



KUDU FUND

EMERGING EUROPE, MIDDLE EAST, AFRICA

MONTHLY REPORT MAY 07

KUDU

Monthly Report

The Kudu Fund rose by 0.5% in May, compared to a rise of +2.7% by the Morgan Stanley Pan European Index, and a fall of -2.4% by the Morgan Stanley EMEA Index.

The divergent performance of western European indices compared to EMEA was extremely pronounced in May, with little correlation between the two. In some individual markets this was even more pronounced, with Russia's Micex Index falling -8% during the month.

The Kudu Fund performed well in the face of these negative market conditions, delivering a strong Alpha return. Some specific positions in Abu Dhabi and Qatar performed well, and short positions in Russian oil and gas names delivered both good absolute returns, and provided a hedge against widespread Russian market weakness.

The success of the Kudu Fund's short and long positions in Russia in May, and in the year to date, is clear evidence of the Alpha returns available in this fascinating market. This is not the first period in which the fund has delivered positive returns in the face of falling Russian markets. The fund delivered strong positive returns during two -35% market falls during 2004 when the Yukos affair was unfolding.

The Kudu Fund's strategy in Russia is based upon the same fundamental valuation process we employ in every other region of EMEA. Where the Russian market differs in some degree from other more open countries, is in the imperfect availability and flow of information available to market participants. Corporate governance is improving in Russia, but in this fast-developing market economy, with continual changes in legislation and policy, it is not always easy to analyse the business dynamics affecting individual companies.

As Joseph Stiglitz showed in his Nobel prize-winning work, equal, efficient and open information flow is a prerequisite for the efficient pricing of assets. Moscow, with its opacity and complexity, currently offers a textbook example of a semi-efficient market. This inefficiency in pricing, when taken together with the heated and often emotional debate internationally about Russia, offers considerable opportunity to the Kudu Fund, which uses a skill-based approach to research and analyse information in Russia, and to use that advantage in a market often driven by short-term swings in mood and generalization.

The analysis of Russian shares often involves more probability assumptions about legislative or political developments, than in any other country in the Kudu Fund's activities. The reason for this is that the Russian government is currently having to make important and fundamental decisions about how electricity, gas, oil and minerals are going to be produced, priced, sold and taxed. President Putin gets little credit abroad for the fact that, unlike his G8 counterparts, he spends a large proportion of his time in actually creating a modern state, where none existed before. It is lucky for Russia that the President, whatever his alleged autocratic tendencies, is both able and diligent, two adjectives which could never have been applied to his hard-drinking predecessor.

The fund has spent most of 2007 holding short positions in the Russian oil and gas industry and long positions in companies exposed to the strong development of the domestic economy.

The problem for the Russian oil and gas sector coming into 2007 was not that it was grossly overvalued, but that expectations had been driven to levels that on a probability weighted basis were unreasonable. Depending to some extent on the choice of valuation technique, the sector traded in January at a premium to western Oil companies. Given the punitive level of taxation of crude oil by the Russian government, the only explanation for this valuation gap lay in two other more positive assessments of the industry. The first positive case, was that given the tough nationalistic stance taken by the Russian government towards future oil reserves, it was reasonable to expect that only Russian companies would get access to future discoveries in the vast landmass and oceans of Russia. The second positive view, was that the taxation regime, and the tariff structure - in the case of the domestic gas industry - would change for the better.

In taking short positions in oil and gas names, our assessment was that both these positives were overstated. It is clearly true that only Russian oil and gas companies will get serious access to new reserves, but it is not the intention of the government to stifle competition within the country. Lukoil, Surgut, Gazprom, Rosneft and Novatek will have to compete for new fields. Finding, assessing and developing new fields costs time and money, and all the Russian majors face years of capex and effort to bring new reserves on stream. Realistically the years involved act as a tough discounting hurdle for those future cash flows.

Secondly the prevailing view in January of a taxation and tariff bonanza seemed misplaced. Russia does have some obligations to the World Trade Organisation to liberalise its domestic gas tariffs, but the WTO is hardly the most feared of international bodies, and with national elections in 2008 it seemed unlikely that the government would annoy its own voters with a massive hike in gas prices. Moving on to oil, there was little hard evidence in January that the punitive tax regime was about to change. There was some discussion about reforms around the fringes to encourage exploration or development, but the basic tax rate was in our view unlikely to change.

After falls of between 15-25% from early January the oil and gas companies now more fairly reflect the positive and negative factors which they face, and the Kudu Fund has largely covered its short positions in the sector.

On the long side the fund remains positive about Russian banking, which offers exposure to the growing domestic economy.

By almost any measure, Russian banks have enormous scope for growth. Mortgage lending is virtually non-existent. In a recent meeting with Open Investments, a Moscow based residential property developer, it emerged that 95% of their Moscow property transactions were carried out using cash, and that this is reflective of the market in general. Consumer lending is currently hard to come by, and typically involves a friend or employer guaranteeing any loan, an approach which might cool even Britain's debt-happy population.

On a price to book or price to earnings basis, neither Sberbank, the national champion, nor Vneshtorbank, the recently IPO'd number two, look particularly good value, but on closer examination both companies offer interesting possibilities. Both banks appear to be over-provisioning for largely non-existent non-performing loans, and strong loan growth in 2007 and 2008 should rapidly reduce forward valuations.

In other regions of EMEA there are many interesting opportunities at present. The fund has taken new positions in Egypt and Turkey and exited a number of long positions which have either risen sharply or in some case been subject to takeover activity. In this last category, the fund is exiting Gold Reef Casinos in South Africa, which has been a core holding for two years, and which is subject to a private equity approach.

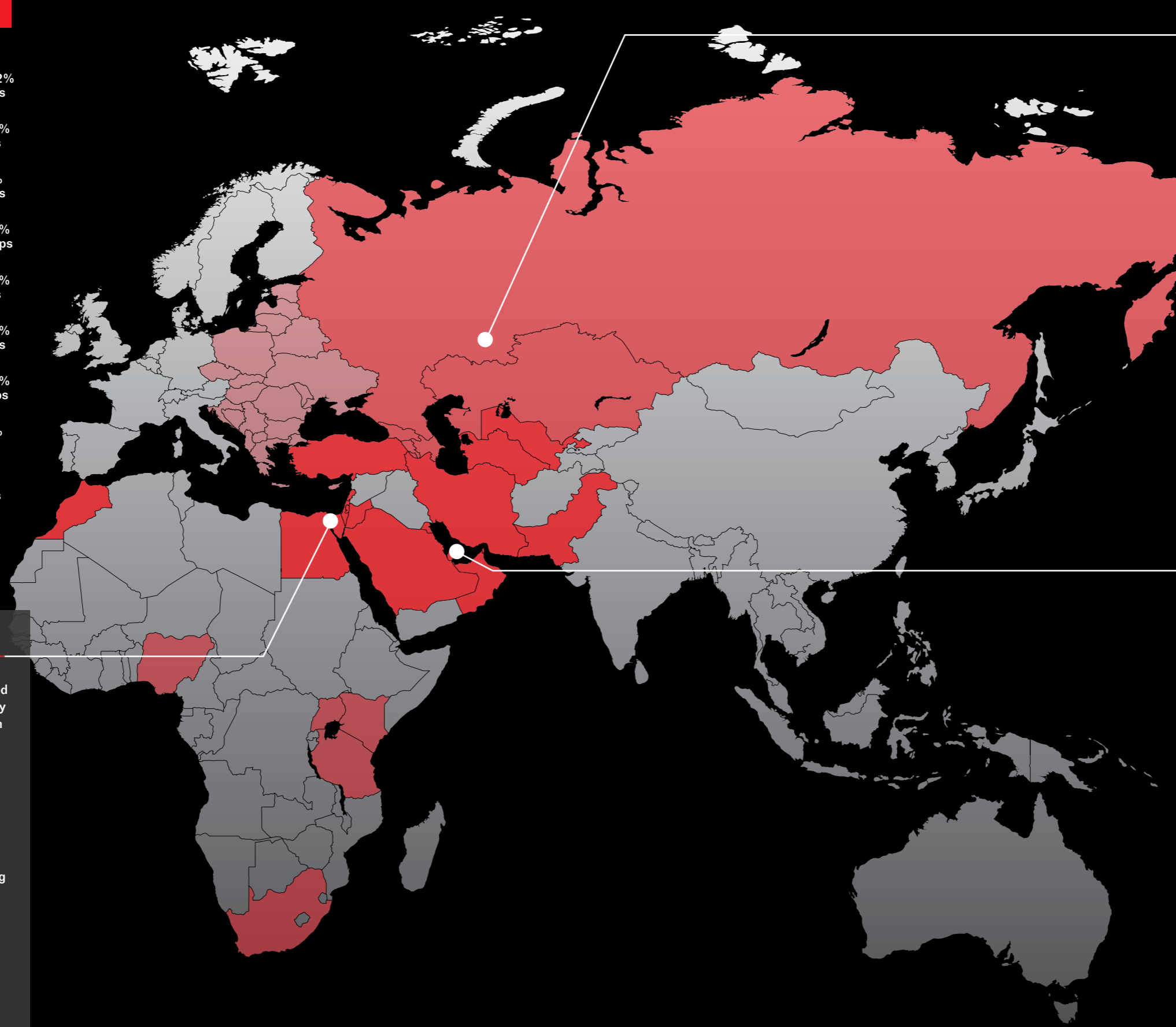
The fund remains well positioned to benefit from the dynamic market of EMEA and we are confident in our positive outlook for the region. ■ **The Kudu Team**

GEOGRAPHICAL EXPOSURES/ATTRIBUTION

Emerging Europe:	
Net Exposure:	-11.32%
Performance attributions:	-22bps
Greece:	
Net Exposure:	16.35%
Performance attributions:	51bps
Israel:	
Net Exposure:	9.55%
Performance attributions:	-50bps
Russia and the CIS:	
Net Exposure:	18.03%
Performance attributions:	-101bps
Turkey:	
Net Exposure:	20.23%
Performance attributions:	70bps
Africa:	
Net Exposure:	14.31%
Performance attributions:	-39bps
Middle East:	
Net Exposure:	17.01%
Performance attributions:	143bps
Others:	
Net Exposure:	0.94%
Performance attributions:	-5bps
Total monthly attribution:	
Net Exposure:	85%
Performance attributions:	46bps

ORIENTAL WEAVERS (EGYPT)

Oriental Weavers is the leading Egyptian producer of woven and printed oriental carpets and rugs. The company enjoys an exceptionally strong position locally with an 85% - 90% market share, and favourable dynamics in terms of a booming domestic housing market, increasing wealth levels of the large middle/lower class and strong population growth. The export market continues to grow, particularly in the US, where volumes have been impressive despite the slowing housing starts. The suppressed earnings of the last couple of years due to the rise in the cost polypropylene provides an interesting opportunity for entry in a company trading on 7 times 2008 consensus earnings, with significant potential for upward surprise and limited debt.



MECHEL (RUSSIA)

Mechel is the smallest of the Russian steel majors, but second largest producer of long products, with substantial upstream production capabilities in coal and iron ore. The Russian steel market is characterised by a sustained level of high local demand as the country recovers from the under-investment of a planned economy. Further protection is afforded by the costs involved in transporting steel products over long distances, a problem exacerbated by the old and decaying infrastructure. This situation provides domestic price support and reduces the sensitivity to short-term global demand/supply imbalances. Vertical integration makes the Russian majors the lowest cost producers of steel in the world, with much of the production margin internalised through upstream operations. The company trades at an EV/EBITDA multiple of 3.8x 2008 consensus earnings, an unjustified discount to global peers.

QATAR NATIONAL BANK (QATAR)

Qatar National Bank is the leading commercial banking group in Qatar. The Qatari economy grew a nominal 25% in 2006, creating a particularly attractive investment climate against the backdrop of a pegged exchange rate, with significant upward pressure to revalue. The QNB investment case is based upon the following: the wealth effect, as the earnings levels increase in line with the tripling of gas production over the next 5 years; migration effect, as vast numbers of migrants, primarily from India, seek well paid employment (population is expected to double by 2015); and a proactive government that is encouraging the diversification of the economy. QNB is the best positioned in the market to benefit from these trends. The group's return on equity is nearly 30%, boosted by the zero taxation regime, and on our estimates the stock trades at 12 times 2008 expected earnings and 2.9x estimated price/book value. This is good value for a company with this growth profile.

TOP 15 LONG POSITIONS

	%
SBERBANK	4.5%
ALDAR PROPERTIES	4.2%
OPAP SA	4.1%
BULGARIAN LAND DEVELOPMENT	4.0%
VTB BANK	3.5%
FIRST GULF BANK	3.4%
HELLENIC BANK LIMITED	3.4%
BANK MUSCAT	3.2%
HALYK SAVINGS BANK	3.2%
ALPHA BANK	3.1%
TURKCELL ILETISIM HIZMET	3.1%
MICHANIKI	3.1%
MIZRAHI TEFAHOT BANK	3.0%
PETROL OFISI	2.9%
MAGNIT	2.8%

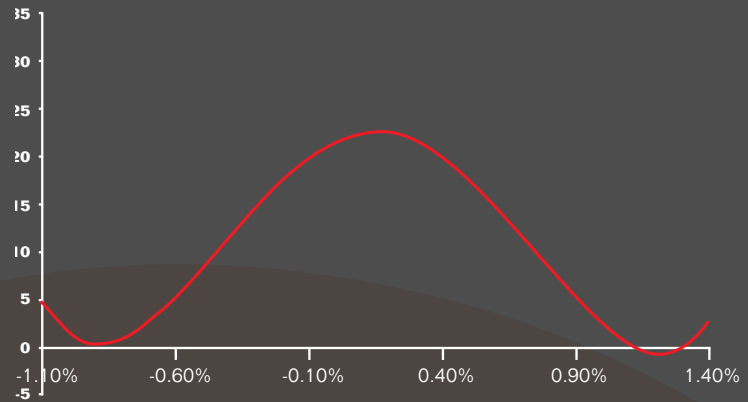
TOP 5 CONTRIBUTORS MTD

	BPS
ALDAR PROPERTIES PJSC	133
MICHANIKI SA	78
FIRST GULF BANK	64
HELLENIC BANK LIMITED	46
BANK MUSCAT SAOG-GDR REG S	35

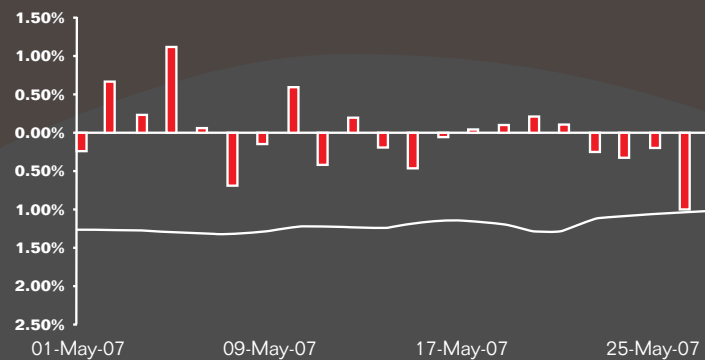
TOP 5 CONTRIBUTORS YTD

	BPS
AFRICA-ISRAEL INV LTD	229
ALDAR PROPERTIES PJSC	169
MICHANIKI SA	160
ENKA INSAAT VE SANAYI AS	86
EVRAZ GROUP SA - GDR REG S	84

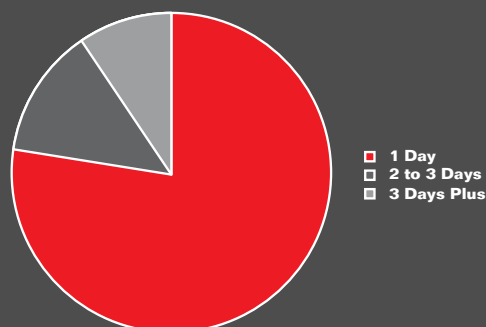
Daily Volatility - 1 Year



Daily % Change Vs Projected VAR



Position Liquidity - Number Days Average Volume



	2001	2002	2003	2004	2005	2006	2007
Jan		0.6	-2.9	3.9	4.6	6.0	4.6
Feb		-0.5	-2.3	4.7	4.1	5.0	2.0
March		5.3	2.6	-0.1	-2.9	-1.4	0.2
April		2.9	-0.3	0.1	-1.0	1.5	3.7
May		0.0	1.5	-0.1	1.5	-5.3	0.5
June	-1.0	-10.5	-3.0	0.1	1.8	-5.5	
July	-1.3	4.8	3.9	-0.2	7.1	0.8	
August	-3.0	-0.5	1.7	1.4	2.6	0.8	
September	-5.4	-1.5	0.3	1.4	3.2	3.3	
October	2.0	0.0	3.1	3.5	-2.4	4.5	
November	7.4	1.4	1.2	5.1	1.3	2.6	
December	2.4	-4.0	1.1	8.6	6.3	5.0	
Year	0.6	-3.5	6.9	31.8	29.1	17.7	11.5

Table 1 – Monthly returns since inception
Numbers net of all fees

Kudu Absolute return fund (Euro class)

