

## Global Value Letter to Shareholders Q3/06

**Q3 2006 return: 4.39%**

### Dear Investor

Equity markets performed well during the third quarter of 2006, and the Sparinvest Global Value fund had a return of 4.39%. Year-to-date the return has been 8.39%. The MSCI World Index returned 5.45% during Q3 making our otherwise satisfactory return look less impressive. Year-to-date, however, we are still well ahead of the benchmark's 3.17%.

The table below presents the third quarter return, the year-to-date return, and the 2005 return of the fund compared with different stock market indices:

Sparinvest Global Value versus Index			
	Q3 2006	YTD 2006	2005
Sparinvest Global value	4.39%	8.39%	31.39%
MSCI World Index	5.45%	3.17%	26.17%
MSCI World Value Index	7.16%	6.69%	26.24%
MSCI World Small Cap Index	1.18%	-0.65%	33.33%

MSCI World Index, MSCI World Value Index and MSCI World Small Cap Index are all indices that contain a broad selection of companies from all over the world. All returns on investment are in EUR. ■

### Economics

Following an unprecedented 17 consecutive increases in target interest rates, the Federal Reserve finally put a hold to US monetary tightening in August. Fed officials argued that economic growth had moderated from its quite strong pace earlier this year and pointed to the cooling of the housing market and the lagged effects of earlier increases in interest rates and energy prices. Once again, at the meeting in September the FOMC left the Fed fund rate unchanged.

Now, market participants are divided on the Fed's next move. Prominent banks such as Morgan Stanley and JP Morgan Chase believe the rates will increase again before the end of the year, whereas both Goldman Sachs and Merrill Lynch expect the Fed to lower the US interest rates by 50 basis points before June next year. On average, interest-rate futures revealed that traders are considering lower rates more likely than higher rates. Residential construction is far from the only explanation as to why the Fed stopped the interest rate hikes. The oil price has fallen by 25% since its peak in mid-August, and consumer spending finally seems to be decelerating. End of the quarter, the US Treasuries posted the best returns in four years with a 3.65% on average.

In Europe, the ECB also left rates alone in July but then chose to raise by 25 basis points to 3.0% at the beginning of August. Right after the quarter-end, ECB raised an additional 25 points, and despite the first rise in European unemployment rates since 2003 and the large decline in oil prices, the ECB is expected to raise an extra 25 basis points before year end.

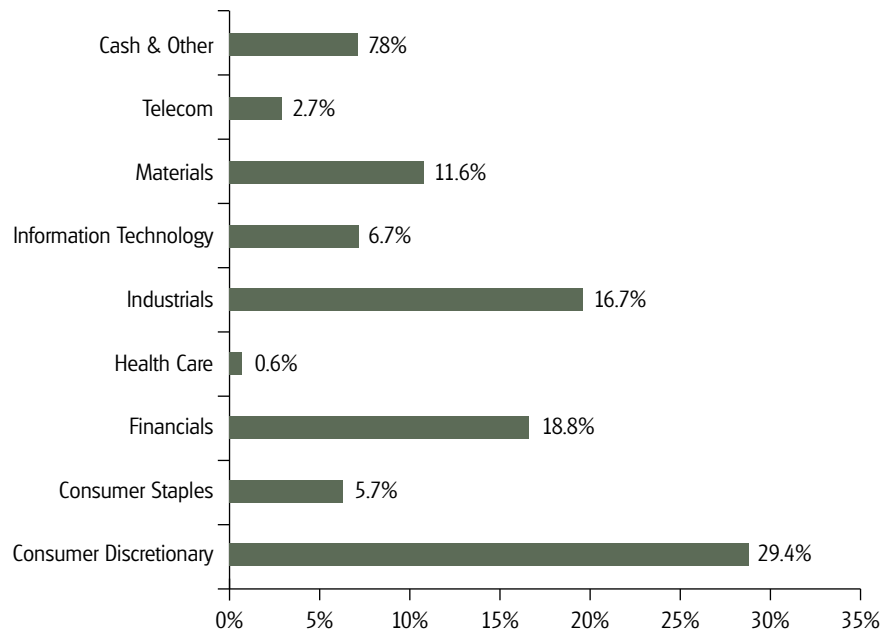
### Portfolio update

2 new investments  
and additional take-over activity

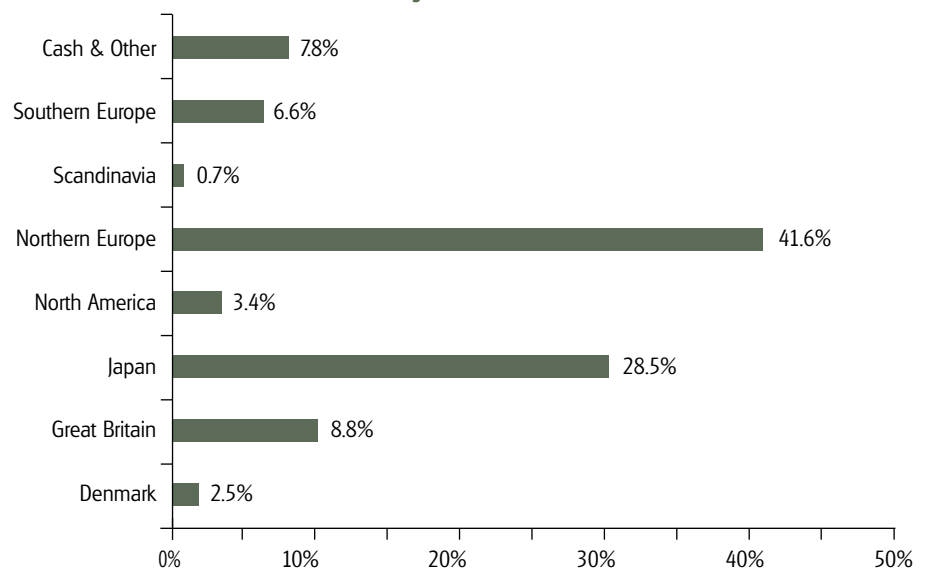
In July, the Bank of Japan raised interest rates for the first time in six years, but despite a EUR 130 billion trade surplus Japanese Yen continued to loose value against EUR and USD. The Bank of Japan's quarterly Tankan business survey beginning of October showed that companies plan to increase spending at the fastest pace in 16 years and confidence climbed to a two-year high. Finance minister Koji Omi declared that Japan's six years of deflation is over. Now, market participants find it likely that interest rates will be raised in either December or March. ■

End of third quarter, the cash position was 78% of assets under management. The fund had 102 holdings with the following industry and country breakdown:

### Industry allocation



### Country allocation



It has been a busy quarter in terms of trading activity. During the quarter we sold our holdings in BAA, De Vere, Hardys & Hanson, Bunka Shutter, Nihon Kohden, Nagase & Co., Kesko Oyj, Fimalac, Metall Zug and Kimball.

We made additional investments in 40 companies, and we bought the shares of two new companies. The newcomers are the well-known Dutch manufacturer of consumer electronics, lightning, medical equipment and semi-conductors, Philips, and the German Bank, Depfa, which specializes in public sector financing.

End of Q3, the 10 largest positions accounted for 28.86% of total portfolio holdings.

Top 10 holdings		
Company	Sector	Share
Volkswagen AG	Automobile Manufacturers	3.52%
Man AG	Industrial Machinery	3.48%
Hochtief AG	Construction & Engineering	2.87%
J.Sainsbury plc	Food Retail	2.85%
Mitsui Sumitomo Insurance Co., Ltd.	Property & Casualty Insurance	2.78%
Peugeot S.A.	Automobile Manufacturers	2.75%
Nippon Tel&Tel	Integrated Telecommunications	2.74%
Nipponkoa Insurance Co., Ltd.	Property & Casualty Insurance	2.73%
Salzgitter AG	Steel	2.62%
Agfa-Gevaert N.V. Mortsel	Photographic Products	2.53%

During Q2 we had take-over approaches for four of our British holdings. Airport operator BAA finally accepted a bid from Spanish construction group Grupo Ferrovial. Brewery and Pub-owner Hardys & Hansons was acquired by its larger competitor Greene King Plc. The hotel operator De Vere accepted an offer from property developer Richard Balfour Lynn, and finally Icelandic Baugur Group is awaiting approval for the purchase of department store chain House of Fraser. ■

#### BAA Take-over

In July, we received payment for our shares in the British Airport Authorities (BAA). The company, at that point in time our largest holding, was acquired by the Spanish construction group Grupo Ferrovial after BAA had entered talks with a rival group of bidders led by Goldman Sachs.

BAA is the world's largest operator of airports. It owns a full portfolio of airports in Great Britain, the best known being Heathrow, Gatwick and Stansted in the London area. The lesser known airports include Glasgow, Edinburgh, Aberdeen and Southampton as well as stakes in airports in Australia and Hungary. BAA generates revenues from servicing the airline traffic but also from activities such as restaurants, tax free shopping and parking services.

In 2003 the BAA shares were trading below their book value. At the same time, the company was generating stable and positive cash flows, and had a robust balance sheet in terms of the asset backing and hidden values. We bought our first shares in October 2003 at 4.71 GBP and built the holding to an average buy price of GBP 6.26.

In late winter of 2006, Grupo Ferrovial approached BAA. At first, the board rejected the bid claiming that it was far from the fair valuation of the company. Then a group of investors led by US investment bank Goldman Sachs became interested in the deal, and Grupo Ferrovial was forced to raise its offer several times. At the end, Goldman Sachs had actually submitted the highest bid, but the BAA board favoured the 950 pence a share bid including a 15 pence dividend from Ferrovial. Since the bidding started on February 7th, the value of BAA had gone up by 45 percent to 10.3 billion pounds, and the story is a clear example of the pay-off, when the board does a good job initiating a beauty contest by inviting other investors to bid.

Including re-investment of dividend BAA had an annual return of 33.7% from our initial investment until the take-over this summer.

### **De Vere** Take-over

We also received payment for our shares in the British De Vere Group. It owns and operates a number of hotels and leisure businesses in the UK employing more than 6,000 people.

End of 2001, De Vere Group was trading at a price to book ratio of 0.5, it was cash positive, paid dividend and had limited debt considering its significant real estate holdings. Furthermore, management had proved historically, that it would pay out extraordinary dividend from divestments. In 2004, the company declined a take-over approach, but in February 2005 it announced a GBP 186 million sale of The Belfry, known for hosting 4 Ryder Cup tournaments, and proceeded to pay out all of the proceeds as special dividend - as management had done 5 years earlier.

We started investing in De Vere in 2002, we bought our first shares at GBP 3.76 and we built the holding at an average price of 419 pence. In June 2006, the company accepted a final takeover bid from property developer Richard Balfour-Lynn pricing the company at 875 pence per share.

Since our initial investment, De Vere stock has had an annual return of 27.6% including re-investment of dividend.

### **Hardys & Hanson** Take-over

Greene King's acquisition of Hardys & Hanson came through as planned, and we received payment mid-September. Nottingham-based Hardys & Hanson is a brewery with a network of pubs mostly in eastern England, and we have been a holder of the stock since 2001. Greene King approached Hardys in the beginning of June with an offer of GBP 10.59, about 48% higher than the average closing price six months prior to the bid and approximately 10 times earnings before interest, tax, depreciation and amortization.

We bought our first shares in December 2001, when the stock was trading at around GBP 3 and only 60% of book value. The company had a strong balance sheet with no debt and no goodwill. At the same time, earnings had been stable and positive since the 1980s.

During our holding time, the stock has had an annual return 36.8% after re-investment of net dividend.

### **House of Fraser** Take-over

Icelandic Baugur group outbid a private equity fund believed to be Apax Partners, and is expected to take over the UK's third largest department store chain. The deal values House of Fraser at GBP 351 million and adds 60 stores to the ten other retail holdings of Baugur Group. We bought House of Fraser in the beginning of July last year at 105 pence per

**Bunka Shutter, Nihon Kohden  
Nagase & Co., Kimball, Kesko,  
Fimalac and Metall-Zug**  
Target reached

share and Baugur's bid of 148 pence means that House of Fraser is up 41% since our initial investment.

We sold three of our Japanese holdings during the quarter. We had been a holder of Bunka Shutter, a Tokyo-based manufacturer of light & heavy-weight shutters, garage doors and sliding doors, since launch of the Global Value Fund. The stock has been a steady earner and climber with a strong balance sheet trading well below its book value for almost a decade. During our holding time, the return of Bunka Shutter has been 32.3% per year in local currency including dividend.

Nihon Kohden is yet another Japanese stock that we could buy very cheap in 2002 and 2003. It produces medical equipment and was in a turn-around situation at the end of the nineties. Since then, the operations improved significantly although it took a while before the share price started to reflect the quality of the company. In 2002 the shares were trading at six times EBITDA and only 0.6 times book value which is extremely low for a company in this kind of industry. Since our initial purchase, the stock has risen from the JPY 360 level to JPY 2000, and the annual local currency return including dividend has been 44.2%.

Also in Japan, we sold Nagase & Co. a chemical, electronics and beauty products manufacturer. Again, the company was very solid both in terms of earnings and balance sheet quality, when we bought our first shares for the Global Value Fund end of 2001. Back then, Nagase was trading at 550 and we sold our stake in July at the 1,350 level. The annual return in JPY has been 23.6% during the holding period.

Despite our average holding time of almost four years, the investment in US furniture and electronics manufacturer Kimball had a very short time span from initial purchase in December 2005 until final sale end of July. This proves that we cannot predict when, one of our holdings will reach our intrinsic value target – it could be a matter of weeks or a matter of years. Kimball took off right after we bought our first shares at USD 10.40 and seven months later we started selling at 18.3. The return was 75 percent during our holding period.

Kesko has a wide range of operations related to food and grocery retailing in Finland. We have been a holder of the stock since 2001, when it was trading below book value, had very strong operational cash flows and a high dividend yield. This quarter it reached our fair value target, and we sold our shares at EUR 32-33. With a price of EUR 10.3 in December 2001, the stock has returned approximately 44.5 during our ownership period.

We have been a long term holder of French conglomerate Fimalac, which used to have a wide spread set of activities including financial rating, diversified manufacturing, furniture and chemical storage. We bought our shares in 2001 as a sum-of-the-parts case. Since then, Fimalac has spun off several businesses, and the shares have risen from 35 to 65 in July, when we decided to sell our shares. This translates to an annual return of 14.1%.

In August we sold our holding in the Swiss company Metall-Zug, a conglomerate with holdings in household goods, heating systems, plastic containers, industrial cleaning and real estate. We have been a holder of the stock since launch of the Global Value fund. At the end of 2001, Metall-Zug was trading at 0.62 times book value. The balance sheet was extremely strong with very little debt and a cash balance of EUR 260 million. The market cap was as low as EUR 308 million, so the down-side protection was indeed very good.

### Outlook

Furthermore, earnings were so strong, that the company was priced at an EV/EBITDA of less than 2. This was a company satisfying every aspect of our investment requirements. The combination of a healthy balance sheet and very strong earnings paid off. In our holding period, Metal-Zug had a return of 36.7%. ■

During the last couple of years, the Euro has gained value against US dollars and Japanese yen. In an unhedged portfolio this will - all other things being equal - influence the return of a globally diversified equity portfolio. We refrain from trying to predict future foreign exchange rates. In fact, our strict bottom-up approach allows us to pick the best value stocks across regions, and we do not worry about having a regional weighting of our stocks that differ significantly from that of our benchmark. So, we do not have overexposure to Japan and underexposure to the US, because we believe that JPY is undervalued and that USD is overvalued. We chose to invest in our Japanese holdings because of the merits of the companies and not because of macroeconomics and currency evaluation.

Although we have achieved excellent returns from our Japanese holdings – as it is apparent when reading the above portfolio update – our EUR denominated returns have suffered from the devaluation of JPY. Year-to-date, the decline in JPY versus EUR exceeds 7%. We are often asked about our opinion regarding the development in major currencies. While it is our job to pick the best value stocks and not the best currencies, it is fair to state that Japan's economy is only now surfacing from a longer period of recession and deflation. Furthermore, at the end of July, Japan had a year-to-date trade surplus of EUR 130 billion, and the central bank is just now starting to raise interest rates making it more attractive to hold the currency. The US, however, posted a record high July trade deficit of EUR 54 billion taking the year-to-date deficit to more than 325 billion dollars. Still, we do not expect better or worse performance due to our currency exposure, and neither should you as an investor. The long run effect will be neutral for a well-diversified global portfolio.

Third quarter, global equity markets saw a recovery from the lows of May and June, and the average equity investor gained 5% or more. There are still a lot of uncertainties with regards to the global economy, and the equity markets remain fragile and have become increasingly volatile during 2006. However, we are very confident in the quality of our current holdings. The risk of permanent loss of capital in Sparinvest Global Value is limited, and the upside potential continues to be very satisfactory. We have a genuinely positive view of the potential of our investments in the future. ■

Yours sincerely,

Sparinvest Asset Management

Jens Moestrup Rasmussen  
Head of Equities and Lead Portfolio Manager  
October 10<sup>th</sup>, 2006

### Notes

### Notes

The mentioned sub-fund is part of Sparinvest SICAV, a Luxembourg-based, open-ended investment company. For further information we refer to the prospectus and the current annual / semi-annual report of Sparinvest SICAV which can be obtained free of charge at the offices of Sparinvest or of appointed distributors. Investments are only made on the basis of these documents. Past performance is no guarantee for future returns. Investors may not get back the full amount invested. Investments may be subject to foreign exchange risks. The investor bears a higher risk for investments into emerging markets. The indicated performance is calculated Net Asset Value to Net Asset Value in the fund's base currency, without consideration of subscription fees. Published by Sparinvest, 28, Boulevard Royal, L-2449 Luxembourg.