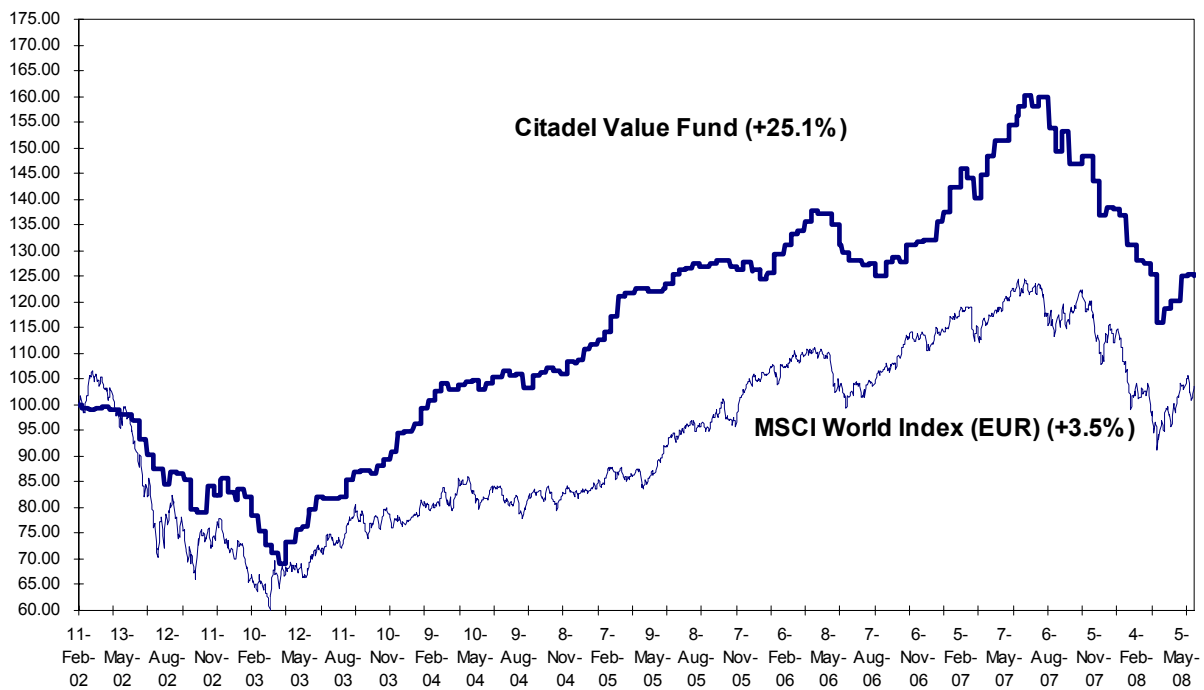




Dear Shareholders,

The 31<sup>st</sup> of May marked the end of Citadel's 6<sup>th</sup> fiscal year and it was in one important respect altogether a bit too reminiscent of the Fund's first year. Then, as now, stock markets fell sharply. The Fund's NAV per share was EUR 125.06 at the end of May which is well down year over year. The year-to-date return (calendar year) is -8.6%, roughly in line with global markets, and reflects a modest upturn after the lows set in March. Whilst this performance gives no reason for cheer, we think the outlook for Citadel in the next several years is rather good, a thought we will expound upon in the paragraphs to come. Although we are in the midst of the second major stock market crisis since inception (and far closer to a bottom than a top we think) Citadel is ahead by 25.1% since inception. The MSCI World Index (in Euros and incl. pre-tax dividends), in contrast, has eked out only a marginal return of 3.5% over the same period. Measured from its lows of March 2003 the Fund is up by 81%, which just goes to show what a difference 11 months can make (i.e. Citadel began trading on February 11<sup>th</sup> 2002 and March 2003 is approximately 11 months later).

**Citadel Value Fund**  
*(performance since inception to May 31st, 2008)*



**IMPORTANT:** An investment in the Fund carries with it a degree of risk. The value of your investment may go down as well as up, and you could lose money on your investment. Past performance provides no guarantee for the future. Investors should read the Fund's prospectus before deciding whether to invest. The opinions and commentary expressed herein should in no way be construed as personal investment advice, they are intended solely to illustrate the Fund's investment strategy and performance.

## Citadel Value Fund Performance

(as of May 31st, 2008)

	Cumulative returns			Annual returns						
	Since inception	5 year	1 year	2008 YTD	2007	2006*	2005*	2004*	2003*	2002*
<b>Citadel Value Fund</b>	25.1%	57.2%	-20.0%	-8.6%	-0.5%	9.7%	12.0%	17.2%	17.0%	-18.4%
<b>MSCI World Index (Euro)</b>	3.5%	49.1%	-16.1%	-8.3%	-1.2%	7.9%	26.8%	6.9%	11.3%	-29.9%
<b>Out/under-performance</b>	21.6%	8.1%	-3.9%	-0.3%	0.7%	1.8%	-14.8%	10.2%	5.7%	11.5%

\* annual returns based on estimated NAV on Dec. 31st; (first NAV Feb. 11th 2002)  
source: European Fund Administration, MSCI

### Portfolio news

The Fund ended the fiscal year with 31 holdings, roughly where it began a year earlier although there have been numerous changes, particularly in the first half. We described these in more detail in the semi-annual letter in December and the most noteworthy include: **Daekyo, Hanil Cement, Nongshim Holdings** and **Toyota Industries** (purchases), **Apache, Carclo, Heineken Holding** (sales).

### Portfolio Changes

November 30th 2007 to May 31st 2008

#### Holdings bought or added to

GS Home Shopping  
Johnston Press  
Springer, Axel  
Ozeki  
SK Telecom, ADR

#### Holdings sold or acquired in a buy-out

LandAmerica Financial Group  
Pioneer Natural Resources  
Sasa Industrie  
Telegraaf Media Groep  
Village Super Market  
Wolters Kluwer

The most significant purchase in the past six months was **Ozeki**, the Tokyo-based food retailer, which had been a very small position, and which is now reasonably sized at 3.9%. This is an efficient, well run supermarket enjoying among the highest returns of any food retailer in Japan, and is endowed with an excellent balance sheet. We added substantially to **Axel Springer**, the German newspaper and media firm, after its stock fell back. This gave us an opportunity to build this long-standing, but small holding, into a larger position. We also added to **SK Telecom**, the South Korean telecoms giant, which had fallen to absurdly undervalued levels, and to **GS Home Shopping**. Finally, we established a smaller sized position in UK regional newspaper franchise **Johnston Press**.

This time last year we wrote of a low-ball bid for **Sasa Industrie** which we and other shareholders had rejected. We also wrote that we hoped, and expected, that a better offer would be forthcoming. That offer did come, and at a 30%

premium to the previous offer (equivalent to an additional EUR 0.70 per Citadel share). This put it in line with our own intrinsic value estimates. The Fund tendered its shares for cash in the last week of May wrapping up a 4 year investment with a 150% return.

Other than Sasa there were 4 positions which were trimmed in the period since November 30th, and one which was sold entirely. The pruning occurred in some of the larger stakes (**Telegraaf, Wolters Kluwer, Pioneer Natural Resources, Village Super Market**), which had done well and where the potential had shrunken as a result. A further consideration was that we sought to maintain reasonable cash reserves to provide both ammunition for the multiple new opportunities we saw, as well as a buffer in the event of any possible redemptions. We sold the entire holding in US title insurer **LandAmerica Financial** which had seen a sharp – and in our eyes somewhat suspect – run-up in its share price after the US Federal Reserve started slashing interest rates. We think the company is undervalued, selling at a only a fraction of book value, but earnings recovery will take years and this was an issue as the firm carries a sizeable debt load. We reasoned that the funds could be better employed elsewhere, and at lower risk. Nevertheless, we intend to monitor its business very closely and may re-establish a position at some point in the future now that the share price has indeed fallen back.

<b>Portfolio Holdings</b> <b>(as of May 31st, 2008)</b>		
<b>company</b>	<b>activity</b>	<b>% of portfolio</b>
Batenburg Beheer NV	business services (technical installation)	4.1%
Belgacom NV	telecommunication services (fixed & mobile)	3.0%
Bristol-Myers Squibb Co.	pharmaceuticals	2.9%
Bull SA	information technology (computers, services)	1.7%
Carclo PLC	industrial goods (plastic components)	1.5%
Clinton Cards PLC	speciality retail (card shops)	3.0%
Companhia Paranaense de Energia (COPEL), ADR	utilities (hydro-electric power)	5.2%
Continental (Grupo) SA	consumer goods (soft-drink bottling)	4.2%
Daekyo, preferred	consumer services (education)	3.7%
Dewhurst PLC. -A- Non Voting	industrial goods (lift panels & controls)	2.6%
GS Home Shopping	speciality retail (TV home shopping network)	3.8%
Hanil Cement	materials (cement production)	3.2%
Heineken Holding NV	consumer goods (brewing)	3.0%
Johnston Press PLC	media (regional newspapers, internet)	2.1%
Molins PLC	industrial goods (tobacco machinery & packaging)	2.5%
Natuzzi SpA, ADR	consumer durables (furniture)	1.2%
Nongshim	consumer goods (food & beverages)	2.5%
Nongshim Holdings	holding co. (consumer goods, packaging, other)	2.9%
Ozeki Co. Ltd.	retail (supermarkets)	3.9%
Pioneer Natural Resources	energy (oil & gas exploration & production)	2.7%
Royal Reesink NV (CVA)	wholesale and trade	1.9%
Signaux Girod SA	industrial goods (traffic signs)	3.9%
SK Telecom, ADR	telecommunication services (mobile)	4.5%
Springer (Axel) Verlag AG	media (newspapers, magazines, TV)	2.7%
Tamedia AG Reg.	media (newspapers, magazines)	2.1%
Telegraaf Media Groep NV	media (newspapers, magazines, radio, TV)	3.1%
Toyota Industries	industrial goods (forklifts, engines, auto's & parts)	2.3%
Village Super Market Inc	retail (supermarkets)	3.6%
Wolters Kluwer NV	media (professional publishing)	1.5%
Zehnder Group AG	industrial goods (radiators)	1.6%
Zwack Unicum	consumer goods (spirits)	4.4%
Cash and other assets and liabilities		<u>8.7%</u>
		<b>100.0%</b>

*note: as percentages are rounded to 1 decimal point the sum of the percentages shown may differ from 100*

### *Some background on the year's performance*

In past downturns, and particularly that of 2002, the Fund held up very well compared to stocks in general. That is a characteristic which is not unique to Citadel. Rather it is common, in greater or lesser measure, to many value funds. The fact that most stocks in a dedicated value fund are cheap to begin with, and don't have many of the fast-money crowd as fellow investors, affords a measure of protection when the bottom falls out. In this decline; however, Citadel's performance has not been meaningfully different from that of the index and this warrants some explanation.

Other than the market downturn which hit stocks throughout the world, including those in the portfolio, two other factors are important in explaining the performance of the past 12 months. The first is currencies. The Euro has risen against almost every other major (and minor) currency in the world. This is not entirely a new phenomenon for Citadel as it has plagued the Fund since inception. Nevertheless, the FX wind from fore was stiff in the past year and new stakes in Asia and the UK compounded that problem. We estimate that currencies accounted for just less than 50% of the decline in NAV in the past twelve months. Unfortunately in a global equity fund currency movements require a stiff upper lip. Over the long-term currency hedging doesn't add value, and may very well subtract from it once costs are taken into account. Furthermore currencies may actually add to returns at some point in the future, this just wasn't the case last year. Slightly tongue in cheek we suggest that our Euro-based investors take comfort from the strength of the Euro; on current trends it may not be long before you will be able to trade in your house in Europe for an entire street in the United States!

The second main detractor from this year's performance – and the most important one relative to the general market decline – is the impact of new stakes in the portfolio. This factor, more than any other, explains why the Fund has not racked up a solid out-performance versus the market as we would normally expect<sup>1</sup>. In fact, more than 50% of the decline in the NAV compared to a year ago is attributable to 9 holdings in the portfolio (which currently make up 27% of the portfolio), out of a total of 11 accumulated since the beginning of 2007.<sup>2</sup> Most of the other holdings did as well if not better than the market, and the absence of any banks in the portfolio was a godsend. Yet it is abundantly clear that our recent picks have hurt us. For the reasons we explain below this is more a case of poor timing than poor picks. The intrinsic values of these companies have not declined, even though their share prices have. In that sense we expect our 'short-term pain' to ultimately translate into 'long-term gain'.

### *The question of timing...*

This is by no means the first time we bought a stock thinking it extremely cheap only to have it fall sharply. In 2002, for example, the Fund began accumulating shares of **Carclo PLC** at 44p. Approximately a year later the stock hit an intra-day low of 15p representing a decline of no less than 66%! Today it trades at 83p (+89% vs. the original purchase price) and the Fund sold half its position in the Fall of 2007 at 119p. We have had similar experiences in many stocks including, but not limited to: **Southern Energy Homes** (first bought at \$2.20, fell to \$1.25, sold at \$7.10), **Altria** (first bought at \$56.75, fell to \$30, sold at \$78.25), **Nexans** (first bought at EUR 20.75, fell to EUR 11, sold at EUR 38.35) and **Merck KGaA** (first bought at EUR 31.80, fell to EUR 18, sold at EUR 75.77). In fact if a generalisation of our experience since 2002 can be made, it is that the share price of a new holding is as likely to fall as to rise in the short-term.

We recount these examples to illustrate that the ultimate success of each investment lies not in perfect timing but rather in the quality of the analysis, and the 'margin of safety' between purchase price and estimated intrinsic value. And what applies to an individual security applies to the portfolio as a whole. Our experience has shown that where a focus on a company's value leads us to a 'contrarian' opinion, and assuming we are correct in that opinion, very satisfactory returns result. This is true even when a stock continues to fall heavily after we first purchase it. In fact

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<sup>1</sup> This is a topic we also discussed at some length in the last semi-annual letter to shareholders for the half year ended November 30<sup>th</sup>.

<sup>2</sup> Note: this amount includes currency losses which are also included in the preceding estimate of the currency impact. A rough estimate indicates that, taken together, currencies and the performance of these 9 new holdings depressed the NAV by some 15% versus May 31<sup>st</sup> last year.

in most cases we actually benefited from these falls – although it may not have felt that way to shareholders at the time - due to the fact that we averaged down, adding to undervalued positions at even more attractive prices.

### *...how opportunity occurs...*

We naturally hope that a stock will appreciate immediately once accumulated. However, we've come to accept that often it will not. This is an almost unavoidable attribute of value investing. There are usually one or a number of reasons why a stock has plunged and these don't disappear the moment the Fund invests. Therein lies both the opportunity, as well as the difficulty in terms of timing. Sometimes a stock has fallen to bargain levels simply as a result of overall market weakness and uncertainty. Other times company or industry specific factors play a role. The opportunity arises where our research and analysis lead us to take a different view. At times we disagree with the market's reasoning. Other times we see the market extrapolating short-term problems and uncertainties far into the future with little factual underpinning. It is astonishing, for example, how often we run across companies whose stock market value is down by half, or even more, on the basis of a bad year or two. Unless a company is greatly overvalued, it just doesn't make sense that 50% of its value should be impaired by weak results during a year or two. Nevertheless that occurs with some regularity, especially during times such as these, and it can lead to incredible opportunities.

### *...and why timing is ultimately unimportant*

The timing difficulty stems from the fact that the reasons which have led others to sell a stock don't disappear overnight. If we're correct in our assessment of a company eventually they will, and investors will recognise this. In the short-term though many of these problems or concerns linger on. These can push a stock down much further. A low valuation provides a cushion but this seldom means that a stock is impervious to further declines. Alas, there is no holy grail to get around this problem. We frequently hear talk of investors waiting until the news-flow turns positive before buying a particular stock. This would seem to be a logical strategy were it not for the fact that when the business improves the stock has nearly always *already* moved upwards in anticipation. Furthermore, it is important to consider that - as a recent study from the fund group Fidelity made clear - much of a stock's return is realised in very short periods. Therefore the investor who waits for positive news before investing may very well avoid the downside risk, but also the return.

Certainly whenever we have correctly anticipated a certain event occurring, for example poor quarterly results, the stock market reaction regularly surprised us. When we thought the market had already discounted weak earnings the stock fell. On other occasions it rose as investors had expected worse. Therefore predicting what our fellow investors will do is a game we stay far away from. We don't try to time the market but rather the price. If the purchase price is good relative to what a company is worth, then this is the best possible assurance that attractive returns will result.

To return to the subject of the Fund's 'new' holdings, their performance in the short-term has not been good, yet this says little (actually nothing we think) about their performance in future. As we describe below the portfolio is as undervalued as it has ever been. And this, to a large degree, is due to the portfolio changes in 2007 when a number of fairly valued holdings were sold and the proceeds reinvested in a range of new 'deep-value' ideas.

### *Reasons for optimism... in the market...*

With markets gripped by fear it would seem a strange time to speak of optimism. However if history is any guide these are exactly the moments when investing is most rewarding. In stark contrast to the past several years you don't need a high powered telescope to find value. On the world's exchanges even many of the largest, best known companies look reasonably cheap, notably in Europe and Asia. Outside that fairly limited number of stocks we are running into countless others where the undervaluation is even more remarkable. In some cases share prices seem to be discounting an 'end-of-the-world' scenario. We have an unusually large number of potential 'buys' which we are working on. What is particularly encouraging is that many of these ideas are composed of really top-quality companies with excellent returns on capital, good business economics, solid balance sheets and capable

managements. And it is precisely this sort of company which, two years ago, was simply not available at a decent price.

### *...and in the portfolio*

The portfolio itself is even cheaper than it was in late 2002 and early 2003 after prices had plunged. We calculate that Citadel's NAV is trading at just more than a 50% discount to our estimate of the Fund's intrinsic value; in other words the sum of the estimates for each company in the portfolio plus the Fund's cash. We have never seen a larger discount. On a 'see-through' basis the Fund is trading at 5.3X 2007 EBIT (Earnings Before Interest & Tax) and 0.5X Sales, both of which are extremely low.<sup>3</sup> The after-tax return on capital (ROCE) is 12.1% which is quite good. This means that for every 100 Euro's in capital which is employed in the portfolio companies an after-tax annual return of EUR 12.10 is generated. This compares very well with other assets classes such as, e.g. bonds which yield (pre-tax) 4-5%. What is even more remarkable is that the stock market is valuing the capital employed in the portfolio companies at only EUR 90 for every EUR 100 invested in plant & equipment, working capital, etc. Not only is this less than the replacement cost, it indicates that the true economic return for Citadel is even higher (i.e. at current market prices Citadel has invested EUR 90 for every EUR 100 in capital in the portfolio companies, on this EUR 100 of capital a return of EUR 12.10 return is realised; therefore the Fund's implied return is actually EUR 12.10/EUR 90, or 13.7%).

Two companies in the portfolio have a cash and investment position that is worth more than their share price which leaves their large and profitable businesses valued at nothing. To put this in context, we have come across only two other such cases in the past six years, a period in which we've analysed hundreds of companies all originally selected on the basis that they looked cheap. 19 other holdings have net cash positions ranging from 5 to 95% of their share prices. While a healthy net cash position does not in itself provide grounds for a company's stock price to rise, it does limit risk. At a time when credit is tight, and the economic outlook uncertain, it is reassuring that our companies are well-financed and will live to fight another day.

Another statistic that shareholders are apt to find interesting is the current dividend yield of the portfolio which is now 4%.<sup>4</sup> This compares favourably to the yields available in other asset classes such as cash, bonds and real estate. Furthermore, one big advantage of dividends is that they tend to rise over time. This tendency is obvious in many of the companies the Fund has held, or still holds. A fine example is **Reesink**. When the Fund first bought shares in 2002 the dividend per share was EUR 3.50, and it yielded 6.9%. Today the dividend per share is EUR 6.00, and it yields 11.8% on the original purchase price (6% on the current share price which has roughly doubled).

These quantitative exercises provide a useful reminder that while the stock market is in one of its periodic manic-depressive periods, the prices of the shares in the Fund's portfolio are in no way justified based on the profitability and assets of the companies themselves. One of these companies is **Contal** which has long been a highly profitable and soundly financed holding and which, despite a steadily higher stock price, is still attractively valued.

### ***Grupo Continental***

**Grupo Continental** or **Contal** as it is known, is one of the major *Coca-Cola* bottlers in Mexico with a franchise area encompassing several states in the centre of the country and nearly 13 million consumers. The founding family holds a majority stake while the other major shareholder is Coca-Cola itself. In addition to a stable of Coca-Cola soft-drinks it bottles and sells a range of non-carbonated beverages and water, as well as owning a major stake in a sugar mill.

Mexico has one of the highest per capita levels of soft-drink consumption in the world, the demographics are favourable, and Coca-Cola is market leader. Not altogether surprisingly Mexican Coca-Cola bottlers are some of the

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<sup>3</sup> A 'see-through' basis assumes that all assets and earnings of the portfolio companies accrue in Citadel's own financials in exact proportion to its ownership. This provides useful insight into the Fund's overall valuation. We encourage interested readers to refer to the December letter where this is described in more detail.

<sup>4</sup> On top of this a good number of companies are returning cash to shareholders through share buy-backs.

most profitable anywhere and Contal is no exception. Last year EBIT margins topped 17% and the company's return on capital approached a stunning 27%. While the company is reasonably capital intensive requiring ongoing investments in inventory, bottling plants and distribution, its cash flows are considerable. And these cash flows are growing as consumption increases in line with population growth, and as a result of regular price increases. A final attraction to the business is its predictability and stability. Day-in, day-out, Contal sells countless servings of low-priced beverages branded with one of the world's strongest trade-marks. This doesn't preclude problems but it does ensure that the odds are very high that any problems will be temporary not permanent.

The company has been a stalwart in the Fund's portfolio since 2002 and has generated a good return despite a halving of the Mexican Peso. One of the drivers of this performance has been management's sensible capital allocation. The bulk of the annual free cash flow has been paid out in the form of dividends. Much like in the preceding example of Reesink, Contal has increased its dividend in leaps and bounds. Today it yields 7.4% on the current (higher) stock price and it is reasonable to expect that this will grow as the company grows.

We realise that these are nervous times for investors. Nevertheless we hope that we have been able to share some thoughts why a contrarian bent is so worthwhile at such moments. We believe there are good reasons to be optimistic looking a couple of years ahead, and hopefully you will now understand why we think this. Via the monthly updates we will keep you informed on new developments, and we will write more extensively in mid-December after the end of the fiscal half year. Thank-you for your investment in the Fund and your continued trust.

Kind regards,

The Board of Directors  
**Citadel Value Fund SICAV**

June 17th, 2008