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Companies Announcements Officer
ASX Limited
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ASX Release – Chairman's Address to AGM

Please find attached the Chairman's AGM Address

CHAIRMAN'S ADDRESS TO ANNUAL GENERAL MEETING OF FAT PROPHETS AUSTRALIA FUND 15 NOVEMBER 2010

Since the last AGM in November 2009, somewhat surprisingly perhaps, benchmark indices for Australian equities have barely moved. From 30 September 2009 to 30 September 2010, our usual reference points on these occasions, the Company's pre-tax NTA adjusted for dividends, declined by 0.67% against a 0.67% rise in the S&P/ASX 300 Accumulation index, mainly as a result of the move to cash towards the end of August 2010.

These numbers, of course, mask a twelve month period containing three discrete phases for the Company:

- A period to 31st July 2010, when the Company's money was managed by Fat Prophets Funds Management Australia Pty. Limited, as an S&P/ASX 300 "benchmark aware" portfolio;

- A "transition" period from early August 2010, through to late September 2010, when the Company's portfolio was liquidated and assets predominantly held in cash by the new manager, Merricks Capital Pty. Limited;

- The period from early October onwards where the Company has operated under a new mandate, publicly announced on 1st October 2010, since which time two investments have been made. In line with the new mandate, these exposures now cumulatively account for just under 40% of the company's assets.

Whilst largely historical, it is fair to note that in the ten month period between end September 2009 and end July 2010, adjusting for the dividend paid in March 2010, the pre tax NTA appreciated by 1.07% against a 2.9% decline in the benchmark S&P/ASX 300 Accumulation index. Part of this gain was as a result of the recognition of tax benefits; there was effectively no change in NTA over the period when the performance is measured both gross of expenses and tax changes, so this still represented an acceptable result against the then benchmark.

In addition, during the period between November 2009 and July 2010, the Company retired just over 1.1million shares, or 3.7% of equity at an average price of 88.25cents per share.

Despite good portfolio performance in 2010, allied to the two prior years, a somewhat differentiated portfolio against the peer set of listed investment companies and a reasonably aggressive share buyback program, our shares continued to trade at significant discounts to net asset backing. On 30 June 2010, the largest shareholding block in the Company – 15.6% of the issued capital - changed hands and was acquired on behalf of funds managed by Merricks Capital. This gave the company a new significant shareholder with a highly differentiated set of skills, and for its size, a large and capable investment team.

In subsequent discussions, it was clear to the board that the status quo was not a realistic option. There were various alternatives, including liquidation, large scale capital return, unitisation or a change of mandate. As you are now aware, the Independent Directors on the board – John Reynolds and I – were effectively charged with this decision, and opted for the latter alternative.

This was announced in late July 2010 and full details of the new mandate and the thought processes behind it, were released on 1st October 2010. Let me briefly reiterate the release of 1st October 2010 and the rationale behind the decision. We are well aware there has been some short term criticism of this move, and I will briefly attempt to answer the misgivings of some shareholders.

The board strongly believe that with an odd exception, the conventional listed investment company sector is likely to revert back to the types of structures which pre-dated the 1980's – internally managed, with low costs structures relative to funds managed. Externally managed companies which are benchmark aware (i.e. those which deviate only to a certain degree from a benchmark index) generally struggle to compete with their unit trust equivalents because of the significant extra overlay of costs. This extra overlay of costs can rarely be justified since such funds hold a relatively liquid investment portfolio, and don't need the more costly attributes of a closed-end, permanent capital structure. They can make do with redeemable, open ended capital.

In our situation, running a benchmark aware portfolio with an equity base of around $30million, became increasingly untenable as total MER's exceeded 2%, as discussed at last year's AGM.

However, this didn't mean the Company and its structure had no worth as an ongoing investment vehicle. A $30million permanent capital base with around $2.5million gross of available tax shielded losses and a franking credit pool equivalent to 13.4cents per share has significant value. The key is in the deployment of this capital, and capitalising on its permanent nature.

It is very easy to talk about running highly concentrated investment portfolios in non mainstream securities with a modest amount of capital, but relatively hard to enact. There are very few practitioners in Australia with the skills, resources and dedication to be able to do this. The Independent Directors firmly believe that Merricks Capital is one of very few managers in Australia with this desire or capability. Investing in such a concentrated portfolio requires robust and detailed analysis, the ability to act corporately and the capacity to perform legal work from many standpoints. It also requires a degree of patience and certainly doesn't need open ended capital which decides to redeem at the most inopportune time. The potential rewards of such activity are extremely lucrative.

I will leave it to Adrian Redlich from Merricks to outline the virtues and talents of Merricks after the conclusion of the formal business. What I will say however, is that as a former professional investment practitioner, I am extremely impressed with what I have seen to date, and believe that the company is fortunate to have a senior ex-employee with the major US hedge fund, Citadel, who chose to return back to Australia, guiding the management of its funds to an innovative mandate which leverages the Merricks and company's attributes.

We have received some criticism. In general, it falls into four areas:

- Why not wind up the company?
- Why did shareholders not get a chance to vote on the mandate change?
- Why was Angus Geddes able to sell his shares?
- Why did you liquidate the portfolio?

I hope I have dealt already with the first question. The capital pool has significant value to the shareholders in an ongoing form and can be used appropriately. The board found it farcical that other LIC's are returning a large quantum of their funds to shareholders, given that the costs of raising a $30million capital pool are well over $1.5million, if underwritten. To then find small groups fighting aggressively to gain control of the last $5million or so pool of money, as has been the case in two recent ASX listed investment companies, is rather bizarre.

Under the constitution of the Company and the management agreements, the board are under no obligation to place a new mandate before shareholders. Moreover, it is not as though there is an independent expert arbitrator available to objectively assess the merits of one strategy versus another. In any event, the Directors are highly experienced and credentialed investment practitioners, who have the relevant expertise to evaluate the costs and benefits of various approaches.

That having been said, the mandate still invests in Australian equities, albeit in a different manner, and the board believed that there were significant opportunities available in the near term, well before notional shareholder approval would be forthcoming.

We have had some queries relating the sale by Angus Geddes of his shares in the Company. Angus was free to sell his shareholding – subject to the usual compliance and dealing window provisions. However, having assigned the management contract held by Fat Prophets Funds Management Australia to Merricks, Angus clearly wished to utilise the capital invested in the company elsewhere. In the circumstances, Angus was given permission to deal his shares outside of the normal dealing window. No rules were contravened, and there was a willing buyer and seller at the agreed price.

Finally, the manager chose to liquidate the portfolio towards the end of August based on their views of markets and a desire to start with a “clean slate” for the new mandate. Whilst the mandate was not known at the time, it was clear to all of the board that it would not be a benchmark aware proposition. In these circumstances, the manager exercised their discretion to move to cash. It is acknowledged in the very short term that the former benchmark index gained some 6.7% between end August and the end of October 2010, and that the timing could have been more advantageous. In the medium term, however, the board do not see this as being of great significance.

In closing my remarks, I should stress that the board believe we have an exciting and differentiated strategy for the company. We hope today marks the end of the transition phase with a name change, readily identifying the manager with the company itself. The board cumulatively own 26% or so of the company’s equity and so have a real commitment to getting it right and earning a return commensurate with the overall risk profile. Once the new name and portfolio is established, the board will clearly think through the future management of the company’s capital in respect of both dividends and desirability of retiring equity.

I would like to thank a number of people. Angus Geddes and Steve O’Hanna, the previous fund managers did an excellent job within their mandate, and were highly communicative with the board. Together with Richard Fabricius, the previous company secretary, they assisted in a smooth manager transition. Likewise, Adrian Redlich, Adam Lindell and Michael Bastin from Merricks together with White Outsourcing’s highly efficient group, lead in our case by Sophie Gartzonis, have cemented the new structure. John Reynolds, my fellow independent Director has been an excellent sounding board and provided sensible counsel.

With that in mind, I would like to move to the formal part of the meeting, after which Adrian Redlich from Merricks will discuss Merricks’ capabilities and their approach to managing the Company’s assets.