



High Yield Value Bonds

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Fund Facts

Strategy	Value Bonds
Risk	Medium
ISIN	LU0232765429
Share Class Currency	EUR
Fund Inception	16-Nov-2005
Fund Manager	Klaus Blaabjerg
Benchmark	Merrill Lynch Global High Yield (EUR Hedged)
Morningstar Category	Euro High Yield Bond

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Performance

February and the beginning of March, saw high-yield bonds coming under new pressure because of the persistent economic deterioration. Last 3 weeks of March saw a steep rise in prices of high-yield bonds and stocks though. The first quarter return for High Yield Value Bonds was -0.08% compared to a 5.74% return on our benchmark – Merrill Lynch Global High Yield (EUR Hedged).

A combination of two value parameters explains our performance lag relative to the benchmark. First, High Yield Value Bonds invests in cheap firms measured by low price-to-book values, which unfortunately happens to be cyclical firms. During the economic downturn, the majority of high-yield investors rebalanced their portfolios and focused on bonds issued by non-cyclical firms. Second, as a consequence of the financial meltdown, high-yield bonds were hit by one of the biggest liquidity crises ever seen. To ensure high liquidity, the market has favoured bonds issued by large companies which are more easily tradable whenever needed. High Yield Value Bonds deliberately has a large exposure to small-cap companies – and thus the more illiquid bonds – because we like to pick up the liquidity premium to ensure attractive long-term performance.

Portfolio Composition

At the end of the quarter, the fund had 81 holdings and a cash position of 4.9% of the assets under management. During the quarter the portfolio adjustments have focused on companies with strong value parameters like low gearing, low price-to-book and low refinancing risk. The focus on the last factor is a direct consequence of the financial crisis in which even large, well-known companies currently have great difficulties refinancing outstanding debt.

At the end of the quarter, our 10 largest positions accounted for 31.09% of total portfolio holdings. A more detailed description of portfolio composition and returns is available on our website.

Portfolio Valuation

The Sparinvest High Yield Value Bonds fund is currently attractively priced, offering access to bonds with extremely low valuations; a price-to-book of 0.5 and a very attractive yield of 22.6%, compared to 19.36% for the average high-yield market. Furthermore, our holdings have strong balance sheets, with an average net-debt-to-equity of less than 100% (ex-financials) compared to more than 300% for the market on average.

Individual Comments

Sevan Marine

At the end of the quarter, our allocation to the Energy sector was 23% of which most was exposed to small-cap Norwegian energy companies. Because of forced selling in Norwegian energy companies, investors did not distinguish between bonds with or without asset pledge. We have used this quarter to focus our investments in bonds with asset pledge and low loan-to-value.

Sparinvest High Yield Value Bonds holds three different bonds issued by Sevan Marine ASA. Sevan developed a cylinder-shaped oil rig which is well suited for exploration and drilling in areas with unpredictable and harsh weather. Sevans rigs have proven their excellent performance potential even under the toughest conditions where waves reach heights of up to 18 meters which, for operators like Statoil Hydro, is a very attractive economic factor.

One of the bonds issued by Sevan matures in 2011 and has first priority pledge on the floating unit, 'Hummingbird', a rig that is currently contracted in the North Sea. Comparing the total debt to the market value of Hummingbird, we estimate that the value of the rig exceeds the book value of the bonds by more than 70%. Currently, the bonds are priced at USD 57 with a yield of 34%.

To us, Sevan is a classic example of bonds issued by small-cap, cyclical companies that are hit by the current liquidity crisis.

Bombardier

The revenue in Bombardier is divided 50-50 between their aerospace and transportation divisions. This has shown to be a fruitful combination at a time where private sector demand for airplanes has decreased but government spending on trains has accelerated.

Currently Bombardier holds USD 3.5 billion in cash and cash equivalents, has a long-term debt of USD 4 billion, and a net-debt-to-equity of 18.95%. Moreover, the company has a backlog in its aerospace and transportation divisions of USD 23.5 billion and USD 24.7 billion, respectively. In addition, during the last 4 years, the firm has deleveraged and stated a goal to become an investment grade company with a solid balance sheet.

The bonds issued by Bombardier have been hit because of the cyclical aerospace business-leg of the company. We think the credit market has - to a large extent - overlooked the less-cyclical but equally revenue-generating transportation division which, in our view, will gain from the accelerated government spending program. At the end of the quarter our fourth largest holding was a BB+ rated bond issued by Bombardier yielding 15%.

Klaus Blaabjerg

Senior Portfolio Manager

8 April 2009

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