Overseas Asset Management

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OAM European Value Fund

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Chairman's statement

The Fund had a good first year. Its net asset value (NAV) per share increased by 36.4%. By comparison, the MSCI European index (US$) increased by 35.2%. We launched the Fund at a time when we felt that European equities offered good value. European equity indices had declined by around 45% from their peaks nearly three years earlier. In retrospect, we were three months too early in our launch. In the first three months of the Fund's life, its NAV per share declined by about 10%, buffeted by the pending Iraq war and SARS. Hindsight is wonderful. Nevertheless, the timing of our launch was reasonable, though by no means perfect.

We are particularly pleased with the Fund's performance because it is mainly invested in less volatile, lower risk businesses and relatively stable investment trusts such as those that purchase endowment policies from policyholders looking to surrender. Such securities tend to underperform in ebullient markets. Indeed, an analysis of the Bloomberg 500 European index shows that the top three sectors in 2003 were computer services, computer hardware and software, and transportation. We held no investments in these sectors apart from limited exposure to shipping through our investment in Bollore. The bottom three sectors were beverages, water, and food. We had no exposure to water, but over $4.5 million (17% of NAV) was invested in Diageo, Weetabix, CSM and Linton Park – all food and beverage businesses.

During the year, we made two mistakes – one big, the other relatively small. The big mistake was in selling half our Weetabix holding at the end of October. Weetabix's share price had climbed more than 50% for the year, and the company was valued at 11 times historic earnings. Arguably, this was below fair value for a cash rich, branded food company with a good track record. However, other factors came into play in reaching this decision. The first was that Weetabix has a dual share structure with the George family controlling the voting shares. The second was that the P/E at which the shares traded at the end of October was at the top end of its historic P/E range. The final reason was that the shares are traded on Ofex, an obscure U.K. exchange with only one market maker. I estimated that it would take 2-3 weeks to sell half our holding. In the event, our shares were snapped up within minutes. In mid-November, Weetabix was bid for by Hicks Muse Tate, a private equity firm, at a 75% premium to the price at which we sold half the holding two and a half weeks earlier. We checked Bloomberg and found that Valentine's Day was the previous day on which as many shares as we sold

at the end of October traded. Armed with this data, we cried foul to the Financial Services Authority (FSA) in the U.K. and asked them to investigate on suspicion of insider trading. Buyout negotiations for Weetabix were almost certainly ongoing when we sold our block of shares. It is more than a little infuriating that someone other than the Fund made a profit of nearly $400,000 on these shares in a few weeks.

The lesser mistake was our relatively small investment in Hagemeyer, a Dutch trading company. In May, Michael Stack visited the company in Naarden so that we could get a better understanding of problems afflicting the company. Not satisfied with their explanations, Michael asked for a list of their top ten customers so that we could contact them. When the list was eventually provided, all the names began with the letters A and B. Suspicious of this coincidence, we contacted one of the companies on the list who told us that they were not customers of Hagemeyer. We sold the shares at a loss of $100,000. This was the right decision, as subsequently, the company breached its banking covenants and are now faced with having to make a massively dilutive rights issue. The share price today is well below where we sold.

Let us turn to happier experiences. During the year we made a profit of over $750,000 selling our holding of Marzotto ordinary shares when its discount to NAV narrowed from around 35% to around 15%. We replaced some of the holding with Marzotto savings shares. The savings shares sell at a 25% discount to the ordinaries. There are more than 25 times as many ordinary shares as there are savings shares and we think that it is only a matter of time before the savings shares are converted to ordinaries on a 1:1 basis. In addition, the savings shares carry a much higher dividend yield which is only subject to 12.5% withholding tax versus 25% withholding tax on ordinary share dividends.

Another happy experience was our sale of our relatively small holding of Zignago shares at a profit of $40,000 after this cash rich company declared a large special dividend. It is a shame that this was not a larger holding, but we were deterred from increasing the size of the holding by its recently collapsed merger discussions with Marzotto at terms which were unfavourable to Zignago shareholders. We also made profits (amounts in brackets) on sales of some other small holdings that reached full value, namely Alpine Select ($20,000); Altin ($20,000) and Roche ($15,000).

Another happy, but more tumultuous, experience was the sale of our IFIL shares at a profit of nearly $300,000. We were attracted to IFIL by its discount to NAV in the high '40's. One of its principal holdings, FIAT, experienced difficulties during the year and conducted a rights issue to which IFIL subscribed. Temporarily, IFIL's discount to NAV drifted above 50%. Later in the year, when its discount narrowed to around 35%, we sold our holding in IFIL and switched the proceeds into IFI, another Agnelli holding company. IFI has two attractions relative to IFIL. One is that its discount to NAV is over 50%. The other is that IFI is sandwiched in the control chain between IFIL and the private Agnelli family holding company. IFI's only assets are its holdings in IFIL and Exor, a Luxembourg holding company which is selling all its assets. We think that within a year or two, the Agnellis will eliminate IFI from the control chain (at a much narrower discount to NAV than today) as it becomes redundant in their chain of control. The market capitalisation of the IFI preferred shares that we own (the only publicly-traded share class) is just over Euro 500 million. This would be a manageable amount for the Agnellis to afford with their Exor liquidation proceeds and the recent Euro 240 million in proceeds to IFIL from selling the properties owned by La Rinescente to Simon Properties. Finally, although we are not counting on it, IFI may benefit from a recovery at Fiat, one of

its key investments. Fiat recently recruited the head of Audi as their new CEO. Fiat also recently won 2004 European Car of the Year with its Panda model.

Another switch between holding companies within the same family group was made during the year. We sold our holding in Groupe Bruxelles Lambert (GBL) at a profit of over $250,000 after its discount to NAV narrowed to around 34%, while the discount to NAV of CNP increased to about 40%. We believe that CNP is the most likely of Albert Frere's three listed holding companies to see a narrowing of its discount to NAV. It therefore seemed illogical for it to sell at the largest discount to NAV of the three entities. The only possible rationale was the lower liquidity of CNP's shares versus GBL's shares. For a shareholding of our size, this is not a constraint. The main differences between CNP and GBL are that CNP is at the top of the control chain and GBL is at the bottom, and CNP has greater exposure to Total Fina Elf, one of the world's largest oil companies. We feel comfortable with CNP's large exposure to Total Fina Elf (nearly 50% of CNP's NAV) which is well managed and sells at a P/E of 12 and yields 3.5%.

We also sold part of our holding in Pantheon International Participations at a $35,000. profit when its discount to NAV narrowed to 8%. This is a well-managed closed-end fund, but we felt that the discount had narrowed to a fair level. Another reason for reducing the holding was that most clients already have exposure to this asset class through their investment in OAM/Greenpark. Subsequent to our partial sale, the share price fell back to a 18% discount which is why we did not sell the rest of the holding. Indeed, three directors of Pantheon International Participations bought 65,000 shares worth over $500,000. in the open market last month which is an encouraging sign.

During the year we sold our shares in one of the RCM Dresdner Endowment Policy investment trusts for a profit of $40,000. We model the endowment policy trusts based on a conservative assumption of an immediate 20% cut in bonus rates (they have already been cut by 50%) and NAV/share growth of 3-6% (higher growth for the longer dated trusts and vice versa). Based on these assumptions, the trust we sold would produce less than 8% annual growth to redemption. This compares to estimates of 10-12% per annum returns to redemption for the endowment policy trusts that we still own, an attractive return we believe for what on an underlying basis are essentially balanced funds, owning a mix of equities, bonds and property.

During the year, after careful analysis by Michael Stack, we added three French-listed companies to the Fund at what we believe are extraordinarily attractive prices. The first new holding was CMT Medical, a small Israeli manufacturer of critical components for digital x-ray equipment that are sold principally to Toshiba and GE. CMT Medical is a cash rich company. Based on stated earnings, its shares are selling at a P/E of less than 8, but adjusted for cash, we estimate that the business is selling at a P/E of 4.5. CMT Medical is contemplating a dual-listing of its shares on AIM. This could be a catalyst for revaluation of the shares to a more reasonable level. We were also encouraged by Shamrock Holdings, the private Disney family company, buying a 20% stake in CMT Medical in May last year. In August, Shamrock sold 7.5 million shares of Disney and stated that they are setting up a $120 million fund for investment in Israel.

The other new French holdings are Societe Fonciere Financiere and Bollore Investissement. Societe Fonciere Financiere is the Peugeot family's listed holding company. Fonciere is debt-free. We bought shares in Fonciere at a 45% discount to NAV. Over 80% of its NAV is accounted for by its holding in Peugeot whose shares sell at a P/E of 6.5 and yield 4%. Peugeot is performing well, driven largely by

its development of world-class diesel engines. I rented a diesel-powered Peugeot in Italy in October and can attest to the quality of the car.

Bollore Investissement is a listed holding company of Vincent Bollore. Like IFI, Bollore Investissement is sandwiched between two other Bollore holding companies and serves no useful purpose. We purchased the shares at a more than 50% discount to NAV, close to a record discount to NAV for this company, and at nearly 20% below the price Vincent Bollore paid a few years ago to buy a 10% stake in Bollore Investissement, increasing Groupe Bollore's stake to 70%. We think that the huge discount to NAV at which Bollore Investissement trades is unwarranted. It has modest debt, particularly after taking into consideration large amounts of net cash held in other companies lower down the control chain. Vincent Bollore has a tremendous track record of investing the free cash flow generated by his companies. He is probably one of the few very wealthy Europeans who is richer now than at the peak of Europe's bull market. One investment that he made, lower down the control chain, was in Rue Imperiale. He made a profit of Euro 290 million on this investment in two years. Rue Imperiale was one of the holding companies within the David-Weil empire (Lazards/Danone) which was selling at a large discount to NAV. Bollore pressured David-Weil to simplify the group's structure and narrow the discount to NAV before he sold at a huge profit. This deal and his ongoing purchases of Bollore Investissement shares suggest that Bollore Investissement will eventually be privatized or acquired by one of Vincent Bollore's holding companies at a much narrower discount to NAV than prevails today.

In the Netherlands, we purchased shares in two companies that are new to the Fund which were not discussed in our 14th February, 2003 newsletter. The first was Vopak, the world leader in tank farms for storing oil and chemicals in places like Rotterdam, Singapore and the Houston Ship Canal. This is an extremely cash generative business that would be very attractive to a private equity buyer. During the year, Vopak sold its non-core assets, consisting primarily of barges and ships. The balance sheet is now strong and they are likely to make earnings accretive acquisitions of tank storage businesses in Eastern Europe and develop greenfield sites in China. In November, following completion of the non-core divestitures, the CFO of Vopak bought Euro 500,000 worth of Vopak shares (at 20% above what we paid) and sold Vopak put options. This is always a good sign.

The other new Dutch addition to the portfolio was Vendex, a large retailer in the Netherlands and Belgium. Vendex's profits are currently depressed by losses at one of its department store formats. However, this summer K-Capital, a boutique fund manager that we admire (whose fund is now closed to investors), built a stake of over 10% in Vendex and formed a shareholder value realisation committee. This committee, of which we are a member, is working with management to realise fair value for Vendex shareholders which we estimate is about 50% higher than the current share price.

As clients are aware from our annual seminar held on April 1st, 2003, I am bullish on the prospects for gold. With the exception of Resources Investment Trust, which we own in several clients portfolios, all the U.K. mining investment trusts sell at miniscule discounts to NAV. Resources Investment Trust shares have been a good investment due to its NAV increasing and the discount to NAV narrowing. The discount to NAV is still around 25%. Towards the end of the year, we had an opportunity to buy a block of shares in Ocean Resources Capital plc, a holding company which finances mining companies, mainly gold mining, on the cusp of starting production. We bought this block at 20p per share, a 50% discount to NAV, and allocated part of the block of shares to the Fund. The Fund's directors determined that we should carry these shares at cost until liquidity of the shares on AIM increases.

The share price today, on thin volume, is 50% higher than our carrying cost so there is a good chance that the value of the holding could increase considerably this year. We are also reassured by the shareholder register. The three largest shareholders are Laxey Partners, Deutsche Bank (proprietary capital run by Lars Bader), and RAB Capital, a hedge fund group. Laxey & Lars Bader are notorious as "fund busters" who push hard for elimination of discounts to NAV.

Another new holding in the portfolio since shareholders were last updated is Banca Popolare di Milano (BPM), a leading bank in Lombardy, Italy's most prosperous region. Normally we have an aversion to investing in financial companies because we struggle in analysing their financial statements. Our only other holding in the financial sector is Almancora, the ultimate holding company of KBC, the third largest bank in Belgium, which has a strong balance sheet and whose shares are relatively cheap. BPM has a clean, conservative balance sheet with a capital adequacy ratio well in excess of Basle requirements. However, its shares are tainted by expensive acquisitions made by the previous management and a pathetic return on equity. The new senior management seems to be doing a good job of improving efficiency, though there is a long way to go judging by their opulent head office banking hall with huge amounts of wasted space. They also seem to be doing a better job of corporate governance and are aware of their fiduciary responsibilities to shareholders. Banks in the U.S. and U.K. are typically valued at around 2-3 times book value. Even in Europe where banking consolidation has yet to really take hold, BPM's shares are a real outlier. We bought the shares at 0.6 times book value. Currently, there is an impediment to the takeover of this bank since it is governed by Italy's archaic co-operative bank laws which give one vote per shareholder, regardless of the number of shares held. However, there are noises that these laws may be amended, prompted in part by an investigation by Frits Bolkestein, the EU Commissioner. A decision is expected within months.

A few weeks prior to the year end, we bought Waterford Wedgwood rights which we exercised. The share price has declined by more than 80% in the past four years. Debt is high and the company will lose money in the year ending 31st March, 2004. The company has not generated enough free cash flow or controlled costs properly in the past. For instance, it has a board of 20 directors. There are strong signs of improving performance and the company has pledged to focus on free cash flow. Costs have recently been cut by moving production of its Johnson Brothers ceramics brand to China. Based on conservative assumptions, we estimate that the shares are selling at around 10 times 2004/5 earnings and interest expense will be about twice covered. While we were doing our analysis, Redmond O'Donoghue, the CEO, bought 1.2 million shares of Waterford Wedgwood for nearly $300,000 in the market. He and the other directors also invested more money in Waterford Wedgwood by exercising their rights two weeks ago. Though this is probably the highest risk holding in the Fund, the upside potential is huge. If net margins return to around 7% which they earned in the mid '90's and also in 1999 and 2000, the P/E would fall to just over 3 based on the current share price.

As you can see from the accompanying table of the Fund's holdings, there is tremendous value, in the Fund's portfolio. The percentage increase column for each category is slightly misleading because it ignores realized gains and losses in each of the four segments that the Fund invests. Based on attribution analysis of the four segments, market leaders and consolidators returned 37.9% during the year; investment trusts and closed end funds returned 31.4%; investment holding companies returned 47.0%; and deep value shares returned 30.9%.

Though I am optimistic about the Fund's prospects, I am increasingly concerned about U.S. equity valuations. If the U.S. equity market falls precipitously, something that I think is very likely, global

equity markets will be affected in the short-term. If the Fund's NAV takes a sharp setback as a result, this should be regarded as an excellent buying opportunity.

Desmond Kinch
Chairman