

under the radar **SMALL CAPS**

SMALL TALK

“Without dividends, there is no point to investing; without dividends, it’s speculation.”
- Radar’s Portfolio Manager, The Idle Speculator

25 JANUARY 2012

From Kill Zone to Green Zone

As reported in our missive last week, three of our picks are starting to generate strong returns, increasing their share prices on average by 20 per cent since we first tipped them.

Value is emerging in this market. But it’s also important to look at the types of stocks that you want to buy.

One of the stocks we tip is regional television broadcaster Prime Media. We regard it as fairly safe, and its yield is over 11 per cent if you include franking credits!

We have also included a stock that has more risk attached to it, in the junior telco, Big Air. The outlook for telecommunications is uncertain, but Big Air has been doing the business (literally) and is paying dividends for the first time this year.

Even with high risk investment opportunities, which have the potential to make massive capital gains, the intention to deliver income within a reasonable time frame is essential.

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 #9

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under the radar

**SHARE
TIP**

01

PRIME MEDIA

This stock gives investors access to top performing Channel 7, an 11 per cent gross dividend yield, and most importantly, management that knows what it's doing.

SHARE PRICE **\$0.65** MARKET CAPITALISATION **\$245 MILLION** ASX CODE **PRT**

PRIME IS STICKING TO ITS KNITTING (FINALLY)

Prime Media finally has a chief executive who is sticking to the company's strength: being a regional television broadcaster in Australia.

Ian Audsley has been chief since May 2010 and was previously a chief operating officer at Channel 9 and has had a stint in private equity. Under him, Prime has sold out of everything from its ill-fated investments in Argentinian TV, to ownership of NZ TV, Prime Media Developments (outdoor broadcasting), Destra, and Prime Digital Media.

REDUCED DEBT

The first positive from this restructure is that Prime is no longer burdened by debt. In fiscal 2011 it reduced its net debt by \$27 million to \$136 million and Prime's debt ratios are now at (more) comfortable levels, with net debt to operating earnings (EBITDA) of just over 2 times. This is still a risk, however. Radar will monitor it closely.

More important though, is that the group now has a simplified operating structure, and so profits will flow more easily to shareholders. Its forecast gross dividend yield for fiscal 2012 of 11.7 per cent should be maintainable.

DOMINANT MARKET SHARE

The main driver of growth for the short-term is market share gains by the 7 Network against the 9 and 10 Networks.

Make no mistake, we aren't saying that the growth rate for advertising is anything but zero. Rather, Prime is growing due to its dominance in regional Australia, which we believe will continue.

Prime is already achieving a market share of greater than 40 per cent, and this should not head south. After all, the Seven has rights to the AFL, and is winning the ratings wars in current affairs and in day and night time drama. Seven seems to have its finger on the pulse of middle Australia.

GOOD BUSINESS MODEL

The company is achieving this ratings success, AND NOT PAYING FOR IT. It doesn't have to fork out huge wads of money to pay the big US production houses like CBS and Disney for its product. It simply pays Seven West Media an affiliation fee. The terms of the current contract last until 2017.

In fiscal 2011 Prime produced a better than expected net profit of \$27.7 million from \$257 million in revenues. Its earnings per share was 7.4 cents, and its dividend per share for the year was 4.5 cents. Next year it should pay out in the region of 5.5 cents.

Prime should be able to achieve earnings growth from fiscal 2012, but even if it just maintains this dividend it will deliver impressive returns – namely a yield of 8.2 per cent at current prices, which grosses up to 11.7 per cent when franking credits are included.

INSTITUTIONAL BUYING

Perpetual certainly likes the Prime story. In mid-December the fund manager increased its holding from 7.5 per cent to just over 8.6 per cent.

AND FINALLY, A CORPORATE ANGLE

Prime is now controlled by three players: Paul Ramsay (30 per cent), Illyria (Lachlan Murdoch) 8.9 per cent and Channel 7 owner Seven West Media (SWM - 11.4 per cent).

The key shareholder here is Seven West, which would presumably snap up Prime if current media rules weren't in place. Right now the "75 per cent reach rule" prevents a company from owning broadcasters that reach more than 75 per cent of the population.

It is in place to promote diversity of views. With the proliferation of the internet, the rule is deemed by many to be redundant, including Communications Minister Stephen Conroy. A media enquiry document is due to be released at the end of March.

The long and the short of it is that Prime is a good investment whether or not it is taken out. ■

BULL POINTS

- Pure-play on success of Channel 7
- Strong and sustainable 11 per cent plus yield
- Debt lower after asset sales
- Institutional support
- Takeover potential

BEAR POINTS

- Media industry under pressure

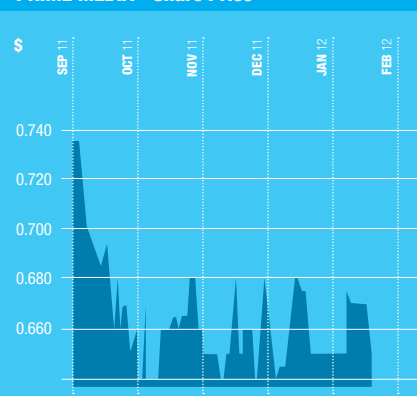
WHY WE LIKE IT

Prime Media is the dominant player in regional Australian television. The company pays Seven West Media an affiliation fee for Channel 7 content, which it distributes to the regional market. It does not have any of the big operating costs of running a network, nor does it have control over content. It is now a slimmed down group benefiting from the dominance of Channel 7, and provides a strong dividend yield.

WHAT'S NEW?

Channel 7 is blitzing it in regional Australia with 40 per cent market share. At its AGM in late November, management said that its audience and revenue share were both growing. By all accounts the group is on track to achieve double digit growth in earnings, which will allow it to at least maintain its dividend returns to shareholders.

PRIME MEDIA - Share Price



SOURCE: ASX

RADAR CRITERIA: PAYING DIVIDENDS



WE ILLUSTRATE WHY DIVIDENDS ARE SO IMPORTANT AND WHAT TO LOOK FOR WHEN YOU FIND THEM

USE DIVIDENDS TO STEADY THE SHIP

With the share market trading near 16-month lows it is easy to forget the reason why we at Radar invest in shares: dividends.

In the words of Radar's Portfolio Manager: "Without dividends there is no point to investing; without dividends, it's speculation."

At Radar, we realise that the most powerful weapon an investor has is choosing to opt out; not to invest.

But dividends offer the biggest protection investors have, when they do opt in. It is often overlooked that extensive studies in the US have shown that about two-thirds of returns from shares come from dividends, or the income that companies pay investors out of their profits. Right now, investors need all the protection they can get.

USE SMALL CAPS TO FIND BIG DIVIDENDS

Small caps are a great place to hunt for high and sustainable dividends because these companies have to work harder than their bigger counterparts to attract investor interest.

Dividends in the companies we advocate are as high as 12 per cent (including franking credits).

IMPUTATION OR FRANKING CREDITS

Franking (also known as imputation) credits allow investors to claim money from the tax department, and reflect the difference between their marginal tax rate and the corporate tax rate. Basically it's a mechanism to stop double taxation, because dividends come from a corporation's after tax profits.

A company might pay out 10 cents a share in dividends, and because this comes from its earnings on which it has paid 30 per cent tax, the investor gets 3 cents of credits when she does her tax return.

At Radar, we also realise that the point of a portfolio for an individual investor is to make money that you can live off.

It's true that you would make money from investing in Fortescue Metals if you traded it when it went from \$1.50 to over \$12 between early 2007 and mid-2008. But just remember that you would have had to have timed your exit extremely well, because it plummeted down to \$2 a few months later.

BE WARY OF SPECULATION

The point is that unless you trade, your value will be embedded in the stock, and your paper gains might add up to nought. Do we need to remind you of spectacular share market failures (preceded by massive success) such as OneTel, or the numerous dotcom plays such as Solution 6 and LibertyOne?

Without dividends there is no point to investing;
without dividends, it's speculation

If your wealth is attached to such companies, and you don't sell, it's obvious that a non-income paying investment can prove to be worth less.

As a private individual, it's always important to find a balance between growth and income when investing. This is what we look at when choosing stocks to invest in at Radar.

Income, after all, provides the fuel for further speculative investment in growth stories.

It's also important to remember that timing is the most difficult thing to get right. This is one of the reasons why it is important to own a portfolio of stocks.

We will discuss market timing in a future issue. The point we are making here is that dividends and income in general offset the need to achieve perfection in investment timing.

...we also realise that the point of a portfolio for an individual investor is to make money that you can live off.

Companies that Radar advocates in the main are paying strong dividend yields. If they aren't, they are just starting to pay dividends, or intend to pay them very soon.

RETURN ON EQUITY IS VERY IMPORTANT

We look not just for high dividend payers, but for companies that can sustain paying dividends. This means the dividends that we forecast are covered by sufficient earnings.

These companies have dividend pay-out ratios in the region of 65 per cent, meaning that the dividends paid are 65 per cent of the profit after tax. This means that the remainder can be reinvested in the company to achieve earnings growth.

So it's important to clarify that we're not fixated by dividends. Rather we look at companies growing their return on equity, and hence can offer increasing dividends in the future.

BE WARY OF BANKS

In contrast, banks are often talked about as "yield investments", as they currently trade on yields of more than 7 per cent before tax or imputation credits are taken into account.

Include these tax credits, and the yield jumps to more than 10 per cent.

Although this seems a good return, in reality the dividend yield is not maintainable because banks will struggle to achieve profit growth and there will be dilution of investors' current stakes.

In the wake of the financial crisis and its associated credit squeeze, regulators are increasing the minimum amount of equity capital banks must hold in order to provide a buffer against loan defaults. In order to maintain this, banks raise capital via dividend re-investment schemes (DRPs), and ordinary or hybrid share issues such as ANZ did late last year.

Banks will struggle to increase profits to pay dividends because lending growth has slowed. Why do you think they are all scrambling to reduce their costs (mainly by sacking workers)?

The key point is that a high yield can often mean that a company is close to going to the wall. Where companies have debt, Radar looks carefully at the covenants that it has with its bankers. We discussed this in our article in this series on "Capital Structure", which we released on 15 December 2011.

IT'S BETTER TO BANK ON DIVIDENDS FROM SELECTIVE SMALL CAPS

Dividends mean money now, and take away the risk of investing. We look for companies that have shareholders' interests in mind. Many pay lip service to this, but the most tangible evidence is dividends. Right now, small caps need all the support they can get from the investment community. Which is why so many are offering outstanding returns by way of dividend income. The question of dividends is always high on Radar's list when speaking with companies.

Just look at the focus we place on them in our share tips. ■

BIG AIR

The junior telco is starting to fulfil Big Promises... its share price is moving northward, and it is about to pay dividends.

SHARE PRICE **\$0.32** | MARKET CAPITALISATION **\$48M** | ASX CODE **BGL**

THE CULT OF BIG AIR Big Air is a growing telco with a growing number of followers.

This is partly because it has grown so quickly. The company has doubled in size over the past year, and has tripled in the past 18 months.

Acquisitions can do that. It has made four of them in the past year and a half. The biggest of these was Clever Comms, previously the second biggest provider of wireless networks in the country.

Big Air is now the largest provider of wireless fixed broadband in Australia, having spent about \$10 million in the past 10 years installing over 100 base stations or transmission sites around the country. It is also the biggest player in the fragmented market of providing internet services for student accommodation.

Fast expansion like this is normally a cause for concern. Companies that grow too quickly and then come unstuck are too many to name.

ZERO DEBT, BIG SYNERGIES But Big Air has been able to achieve this feat without taking on debt, and it has also been generating synergies from the four acquisitions it has made in the past year – so far it has generated about \$2 million and chief executive Jason Ashton estimates it can find another \$1 million in cost savings and revenue gains in the current year.

In fiscal 2011 Big Air turned over \$15.5 million in sales, generating \$1.5 million in profit. The current year, however, will see the full benefits of its acquisitions. Expectations are for \$27 million in sales producing over \$5 million in profit after tax, which translates to earnings per share of 3.5 cents.

DIVIDENDS GIVE CONFIDENCE The company has said that it will pay a dividend of 1 cent next year and will pay out 33 per cent of net profits in the future.

The massive profit growth is also because Big Air has done much of the installation work for its network and now sales dollars drop through to the bottom line. Its operating (EBIT) margin in fiscal 2011 was just above 18 per cent. Based on the above profit forecasts, this means it may climb to close to 30 per cent in the current year.

THE CLOUD, NBN AND JASON ASHTON Big Air is a big beneficiary from the NBN rollout according to chief executive Jason Ashton, because companies need the backup that his wireless service provides as they transfer their servers onto the “cloud” – a fancy term for data centres.

He also says that many small and medium sized businesses urgently need the kinds of speed that the NBN promises in the future:

“The NBN is creating a pent up demand for high speed internet, and we’re able to deliver NBN speed of 100 megs a second before the NBN is constructed.”

STUDENT ACCOMMODATION He is also bullish about the growth the group is achieving from providing internet services to student accommodation. In 2011 earnings from this segment represented about 15 per cent of operational earnings. Ashton says that this proportion will only go up because in the second half it achieved revenue growth of 25 per cent.

TELSTRA The elephant in the room for Big Air is Telstra. The telecommunications world in Australia is a fast changing one, and Big Air wouldn't even be a blip on the Telstra radar. Compare Big Air's annual spend of about \$4 million on plant and equipment and acquisitions to Telstra's \$3.5 billion spend on capital expenditure – and this doesn't include investments!

Hypothetically, if Telstra wanted to get into the wireless act (no pun intended) it would simply create its own network, leaving Big Air out in the cold. We can't see why it would, though.

HIGH RISK/HIGH RETURN (POTENTIAL) The key point is that Big Air is in an industry moving at breakneck speed and investors need to place a great deal of faith in Jason Ashton's ability to move even more quickly in anticipation of such changes.

Big Air is currently the cheapest telco on the market, trading at a discount to even fellow junior telco Vocus. We envisage if it can get through 2012 unscathed this discount will turn into a premium. ■

BULL POINTS

- Growing need for two telecommunications lines
- Benefiting from capital expenditure
- Fast growing telco provider for student accommodation
- Paying dividends

BEAR POINTS

- Outlook for telco sector cloudy
- Speculative investment
- Telstra

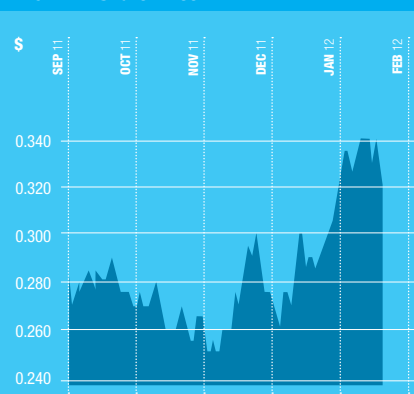
WHY WE LIKE IT

This junior telco is going places under its talismanic chief Jason Ashton, a founder of internet service provider Magna Data in 1993, and previously chief of the telco Davnet. Big Air is Australia's biggest provider of wireless broadband, and is also the leading provider of managed internet services in tertiary education.

WHAT'S NEW?

In November Big Air announced a profit upgrade, saying that it will generate about \$9 million in operating earnings for fiscal 2012. This means it will have tripled earnings in the past two years. Based on its first quarter earnings however, it should comfortably exceed this. It will also start paying dividends.

BIG AIR - Share Price



SOURCE: ASX

FUND MANAGER: MICRO EQUITIES

CARLOS GIL, CHIEF INVESTMENT OFFICER



A COMBINATION OF NOT FOLLOWING THE HERD AND FORTUITOUS TIMING HAS DELIVERED INVESTORS IN MICRO EQUITIES FUND A RETURN OF ALMOST 30 PER CENT A YEAR SINCE COMMENCING IN EARLY 2009.



A GENUINE SMALL CAP INVESTOR

For many small cap fund managers size is a big issue. These managers won't invest in companies that have market caps of less than \$100 million and are rarely traded, and therefore are difficult to extract profits from.

One of the few specialists in the field is Micro Equities, which runs a value fund of about \$20 million, largely from individual investors.

It invests in listed companies that have market caps of less than \$250 million. The fund has invested in companies that had market caps as small as \$5 million.

Under Carlos Gil, Micro Equities has achieved a return of almost 30 per cent a year since commencing in early 2009. Over the same period the All Ordinaries Index has returned just under 15 per cent a year.

The fund has had success investing in the "micro-cap" end of the technology and mining services sectors.

CONCENTRATED PORTFOLIO

This success can be partially attributed to it only owning 15 companies at any one time. And by investing in companies that are not widely owned by Gil's competitors, his fund has kept clear of the herd mentality that predominates in Australian funds management.

He is wary about illuminating much in the way of his fund's actual holdings, saying that this is intellectual property. But we find out that they include some companies which Radar has tipped: junior telco **Big Air (BGL)**; nutritional biotechnology company **Clover (CLV)**; and mining services software specialist **ISS (ISS)**. Another company Gil likes, but won't commit to being invested in, is **XRF Scientific (XRF)** which analyses mineral samples for miners. So far, Radar hasn't tipped this one.

TECHNOLOGY BIAS

Micro Equities' fund's high IT concentration was not pre-meditated, according to Gil, but has occurred because it has been largely ignored by the institutional world:

"Because my peers don't value Australian software and technology companies with the exception of some mainstream players like Reckon and Technology One, we have been able to find really attractive stocks on low (PE) multiples."

Gil says he buys technology stocks on PE multiples of 8 to 10 times that, if listed on the NASDAQ in the US, would trade on 15 to 20 times.

FLYING START

The fact that the fund started just as the share market was recovering has also helped its performance – something like 90 per cent of the return was in its first year of operation.

This gave Gil and his team of four analysts the kind of opportunity that does not occur every day (or year, or decade).

"We like buying companies that are trading at ridiculous multiples, multiples that suggest the company is going to the wall," says Gil.

He says that many of his fund's original investments were in companies that were trading on cash flow multiples (enterprise value, or market cap plus net debt, divided by operational earnings, or EBITDA) as low as 2 times. These days the average cash flow multiple for a small cap is between 5 and 7 times.

A case in point he relates is Clever Communications, which was the second biggest player in the fixed wireless telecommunications space. Having said that, its market cap was still less than \$30 million.

Gil's team bought in when its shares were trading at 2 cents and on a multiple of cash flow multiple of 2 times. It had about \$1.5 million in debt and was in breach of its covenants with ANZ Bank.

After several false starts, Gil says that he finally convinced Clever's board to merge with its competitor **Big Air (BGL)**.

FUND MANAGER: CARLOS GIL CONT

His fund now finds itself holding 7.8 per cent of the combined group, a position which Gil unsurprisingly says he is extremely comfortable with. Luckily for us, he does expand on this:

“2012 is a pivotal year for Big Air because it is only now that it can reap the benefits for scale. It has undertaken a lot of capital expenditure, and it finally has an Australia wide franchise. This means its margins will expand a lot.”

Read Radar's Share tip on page 5 on Big Air to find out more.

BIG AIR VERSUS VOCUS

We ask him to compare Big Air to fellow junior telco, **Vocus Communications (VOC)**, which his team also follows closely. Vocus resells the fibre capacity it owns on Southern Cross's cable to internet companies like iiNet, Yahoo and Vodafone Hutchison.

“Vocus has competent management, but (Big Air) is still the cheapest telco in Australia, when it comes to growth,” he says.

MINING VERSUS MINING SERVICES

Elsewhere, his fund has invested in mining companies previously, but prefers mining services, because these companies are not “price takers”:

“A mining company is exposed to commodity price fluctuations, and the share prices move on that basis. A mining services company has a say in the prices it receives rather than being a price taker.”

In this department his fund owns ISS, which Radar covered in our previous issue dated 12 January. This company provides software for the oil and gas industry that saves them money by summarising data and reporting exceptions. Due to a renewed focus on sales, it is forecast to grow earnings over the next few years having produced flat results for the past three years.

Another one of Gil's favourites is **XRF Scientific (XRF)**, although he won't commit to being invested. This company does mineral testing for miners and generates half its income from exploration, and the other half from production.

“This company has a great business, because its business is based on exploration spending and capital expanding in mining production, both of which keep going up.”

In the end, investing all comes down to risk and risk tolerance, according to Gil, which is particularly pertinent for small companies, which are often viewed as very risky in times of massive uncertainty, like now.

GIL DISMISSES THAT BEING SMALL IMPLIES MORE RISK

“This is a big misconception. Risk is something that can damage a company, or business; an unforeseeable event wreaking damage to a business.”

An image of an Italian ocean liner pops into my mind.

“But this is unrelated to size. You just have to look at the collapse of European and American banks, and the fact that Telstra's return over the past 10 years has been dismal.

[Even after its bounce, its shares are close to 40 per cent of their value 10 years ago]

“A business like your humble corner store is often in a much better position... it has a diverse client base; it doesn't have a technology threat; and there are little threats in the way of regulation.”

Gil might not be investing in corner shops, but this is music to the ears of this publication. ■

MANAGING A 20-20 SHARE PORTFOLIO

OUR PORTFOLIO MANAGER, "THE IDLE SPECULATOR" DOES FURTHER ANALYSIS ON OUR DEVELOPING PORTFOLIO, AND PONDERES WHETHER THE RECOVERY FOR INVESTORS WILL PICK UP IN PACE

TRANSACTIONS FOR UNDER THE RADAR SMALL CAPS PORTFOLIO

ASX CODE	COMPANY NAME	LAST TRANSACTION DATE	NUMBER HELD	TOTAL COST (\$)	PRICE @ 23/01/12 (\$)	CURRENT VALUE (\$)	SHARES (%)
AJM	Altura Mining	22/11/11	10000	1,678	0.175	1,750	3
CKF	Collins Foods	20/12/11	1000	1,308	1.36	1,360	3
MLB	Melbourne IT	22/11/11	1000	1,468	1.61	1,610	3
NMS	Neptune Marine Services	20/12/11	50000	1,478	0.027	1,350	3
RED	Red 5	22/11/11	400	722	1.55	620	1
AFI	Australian Foundation Investment	6/12/11	2000	8,368	4.16	8,320	17
STW	SPDR S&P/ASX 200 Fund - ETF	22/11/11	400	15,856	39.44	15,776	31
Shares	61.2%					30,786	
Cash	38.8%					19,549	
Portfolio	100.0%			Grand Total		50,335	

PERFORMANCE

Radar's portfolio is up 1 per cent to the 20th of January, 2012 after commencing close to two months ago, and a couple of observations are necessary. Firstly, we have been lucky that the majority of our stocks have seen their prices rise since we purchased them. In the short and medium term there are no guarantees about the direction of particular stock prices. Even when a stock is cheap, that can mean it is on the way to getting cheaper still. A stock might be priced at three times underlying earnings, which would seem to be a very cheap price. But if the underlying earnings are currently so obscured that the market cannot easily find reference points (ie the company is losing money now), the stock is just as likely to fall as it is to rise.

Obviously, if we are right about the underlying earnings, the fact that a stock has fallen by a third is simply an opportunity to buy more. And over time, this is one of the primary sources of the best returns, delivered not through being right at the right time, but having the courage of one's convictions and continuing to invest despite the fact that one appears to be wrong for months and sometimes years.

SPECIAL DIVIDENDS

One thing I will be looking for from companies is big dividends. More than once in the past few years, I have come across a company which paid a special dividend greater than its share price had traded at for some time. This can be close to an ideal investment. Here the

stock returns your original investment capital as quickly as possible (in cash) without diluting your share of the underlying business. Your original capital can then be redeployed to new opportunities.

The Idle Speculator did not see this particular opportunity, but some of the fund managers the editor has interviewed for Under The Radar Report have achieved this result from RHG – the mortgage book of the old Rams Home Loans business. Its float in 2007 was oversold leading to a huge financial opportunity that was nearly taken away from shareholders by management. Another peril of smaller company investing, is that management can sometimes help themselves at the expense of shareholders. In the case of RHG, shareholders prevailed and have been very well rewarded for their efforts and commitment.

RADAR'S CAUTIOUS APPROACH TO INVESTING

We are adding another \$25,000 this issue, and it is clear that all of the positions in the smaller companies that we have invested in are of sub-optimal size. This is partly because as we are starting out, we have a natural caution to ensure that we do not blow the portfolio up in the first five or ten issues. A full position in any one stock of perhaps \$2,500 would have represented 5 to 10 per cent of the overall portfolio, or at least 20 to 40 per cent of the small caps allocation in the portfolio.

While you might sometimes let one of your winners run this far, you would only come close to this sort of over-allocation as a result

CONTINUED OVER

of letting a particularly successful stock run once you have taken sufficient profits to cover the cost of the position, provided of course that you still like the story. Ordinarily, over-exposure to one small cap stock could prove disastrous, due to some extraneous event.

PROPOSED TRANSACTIONS

Part of the task over the next few months will be not only to find the next 5 to 8 stocks for the small caps part of the portfolio, but also to identify among those holdings we already have, which ones should be added to and when, and which should be discarded and when. The point being that leaving the holdings at their existing size is not a medium-term option. The bottom line is that we want to see the fundamental story about our companies and stocks improve. But if the share price declines then we ought to regard that as an opportunity to add to a holding.

As for next week, we will buy 1600 Argo Investments (ARG) for the Market weighted part of the portfolio, at below \$5.40, (December's NTA pre deferred tax). We will also place a couple of limit orders for existing holdings.

Buy 500 Melbourne IT (MLB) @ or below \$1.50
Buy 25,000 Neptune Marine (NMS) @ or below 2.6 cents

We do not expect all these orders to be completed unless the market turns down as a whole. We will leave these limit orders in place from Tuesday until the end of next week in the first instance, and advise you in our regular emails if we want to keep these orders in place through the following week until the next issue

Collins Foods' (CKF) results will be very interesting, and with such a short publicly listed track record there is no need to commit more there, though to be fair management have been running the business for more than 20 years.

From previous issues, we could be interested in Tap Oil (TAP), which may have run ahead of itself, Engenco (EGN), WDS (WDS), Global Construction Services (GCS) and particularly Southern Cross Electricals (SXE), but would like to see half year results before spending more money.

"GREEN SHOOTS"?

My investment thoughts for this issue revolve around the fact that there has been some positive price movements in the specific situations within the small cap space both in Australia and in some of the overseas markets that I follow.

This is after at least 9 months of downward trends. While it may be too early to call these price indications "green shoots", it might mean that there is less tendency on the margin for stock specific issues not to be taken into consideration. I'm not sure how many negatives there are in that sentence, but it seems to me that there may be one last down-draught in the markets in relation to the European debt situation before the decks can be cleared and stock specific factors ought to generally be more important than the state of the nation.

It might even be that some unrelated strategic event, such as a stand-off in the Straits of Hormuz indirectly contributes to a denouement of the situation in Greece which we do not expect to remain within the euro.

It is not that we want to comment on geopolitical or high-level forex matters, but at the same time the story of markets in times of difficulty is that the stock specific information that should impact the valuation of smaller companies is less important than the general market for smaller company equities in the context of the investment environment for each particular investment group who might be interested in this sector.

As Keynes is credited with saying: "the market can remain irrational longer than you can remain liquid".

In investing in smaller companies, ample spare liquidity needs to be maintained at all times. Our Under The Radar portfolio will reflect this need to ensure that ammunition is available for opportunistic purchases, as well as funds to cover occasional disasters which will inevitably rock the portfolio.

COMMISSIONS

Finally, on the question of performance, we are disappointed in a way that the otherwise mild success we have had with our current stock picks has to some extent been outweighed by the costs of commissions. We are using a figure of \$27.50 including GST for a commission which is somewhere in the middle of the range of potential prices for online broking. We may run an exercise later in the year identifying what the impact of a lower rate commission might have been, but in the meantime we need to ensure that each transaction counts and is not wasted in its net contribution despite these relatively high commissions. In the meantime, we remain committed to representing investment performance as it is, and not as it theoretically might be. ■

WARNING: This publication is general information only, which means it does not take into account your investment objectives, financial situation or needs. You should therefore consider whether a particular recommendation is appropriate for your needs before acting on it, and we recommend seeking advice from a financial adviser or stockbroker before making a decision.

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