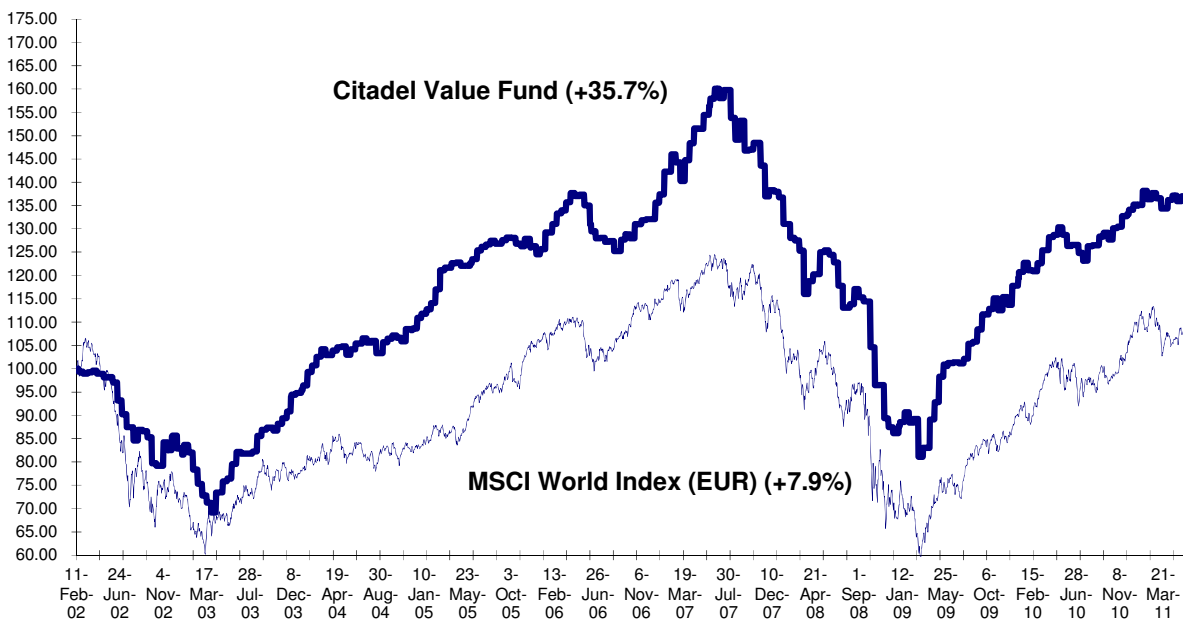




Dear Shareholders,

Citadel's financial year ended on May 31<sup>st</sup>. This provides a good opportunity to report back to you on the Fund's progress and perspectives. At the financial year-end the NAV per share was EUR 135.69; up, but only slightly (+0.5%) versus December 31<sup>st</sup> 2010. The calendar year began pretty well with a strong run-up in the first two weeks of January. Prices then eased slightly and moved side-ways until mid-May, when they slipped again. Based on the virtually unchanged NAV in 2011 you'd be excused for thinking that not much had happened in the portfolio. However, there were actually fairly big movements (both up and down) in individual stock prices and currencies. Notably a number of the stalwarts in the portfolio did very well; in a few cases reaching their estimated intrinsic values and were sold. The performance of these stocks was muted by falls at a handful of other holdings. While very undervalued, those companies generally share the characteristic that earnings haven't yet recovered to what we would describe as a 'normalised' level (some of the retailers being a notable example). Furthermore the uncertain short-term economic outlook is weighing heavily on investors. As a result their share prices were weak. Since inception the Fund's performance stands at +35.7%, healthily ahead of the MSCI World Index (EUR) which clocked returns of +7.9% (incl. untaxed dividends) and +2.8% (incl. taxed dividends), respectively.

**Citadel Value Fund**  
*(performance since inception to May 31st, 2011)*



**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, 2011)

	Since inception (11/02/02)	YTD	2010	2009	2008	2007	2006	2005	2004	2003	2002
<b>Citadel Value Fund</b>	35.7%	0.5%	12.9%	36.2%	-35.8%	-0.5%	9.7%	12.0%	17.2%	17.0%	-18.4%
<b>MSCI World Index</b>	7.9%	0.1%	20.1%	26.7%	-37.2%	-1.2%	7.9%	26.8%	6.9%	11.3%	-29.9%
<b>+/- vs. index</b>	27.8%	0.4%	-7.2%	9.5%	1.4%	0.7%	1.8%	-14.8%	10.2%	5.7%	11.5%

note: MSCI World Index based on total returns (including gross dividends excluding dividend withholding tax) in Euro's  
 \* annual returns are based on Citadel's estimated NAV as of Dec. 31st, out/underperformance figures may differ due to rounding  
 source: European Fund Administration, MSCI Barra

### *Portfolio news*

Belying the relative stability of the NAV in the first 5 months of 2011 the portfolio has undergone a number of significant changes, certainly more than is typically the case. This is in large measure due to the bifurcated nature of the portfolio's returns in 2011. We took advantage of higher prices to sell a number of long-standing holdings whose undervaluation had all but dissipated. In turn we added to a number of holdings which did poorly recently but where we see great value. Buying more of something which you are still convinced is very undervalued - at even lower prices - is a strategy which has served the Fund well over the years. Since the last letter at the end of November 2010 we bought or added to 8 stakes and sold (in whole or in part) 5 holdings. The portfolio now consists of 32 positions although a couple of these are rather small. The net cash position has risen somewhat to just more than 18%. This is a little higher than normal but we don't consider it unusually high. As explained in earlier letters, there isn't much evidence that long-term returns are improved by a rigid requirement (all too common in the fund industry) of always being fully invested - rather the reverse in fact. Given that we look for companies which are hugely undervalued, where returns can be very high, it makes sense to hold cash until we can put it to good work. If anything we've probably erred in the past by holding certain stocks too long - holding out for that last fifteen or twenty percent - rather than simply selling at acceptable prices and waiting to strike when really undervalued stocks came our way.

The only new addition to Citadel's portfolio is **Tessi**, a family owned and operated firm based in France, with EUR 235m in sales last year. Tessi doesn't lend itself to a nutshell sized résumé but is active in two main businesses essentially; document processing, and as a wholesaler of foreign exchange and gold. In document processing it handles high volumes of mail and other documents whose contents are processed, digitalized, often archived or stored in databases, and the information made available for use in a client's own information systems. The transformation of paper-based information on a large scale to an electronic format where it can be readily accessed and used is a huge and growing market. Examples of this operation are processing tax and social security declarations for the government. Another example, where Tessi is number 2 in France, is cheque processing. In that business the company has grown in a large, albeit slowly declining market. Related to this core competence in document handling is a sizeable marketing services operation which deals in redeeming manufacturers' coupons, managing the logistics of promotional gifts, maintaining call centres and numerous other marketing related activities. Document processing is a business where scale and efficiency matter and Tessi enjoys both as market leader. Capital requirements are reasonably modest and we estimate margins to be in the low teens. Its other principal activity is supplying banks and others with physical currency and gold. This is a highly attractive activity which employs almost no fixed assets and benefits furthermore from the strong demand for gold. In this niche Tessi is the sole supplier in France. While we assume that medium-term profitability from the gold operations will fall from today's extraordinary levels, this should be compensated for by growth in the other businesses. Tessi's after-tax returns on capital are around 40%, cash generation is high, and the firm compounded its value at almost 15% annually in the past decade. At the Fund's entry price, taking into account the burgeoning net cash position, a valuation of only 4.5X 2010 EBIT coupled with a 3% dividend yield made for a very compelling investment case.

**Portfolio Holdings**  
(as of May 31st, 2011)

<b>company</b>	<b>activity</b>	<b>% of portfolio</b>
GS Home Shopping	speciality retail (TV home shopping network)	7.1%
Tessi SA	industrial services (doc. Processing/FX&gold wholesale)	4.7%
Aéropostale Inc.	speciality retail (casual clothing stores)	4.3%
BAE Systems PLC	industrial goods (defence)	4.1%
SK Telecom, ADR	telecommunication services (mobile)	4.0%
Nongshim Holdings Co.	holding co. (Nongshim, packaging, ingredients)	3.6%
Pronexus Inc.	business services (printed & electronic filings/reports)	3.3%
Zehnder Holding AG	industrial goods (radiators)	3.3%
Bristol-Myers Squibb Co.	pharmaceuticals	3.2%
Toyota Industries	industrial goods (forklifts, engines, auto's & parts)	3.1%
Dewhurst PLC. -A- Non Voting	industrial goods (lift panels & controls)	3.0%
Daekyo, preferred	consumer services (education)	2.8%
Zwack Unicum	consumer goods (spirits)	2.8%
Signaux Girod SA	industrial goods (traffic signs)	2.7%
Heineken Holding NV	consumer goods (brewing)	2.6%
Bijou Brigitte Modische Accessoires AG	speciality retail (costume jewellery stores)	2.5%
Circle K Sunkus Co. Ltd	retail (convenience stores)	2.4%
Bull SA	information technology (computers, services)	2.3%
Nongshim Co.	consumer goods (food & beverages)	2.2%
Village Super Market Inc	retail (supermarkets)	2.2%
Thorpe, (FW) PLC	industrial goods (lighting)	2.1%
Kuoni Reisen Holding -B-	consumer services (travel agents)	2.0%
Family Mart Co. Ltd.	retail (convenience stores)	1.8%
Hanil Cement	materials (cement production)	1.5%
Mediaset Espana SA (was Telecinco)	media (TV)	1.5%
Molins PLC	industrial goods (tobacco machinery & packaging)	1.5%
Coltene Holding AG	healthcare (dental products)	1.3%
Clinton Cards PLC	speciality retail (card shops)	1.2%
Royal Reesink NV (CVA)	wholesale and trade	1.2%
Wolters Kluwer NV	media (professional publishing)	1.1%
Telegraaf Media Groep NV	media (newspapers, magazines, radio, TV, internet)	0.1%
Johnston Press PLC	media (regional newspapers, internet)	0.1%
Cash and other assets and liabilities		18.3%
		100.0%

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

Other than Tessi we bought additional shares in the Japanese financial information provider **Pronexus**, US clothing retailer **Aéropostale**, UK defence giant **BAE** and – in the wake of the Japanese earthquake and tsunami - Japanese convenience store chain **Circle K Sunkus**. The Fund also participated in two rights issues by portfolio companies financing recent acquisitions. As a result we acquired more shares in the Spanish TV network **Mediaset Espana**, (renamed from Telecinco – we referred to this transaction in the last letter as it was completed in early December), and Swiss travel organisation **Kuoni**. Finally we added to the position in **Nongshim Holdings** while simultaneously reducing the stake in **Nongshim** by a similar amount. This is admittedly a noteworthy move and we provide some background a little later in this letter.

The Fund's sales are particularly significant as they included a couple of the largest and oldest stakes. Mexican Coca-Cola bottler **Grupo Continental (Contal)**, which was first purchased in 2002, was sold shortly after announcing a merger with bottler Arca. While the prospects for this new combination are excellent the share price had risen sharply and was close to our intrinsic value estimate. Likewise we sold the large shareholding in **Copel**, the Brazilian hydro-electric producer. A key factor in our decision was that competition for new generation projects has heated up meaning that future returns will inevitably fall. Furthermore, from our discussions with the company, it appears as if the regulator will trim what it views as acceptable industry returns. This is a key metric in setting electricity prices and could have a negative impact on Copel within a year or two. In that light, after a couple of years

of strong stock performance, it was prudent to sell the Fund's shares at a modest discount to our value estimate. Both these stakes generated returns including dividends in excess of 100%, despite a negative currency impact.

After many years in the portfolio we sold the positions in two newspaper companies **Axel Springer** and **Tamedia** after a good performance in 2009, 2010 and early 2011. The former returned more than 100% and the latter a little more than 60%.

### *The curious case of Nongshim and Nongshim Holdings*

As shareholders are likely to recall from earlier letters (see May 2010 for example), Nongshim is a major Korean food producer with leading brands and dominant market shares. Nongshim Holdings is the controlling shareholder of Nongshim besides owning several other companies and assets. Recently Nongshim's share price rose substantially while Holdings did little better than tread water. Even though discounts are common for holding companies this complete divergence was remarkable given that the major asset of Nongshim Holdings is Nongshim. Even though Nongshim's shares performed well in the past half-year, it trades currently at some 4X 2010 EBITDA. This is a multiple roughly half what even run-of-the-mill food companies garner in pretty much any other market in the world. Besides a discount multiple current earnings are also clearly depressed. Apply the same 4X multiple to higher, "normalised" earnings and the share price would be substantially higher.

To this already remarkable situation you can add a third level of discount, namely the discount between Nongshim Holdings and Nongshim which widened considerably in recent months. The 34.4% stake owned by Nongshim Holdings, based on market prices (i.e. forgetting about the undervaluation in Nongshim itself), is valued at roughly 190% of its own share price. In other words you could indirectly buy Nongshim shares at approximately half their stock market price by investing in Nongshim Holdings. To make matters even stranger, Nongshim Holdings holds other assets, after deducting debt, worth some 60% of its stock price. In total, simply adding up the stock market value of Holdings' listed investments and the book value of its other assets leads to a price tag 2.5X greater than its own share price. Although there are some 40,000 different shares listed globally you'd have to look very hard to find a situation as absurdly inefficient as this. We traded in a fair number of the Fund's Nongshim shares for shares in Nongshim Holdings. In so doing the Fund's margin of safety and return potential improved, but the overall weighting in the Nongshim group remained unchanged.

#### **Value of Nongshim Holdings versus share price**

KRW 112,853	stock market value of Nongshim shares (c. 4X EBITDA) per Nongshim Holdings share
KRW 18,328	stock market value of Youlchon Chemical held by Nongshim Holdings per Nongshim Holdings share
<u>KRW 18,343</u>	other financial assets at book value and cash less debt per Nongshim Holdings share
<b>KRW 149,524</b>	value of investments per Nongshim Holdings share
<i>versus</i>	
<b>KRW 60,000</b>	stock price per share Nongshim Holdings

### *Picking stocks and the importance of good capital allocation*

In these semi-annual letters we traditionally make a side-step from reviewing the performance and portfolio and also highlight a particular aspect of the Fund's value investment strategy. Ultimately our goal is to contribute to a better understanding of how we manage your money, and to a certain piece of mind. There are a number of recent shareholders for whom this may be relatively new material, but we hope it will be interesting and informative as well for the large group of long-standing shareholders who are already well versed in Citadel and its investment philosophy.

Citadel's basic strategy of looking for stocks which we calculate are worth 100 and which are trading at 50 is straightforward. Determining what a company is worth is without a doubt the difficult part of this process. The theory is fairly simple; a company is worth no more than the total of the cash it generates over the course of its life measured in today's money. Assessing a company's value is therefore forward looking. Yet predicting the future is perilous which is why we rely on two basic protections; a low stock price or more accurately a low valuation, and a

thorough and conservative process to estimate a company's value. Value investors, like ourselves, tend to put more weight on the bird in the hand than the two in the bush. In practice this means that it's easier and more certain to put a value on a company based on its tangible assets like cash or investments than on a forecast of its future cash flows. That being said, the best investments are usually almost always those that can grow their value in time, which explains why most investors are singularly focused on earnings and earnings growth.

When focussing on growth it is all too easy to get carried away, by extrapolating high recent levels of growth far into the future, or building unrealistic growth forecasts based on expectations about the success of a new product or service. All too often this ends in disappointment. The bird in the hand versus two in the bush mind-set is helpful though in trying to put a value on a company's future cash flows. For example, there is a lot less room for error mapping out the cash flows of a branded consumer products company like Heinz than, say, Facebook. Determining how much or little Heinz will earn from its ketchup in 10 years' time is infinitely easier than predicting how successful Facebook will be in commercialising its services and what that might mean for its cash generation. The former we would attempt, but the latter we choose to avoid. The safest way to view growth is sometimes simply to avoid predictions altogether but merely build a case in which, at a minimum, a company looks capable of continuing to perform roughly as it has done. A better result than this would be gravy.

In appraising a company it is not only critical how well a business performs in terms of earnings, but also whether the cash that is generated is wisely spent. An overpriced acquisition, an ill-timed investment, or even a share buyback at an overvalued share price are common examples of how capital is misspent. There are legions of instances where companies flush an entire year's earnings away, or more, through bad capital allocation. We are always a bit cynical in assessing a management's capital allocation abilities; we usually assume the worst and hope for the best. Sadly our cynicism is many times warranted. We were, for instance, disappointed that **Heineken** (which the Fund owns through **Heineken Holding**), and which traditionally had a reasonable record in this regard, acquired Mexican brewer Femsal last year paying a stiff price and, furthermore, paying in its own undervalued shares. The deal was complicated but could be summed up as follows: Heineken traded 20% of itself for 100% of Femsal. Now recall that Heineken is one of the largest global brewers, with no. 1 or 2 positions in more than 20 markets world-wide, and possesses the leading international premium beer brand in addition to tens of other major brands. Femsal is the number 2 Mexican brewer. Was Heineken equivalent to 5 Femsal's? Put in those terms we suspect even management would have difficulty defending its deal.

Some investors, certain of whom we greatly admire, are outspoken in their intention to invest only with company managers who spend shareholders' money wisely. We agree wholeheartedly with the sentiment but choose to balance our desire with pragmatism. The vast majority of companies are at best middling allocators of capital and it is good to recognise that. Furthermore, it is not always clear if managers who, at first glance, look to be decent stewards of shareholder's capital won't prove to be wolves in sheep's clothes. Flashy power-point presentations using all the right terminology can, at times, turn out to be red flags. Mastering the art of shareholder communications certainly provides no guarantee for future performance!

While consciously avoiding firms where historically substantial cash was thrown overboard, we *have* invested in companies where modest amounts of capital were put to questionable use. In these cases valuations were so low that it more than compensated for this effect. Additionally the amounts were rather small in the context of both earnings and balance sheets. In Asia companies are generally recognised as being poor capital allocators. Some of the Asian companies Citadel has in the portfolio can definitely be accused of not using their cash to best effect, by hoarding it usually. Naturally that is very different than actually wasting it, although that sadly also happens from time to time. Ironically our experience is that some of the worst examples of over-priced acquisitions, ill-timed share issues or other value destroying actions occurred in Europe and the United States.

As the years pass our thinking on this topic has evolved somewhat. We are quicker to mark down our intrinsic value estimates for portfolio companies which squander shareholder's funds, sell them sooner, and are paying even more attention to this subject before making new investments. However well a company does operationally the value this creates can largely, or even entirely, be consumed if that capital is poorly deployed. We've seen excellent businesses

with incredible earnings power (e.g. **Wolters Kluwer**) turn into mediocre investments largely because of weak capital allocation.

When a company allocates its capital well it has a hugely positive impact for its shareholders. Fortunately Citadel has more than its fair share of companies in the portfolio which are adding lots of value through their intelligent use of capital. **Contal** (just sold) and **Zwack** are worth mentioning. They make the necessary investments in their businesses but pay virtually 100% of their remaining cash flows to shareholders in the form of dividends. This was a major source of the Fund's returns in both cases. Numerous others also pay generous dividends out of their excess cash flow. Perhaps unsurprisingly some of the best operators in this regard are the family owned and operated firms like Contal and Zwack as well as others such as **Village Super Market**, **Dewhurst**, **Bijou Brigitte**, etc. They fuelled growth in their businesses through high return investments and acquisitions, paid substantial dividends and bought back shares at low prices with excess cash. Owner-operators like these truly appreciate the value of their own shares, know the sweat and hard work gone into accruing cash, and think long and hard before deciding what to do with their firms' capital. Overall the Fund's companies performed decently on this score. Seeing how important capital allocation is for the potential returns of minority shareholders like Citadel, you can be sure it will occupy a prominent position in our work monitoring and analysing companies.

#### ***Zehnder – a radiator company run like a Swiss watch***

Zehnder, a company the Fund has owned since 2005, ties in very well to the discussion on capital allocation. It is another excellent example of a firm (family owned and operated as it happens) which, by carefully and sensibly employing its cash flows, is a model of financial health and value creation for its shareholders (net cash equal to 10% of the share price/ 6% annual value compound plus c. 2-3% dividend yield in the past 20 years ).

Zehnder is based in Switzerland and is primarily known for its radiators. This is a product which to all intents and purposes has become a commodity with demand linked to the highly cyclical construction industry. To its credit management transformed the company away from the commodity side of the business through focusing on premium, customised, innovative and smaller-run products. It also scored a home-run with its acquisition of StorkAir a number of years ago. That company is active in so-called 'comfort ventilation'; products to ventilate, cool and heat the increasing numbers of energy efficient buildings in Europe and abroad. Sales grew at double digit rates since it was acquired and prospects look very bright. The success of Zehnder's strategy is evident from the fact that its 2009 sales only slipped slightly, and 2010 sales and profits were already ahead of their pre-crisis levels.

One of the factors that originally drew us to Zehnder (other than a very low valuation) was the company's remarkably strong profitability – in a tough market where competitors were noticeably less profitable. Operating margins averaged 10% in the past 2 decades while after-tax returns on capital were an even more impressive 13%. The company has balanced revenue enhancing initiatives such as new product innovation and geographic expansion with stringent cost control. The icing on the cake has come from wisely allocating its capital; cash flows were used to acquire a string of companies (including StorkAir) at reasonable prices, and on dividends. Looking further back the company also bought back large chunks of its own shares when they were selling at low levels.

After toiling for years in obscurity Swiss investors and others discovered the firm and the shares steadily ran up before plunging in 2007 and 2008. Since then they recovered much of that fall and are up almost 70% versus the level at which Citadel bought. At approximately 10X 2010 EBIT the company is one of the more highly valued holdings in the portfolio. Nevertheless Zehnder trades at a discount to our intrinsic value estimate, while earnings should rise strongly this year and next. At some point (hopefully sooner rather than later) the company will exit the portfolio but it remains a classic case of a company being run as companies should be run.

#### ***In conclusion***

It strikes us that reading the average newspaper these days is not a particularly uplifting experience. For those so inclined there is more than enough to worry about. In fact, as we write this, markets continue their correction. After a virtually uninterrupted rise since March 2009 it is natural and even healthy that markets pause now and again. From

our perspective a bit of a shakeup is not a bad thing as it does lead to opportunities. We are finding undervalued companies although admittedly less than a year or two ago. The correction of the past several weeks helps in this endeavour though. We are also fortunate in that we were able to sell a number of holdings at good prices and recycle the proceeds into more undervalued companies, and into cash. That cash could prove invaluable in the coming time. Looking at the portfolio many of the 32 companies Citadel owns are still trading at big discounts to what we calculate they are worth. Currently, on a see-through basis, the Fund is valued at 4.6X EBIT and at less than 90% of Capital Employed with an after-tax return on capital of roughly 13.5%. The average dividend yield is 3.3%. These are figures which are highly attractive and they compare very favourably to the overwhelming majority of listed companies. Our task is to continue to expand the long-term performance gap between Citadel and the unmanaged index. We do so by sifting through stocks on a company-by-company basis, and investing in those where we conclude that the risk of permanent loss is minimal and the potential for large absolute returns is high. With the portfolio in hand we have every confidence in Citadel's prospects.

As a final note we want to thank you for your continued investment in the Fund. The responsibility for investing your money is something we take very seriously. As many of you know we have an additional reason not to fall asleep at the wheel; the investment advisors and directors have been, and still are, sizeable shareholders in Citadel. The next letter will be out sometime in mid-December and by that time it will be clear how 2011 is turning out. Enjoy your summer!

Kind regards,

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

June 16th, 2011