



26 July 2010

**Officium Special Situations Fund
Investment Manager's Annual Letter 2010**

Dear Investor,

Although not as eventful as financial year 2009, the 2010 financial year was littered with noteworthy developments. The first quarter of the year saw both the United States and Japan announce that their economies had returned to growth in the June quarter of 2009 as government stimulus measures and monetary policy actions appeared to place the global economy on a recovery path. Corporate earnings also tended to rebound strongly in the first quarter, which led to improvements in investor sentiment. However in the following quarters, debt issues, firstly in Dubai and then in Greece and Southern Europe, saw hopes of a global economic recovery begin to wilt and investor risk aversion return to markets. In this environment the domestic market, as measured by the All Ordinaries Accumulation Index increased by just over 20% in the first quarter, before finishing with a full year return of 13.8%.

PORTFOLIO SUMMARY

The Officium Special Situations Fund returned 23.0% for the year, outperforming the major Australian indices. The gold equities held in the portfolio were the main positive contributors to this outperformance, as they benefited from a 34.1% increase in the USD gold price. The main detractor from investment performance was the investment in Oceania Capital Partners which declined by 37.1% in June, pulling the full year return from the investment down to -12.6%.

During the year the decision was made to focus Officium Capital's efforts purely on the management of its fund of funds and its product manufacturing capabilities. As a result it was decided to transition the management of the Officium Special Situations Fund to an external specialist equities manager who would invest in a spread of investments across 10 to 20 securities, whilst maintaining the focus on 'special situations'. Given Officium's knowledge of the underlying holdings, it was decided that Officium will continue to manage the holdings that were deemed to be trading at discounts to intrinsic value, and to transition the cash holdings, as investments are sold, to Intelligent Investor Funds Management.

Intelligent Investor Funds Management is part of The Intelligent Investor Group of Companies which has been providing investment advice to retail investors through a subscription-based publishing business for the past 11 years. Steve Johnson is the Chief Investment Officer at Intelligent Investor Funds Management and is also the manager of the Intelligent Investor Value Fund. During May the majority of the cash position in the Officium Special Situations Fund was transitioned to Intelligent Investor Funds Management to invest.

With the market volatility since this cash was transitioned, Intelligent Investor Funds Management have been able to establish positions in 11 holdings, representing 30.2% of Fund assets at the end of the financial year. Officium Capital continues to manage the remaining equities within the portfolio which consists of

nine holdings. The cash weighting was 24.8% at the end of the financial year. The individual holdings within the portfolio include:

Resolute Mining – Holding Managed by Officium Capital

Resolute Mining Limited (ASX Code: RSG) has been a long-term core holding of the Officium Special Situations Fund. However, throughout the year the position was sold down from 32.8% to 5.2% of the Fund's assets. This sell down was undertaken to take advantage of the narrowing of the assessed discount to value that the company was trading at, with the share price increasing 61.1% for the year, and to further diversify the portfolio. The Officium Special Situations Fund supported a capital raising programme undertaken by the company mid way through the 2009 financial year and as such has 11.8% of the Fund's assets invested in the Resolute Mining Convertible Notes (ASX Code: RSGG) and 3.0% of the Fund's assets invested in the Resolute Mining Limited Options (ASX Code: RSGO). In the 12 months to the end of June these holdings provided returns of 75.4% and 57.9%, respectively.

These returns followed solid production rates being recorded at RSG's gold mining operations at Ravenswood in Australia and Golden Pride in Tanzania. In addition, the Syama Gold Mine in Mali was able to increase quarterly production throughout the year as the mine ramp up continued. Despite the improvement in production rates at the Syama Gold Mine, quarterly production rates remain below management guidance and resulted in management reducing financial year 2010 production expectations from 400,000 ounces of gold to 370,000 ounces of gold.

Oceania Capital Partners – Holding Managed by Officium Capital

At the end of June the Officium Special Situations Fund had 18.9% of the portfolio invested in Oceania Capital Partners (ASX Code: OCP). After adding to the position last financial year in the \$1.60 to \$1.70 per share range, the Officium Special Situations Fund slightly reduced exposure to the holding this financial year when the share price was trading around the \$2.80 to \$3.00 per share range. The company paid a distribution of six cents per share during the year, provided a return of capital of 30 cents per share and ended the year trading at \$1.51 per share. Despite the recent share price decline, management have committed to providing investors with the opportunity in April 2011 to vote on the future direction of the Company, subject to the share price continuing to trade at a discount to net asset value of more than 15%. This vote could provide the Fund with an opportunity to exit this position and still earn an attractive return from current prices.

Early in the financial year OCP rescinded its management agreement with Allco Equity Partners Management and have since been managing its own assets. Despite the change in management, the company maintained its investments in iSOFT Group (ASX Code: ISF), Signature Security Group and Baycorp Collections. ISF is the largest of these investments and is a global leader in providing IT health solutions to the healthcare industry. The ISF share price declined by 73.5% during the year, as the company announced an earnings downgrade in June 2010 that saw EBITDA revised down from a range of \$105 million to \$120 million to \$45 million to \$60 million. This revision was attributed to the deferral, of revenue resulting from the uncertainty in the industry caused by the change of government in the United Kingdom and the weakening of the pound. In contrast, Signature Security Group and Baycorp collections performed well throughout the year.

Remaining Holdings - Managed by Officium Capital

Towards the end of the 2009 financial year the Officium Special Situations Fund had commenced reducing exposure to Intrepid Mines, as the share price traded at prices around the Fund's assessment of its intrinsic value. This sell down was

completed towards the end of the 2010 financial year following sharp share price gains that were associated with the announcement of transactional activity. This leaves the Officium Special Situations Fund with holdings in the Ethane Pipeline Income Fund, Catalpa Resources, the Daisy Holding Company, Paladin Energy and the LinQ Resources Fund. Combined, these holdings represent 6.0% of the Officium Special Situations Fund.

Infrastructure Investments – Managed by Intelligent Investor Funds Management

The Officium Special Situations Fund has established positions in a number of listed infrastructure funds, including Spark Infrastructure (ASX Code: SKI), MAP Group (ASX Code: MAP) and Prime Infrastructure (ASK Code: PIH). Across these three holdings the Fund owns a diverse range of infrastructure assets including airports, gas pipelines, coal terminals and electricity distribution networks that all share the characteristic of being broadly immune to the economic cycle. As such they are well aligned with the Fund's pessimistic outlook for the global economy (see "Market Outlook" below). In addition each holding is an excellent investment in their own right, with all three holdings currently yielding in excess of 8% per annum.

UXC – Managed by Intelligent Investor Funds Management

IT services company UXC (ASX Code: UXC) has been a dramatic underperformer amongst Australia's otherwise highly successful listed IT businesses (competitors include Oakton and SMS Management and Technology). The company hasn't made a profit for the past two years thanks to a disastrous dalliance with the Federal Government's 'green' stimulus programs. The Fund has invested in the company because these short-term issues are masking an otherwise highly profitable business (the loss making businesses have already been shut down). The board has also told shareholders that some or all of the business is up for sale. The company's \$720 million revenue stream should be appealing to a competitor or private equity investor looking for scale in this rapidly growing industry.

Photon Group – Managed by Intelligent Investor Funds Management

Marketing company Photon Group (ASX Code: PGA) is in the middle of a large capital restructure. The shares haven't traded since the 7th of June while the new CEO and its bankers negotiate with investors and vendors of businesses Photon has previously acquired – it owes an estimated \$176 million in deferred consideration.

The company is generating enough profit to justify the \$191 million market capitalisation implied by the last traded price. Despite the current troubles, the business is still expected to generate an underlying post-tax profit of \$28 million this year. But it is going to need cash to get through the next few years of deferred payments and debt obligations and the Fund will most likely be participating in the restructure plans due to be announced in the next few weeks.

Remaining holdings – Managed by Intelligent Investor Funds Management

During the past three months, the Fund has also established meaningful positions in 1300 Smiles, RNY Property Trust, Tassal Group and smaller positions in a number of other stocks the Fund is continuing to purchase as opportunities arise.

MARKET OUTLOOK – Intelligent Investor Funds Management

The Greek Crisis has spurred a wave of fiscal austerity measures that dramatically increase the risk of a 'double dip', or second recession, for the global economy. As Nobel Prize winning economist Paul Krugman put it in a recent piece for the *New York Times*, *'while long-term fiscal responsibility is important, slashing spending in the midst of a depression, which deepens that depression and paves the way for*

deflation, is actually self-defeating'. Pulling the rug from under the still struggling economies runs the risk of ushering in what Krugman is already calling The Third Depression.

The other side of the argument is that the debt-fuelled level of consumption that Krugman wants his government to maintain is clearly unsustainable. Substituting private debts with public ones is not a long-term solution. *'Public debt is ultimately a private burden'*, Nouriel Roubini wrote in a 31 May piece for the *Financial Times*, *'governments subsist by taxing private income and wealth, or through the ultimate capital levy of inflation or outright default. Eventually governments must deleverage too, or else public debt will explode, precipitating further, deeper public and private-sector crises.'*

Our view is that both Krugman and Roubini are right. Now is not the time for fiscal austerity. But neither is government spending a panacea. The US, the UK and Europe need to run short-term deficits but they also need long-term policy that is a genuine solution to the structural problems at hand: labour market inefficiencies, unsustainable pension and health care systems and a general standard of living not justified by current productive capacity. What this means for Australia, with its exposure to Asia and strong government balance sheet, but overleveraged consumers, is difficult to ascertain. Intelligent Investor Funds Management remain extremely cautious and are reluctant to venture from the defensive end of the spectrum, especially given the relative value on offer at the moment.

We thank you for your continued support through what has been a volatile 12 months. If you have any questions regarding the Fund please do not hesitate to contact Officium Capital at admin@officiumcapital.com.au or by phone on (07) 3876 4333, or Intelligent Investor Funds Management at info@iifunds.com.au or by phone on 1800 620 414. Also, please visit our website, www.officiumcapital.com.au to view the latest unit prices, performance data, product disclosure statements and monthly investment reports.

Yours sincerely



John Nunan & Steve Johnson

Important Information

The information in this report has been prepared as at 30 June 2010. Unless otherwise stated, position sizes are as at 30 June 2010. This report is provided for the information of clients and is not intended to provide advice. Whilst all care has been taken in the preparation of this report (using sources believed to be reliable and accurate), no person including Officium Capital, Intelligent Investor Funds Management or any other affiliated company accepts responsibility for any loss suffered by any person arising in reliance on this information other than under law which cannot be excluded. You should seek your own financial and taxation advice before dealing with your investment.

The product disclosure statement ("PDS") for the Officium Special Situations Fund is issued by Officium Capital. The PDS details the terms of the offer and if you wish to invest in the Fund, then you should consider the contents of the PDS, consider whether or not an investment in the Fund is appropriate for you and complete the application form accompanying the PDS. You should also consider the PDS in deciding whether to continue to hold an interest in the Fund.

Past performance should not be taken as an indication of future performance. This information does not take into account your investment objectives, financial situation or particular needs. Before making any investment decision, you should obtain and carefully consider the PDS, having regard to your investment objectives, financial situation and particular needs.