Overseas Asset Management

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3rd January, 2006 **OAM European Value Fund**

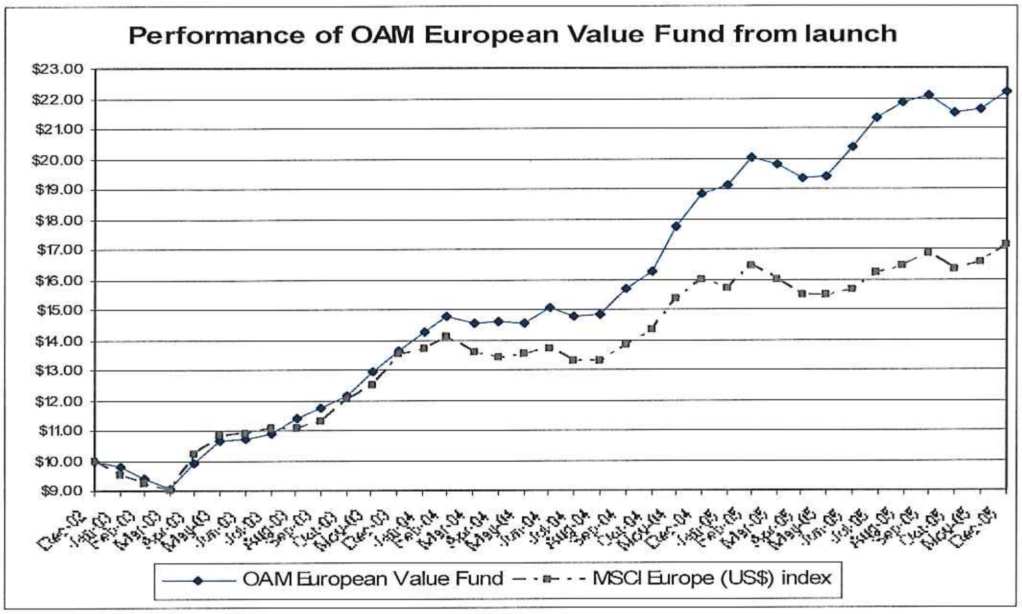
Dear fellow shareholder,

Last year, OAM European Value Fund's NAV increased by 18.1%. By comparison, the Fund's principal benchmark, the MSCI Europe (US$) index, increased by 7.3%. In early 2005, the Fund won an award from Standard & Poor's Fund Services for being the #1 performing European equity offshore fund over one year out of over 300 funds in their universe of European equity offshore funds. Last year I wrote:

"I think shareholders will agree that there is still good value in the Fund's holdings. My principal concern is the level of the Euro and Sterling which on a purchasing power parity basis are about 20-25% overvalued against the Dollar."

In 2005, even though the Euro declined by 12.7% against the Dollar and Sterling fell 10.4%, the Fund still provided shareholders with an attractive return in Dollars. In Euro terms, last year's return was 35.3%.

This is the Fund's third anniversary and its third consecutive year of outperformance. Over the past three years, the Fund's NAV has increased by 122.5% versus 71.3% for the MSCI Europe (US$) index. As subsequent history has shown, the Fund was launched at a time when European equity valuations were cheap. I can assure you that over the next three years, the Fund will not match its historic performance to date of 30.5% per annum. Valuations are still quite attractive in Europe and are still at a significant discount to US equity valuations, though in absolute terms and relative to the US, they are not as compelling as they were three years ago.



I think the best way to enable shareholders to determine for themselves the Fund's future prospects is to provide a bottom-up analysis of the Fund's holdings. The top ten holdings account for just over 50% of the Fund's net assets and the next ten largest holdings account for a further 27% of net assets. The performance of these top 20 holdings (with percentage of the Fund's NAV in brackets) will largely determine the Fund's future return. So here goes with my cursory bottom-up analysis:

Heijmans NV (7%): In the past year, Heijmans returned 51% in Euros and we trimmed the holding slightly. The strong performance was due to Heijmans settling a longstanding investigation with the Dutch government that plagued the entire Dutch building industry who were involved in infrastructure work. Heijmans makes about half its profit from developing and selling residential homes in The Netherlands. Unlike other parts of Europe and the UK and US, The Netherlands does not have a housing price bubble. Heijmans' growth from housing should be quite strong in coming years as there is a housing shortage estimated by the Dutch government at nearly three years' current supply. Moreover, this is a relatively low-risk business since Heijmans pre-sells the homes before they begin construction. Heijmans still remains the Fund's largest holding because we think it is possibly the best managed construction company in Europe and the shares still appear undervalued. On a 2005 P/E of 10 and a dividend yield of 3.8%, the shares are attractive relative to the company's historic EPS growth rate of 17% per annum over the past 15 years. Heijmans' downside risk is protected by a strong balance sheet and a valuable land bank that should provide the company with sufficient land for constructing houses for the next ten years.

IFI preferred (7%): IFI is the Agnelli holding company at the top of the pyramid of publicly-traded Agnelli-controlled companies. Whenever we invest in family-controlled holding companies, we prefer, though not always, to invest in companies at the top of the pyramid. There are two reasons for this: it aligns our interests most closely with the controlling family shareholder, and often you get a discount on a discount on a discount as each holding company within the chain of control typically sells at a discount to NAV, at least in the situations we consider. In the case of IFI, it only has two assets: a controlling stake in IFIL that accounts for more than 95% of its NAV, and a 29% stake in another Agnelli company, Exor, which is now essentially a cash shell that is likely to be liquidated in due course. IFIL's net assets are comprised of a controlling shareholding in Fiat, accounting for around 45% of NAV, a stake in Sequana, a French holding company trading at around a 25% discount to NAV, and Sanpaolo IMI, a leading Italian bank that currently sells at a P/E of 12 and dividend yield of 3.6%. Sequana and Sanpaolo IMI each account for more than 20% of IFI's NAV. Fiat itself is a holding company that sells at a more than 20% discount to NAV. Contrary to the perception of most investors, Fiat's 85% stake in CNH (Case New Holland) and Iveco (commercial trucks) are each worth more than its stake in Fiat Auto based on most analyses that I have seen of Fiat. IFI currently trades a 37% discount to NAV and its underlying assets look attractively valued. IFI has debt net of its stake in Exor of about Euro 100 million versus net assets of about Euro 3.8 billion while IFIL has net cash of about Euro 350 million. Their strong balance sheets have enabled both companies to repurchase shares. We believe that IFI is redundant in the chain of control for the Agnellis and will be merged into IFIL. Since IFI is higher up the chain of control, it is likely that the Agnellis will choose a time when IFI's share price is high relative to IFIL to execute a merger.

<u>Italmobiliare savings (6%)</u>: Italmobiliare is an extremely well-managed holding company that is controlled by the Pesanti family. In spite of these shares providing a total return of more than 25% per annum during the past ten years, the company remains off the radar screen of most investors and consequently still trades at a 39% discount to NAV. The holding company's balance sheet is extremely strong with virtually no debt when holding company debt is offset against cash held in its offshore finance subsidiary (no, this is not another Parmalat!). Its principal asset is a controlling stake in Italcementi which is one of the largest cement companies in the world with operations spanning four continents. This is a highly cash generative business with quite strong barriers to entry. Italcementi has other peripheral investments in Italy which have been carefully selected by the Pesanti family. For instance, they recently sold their stake in Gemina, the share price of which was up 120% year to date at the time of the sale. There is no catalyst for unlocking the huge discount to NAV at which Italmobiliare's shares trade but in the meantime, we are aligned with the Pesanti family which has a superb track record of compounding NAV.

<u>Frere family companies - Cie Nationale a Portfeuille & Pargesa (5%)</u>: CNP is at the top of the holding company structure of Albert Frere, Belgium's wealthiest man who is a self-made man and an extremely savvy investor. The principal assets of CNP are shares in Total Fina (33% of NAV), one of the largest oil companies in the world, and shares in Pargesa (36% of NAV) – jointly controlled with the Desmarais family, one of Canada's wealthiest families - which is sandwiched between Groupe Bruxelles Lambert (GBL) and CNP in the Frere family structure. CNP's other principal investment is a controlling stake in Transcor (recently written up and now accounts for 7% of NAV) which owns oil refineries and has therefore performed extremely well in the past year. Following its sales of stakes in Taittinger, Societe de Louvre, and Joseph (Project Sloane) last year at

multiples of their original cost, CNP now has Euro 1.1 billion in net cash (20% of NAV) on its balance sheet. Pargesa's principal asset is a controlling stake in GBL (83% of NAV) with most of the remainder accounted for by a stake in Imerys, a quoted French building materials company with a good track record and a small amount of net cash. GBL's NAV is comprised of shares in Total Fina (39% of NAV), Bertelsmann (32% of NAV), Suez (19% of NAV), Imerys (8% of NAV), and about Euro 230 million in net cash. Consequently, on a look-through basis, Total Fina accounts for about 45% of CNP's NAV so together with its investment in Transcor, CNP has just over half its assets invested in the oil sector. Prior to owning shares in CNP, the Fund owned shares in GBL but sold them about 18 months ago when the discount to NAV narrowed to the teens and switched into CNP on a low 30's discount to NAV. Today, CNP's discount has narrowed substantially to 16% while Pargesa's discount to NAV is not much narrower than it was two years ago at 26%. The Fund therefore switched a third of its investment in CNP into Pargesa just prior to the year end.

<u>Endowment policy trusts (5%)</u>: The Fund owns shares in five London-listed endowment policy trusts which are the most conservative investments in the Fund's portfolio. These endowment policy trusts buy traded life endowment policies that UK mortgage holders sell in the secondary market rather than surrender. The trusts keep paying the premiums until the policies mature. On a fairly low-risk basis, these trusts will provide the Fund with a Sterling return of 7-10% per annum over the next 1-5 years which is the range of maturities of these trusts. We think this is an attractive return relative to UK gilts of similar maturity which yield about 4.3% over this entire spectrum of maturities, particularly since we do not believe that the risk is anywhere close to an equity-type risk. There could be a boost to returns of these trusts later this year as Standard Life is expected to demutualise and as holders of Standard Life issued policies, these trusts would be entitled to receive shares in Standard Life if it proceeds with its demutualisation plans.

<u>Telecom Italia savings shares (5%):</u> In contrast to 6 years ago at the height of the TMT boom, telecom stocks are viewed quite negatively by most investors, a somewhat justified view in my opinion given the growing competitive threat of VOIP (voice over internet protocol). Nevertheless, Telecom Italia savings shares still stand out as a bargain. The shares are currently valued at a free cash flow yield of more than 10%. Since Olympia, the holding company for Telecom Italia, has huge debt which it needs to service, Telecom Italia pays a generous dividend. Under Italian law, savings shareholders must receive a higher dividend than ordinary shareholders and savings shareholders are taxed at half the withholding tax rate (only 12.5%) as ordinary shareholders. The gross yield on Telecom Italia savings shares is 6% which translates into a net yield of 5.25%. Savings shares represent about a quarter of the equity market capitalisation of Telecom Italia and they represent by far the most expensive part of Telecom Italia's capital structure. I therefore think it is only a matter of time before Telecom Italia's savings shares are eliminated, probably through an exchange for ordinary shares on a one-for-one basis. If this happens, it would give a boost to the savings shares since the ordinary shares currently trade at a 15% premium to the savings shares. In this regard, it is encouraging that Tronchetti Provera, the Chairman of

Telecom Italia, recently bought 1 million Telecom Italia savings shares at around the current price, and last month, Gilberto Benetton also bought 1 million Telecom Italia savings shares (the Benetton family is a large shareholder in Olympia).

Yara International (4%): Yara is the world's largest and lowest cost producer of mineral fertilizer. The company was spun off from Norsk Hydro (spin-offs are often a good area to look for investment ideas). It is the lowest cost producer in its industry with production based primarily in Norway, Qatar and Trinidad, all low cost sources of natural gas which is the main ingredient in the production of nitrogen-based fertilizers. In comparison to its competitors in the US, Yara is very well positioned as the price of natural gas in the US which comes mainly from the Gulf of Mexico is meaningfully higher than what Yara pays for its natural gas. The higher price of natural gas from the Gulf of Mexico, a situation exacerbated by this year's hurricanes, creates a floor price for fertilizer as below that level, many North American producers would shut their production, at least temporarily. In spite of more than doubling since we bought the shares less than two years ago, Yara still sells at a P/E of less than 10. Although Yara's earnings will be cyclical, as with all commodity producers, its management is confident that it can earn a minimum 10% average cash return on investment throughout a cycle. In relation to the current share price, that equates to a P/E of barely over 10 times average earnings throughout the cycle. The fertilizer business is a good business for low-cost producers. Over the past 35 years, fertilizer demand has grown at 6% per annum – faster in the most recent 10 years. Yara is highly free cash flow generative and has been using its free cash flow to repurchase shares and to expand capacity in low cost production centres such as Qatar. Management estimates that the company will be able to increase its global market share from 6% to 10% over the next 10 years through capacity expansion and acquisitions. This should translate into just over 10% per annum top-line growth over the next ten years and even higher EPS growth. This is surely worth more than 10 times earnings.

Bollore family companies - Financiere de L'Odet & Bollore Investissement (4%): Financiere L'Odet is at the top of the holding company structure of Vincent Bollore, one of the wealthiest men in France who is self-made and has an extraordinary track record of making opportunistic investments in companies that are ripe for turnaround or break-up. Bollore Investissement is sandwiched in the middle of Odet and Bollore which largely owns shipping and transportation assets in Africa. Vincent Bollore has realised huge gains on investments made in recent years, most notably in Rue Imperiale & Bouygues. Since 1991, Vincent Bollore has grown the group from Euro 50 million to over Euro 5 billion in turnover. He bought assets cheaply when they were out of favour, using free cash flow. The group has never been to the stock market to raise equity capital. In fact, Bollore Investissement has continually acquired shares in Bollore, increasing its stake from 55% to more than 91% during the past nine years. Odet owns 64% of Bollore Investissement and 1% of Bollore. It too has been buying shares in the other Bollore group companies to increase its shareholding. Bollore has always cited French capital gains tax as an impediment to simplifying the group's structure. At the beginning of last year, the French government eliminated capital gains tax for sales of assets by holding companies. This appears to have been the principal catalyst for the narrowing of the discounts to NAV and consequent strong performance of the Bollore group companies. We sold half the Bollore Investissement holding in October when its discount to NAV narrowed to just over 10%. Its discount to NAV currently stands at 21% while the discount on our much larger holding in Odet stands at 31%.

Vopak (3%): Vopak is the world's largest owner of storage terminals for the oil and chemicals industries. This is an annuity-type business typified by long-term contracts signed with oil and chemical multinationals to store oil in key locations such as Rotterdam, Singapore, the Houston Ship Canal, Tallin, and Shanghai. Vopak's share price has more than doubled from the Fund's original cost and the shares are looking fairly valued at 16 times 2005 estimated earnings. We continue to hold the shares because this is a well-managed company in a fairly predictable business with high barriers to entry. The company also generates high free cash flow. In fact, depreciation is higher than maintenance capital expenditure which means that the company's free cash flow yield is higher than its earnings yield. In other words, the shares are cheaper than they look on a P/E basis. Vopak currently earns a return on equity (ROE) of 14%. This high free cash flow and an attractive ROE allows the company to fund its expansion opportunities which currently include storage terminals in Shanghai, Darwin, Singapore, Rotterdam, Antwerp and Zhangzijagang which come on stream over the next 2 ½ years. This expansion should result in fairly predictable EPS of growth just over 10% per annum for at least the next three years. These new terminals are only built once Vopak has signed long-term contracts of 15-25 years to justify their construction. Any subsequent storage contracts that are signed boost their baseline return. Vopak's management has indicated that, on average, they require a return on invested capital of at least 12% initially and 16% longer-term when evaluating new projects.

Cattles plc (3%): Cattles is a new holding that was added in recent months. They are focused on consumer lending through a branch network in the UK, supported by consumer profiling done in a central location which is based on many years experience in the non-standard consumer finance market. Although consumer indebtedness has climbed in the UK in recent years, Cattles has maintained stable arrears and bad debts, primarily by making small loans and avoiding re-mortgages and credit cards which have been the areas that have started to suffer recently from defaults. Cattles is conservatively financed with a capital adequacy ratio of 24% (compared to 7-8% for most banks). In spite of their relatively low gearing, they have a return on equity of 22%. It is a very well-managed company with 7 out of 9 board members being chartered accountants, including the Chairman, Barrie Cottingham who is the former senior partner of Coopers of Lybrand in the UK and Sean Mahon, the CEO, who was previously chairman and senior partner of the northern region of Pricewaterhouse Coopers. What attracted me to Cattles, other than the fact that it is one of the best financial businesses (outside investment management) that I have ever encountered, is that its share price had essentially moved sideways for the past 7 ½ years and it was at the bottom of this trading band. Meanwhile, in the past 7 years, its EPS had increased 2 ½ times, maintaining its 16% per annum growth rate that it has achieved over the past 15 years. While the shares had justifiably traded at a premium to the market – typically at 15-20 times earnings – I bought them arguably at half their historic average valuation. For the first time in 2005, Cattles had to adopt IFRS instead of UK GAAP reporting of its financial statements. The switch to IFRS reduced Cattles' EPS by 29% but it had no effect on cash flow as IFRS simply resulted in deferral of some current cash flows. It seems that few retail and some institutional investors did not understand the effect of the switch to IFRS. This enabled me to buy the shares at less than 9 times UK GAAP earnings and 11 times IFRS earnings and a 5.7% dividend yield.

This completes my summary of the top ten holdings which account for more than 50% of the Fund's NAV. My summary of the next 10 largest holdings will be brief.

Lanxess (3%): Lanxess is a bulk and specialty chemicals business that was spun off from Bayer in February 2005. As I said, spin-offs are a good place to look for bargains. In ten months, Lanxess' share price has appreciated 80% in Euros from our cost – a bit less in Dollars. The principal attraction of Lanxess was that it was a turnaround situation that had a good chance of working and the upside was large if it worked. The senior management all had large incentives to make the turnaround work and the CEO and CFO had track records of turning around other businesses in the chemicals industry. The upside was large because when we bought shares in Lanxess, its market capitalization was 20% of sales.

Hiscox plc (3%): From the end of 2000 to early 2005, the FTSE All Share Insurance Index had declined by two-thirds. Many of the London-listed Lloyds underwriters were selling at single digit P/E's and I knew that insurance pricing was strong following the large claims made in 2004. After analyzing several of the Lloyds underwriters, I concluded that Hiscox had the best underwriting track record of the London-listed insurers going back 30 years under the current Chairman, Robert Hiscox. After meeting the impressive South African-born CEO of Hiscox, Bronek Masojada, in May last year, I bought a shareholding for the Fund at a P/E of 7 and then added to the holding by subscribing to their November rights issue which is funding their new Bermuda reinsurer which is being formed to take advantage of even higher insurance rates following the 2005 hurricane season.

Blue Planet Financials Growth & Income Trust (3%): This investment trust has multiple attractions: it is well-managed with a superior investment track record, shareholders' interests are aligned with management which owns 23% of the Trust's shares, the shares trade at an attractive 27% discount to NAV, and there is a wind-up vote in 5 ½ years. The Fund accumulated its holding at record 30-35% discount to NAV this past summer and already has a 30% gain on the holding. This is one of the Fund's riskier holdings since half the Trust's net assets are invested in Eastern European banks. Nevertheless, the return prospects are also high. The development of the banking market in Eastern Europe should lead to high earnings growth for the Eastern European banks in the Trust's portfolio. Currently, the ratio of mortgages to GDP in Central and Eastern Europe averages 5% whereas in the US the ratio is 60%, in the UK it is 70%, and it is 25-50% in most of Europe with Denmark, The Netherlands and Italy being outliers with ratios of 90%, 100% and 15% respectively.

Permasteelisa (3%): Permasteelisa is the world's leading designer and manufacturer of curtain walls for large commercial buildings using modern architectural aluminum, steel and glass facades. In the past, they designed and built curtain walls for buildings such as the Sydney Opera House and the Guggenheim Museum. Permasteelisa's share price declined by 40% between mid-2002 and mid-2003 when I bought an initial holding. In the 2 ½ years since mid-2003, Permasteelisa's share price has moved sideways in a very tight trading range. In October 2005, I spent about two hours with Enzo Pavan, the Chairman, in his office north of Venice improving my understanding of the business. I discovered that Enzo Pavan and other members of senior management are buying more shares in the company, increasing their already large 15% aggregate shareholding. I therefore doubled the size of the Fund's shareholding. Based on my estimate of a recovery in earnings in 2007, Permasteelisa's shares are trading on a P/E of 9 times next year's earnings and will be in a net cash position by the end of this year.

Van de Velde (3%): Van de Velde makes sexy bras and knickers. This is a very well-managed company with a superb track record. Van de Velde has continually gained market share, increasing its sales by more than 10% per annum and its earnings per share by more than 15% per annum during the past 10 years. Even during recessions, the company is still able to increase its earnings. It seems that wives and girlfriends may cut back on their purchases of expensive jewelry and other luxury goods but they do no want to disappoint their husbands and boyfriends, regardless of whether there is a recession or severe stock market downturn. The company generates huge free cash flow which it uses wisely – during the Asian financial crisis to buy a 25% stake in Top Form, the world's largest manufacturer of lingerie whose plants are in China; more recently to expand into retail stores dedicated to selling their brands; and in 2005 they paid out a special dividend from excess cash that, net of withholding tax, was more than 10% of the Fund's purchase price. The shares currently sell at a P/E of 15 times 2005 estimated earnings which is still too cheap for a company of this quality with net cash on its balance sheet.

ASM International (3%): The attraction of ASM International is that the sum of its two parts is considerable higher than the market is currently recognising. ASM International is a semiconductor equipment company with two businesses: the front-end (FE) business which designs, manufacturers and sells equipment that is used to deposit the thin layers of conductive and insulating material on silicon wafers in semiconductor fabrication plants; and the back-end (BE) business which makes equipment for assembling, packaging and inspecting semiconductors. The businesses are roughly equal in size in terms of sales but the FE business is currently unprofitable. ASM International generates virtually all its BE business through its ownership of 53.84% of ASM Pacific Technology, a Hong Kong-listed company. In the notoriously cyclical semiconductor business, ASM Pacific has an unrivalled track record. It has been profitable every year since its formation 29 years ago and shareholders who bought shares when it was floated on the Hong Kong Stock Exchange 16 years ago have made a total return of over 50 times their initial investment. ASM International's stake in ASM Pacific was worth 35% more than its market capitalisation when I bought the shares and it has low debt.

Financiere Tubize (3%): This is the Janssen family's holding company through which they control UCB, a mid-sized Belgium bio-pharmaceutical company. UCB has discovered two important drugs in the past twenty years, Zyrtec and Keppra, and they are on the cusp of launching a third blockbuster, Cimzia, which is an effective treatment for Crohn's disease. UCB's ability to attract and retain some of the world's leading pharmaceutical researchers has resulted in it becoming one of the world's most successful drug discovery companies in the world relative to size. This has resulted in Tubize being one of the world's top performing shares during the past 25 years with a more than 100-fold return. Tubize shares still trade at an attractive 20% discount to the value of their UCB stake.

Diageo (2%): In the middle of last year, the Fund sold half of its Diageo shareholding as, though I still feel that it is an excellent company with a predictable business, the shares looked fairly for a company that will struggle to grow its EPS at 10% per annum. Diageo's shares were (and still are) valued at a P/E of 16 times estimated calendar 2005 earnings and a 3.5% dividend yield. Shortly after selling half the Fund's holding, Warren Buffett's Berkshire Hathaway disclosed that they had bought 15 million Diageo shares. We possibly sold them some of the Fund's shares. Though I like to think independently, it is seldom a good idea to sell shares to Warren Buffett!

Banca Populare di Milano (2%): The share price of this Northern Italian cooperative bank has doubled since we bought them two years ago but still remain reasonably attractive. The bank's management has delivered so far on its cost-cutting programme announced two years ago and there is scope for further cost cutting which should increase EPS by 15-20% this year. The bank's shares still look cheap at 1.2 times book value and fairly valued on 14 times 2005 and 12 times 2006 estimated earnings. This could be a possible takeover target if Italy's archaic law on the voting rights of shareholders in cooperative banks changes under pressure from the EU.

Societe Fonciere Financiere (2%): This is the holding company of the Peugeot family who owns 77% of the company's shares. The shares still trade at an attractive 29% discount to NAV. A 21% shareholding in Peugeot accounts or 80% of the company's NAV with the balance comprising cash and a portfolio of French and Spanish companies. Peugeot is one of the better performing European car companies and looks quite attractive on a P/E of 9. Fonciere has net cash of Euro 225 million, equivalent to 7% of its NAV, following its very profitable sales this year of shares in Taittinger and Societe de Louvre.

Desmond Kinch
Chairman