



13 January 2010

PO Box R718  
Royal Exchange  
NSW 1225

Dear Investor,

**Smallco Investment Fund  
6 Monthly Newsletter to 31/12/09**

The Smallco Investment Fund continued to perform well in the six months ended 31 December 2009 with a return of 35%. The closing unit price was \$1.67. For the calendar year the fund returned a strong 54%. These performances were buoyed by a strong market in which the fund outperformed the Small Industrial Index by 7% in the most recent half and 9% for the year.

In world markets, the first three months of the 2009 calendar year continued on the same extremely negative mood as 2008. Since then, however, equity markets around the world have rebounded strongly. Looking forward, assuming the Australian economy performs solidly as most economists expect, the prospect is for corporate earnings to strengthen as 2010 progresses.

One of the significant contributors to the performance of the Fund over the last year has been Southern Cross Media Group (SXL – formerly Macquarie Media Group). SXL is a major regional television and radio broadcaster. About a year ago when we were buying the stock, the market didn't like SXL's total debt level or its "Macquarie" structure and accounting. In its panic, the market ignored the fact that while SXL's share price was around \$0.80, the parent company had \$1.60 of cash and all the debt was at the subsidiary level and non-recourse to the parent. Approximately a year later, SXL has reduced debt to acceptable levels (issuing equity at prices well above what the market was previously fretting about) and is also changing its holding structure to a standard corporate model with internalised management. The stock is now trading around \$2.00 and while no longer extremely cheap, SXL not only provides significant leverage to an emerging turnaround in advertising spend, it also remains one of the cheapest traditional media companies – despite having assets that are at least as good as other traditional media companies.

We have previously mentioned our holdings in the internet companies Seek, REA Group and Wotif. In September, carsales.com listed and the fund purchased a position. Carsales.com is the dominant website for Australian automotive classifieds with over 50% of the market. Over the last few years there has been a strong move from print classifieds to online classifieds with online automotive classifieds forecast to grow at over 20% compound to 2012. As the dominant website owner we anticipate that carsales.com will continue to grow its earnings strongly and the market forecasts exceed 15% EPS growth over the next three years. All four of these internet stocks have returned more than 45% over the last six months as the market anticipates a period of solid earnings growth.



The Fund has re-opened to new investors. Historically we have strictly managed capacity to ensure that the size of funds-under-management does not hinder performance. We will continue to monitor this and will re-close the Fund at a size that ensures it remains nimble.

On behalf of the Smallco team, I would like to take this opportunity to thank you for your support of the Fund. We will continue to work diligently over the coming period to achieve a satisfactory return and I look forward to giving you an update in 6 months.

Please remember that along with providing regular 6 Monthly Newsletters we are available during business hours to discuss any relevant issues or provide ongoing updates. Please feel free to contact Craig Miller, one of our investment managers, on 02 8256 1000.

Yours sincerely

A handwritten signature in black ink that reads "Rob Hopkins".

**Rob Hopkins**  
Smallco Investment Manager