

European Value Fund Update Q4/07

Performance highlights

Q4 return -9.56%
2007 return -4.13%

Dear Investor

2007 was a disappointing year for stock market investors in general and also for investors in the Sparinvest European Value fund. The fourth quarter saw a loss of 9.56% taking our full-year return to -4.13%.

The general European equity markets, when measured by the MSCI Europe Index returned 2.69% in 2007, while MSCI Europe Value and MSCI Europe Small Cap had losses of 2.38% and 7.51% respectively. Still, the return of our fund is unsatisfactory in both absolute and relative terms. For new investors it is important to stress, that we - as long-term value investors - must sometimes face losses in the short and medium term in order to achieve superior returns in the long run.

The table below presents the fourth quarter return, the 2007 and the 2006 return of the fund compared with different stock market indices:

Sparinvest European Value versus Index		
	Q4 2007	2007
Sparinvest European Value	-9.56%	-4.13%
MSCI Europe Index	-3.18%	2.69%
MSCI Europe Value Index	-5.07%	-2.38%
MSCI Europe Growth Index	-1.39%	7.82%
MSCI Europe Small Cap Index	-7.20%	-7.51%

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

Economics

History repeated itself in 2007. It is far from being the first time that a real estate bubble and a lack of proper credit controls have caused problems that have spread to the stock markets. The sub-prime crisis is, however, proof that globalisation and the integration of the international financial markets have changed the rules of the game. The current situation compares in many ways to the crisis in the Japanese real estate market in the late eighties. Back then, the losses were mostly limited to Japanese companies and investors. Today, although the large US banks have suffered some of the largest losses, victims of sub-prime have emerged in Germany, Japan and many other countries.

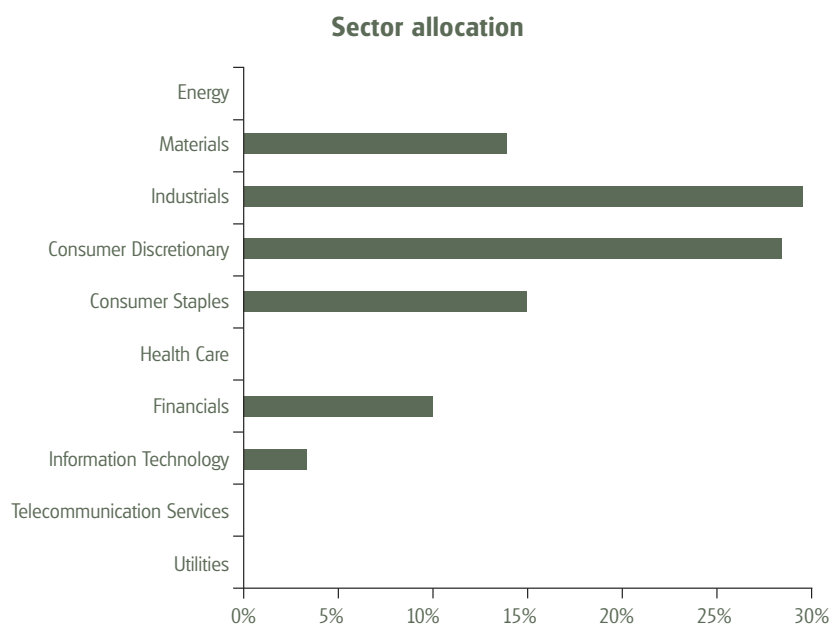
Using both individual rate cuts and coordinated efforts, the larger central banks tried to ease markets as liquidity dried up and market participants failed to engage out of the fear that a counterparty could have sub-prime exposure. At first, the Federal Reserve lowered its rate by 0.5% in September and later by 0.25% in November. But, when the credit crunch continued its rage at the beginning of December, market participants were expecting another 0.5% rate cut. The FED settled for only 0.25%, and the stock markets dropped again. On December 12th, the largest coordinated central bank effort since 9/11 2001 took place. Besides the Federal Reserve, ECB, Bank of England, the Canadian and the Swiss central banks participated.

Alongside the negative impact of the sub-prime crisis on stock markets, the US-dollar came under serious pressure. USD fell to a record low level against EUR, as the expected re-allocation of China's massive 1.4 trillion foreign reserves away from USD caused concern. The US dollar has lost almost half its value against EUR when compared to the 2001 level.

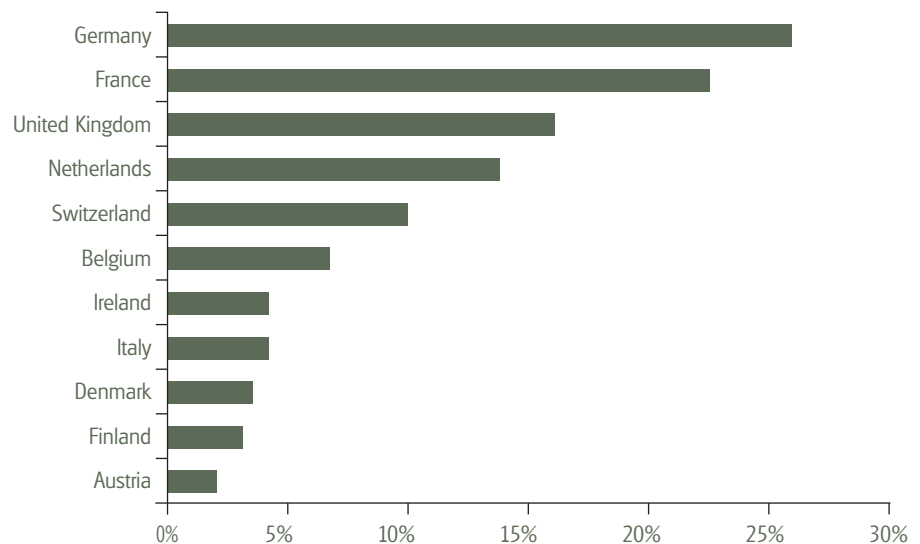
The outlook for both inflation and output in the developed countries has deteriorated significantly during 2007. The one exception is Japan, where growth has finally climbed closer to the 2 percent level, although the country still suffers from serious economic difficulties. The oil price has not improved the situation, as it has gone up steadily and broken new records during fourth quarter. In the beginning of the new year, it crossed the USD 100 level, causing stock markets to drop even further. ■

Portfolio update

At the end of the quarter, the cash position was 1.5% of assets under management. The fund had 61 holdings with the following sector and country breakdown:



Country allocation



We are still building the fund towards 80 or more positions, and the current market conditions – however tough they are on returns – create new opportunities for us to find value stocks. During the quarter, we invested in one new company, Swiss radiator manufacturer, Zehnder Group.

End of Q4, the 10 largest positions accounted for 26.5% of total portfolio holdings.

Top 10 holdings		
Company	Sector	Share
L.D.C.	Consumer Staples	3.13%
Grammer	Consumer Discretionary	3.07%
Philips Electronics	Industrials	2.98%
Alfred McAlpine	Industrials	2.60%
Renault	Consumer Discretionary	2.52%
Guyenne & Gascogne	Consumer Staples	2.50%
A.P. Moeller - Maersk	Industrials	2.47%
Peugeot	Consumer Discretionary	2.42%
Deutsche Postbank	Financials	2.41%
Dexia	Financials	2.41%

Take-over activity may stall Sainsbury bid withdrawn

The Sparinvest value funds have historically benefited from a large share of take-overs in the portfolio. Approximately one third of the stocks, we have exited, were taken private by financial buyers such as private equity funds. The reason that private equity funds target the companies in the Sparinvest value funds is that they focus on similar criteria - such as stable long-term earnings power and strong balance sheets.

Alfred McAlpine Take-over

However, the sub-prime crisis has made it more expensive for the private equity funds to finance their leveraged buy-outs. Furthermore, many of the largest US investment banks have struggled when passing on the loans that they had already guaranteed before the sub-prime crisis surfaced to investors. This has, in turn, forced the banks make write downs on the financing of deals that took place in the spring and summer of 2007.

The change in liquidity and credit policy has also had consequences for our portfolio, and the offer for British group, Sainsbury – at the beginning of quarter our fourth largest position. The Delta Two fund, which invests the oil revenues of Gulf emirate Qatar, with-drew its 6 GBP offer for the British retailer. ■

When private equity funds struggle to keep up the pace of the aggressive buy-out behaviour that we have seen in recent years, new opportunities arise for industrial buyers – companies buying companies in their own or related industries – as they can benefit from the stock market losses and buy a low-priced competitor. Carillion, England's second largest builder, showed interest in the engineering group Alfred McAlpine, a member of our European Value portfolio. At first, the McAlpine management rejected the offer as being too low. But, when stock markets took a dive in the fourth quarter, McAlpine suddenly changed its mind, despite the fact that Carillion had lowered its bid in the meantime.

The take-over offer consisted of both cash and shares, and therefore as a general rule we are against this method of payment. In addition, we consider the management's hostile attitude towards the first offer - and subsequent endorsement of the second but lower offer - very odd, to say the least. ■

Outlook

It has been a tough first year for the European Value fund. The fund underperformed the MSCI Europe Index by a significant margin. Many of our holdings, large cap as well as small cap, underperformed their peers.

The US sub-prime issue triggered the crisis that later spread to the rest of the world. The crisis has shaken the financial sector and there was extreme uncertainty as to which financials had sub-prime exposure, and which had none.

Many of our holdings belong to the industrial, financial and retail sectors. These industries experienced a particularly tough 2007. At company level, however, we have seen lots of healthy trading statements with strong earnings and balance sheets. In other words, the fundamentals of our portfolio companies are intact, but the 2007 price chart unfortunately stated the opposite. At the end of the year, the average price to book value of the stocks in our portfolio is as low as 1.3, enterprise value is only 4.7 times EBITDA and net debt to equity is 6.1 %.

As a value investor, at some periods in time one appears to be 'the dumb kid in class', when compared to the rest of the crowd. We have experienced this before, and we will most likely experience it again at some point in the future. It is in times like these that it is extremely important to remain disciplined and stick with the strategy. We continue to focus on the operational value of our companies and not short term price fluctuations. Once you decides to invest in equities, you also expose yourself to market risk that cannot be diversified away. On the other hand the risk related to buying the individual stock can be minimized through careful research.

Even though we experienced very volatile markets with a lot of uncertainty the past quarter, and we see very few signs of improvement in the short term, we have a genuine positive view on the future potential of our investments, due to the quality of the companies in the portfolio. ■

Yours sincerely,

Sparinvest Asset Management

Jens Moestrup Rasmussen
Head of Fund Management and Lead Portfolio Manager
January 9th, 2008

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 full and/or simplified 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 together with the initial statutes of the funds and any subsequent changes to such statutes. 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. For investors in Switzerland the funds' representative and paying agent is RBC Dexia Services Bank S.A., Zurich Branch, Badenerstrasse 567, P.O. Box 101, CH-8066 Zurich. Published by Sparinvest, 28, Boulevard Royal, L-2449 Luxembourg.