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Manager's Third Quarter Report ***October 22, 2012***

Update on Current Positions: We are on a good path in our quest to purchase deep value stocks for the portfolio. Due to the very good prices and low valuations of such stocks, their liquidity is extremely low so we have to buy relatively small amounts of stock daily to avoid raising prices due to mainly to our own purchases. Although the pace at which we purchase the stock is slow, we think that our patience is paying off as we continue to obtain value stocks at bargain prices. So far we have managed to invest slightly above 10% of the Fund and here is a report on those positions:

1. ***Tour Eiffel (indicated gross dividend yield of 9.6%):*** We previously reported on this French REIT – see the earlier report on the company's website www.terracapitalplc.com. We bought into this position at an average share price of 41.79 Euros and subsequently received a semi-annual dividend of 2.10 Euros (equal to more than 10% p.a. gross). The dividend terms allowed us to accept shares at a price of 37.04 Euros per share instead of cash, while the stock was selling at 41.25 Euros. Taking into account the dividend, we bought in at about 40.22 Euros average price and, as of this writing, the stock is trading around 43.80 Euros. While this would be an amazing annualized return if it would continue for the rest of the year, we don't like to dwell on short term returns and prefer to look at a stock's long term growth prospects. For the reasons set out in the prior report, we think Tour Eiffel will continue to provide value for the fund.

2. ***Euro Properties (indicated gross dividend yield of 8.2%):*** We had bought in our position at an average price of 4.34 Euros and since that time the price hit 5.30 before correcting "back" to about 5 Euros where it now trades. It is still quite attractive and will pay us a fat dividend in addition to anticipated capital gain. Unless the problems with Greece return with a vengeance, we expect it to remain in the portfolio for some time. The "*What can go Wrong*" scenarios noted in the prior report still remain, and the fat lady has not yet sung, but we still like this position a lot.

3. ***U-Blox (indicated gross dividend yield of 2.2%):*** As befits a Swiss based company, this position simply performs and does its job. It announced the release of 3 new receiver modules which support all satellite positioning systems in operation today and, according to the company, each of them "…delivers fast, accurate and reliable GLONASS and GPS positioning with the industry's lowest power consumption." We continue to like this company and expect it to rise after it posts its 2012 returns in a few months.

New positions:

<u>Equity Bank</u> (indicated gross dividend yield of 4.3%):

What is it: Equity Bank is the largest bank in Kenya (by most metrics) and has a significantly different approach to third world banking than we have seen previously, providing services to the significant "unbanked" market throughout Kenya. It also has operations in Southern Sudan, Uganda, and lately Tanzania and Rwanda and also holds a 24.9% stake in Housing Finance, a leading mortgage provider in Kenya. The bank's loan book is divided into two main segments, with roughly half of all loans made to SME clients and the other half consumer spending loans, with a very small corporate book. As common in microcredit companies, NPLs are low: under 3%. Because of the spike in interest rates in Kenya, caused by the Central bank's attempt to keep inflation low, it would be reasonable to see a spike in NPLs, but this has not happened -- most likely because of the resilience of SME and Microcredit loans to any but the worst macroeconomic shocks.

Equity Bank differs from most microcredit banks due to its reliance on a domestic, unbanked deposit base. It provides rural area residents the chance to have a bank account and receive interest, and does not merely take deposits from wealthy urban centers (or IFIs) and loan them at a punitive interest rate. The difference shows in the spread: whereas a typical Microcredit in Bangladesh pays depositors 7-8%, and charges 35-40%, Equity Bank pays depositors about 11-12% and charges only 24%. Although the spread is high by conventional banking standards, it's the best deal in the microcredit world. Not surprisingly, Equity Bank now has half of all open Kenyan bank accounts.

<u>Why did we buy this?:</u> Kenya is the biggest economy and the hub of the East African Region (Horn of Africa) with a nominal GDP of $30 billion. The Kenyan economy has been growing consistently since political and economic problems in 2007/8. In 2008, real GDP growth was 1.5%, which accelerated to 2.6% in 2009. The growth rate doubled in 2010 to 5.6%. Initial estimates for 2011 had placed the country's GDP growth at 5.0%, but the actual growth was 4.5%. Equity Bank currently trades on an annualized forward P/E of 7.1x, making the bank cheap on an earnings basis. Both the present and the prognosis for the macro situation in 2012, and our conclusion is supportive of an improved performance from Equity Bank.

<u>PORTUCEL SOPORCEL</u> (indicated gross dividend yield of 10.6%):
<u>What is it:</u> Portucel Empresa Produtora de Pasta e Papel SA's main business is the production and sale of writing and printing paper and related products, and it is present in all of the value added chain from research and development of forestry and agricultural production, the purchase of wood and the production and sale of bleached eucalyptus kraft pulp (BEKP) and electric and thermal energy; Portucel is a vertically integrated forestry group that recently boosted annual production capacity to 1.6m tons of pulp (of which 1.1m is integrated into paper) and power generation of 2.5 TWh; the Company exports its products to 119 countries over five continents.

Why we bought it: The Company's valuation, based on P/E, EV/Sales and EV/EBITDA stands close to the lowest levels over last 10 years. We attribute this to its listing in Portugal rather than to any issues with the company itself, in line with our policy to find great companies in troubled markets. Although we are well aware of the situation in paper industry, the Group has been able to overcome even worse times (three or four years ago) without posting a loss. Furthermore, based on new production facilities it put into operation during the last few years, Portucel has been able to increase its output (as well as sales) in the paper market despite a shrinking market; put another way, the Group has continuously increased its market share. The Company invested about €1 billion over the last few years into new manufacturing facilities equipped with the state-of-the-art technology that produces with high efficiency, creating a positive impact on the Company's margins. The Group has proven its ability to wisely use external financing (all covenants related to borrowings have been comfortably met); this, in conjunction with strongly cash-generating operations, shows the strong position of the Group and we have high confidence about its financial situation and its ability to adequately cover all of its debt amortization. Although Portucel recorded a slight decline in revenue from European markets in 2011, it was able to offset this drop by doubling revenue from other markets; obviously, the Group has been able to find new markets for its production. Further, the Group has paid out solid dividends, currently providing a dividend yield in excess of 10%.

What can go wrong?

1. A reduction in the Portuguese tariffs for electricity produced in co-generation facilities, from renewable and non-renewable sources (the effect is not possible to reliably estimate, at the moment);
2. An enlargement of production capacities in Brazil and Uruguay (from 2013 onward) that could disrupt the balance between the paper supply and demand in subsequent years.

OMAN REFRESHMENTS (indicated gross dividend yield of 2.9%):

What is it: Oman Refreshment is the franchisee for Pepsi in Oman, as well as a number of other soft drinks, including Aquafina water, domestically produced fruit juices, and is the importer of Frito Lay.

Why we bought it: It has consistently grown sales and earnings over the last eight years and increased its dividend by over 200%. We think this growth will continue for a number of reasons, including lifestyle changes in Oman, which is urbanizing as a result of increased government infrastructure spending and government urbanization policy and increased discretionary personal income in Oman. Although the company does not release such figures, we estimate that the current *per capital* consumption of Pepsi Cola is about app. 48- 56 Eight ounce drinks per year. Penetration of soft drinks ranges from the relatively high United States where only one company, i.e. Coca Cola, sells over 400 drinks per person per year and with national consumption of about 800 drinks per person – to the relatively low Indian per capita consumption at 15 drinks per person per year (in a billion person population however). It is hard to get figures for most Gulf companies, but the United Arab Emirates has a listed Pepsi Bottler and we assume a consumption of about 250 drinks a year for Pepsi alone. Some evidence from Saudi Arabia implies similar consumption there. This gives an idea of the room for growth that exists for Oman Refreshments. While Coca Cola is present in Oman, it must be imported from Dubai – there is no domestic bottling – and it cannot match Oman Refreshment's wide distribution base. Based on its local bottler and strong penetration of Pepsi coolers throughout the country – and on the shelves, it appears that Pepsi is dominating. The company can comfortably double sales from this point, leading to an eventual forward P/E of 6. As sales have increased margins have increased as well, growing from 6.8% in 2005 to a much healthier 14.1%. In addition, the company has begun replacing fixed assets and spent about 3 million USD on bottling equipment in 2011-2012.

On October 18th the company released its 9 month returns ending September 30 showing a 21% revenue increase over the prior corresponding period in 2011 and a net profit increase exceeding 72% for the same period comparison. The company explained that "The increased profit is mainly due to growing market, increased revenue on account of intensified marketing efforts, improved sales realization along with the efficiencies resulting out of various cost control & costs optimization measures."

What can go wrong?

1. The Omani Macro-economy could be hit with significant shocks which slow down or even prevent the continued urbanization and accompanying growth.
2. Coca Cola's local franchisee could build a bottling plant in Oman, invest a huge amount of money and fight strongly for market share.
3. The beverage business in general is subject to input price shocks; however we believe that this risk is mitigated by management's proven ability to contain damage when it occurs and to increase marketing and distribution abilities to handle input shocks.

OMAN CEMENT (indicated gross dividend yield of 4.6%):

What is it? Oman Cement is a high growth company, dominating cement manufacturing in Oman, a company in the midst of a long term infrastructure expansion program led and managed by a centralized government agency. As opposed to other Gulf countries, urbanization of Oman has started in the relatively recent past, with roughly only 40% of the population currently urbanized with significant future urban expansion planned.

<u>Why did we buy it?:</u> The company has negligible leverage, is conservatively run, and we were impressed with the abilities and management's conservative outlook when we met the CEO personally during our site visit. Oman Cement, as opposed to its GCC competitors, is connected to its own gas line making it the low cost manufacturer in the region. This was one of the factors that allowed it to maintain its market share, although at the cost of slashing margins, during the Dubai crises. Oman Cement has suffered in recent years due to the boom-bust cycle in the UAE. As part of the GCC, Oman had to deal with dumping prices from Dubai cement manufacturers, who were not able to sell in their local markets. The fact that the company was able to survive, and even profit, during those recent difficult years gives confidence that it will be able to prosper during less challenging times. Now that some smaller Dubai cement companies have gone under, the situation has turned around with Oman cement not only done fending off imports, but exporting some of its production to Dubai. As we went to print, the company released its unaudited interim financial statements for the nine month period ending September 30, 2012. The Company recorded total sales of 41,761,564 Omani Rials for the nine months ended 30th September 2012 as compared to 36,265,393 Omani Rials in the corresponding period of the prior year; this lead to a pre-tax profit increase for the period to 14,463,929 Omani Rials as compared to 11,035,537 Omani Rials for the corresponding period of the prior year.

<u>What could go wrong?:</u>

The Oman government could be forced to cut back on its ambitious building program. The Omani Government budget was set on assumed prices of USD $75 per barrel oil. While oil is still well above this price, if it should drop substantially this could adversely affect the government's budget and building plans.

The stock seems to be relatively closely correlated to the movements of the Omani stock market, and even world indices, since cement prices are a commodity product so a global drop would not insulate this position.

As of October 22, 2012 we hold cash and the following major positions, using an approximate valuation on Oct. 22:

Stock	**# of Shares**	**USD Valuation**
Tour Eiffel	26,149	$1,498,000
Eurobank Props	178,017	$1,157,000
U-Blox	21,904	$966,000
Equity Bank	4,210,200	$1,175,000
Oman Refreshments	150,000	$935,000
Oman Cement	360,950	$609,000
Portucel	101,295	$275,000

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