



# **KUDU FUND**

**EMERGING EUROPE, MIDDLE EAST, AFRICA**

## **MONTHLY REPORT OCTOBER 07**

# **KUDU**

## Monthly Report

The Kudu fund rose 5.4% in October, compared to a rise of 2.7% by the Morgan Stanley Pan European index, and a rise of 8.6% by the MSCI EMEA index.

The fund delivered strong gains from holdings in Abu Dhabi, Qatar, Oman and Turkey, many of which have been held by the fund for some time.

The Kudu fund is committed to a long term approach to company analysis and valuation. The example of investors like Warren Buffett or Bill Miller, and indeed of our own experience, is that it is long term analysis and commitment which delivers the best consistent returns to investors.

Right now, for example, the markets of EMEA are the cheapest in the emerging markets universe. Chinese local shares trade on 57 times 2007 estimated earnings, India on 24 times, compared with much lower valuations in countries in the EMEA region, such as Russia and Turkey, each on 12.8 times earnings. Whilst no-one would doubt the long term prospects of the economies of China, India and Brazil, there are in many cases equally bright futures predicted for many EMEA countries, with shares trading on considerably lower valuations.

EMEA offers shares trading on a median price to earnings multiple of 11.9x. Few companies hold much debt, so credit prices have little direct bearing. We continue to find new ideas at compelling valuations.

We are also keenly aware of the fact that as investors we are buying shares in companies, not in the GDP index of a country. The higher multiple you pay today, the more earnings the company has to deliver over the years to make you a profit.

Currently Severstal Steel in Russia trades on 10.7x 07e earnings, compared to 18.6x for Angang Steel, Gazprom trades on 12.7x compared to 17.8x for CNOOC, and Israel Chemicals trades on 25.7x compared to 43x for Qinghai Potash Corporation.

It is not inconceivable that some emerging market stocks now trading on higher multiples of earnings will deliver the expected - and already priced in - growth, but also see their shares de-rate. The Kudu fund is generally looking for the opposite phenomenon. The fund buys shares trading on low valuations with good earnings prospects. As the earnings deliver, the shares often re-rate, delivering a geared effect to our investment.

The other strong argument for buying cheap is that economies do not just grow in a straight line, they have problems with unwanted currency strength (India), or food inflation (China). Worse still, surges of growth may be followed by unexpected slowdowns, problems with labour and labour flexibility, infrastructure or pollution. The lesson of emerging markets is to expect the unexpected, from Argentina's debt collapse to Hugo Chavez, to countless wars and macro problems from left field. Buying cheap gives a little of what Ben Graham called a 'margin of safety', an asset with deep fundamental value, even as human life delivers its usual volatile surprises.

One area of the world where good economic growth, and fair valuations appear to coincide is in the Gulf. The countries of the Gulf Co-operation Council (GCC), the loose political body that brings the neighbouring states together, control the greatest hydrocarbon wealth on the planet. Saudi Arabia controls the largest crude oil reserves in the world, followed by the UAE at 5th and Kuwait at 6th largest reserves. The state of Qatar, with a population of just 1.2 million people, is blessed with the world's third largest proven reserves of natural gas, ranking after Russia and Iran.

Dubai, which probably gathers more international attention than the rest of the GCC states put together, sits on a meagre seven years supply of dwindling oil. However, the Dubai experiment of economic diversification through developing infrastructure, real estate and service industries, is being keenly watched by the other GCC countries and emirates.

Qatar plans to spend \$130 billion over the next few years in developing and diversifying its economy. Abu Dhabi's investment budget is even larger. The banks in both states will be key beneficiaries of this spending and GDP boom. Well positioned and managed banks should be able to profit from both increased deposits from richer citizens, growing companies and cash rich parastatal and sovereign funds, and also from sharply increased lending to project finance and growing demand for home loans and consumption.

The GCC countries generally peg their currencies to the US Dollar, which means also pegging to US interest rates. With the American economy slowing, and rates falling accordingly, the GCC countries are in a bind. Their own economies are growing fast, with in many cases overly high inflation. The resultant negative real interest rates are an extreme version

of the Spanish, Irish and now Greek experience in the Eurozone, and the results are not dissimilar - rising asset price inflation. There is increasing talk of moving the GCC to a global basket peg, but the innate conservatism of many ruling families, and the implicit or explicit military umbrella offered by the US, may mean this move takes time to put into effect.

At a time when markets are generally mistrustful of banks, it is worth considering that not all banks are alike. As an absolute return product, the Kudu fund is in a position to compare and value banks according to their merits and position the portfolio accordingly.

The current liquidity problems in the credit market are a major concern for many banks, primarily those in the developed markets that do not have adequate deposit-based funding. This situation could not be more different across the cash-rich gulf states, where liquidity abounds.

The fund currently owns Qatar National Bank, Commercial Bank of Qatar, National Bank of Abu Dhabi and Commercial Bank of Abu Dhabi. In spite of their various descriptive names, these banks have varying degrees of exposure - and possible profit - from both the infrastructure, commercial, state and retail sectors in their respective markets. Qatar National Bank has the benefit of a small but growing exposure to Oman, where its cheaply bought stake in the troubled National Bank of Oman should offer access to Oman's growing economy.

These Gulf banks, with their strong balance sheets and high level political connections may also in time leverage their positions to expand in Algeria, Libya and other growth markets, in the same way that Gulf based mobile and fixed line telecom companies have made successful acquisitions in many markets which are difficult to access for western based companies.

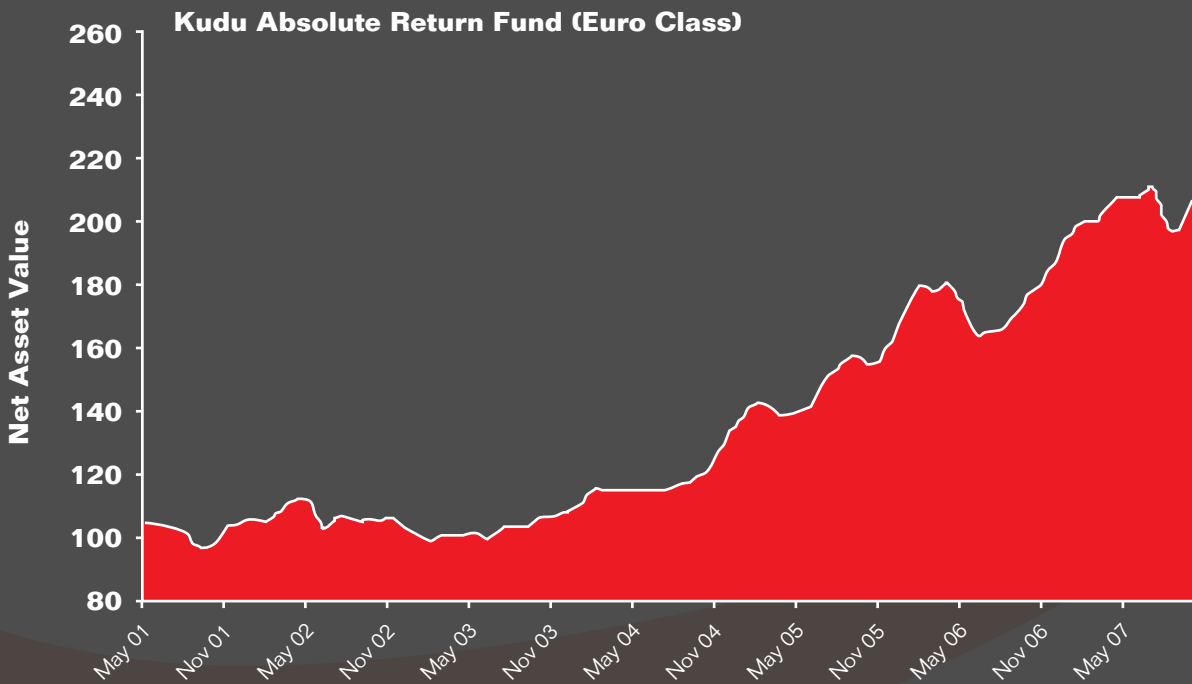
The Kudu fund continues to meet, analyse, and value companies across the EMEA region, with recent research trips to Russia and central Europe bringing in new opportunities.

Emerging markets are currently experiencing another period of weakness and investor concern. This volatility is already lowering market prices for a number of target companies, and the Kudu fund will continue to invest for absolute return for the benefit of its investors.

■ **George Case**  
 ■ **Jon Bond**  
 ■ **Malcolm Levy**

NAV per redeemable share: Class A: £99.95 \$100.03 Class B: €204.54 £214.94 \$214.52

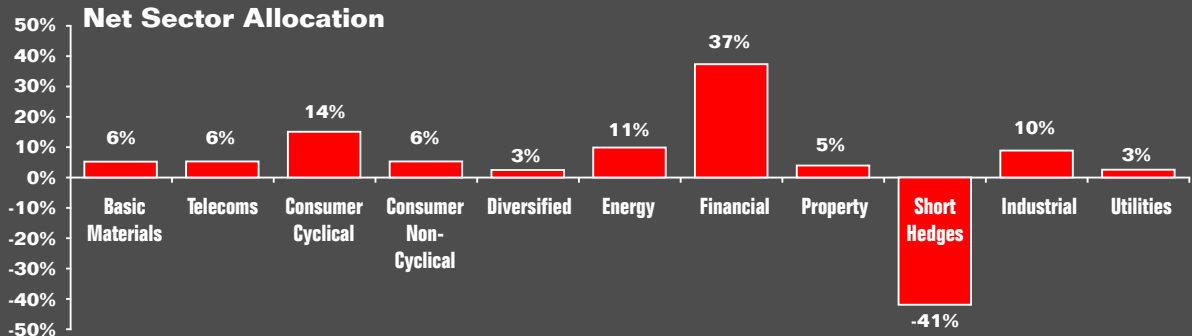
Performance	October	YTD	Rolling 12 months	Since Launch
Class A:	5.46%	0.03%	N/A	0.03%
Class B:	5.39%	11.14%	19.73%	132%



**Geographic Allocation Exposure as % of Fund NAV**

Region	Long	Short	Net	Beta Adjusted Net	Performance Attribution
Europe	6.7	0.0	6.7	5.0	0.5
Greece	10.1	3.0	7.1	5.7	1.1
Israel	0.0	0.0	0.0	0.0	0.0
Russia	20.7	4.4	16.3	11.8	1.4
Turkey	13.4	3.2	10.2	7.7	0.2
Africa	21.8	0.0	21.8	16.3	0.6
Middle East	30.8	0.0	30.8	23.1	2.6
Other	9.3	20.5	-11.2	-6.1	-1.0
<b>Total</b>	<b>112.8</b>	<b>31.1</b>	<b>81.7</b>	<b>63.5</b>	<b>5.4</b>

**Net Sector Allocation**



## TOP 5 LONG POSITIONS

	%
TURKIYE VAKIFLAR	4.32%
HELLENIC BANK	3.61%
OPAP	3.18%
FIRST GULF BANK	3.17%
NOVATEK	3.10%

## TOP 5 CONTRIBUTORS MTD

	ATTRIBUTION %
FIRST GULF BANK	0.87
ISLAMIC ARAB INSURANCE	0.56
SHUAA CAPITAL	0.45
MECHEL	0.42
ENKA INSAAT	0.34

## TOP 5 CONTRIBUTORS YTD

	ATTRIBUTION %
AFRICA ISRAEL	2.43
EVRAZ	2.42
HELLENIC BANK	2.10
FIRST GULF BANK	1.69
MECHEL	1.68

## FUND INFORMATION

CLASS A

ISIN

€ BMG532541270

£ BMG532541197

\$ BMG532541015

SEDOL

£ B1W7LS0

\$ B1W7LR9

BLOOMBERG

£ CLACTAS BH

\$ CLACTAD BH

US DELAWARE FEEDER

\$ US5011831071

## INVESTMENT FOCUS:

### CHERKIZOVO – RUSSIA

Cherkizovo is the leading producer of live poultry and hogs in Russia, with extensive meat processing capabilities. Russia remains a significant importer of meat products, the result of grossly inadequate supply following the collapse of the Soviet Union. The state has imposed import 'quotas' in response to continued government subsidies across Europe and a desire to re-establish the production independence it enjoyed in the Soviet era. Per capita meat consumption in Russia remains 25% below that of the USSR and 30% below Europe. The removal of protectionist measures by both regimes would strongly benefit Cherkizovo as the outright lowest cost producer across the region. Fundamental organic growth remains strong, driven by the company's own impressive distribution network, covering 80% of the population. The company continues to consolidate the fragmented market and its recent acquisition of Chicken Kingdom further affirms its market dominance. The company trades on a multiple of 7.5x 2008 earnings, excellent value for assets of this quality.

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sept	Oct	Nov	Dec	YTD
2001						-1.0	-1.3	-3.0	-5.4	2.0	7.4	2.4	0.6
2002	0.6	-0.5	5.3	2.9	0.0	-10.5	4.8	-0.5	-1.5	0.0	1.4	-4.0	-3.5
2003	-2.9	-2.3	2.6	-0.3	1.5	-3.0	3.9	1.7	0.3	3.1	1.2	1.1	6.9
2004	3.9	4.7	-0.1	0.1	-0.1	0.1	-0.2	1.4	1.4	3.5	5.1	8.6	31.8
2005	4.6	4.1	-2.9	-1.0	1.5	1.8	7.1	2.6	3.2	-2.4	1.3	6.3	29.1
2006	6.0	5.0	-1.4	1.5	-5.3	-5.5	0.8	0.8	3.3	4.5	2.6	5.0	17.7
2007	4.6	2.0	0.2	3.7	0.5	0.3	1.5	-6.6	-0.5	5.4			11.1

Total Return in €  
Numbers net of fees (€class)

Domicile: Bermuda and Delaware, USA  
 Listing: Irish Stock Exchange  
 Assets: \$200mln  
 Start Date: Jul-01  
 Liquidity: Quarterly  
 Lock up: 1 year soft lock up (3% redemption fee)  
 Minimum: Class A £/€/ \$100,000  
 Performance: 20% with HWM  
 Management Fee: 2%  
 Administrator: Citi hedge fund services  
 Nicola O'Neil +353 1436 7292

Auditors: Ernst and Young  
 Management Company: Kudu Emerging Markets Limited  
 Subscriptions: Up to last business day of every month

Kudu Emerging Markets Limited is the London based investment advisor to The Kudu Fund, an emerging market absolute return fund. The primary objective of the fund is to achieve long term capital growth by investing in poorly understood markets with high levels of miss-pricing.

The Kudu Fund takes a fundamental approach to investing and looks to capitalise on valuation discrepancies and developing themes across the regions of Africa, the Middle East, southern and eastern Europe as well as western companies with emerging market exposure.

The Kudu Fund is invested in equities, both long and short, and generally invests with a time horizon of 3-18 months.

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