION
WE WILL REVEAL
THE CRITERIA THAT
UNDER THE RADAR
REPORT USES
TO SCREEN THE
COMPANIES
WE COVER.**

In Geoff Wilson's ratings system, out of his five criteria for stock selection, management ranks in the top two.

Wilson's portfolio of companies is focussed on small cap stocks, or companies with market caps of less than \$300 million, because he says he realises that there is an "asymmetry of information" in the market.

This means that the market is not always aware of "material" information relating to small caps. Put another way, often investors are slow on the uptake in matters relating to small companies, whether it be official announcements, or market information. There is often a big discrepancy between what is known, versus what is happening.

This means that an investor in small caps relies heavily on what management tells them about the status quo regarding operations and finances.

Wilson's team gets very close to management when it perceives that the company is in danger of falling over because of too much debt, but every fund manager we have spoken to in small caps looks to management first before investing in a company.

Some look for charismatic managers that are good at sales, others look for industry operators that have a strong understanding of the mechanics of running the business in question.

Here are some criteria that Under the Radar Report takes into account:

- Years the operator and the team have worked in the industry in question.
- Their base level of pay – we would be unhappy if the base salary exceeded the average profit after tax forecast for the next two years.
- Accessibility – how easy is it to contact different members of the team.
- The stake senior management has in the success of the company.
- The history of the chief executive and the chief financial officer.
- The influence of the non-executive directors – particularly the chairman.

As you can tell from the above, the criteria of experience counts a lot more for us than whether the managing director or chief executive is a good salesperson.

This is because many of the companies we look at are turnarounds. In many cases, these turnarounds have new management. It always takes time for investors to trust new management, because invariably they have been burnt by the old ones.

Just because a business was successful, doesn't necessarily mean that this will translate to being a successful listed company. Managing expectations is everything.

In these situations, being conservative pays dividends. So for small caps, a conservative management is a good thing. This means one that doesn't over promise and under deliver. And one that is competent at the basics needed to grow earnings, which is the only way to build shareholder trust.

Just because a business was successful, doesn't necessarily mean that this will translate to being a successful listed company. Managing expectations is everything.

Collins Foods' management has learnt this lesson the hard way, having downgraded only three months after its IPO. And with someone as experienced as Russell Tate as chairman, we fervently hope it doesn't happen again. Tate has a long history in advertising. He was an executive director of ASX listed STW Communications from its IPO (as John Singleton Advertising) in 1994 to 2008. Now he is also executive chairman of Macquarie Radio Network.

If you back the right management in a little company, the rewards are certainly there

Of course, we are confident in the management of both the companies in this issue.

Engenco (EGN) is in the process of looking for a new managing director, to replace Vincent De Santis, who is 44 per cent shareholder Dale Elphinstone's main man (in a business sense). Elphinstone has invested much capital, both emotional and financial into Engenco. Having spoken to different managers for his group, we believe that the team understands what it takes to turn the business around. De Santis will continue to remain on the board.

Lachlan Star's Mick McMullen has experience on both the operational side of mining, as well as the administrative and deal making sides. He seems to be the full package.

A manager needs to sell the story first to his team, who then have to implement it. He or she then needs to gain the confidence that the company's targets will be met. This must happen before investors in the company are made aware of its ambitions.

If you back the right management in a little company, the rewards are certainly there. ■

LACHLAN STAR

This Chilean gold miner is ramping up its production. It is a stand out because not only is it fully funded, it also has more opportunity to expand than any small cap domestic gold producer.

SHARE PRICE **89C** | MARKET CAPITALISATION **\$52M** | ASX CODE **LSA**

A CHILEAN GOLD PRODUCER This Chile based miner has the kind of economics not available to Australian miners.

For one thing, its costs of production are much lower, using a heap leach process to extract gold. This process stacks the rock onto a big pad, then treats it with a cyanide solution to extract the gold. There are few large scale Australian heap leach operations in production today, the bulk of production coming from power intensive crush, grind, carbon-in-leach or "CIL" extraction plants.

The size of the operation is also not comparable. Lachlan can process as much as 8 million tonnes of rock and ore a year. When it bought the mine last December, it ran at 1.5 million tonnes a year, and now it runs at 3.5 million.

Only a handful of pure gold mines in Australia have this capacity.

BUT WHAT DOES THIS MEAN? Basically, that Lachlan has more ability to ramp up production at lower cost. The company's cost of production is about \$755 for every ounce of gold it mines, and when production ramps up this will reduce to about \$650 an ounce in the middle of next year. This compares to an average for Australian producers of about \$900 an ounce.

Lachlan is currently running at 50,000 ounces of gold a year in production, and next year it should increase to 75,000, and 100,000 the year after.

WHAT IT'S SITTING ON The size of the gold mine Lachlan thinks it's sitting on, or "resource" is 1.44 million ounces, of which it knows it definitely has 0.5 million ounces in reserves of gold.

Its chairman, Mick McMullen, is confident that because of its aggressive drilling program, this will be increased.

Also, because it has a low cost of production, the mine runs at a profit, even including the \$6 million a year it spends on exploration drilling.

CASHED UP And Lachlan has more than enough cash, having raised \$14.2 million in Canada this month after selling a combination of shares and options (which exercise at \$1.20 a share). This means it has about \$16 million in cash in the bank, although it has about \$3 million Chilean based debt.

McMullen has been in the mining game for the past 20 years. He has bought and sold iron ore companies, and has bought into consulting businesses. The man has mining in his blood.

He says this product stood out because it was "capital starved, with sunk costs... we knew that if we applied our skillset and some money we could reduce the costs easily and increase the volume of production. It was a no-brainer."

BIG ANNOUNCEMENTS COMING The next big announcement will either be later this year or early next year, according to McMullen. Lachlan will update the market on its gold resource and reserves, and it will also update on whether it can treat low grade material. It is currently conducting dump leaching trials to test the viability of this.

"If we're successful, we'll be able to process tens of millions of tonnes of waste at little cost," he says.

From an investor's point of view, this will be icing on the cake.

OUTSTANDING VALUE Including the capital it just raised, Lachlan has an enterprise value (market capitalisation minus cash) of about \$55 million. It should make this much in operational earnings (earnings before interest, tax, depreciation and amortisation) in the calendar year 2012, and the upcoming reserve and resource upgrade may show this can keep happening for quite some time (with a seven to 10 year mine life).

Opportunities like this don't happen too often and it has come about because of the investment community's lack of understanding of the opportunities in South America.

One guy who doesn't underestimate the potential is Mick McMullen. ■

BULL POINTS

- Low cost gold producer
- Fully funded
- Opportunity to expand gold resources and increase production
- Cheap! Enterprise value equates to expected operational earnings in 2012

BEAR POINTS

- Relatively small operation which has production risk
- Still in ramp-up mode

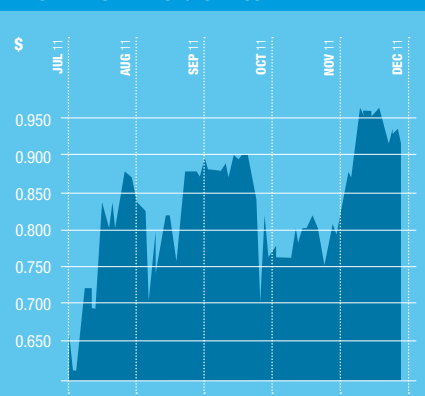
WHY WE LIKE IT

Lachlan is a well-funded Chilean gold producer with low operating costs. From next year it should be earning about \$55 million, which is as much as its enterprise value (market cap less cash).

WHAT'S NEW?

The company has recently raised just over \$14 million in a combination of stock and options from Canadian investors to underpin its Toronto Stock Exchange listing. Its last quarter result showed that it is already operating at a profit. It is also on track to ramp up production from its current run rate of 50,000 ounces a year to 75,000 ounces.

LACHLAN STAR - Share Price



SOURCE: ASX

WILSON ASSET MANAGEMENT

GEOFF WILSON

FUNDIE

THE INVESTMENT MARKETS VETERAN DIVULGES SOME OF THE SECRETS TO HIS FUND'S PERFORMANCE OF ALMOST 24 PER CENT A YEAR OVER 14 YEARS. IT SEEMS SIMPLE AT FIRST...



When you first hear Geoff Wilson's explanation for picking up cheap companies and then making big returns, you think, he makes it look as though anybody could do it.

After all, since his company first kicked off about 14 years ago, his fund, the Wilson Asset Management Equity Fund, has returned almost 24 per cent a year to 30 September this year, which compares to the ASX All Ordinaries Index return of just over 7.5 per cent a year over the same period.

In the past year it has returned about 6 per cent, compared with the 8.4 per cent decline in the benchmark index.

Wilson is also a man who has had an interesting life outside of funds management. He has not only been at the top of the broking tree in both Australia, New York and London, but has also been a restaurateur and a commentator on the successes of others in the boiler room of funds management in this country (see his two co-authored books, titled, "Masters of the Market").

When he tells me the "secret", he has a twinkle in his eye and the temerity to say that he's given the game away:

"Now anyone can replicate my success."

HERE'S THE SECRET:

"When I started, all the research I had read, everything I'd seen, said that share prices had the greatest correlation to (earnings per share) growth...not cash flow, not return on equity, not net tangible assets. So I just looked for stocks that were cheap, but were achieving extra-ordinary EPS growth..."

He looked for stocks that had price earnings multiples of between 8 and 10 times, but were forecast to grow earnings per share at more than 20 per cent a year over two years. And he found about 30 of them. But he didn't buy them all, he only bought those where he could see a "catalyst" or an event that he thought would encourage investors to buy the stock.

Fast forward to today and it is clear that his system is far more peripatetic than his "secret" would suggest.

Driving the big returns have been what seem like inspired investments. His fund bought Reckon at 15c in November 2002, it's now \$2.55. Other winners include technology plays **Melbourne IT (MLB)** and Secure Net, as well as Rams Home Loan mortgage book **RHG (RHG)**, fund manager **Everest Babcock Brown**, and household products provider **McPherson's (MCP)**. Some of these investments increased in value by more than 10 times since Wilson's initial investment.

BIG WINNERS, BUT CUT YOUR LOSERS

But no matter how good he has been at picking winners, he quickly admits that there have been at least as many disappointments.

"Less than 50 per cent of the stocks we pick are winners, and it sounds clichéd but we let our winners run and we cut our losses."

When you look through the big winners, it's also clear that his fund looks for more than just cheap stocks with earnings growth.

RATINGS SYSTEM

Part of the way he picks stocks is on the basis of a ratings system. His team hunts for ideas, or hypotheses on stocks that it believes will go up. It rates each stock on the basis of its earnings growth and PE ratio. Wilson also looks at management, and the industry it operates in, and its position in that industry.

TRADING PHILOSOPHY: CASH IS KING

But another portion of Wilson's investment philosophy is trading. This may come from his background as a broker. He doesn't call it trading, of course, but his "market driven" strategy.

What this boils down to is holding cash (it's the fund's "default position") unless he can see a compelling trade. So what's a compelling trade?

"Less than 50 per cent of the stocks we pick are winners"

FUND MANAGER: GEOFF WILSON CONT

“You never pick the top or the bottom, but if you can find a company trading at a discount to its cash backing, what could be better than that? The next best thing is a stock trading at less than the value of its net assets, and only after this do you look at earnings.”

Some companies he purchases simply because the returns are greater than cash, such as companies that are being taken over. For example his fund has held Coal & Allied and Hunnu Coal for less than 30 days, generating annualised returns of 5.8 per cent.

BIG RETURNS FROM BIG PAIN

But the big returns have often occurred in the wake of cataclysmic events. Wilson and his team bought companies that were distressed in the aftermath of the tech wreck in 2000 or the financial crisis during late 2007 and 2008.

His strategy is not to look for companies that have little debt, but rather those that have a lot of debt, but which he thinks will get through the pain. If they do, because of the leverage that debt represents, the equity component will increase substantially (which explains the 10 fold increases in some of the stocks he has bought and sold).

But for these companies, the risk is great that they might go under. For this reason, his team visits the company's management as often as every two months after the fund has made an initial investment. This is often quite small, compared with the stake the fund will finally place in the company. The fund increases its holding as it grows in confidence that the company will navigate its way out of trouble.

RECENT BUYS

Companies Wilson's team have backed recently that fit this description include: infrastructure consultant **Coffey International (COF)** which is under new management; energy retailer, **Australian Power and Gas Company (APK)**, and property developer **Sunland (SDG)**.

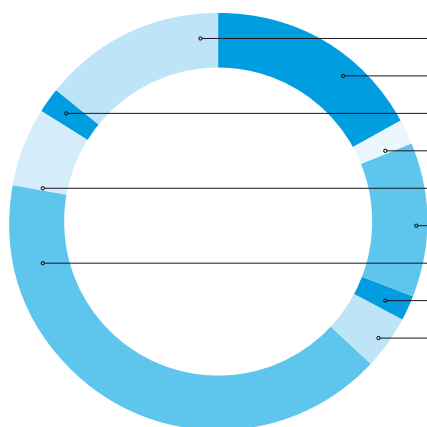
And then there are the investments that Wilson makes that don't follow any formula.

“We bought **Virgin Blue (VBA)** at 32c because we were travelling around and we noticed that the discounts weren't what they used to be. Virgin used to be the cheapest, but in the wake of Tiger's collapse, this isn't the case. So we flew over and had a chat with (CEO) John Borghetti.”

After any meeting with Geoff Wilson, it's obvious that although there is an “investment strategy” his team follows, it's as much about instinct, which is a lesson in itself. ■

TOP HOLDINGS AS AT 30.09.2011

CODE	COMPANY	MARKET VALUE AS % OF GROSS ASSETS
CIW	Clime Investment Limited	5.1%
RKN	Reckon Limited	4.4%
SGI	Signature Capital Investments Limited	3.7%
CNA	Coal & Allied Industries Limited	2.3%
MMS	McMillan Shakespeare Limited	2.2%
DKN	DKN Financial Group Limited	1.8%
MYS	Mystate Limited	1.8%
CCQ	Contango Capital Partners Limited	1.6%
BRG	Breville Group Limited	1.4%
MAQ	Macquarie Telecom Group Limited	1.0%
SGN	STW Communications Group Limited	1.0%
RCR	RCR Tomlinson Limited	1.0%
SAI	SAI Global Limited	1.0%
BKL	Blackmores Limited	0.9%
TLS	Telstra Corporation Limited	0.9%
SOE	Souls Private Equity Limited	0.9%
IPP	Iproperty Group Limited	0.9%
AAD	Ardent Leisure Group	0.9%
HOM	Homeloans Limited	0.8%
SYM	Symex Holdings Limited	0.8%
IMFG	IMF (Australia) Ltd 10.25% Conv Note	
	Mat. 31-Dec-2014	0.8%
MRN	Macquarie Radio Limited	0.8%
SDG	Sunland Group Limited	0.7%
ARP	ARB Corporation Limited	0.7%
SKE	Skilled Group Limited	0.7%



PORTFOLIO STRUCTURE - SECTOR BREAKDOWN

14%	Industrials
17%	Consumer Discretionary
2%	Health Care
2%	Other
6%	Telecommunication Services
12%	Information Technology
41%	Financials
2%	Materials
4%	Energy

BUILDING A 20-20 SHARE PORTFOLIO

OUR PORTFOLIO MANAGER, “THE IDLE SPECULATOR” HAS FOUND ANOTHER LITTLE GEM FROM OUR TREASURE CHEST OF SMALL CAPS. HE CONTINUES TO GUIDE ON THE PROCESS AND MIND-SET THAT HAS GENERATED A RETURN OF 20 PER CENT A YEAR OVER THE LONG-TERM.

TRANSACTIONS FOR UNDER THE RADAR SMALL CAPS PORTFOLIO

ASX CODE	COMPANY NAME	LAST TRANSACTION DATE	NUMBER HELD	TOTAL COST	PRICE @ 22/11/11	CURRENT VALUE	SHARES %
CKF	Collins Foods	22/11/2011	1,000	-\$1,308	1.280	\$1,280	6.9%
NMS	Neptune Marine	22/11/2011	50,000	-\$1,478	.029	\$1,450	7.6%
AJM	Altura Mining	TBA	TBA	TBA	TBA	TBA	TBA
STW	SPDR S&P/ASX 200	22/11/2011	400	-\$15,856	39.570	\$15,828	85.5%
Shares	74.5%		Subtotal	-\$18,641		\$18,558	
Cash	25.5%		Cash Held			\$6,360	
Portfolio	100.0%		Grand Total			\$24,918	

TRANSACTIONS

Last week we just got Collins Foods (CFK), and had no trouble with Neptune Marines (NMS)

Neptune Marine (NMS) never threatened the top of our buy range, and we were able to purchase at a few per cent below the price at which the stock was trading on the publication date of Issue 5. This was despite the announcement of a contract worth \$7.5m in sales to Neptune, to be delivered over just 75 days. Apart from cashflow benefit, the development demonstrates the operational potential of this business.

Collins Foods (CKF) raced higher on publication day by almost 10 percent before settling back down below our limit price of \$1.30 on Tuesday afternoon, just in time for our transactions at the close of trading that day. Neither stock has moved much since, as markets have been quite dull.

NEXT WEEK...

Tap Oil (TAP) reported yet another dry drill hole – not the end of the world, but not very encouraging.

Red 5 (RED) is in the middle of a 1 for 10 consolidation. Elsewhere, Engenco (EGN) looks interesting, but we have settled on Altura (AJM), covered in Issue 5.

We will buy 10,000 AJM at less than \$0.17 (as usual we will purchase on the Tuesday following publication, and we will wait to build a further position over time if conditions encourage us).

It is worth pointing out that we expect to reach our proposed ideal weighting of smaller stocks within about six to nine months. Previously we said that we intended to invest in the stocks over three to four months. This reflects the uncertainty of opportunities arising at the precise time when we decide to invest the money.

MANAGING YOUR EXPECTATIONS

When you are under the radar, you run the risk of being your own worst enemy if you do not rationally manage your expectations to ensure that you are not at risk of crashing into unforeseen obstacles.

Ultimately, there is more noise than substance in the stock market, but success most often comes down to the fundamentals of the companies you invest in. You will need to analyse and understand the relationship between sales revenue, which is a function of sales volume and realised prices, and operating costs leading to profit and cashflow.

The market for a stock might sell off in a second. This event might anticipate occurrences or events that may take months or years to reflect themselves in a company's cash flows or balance sheet. On the other hand, the stock market may ignore for months or even years the impact of other events or circumstances despite the proximity of a report of significant direct financial effects. This ignorance might last until it (the market) is slapped about the face with figures that leave the previous hypotheses gasping for air.

One of the expectations that you have to manage is that it is more than likely that at least one or two of your ten holdings will halve or worse in value at a point when you are not expecting it (because otherwise you would have sold). You will feel sick to your stomach, and angry with the source of the suggestion or idea. While obviously wishing to deflect any such anger away from The Idle Speculator, it is axiomatic to what we are doing that you are responsible for your own investment decisions. We will attempt to guide you to the best of our ability, but we cannot take into account your personal circumstances in relation to an investment and any peculiarities relating to your cash flow needs and capacity.

CONTINUED OVER

This is not merely a matter of legal technicality. Your decisions have to reflect your temperament, your appetite for risk, your ability to take decisions for the right reasons and ignore the irrelevant factors that will attempt to misdirect your decision-making. You have to understand why you will invest or have invested in particular companies, and what you expect to get from it, and how you will react when circumstances change. The better you know yourself, the better you know your investing.

This is one reason we take our portfolio investing decisions slowly and deliberately. The last state that you want or need to be in when investing is a state of obligation. We try to avoid having to take any particular action in our portfolios. Once you become obliged in relation to a particular investment, your decision making is easily compromised. But if you don't participate, your position and share of the company's profits will be heavily diluted. If you do participate, your investable cash is diminished at a bad time for the markets, when perhaps it could be better deployed elsewhere, and your somewhat diminished portfolio is even more exposed to this so far poorly performing stock. It would take an investing angel to easily ignore these painful but nevertheless completely irrelevant factors when it comes to deciding whether the shares you are offered and/or the shares you already hold offer an appropriate reward relative to their risk over your investment time horizon.

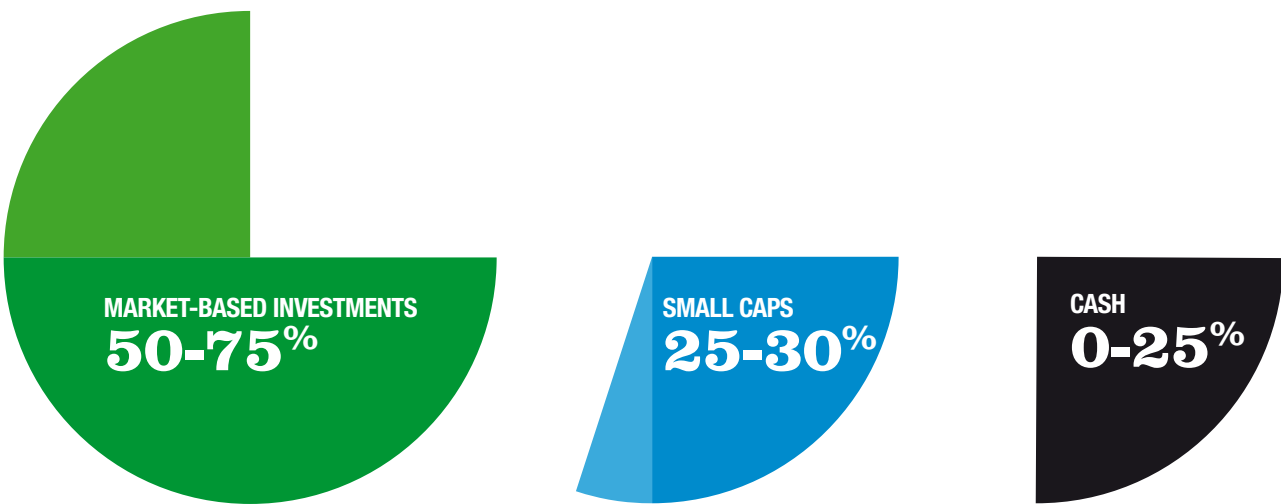
Going back to moving slowly. Our experience is that we may arrive early on the scene of stocks which eventually turn out to have been cheap. On the other hand, small stocks may be priced for growth and in fact over deliver, and if we manage to find and buy any of these, we may well be late to the story. We want to be sure that we are buying secular growth not cyclical growth before we pay a growth multiple. Other sorts of stocks that we will

Your decisions have to reflect your temperament, your appetite for risk, your ability to take decisions for the right reasons and ignore the irrelevant factors that will attempt to misdirect your decision-making

look at may have gone or be going through train wrecks, and this may or may not have been fully reflected in their share price and market expectations. In the meantime, this type of stock which is unloved for a good reason may go through a very long period of rehabilitation before it is valued on the same basis as other companies even if it does achieve a financial turnaround.

So we buy slowly as a general rule. We always want to be ready to buy more. We ask ourselves before we commit whether our response to a substantial share price fall on no company specific news would be to buy more. At some point we anticipate being asked that question for real. We may sell slowly, if we were right, and fast if we are or were wrong, but there are no hard and fast rules, stop-losses or any quantitative constraints that will cause us to transact one way or the other. Each circumstance is different and dynamic, and each egg in our smaller company portfolio basket is especially precious. ■

INVESTMENT BREAKDOWN



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