CITADEL
VALUE FUND

INVESTMENT PHILOSOPHY

"Investing is most intelligent, when it is most business-like"

Benjamin Graham
The Intelligent Investor

IMPORTANT: THIS BROCHURE CONSTITUTES MARKETING COMMUNICATION

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 and KID before making any final investment decision. The opinions and commentary expressed in this brochure should in no way be construed as personal investment advice, they are intended solely to illustrate the Fund's investment strategy. The Fund is actively managed without a reference to a benchmark.

The Citadel Value Fund is a Société d'Investissement à Capital Variable (SICAV), and is regulated as an Undertaking for Collective Investment in Transferable Securities (UCITS) by the Luxembourg Commission de Surveillance du Secteur Financier (CSSF). It is furthermore registered with the Autoriteit Financiële Markten (AFM) for sale to the general public in the Netherlands, conforming to section 17 of the Act on the Supervision of Collective Investment Schemes.

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Investment Philosophy

Citadel: A tower of strength since 2002

The Citadel Value Fund started investing in 2002. Since then it has established a solid track record as a successful equity fund with good returns and a stable investor base. The Fund weathered tough market conditions by remaining true to its rock-solid fund principles formulated at its inception. Citadel's portfolio of companies is financially healthier than the index average and valued at a much lower multiple than the index average. In the long run this should result in solid absolute and relative performance. Combined with a low risk profile, we believe that Citadel is a sensible alternative to an investment in an equity index. In this brochure, you can read more about the Fund's principles that have been key to successful investing.

Seek out & invest in undervalued businesses

Our investment philosophy is a value one. But what is value? As consumers we don't buy a car or a refrigerator without having an idea of their value in our heads. We want to compare what we get in terms of functionality, appearance, etc. with what we pay. Nor, are we convinced, is this any different with stocks. When investing in stocks what we are buying are pieces of companies. A company's value or its 'intrinsic value' as we call it, is determined by discounting future cash flows back to today's money. What we pay for those cash flows can vary a lot as stock markets rise and fall. But determining just what we should pay is crucial to successful investing.

One way to view this is to imagine yourself in the shoes of an owner of a business. Over a number of years he expects to get more cash out of his investment (hopefully a lot more!) than he's put in. In the company's business plan the owner has weighed the costs of investment against the profits that he expects to flow in the future. Whether the eventual profits from the business will generate a decent return on that investment will, of course, depend on his skills and hard work. However, no one in their right minds will invest in a business where the chance of getting one's money out is slim.
As investors, and potential part owners of various companies, we approach the question of investing in shares in much the same way.

We want to identify stocks where the 'what you put in versus what you get out' relationship is a very favourable one. But make no mistake about it, we won't be predicting stock prices. That is a game best likened to roulette we believe. Rather, we'll spend our time thinking about how individual businesses will evolve in future, and putting a value on them. We aim to find stocks where there is a major difference between our estimate of intrinsic value and the stock market value at a particular moment in time. We're convinced that this value discipline is the cornerstone to achieving superior long-term returns, while minimising risk.

Our two investment priorities are:

- Preserving capital
- Generating attractive long-term absolute returns

Preserve invested capital

The most important risk that we think is **really** worth worrying about is a permanent, as opposed to a temporary, loss of capital. Permanent capital loss can, for example, result from a decline in the intrinsic value of a business, or from paying too much for a stock in relation to its intrinsic value. We think that we can greatly minimise the risk of permanent capital loss by concentrating on value. By that we mean investing in companies at prices well below our estimate of their intrinsic value based on various measures such as the value of their tangible and intangible assets, their brands and market positions and their ability to generate cash.

In principle we are open-minded about investing in all sectors but our value approach tends to limit, or even preclude, our exposure to certain sectors. To name a few examples; we have difficulties investing in businesses with a high chance of fast technological disruption or in pharma or biotechnology companies whose value is dependent on yet-to-be-developed products. Also, we find banks and insurance companies very difficult to value. In fast changing industries, the degree of certainty which we seek in estimating intrinsic value is usually just not there. Value, we believe, is a more enduring quality and can stand up to a few bumps! This brings us to a crucial element in our investment philosophy, that of **'margin of safety'**.

Margin of safety, first described by the famous investor and author Benjamin Graham, is all about building in a cushion to protect against the risk of permanent capital loss, while offering the potential for an attractive return on investment. A big margin of safety, usually a low price relative to what we think intrinsic value is, can provide a lot of protection against set-backs and still leave our investment looking sound. A simple example given by Graham is that of a bridge rated to take trucks up to 10 tonnes. While there shouldn't be a problem driving a 10t truck across, it doesn't leave much room for error in the event that the engineers erred slightly in their calculations, or that time has weakened the structure, etc. But a 5t truck, on the other hand, should easily make it to the other side. In stocks, our main protection is in the price. We can't influence how companies will develop, but we can choose the price at which we buy. That provides our margin of safety.

While we are very conscious of avoiding the risk of permanent capital loss, we and you shouldn't lie awake at night worrying about short-term price swings. A big fall in share prices may be very painful at the time; however, it often reveals surprisingly little about what is happening at individual companies, let alone what they're worth. When we're convinced of the correctness of our analysis, continual reassurance from the stock market is superfluous.

We don't need to be right in the short term, **but** we do need to be right in the long term. We would, for example, much rather generate an average 20% annual return over time with bumps along the road than a steady 10% year in, year out. Although stock prices can fluctuate wildly, most companies' prospects don't actually change that much and certainly not that quickly. Big swings in share prices can give us wonderful opportunities to buy good companies at **good** prices. That, we are convinced, is the best protection an investor can have.

Generate attractive long-term returns

Our second main objective is to generate an attractive long-term return. We strive to produce good absolute returns measured over a period of at least three to five years. This should, over the long-term, give a fair chance that the fund's performance will stack up well to that of the market.

A disciplined value philosophy not only reduces risk, as we described earlier, it also increases the probability of good returns.

To explain it is helpful to look at how many asset managers approach investing. Volatility is generally much feared and with good reason. When a manager's performance is regularly measured against an index, the last thing he or she wants to occur is to suddenly fall behind that index. The safest course of action, therefore, is to more or less mirror the index by buying identical companies, in similar proportions. If the index then performs poorly, the manager can at least argue that his performance reflects a "weak market", and is probably no worse than his peers.

We came across an excellent example of this in practice. A fund manager at a large, well known investment company bought a sizeable position in a certain technology company. The main purchase argument was that his fund was running a large risk by not owning the company's shares as the benchmark index included them. Three weeks later the stock in question had plunged by more than 50% (not much later they were down by more than 90%) and his investors were a good bit poorer. Yet the fund manager could still claim that the fund had held up well since the index also fell by a similar amount thereby nicely camouflaging the damage. Needless to say, that style of investing completely ignores the concept of value.

We are convinced that if one is disciplined enough to ignore the short-term noise, volatile markets actually provide attractive opportunities. When share prices change suddenly, the chance that a company's stock becomes mispriced dramatically increases. That works very much in our favour if we remain focused on analysing individual businesses and assessing their value. If other more durable measures convince us that the shares of a company are good value, even if the stock market momentarily says otherwise, we will take the opportunity to load up. Equally, by sticking to our value discipline we can profit from moments of market euphoria to dispose of over- or fairly valued holdings.

By doing so, we greatly improve the probability of future performance. This will often make us contrarians. When prices are pushed determinedly in a single direction by an overwhelming consensus of opinion, mistakes in valuation happen. We will work to take advantage of those moments.

Buying cheaply often requires patience. Prices can, and often do, remain low for a long time. The beauty of buying shares in a company at a low price though is that the odds favour good news; a company can be acquired, it can buy back its stock, poor results can improve, etc. Still, we recognise that our ideas will take time to come to fruition. It would be nice to think that after finding a very undervalued stock, we could also pick precisely the right moment to invest to reap the rewards. In practice that appears to be a pipe dream. It is **far** more difficult to determine when a share price will rise than merely to demonstrate that the share is cheap.

Therefore, we'll concentrate on identifying shares whose intrinsic value is so much higher than the share price that even after a wait of several years a good return is possible. Our strong preference is for the single idea with an estimated potential of 100% within a period of four years, than the four ideas with a short-term estimated potential of 25% each.

Investment Strategy

Bottom-up Analysis

The core of our investment strategy is to identify and invest in under-valued businesses. However, almost as important as what we **will** do, is what we **won't** do. We aren't out to pick the best performing sector, currency, or country. Incredibly, huge amounts of time, energy and resources are devoted to forecasting the direction of interest rates, the growth of economies, the level of currencies and the future performance of stock markets overall, with little obvious effect. Nor do we think we can do better. So, we won't even try. Our efforts will be exclusively concentrated on identifying individual companies which meet our value criteria.

Invest Globally

By investing globally we have a pool of approximately 30,000 listed companies from which to choose. However, we won't devote much time to 99% of these stocks. They just won't come close to meeting our investment criteria. Still, even after eliminating all but a few, this leaves us with the biggest possible pool on which to focus our analysis.

Notwithstanding the fact that the North American stock market represents the single largest market and opportunity set, the Fund will not necessarily own a large number of US holdings. The geographic weighting is heavily dependent on the question whether stocks in any particular market can be found that meet our value criteria.

The Fund will not invest in risky emerging markets, but will only select stocks listed in OECD countries, meeting certain standards of proper accounting, corporate governance and stability of the legal system.

Ultimately, the actual geographic spread of the portfolio won't be determined by a conscious choice. Rather, it'll simply be the result of seeking out companies that meet our value criteria. For the same reason the portfolio's breakdown by sector will not follow pre-determined lines.

A Focused Portfolio

While maintaining a sensible level of diversification, we concentrate our investments. There are two reasons for this. The first is based on our conviction that knowledge reduces uncertainty. As Warren Buffett describes it, "diversification is a protection against ignorance". With a portfolio of 100 or more stocks, which is common in many funds, we can't hope to know enough about each of our holdings to derive any degree of certainty or comfort. The second reason is equally straightforward. Once we have identified an opportunity that fits our demanding criteria, we want to make it worth-while. A position of a ½ or 1% of a portfolio, even if it doubles in price, just doesn't make that much difference to total returns.

The degree of concentration will depend on the answers to two questions: (i) how cheap is the stock compared to what we calculate that it is worth; and (ii) how sound are the business fundamentals? Where the discount to intrinsic value is large relative to other opportunities, our commitment will tend to be larger. We will also favour the investment where we are convinced that the business fundamentals are excellent and will remain so, to the one which is merely cheap.

By law, the Fund may invest a maximum of 10% of its assets in a single position, and a maximum of 40% in individual positions of 5% or more. Depending on the factors described above, the Fund will generally hold between 20 and 40 stocks.

A 'Buy and Hold' strategy

Our strategy is to 'buy and hold'. Turnover has been between 20% and 25% in the last 10 years[1], implying an average holding period of at least four years. Trading by itself doesn't generate returns, and more often than not it reduces them due to transaction costs. This less than frenetic approach should therefore pay dividends by simply keeping expenses down.

Our selling discipline is simple. We will sell a holding when we estimate that:

1) it is approaching its estimated intrinsic value, or;
2) intrinsic value has fallen to a point where the upside potential is insufficient, or;
3) there is an even more compelling bargain to be found elsewhere.

[1] Turnover is the term used to describe how long the average share in a portfolio is held before being sold. It is measured by taking the total value of shares sold as a percentage of the portfolio's value. A turnover of 100% (quite common) would imply that the entire portfolio is replaced once a year.

A mid and small cap bias

The portfolio generally has a bias towards mid and smaller sized companies. The relatively limited size of the Fund gives us great flexibility in making investments. Many large funds are forced by virtue of their size to invest only in large companies. However, as mid and small cap companies are generally less-well followed, the chances of finding beaten-down or overlooked companies are much better. With smaller firms we pay even more attention to finding those with little or no debt.

Dedicated to equities

The Fund will invest in publicly listed shares. The Fund will not invest in options, futures, swaps or other derivatives, and will not engage in currency hedging. It will make no use of leverage.

Describing the Investment Process

As we wrote earlier, the investment process is characterised by a 'bottom-up' approach. A key to that is doing extensive research and fundamental analysis on individual companies.

The process of identifying undervalued securities can be broken down into three stages.

1. Screening - In the first stage we want to identify a list of stocks with promising value characteristics. Because value can come in many guises, we employ a number of different quantitative screens to filter out companies that warrant further analysis. Some examples of what we look for are:

- a low multiple of Enterprise Value to free cash flow
- a low Enterprise Value to operating profit multiple
- a return on capital of 15%+ together with a price to capital (EV/CE) of 1.5X or less
- solid operating cash flows
- sound balance sheet characteristics
- high levels of insider buying, etc.

Subsequently we will hold these ideas up to the light and quickly eliminate those with problems such as very volatile profitability, a history of negative cash flows, poor capital allocation and excessive share dilution.

Other methods are more qualitative. They include monitoring and screening companies in sectors which we feel have highly attractive economic characteristics, obtaining ideas from sources such as industry contacts, analysts, etc. In the screening process we want to identify a small but steady stream of companies whose market values appear to be substantially below their intrinsic values.

2. Estimating intrinsic value - The companies that pass through our initial screening will be researched in-depth. That will involve thoroughly analysing the industry, competitors and the companies themselves, partly through use of proprietary financial models. We intend to make a well informed estimate of each company's intrinsic value, and look to find companies that sell at discounts of 50% or more to those estimates.

This process will naturally eliminate many companies as potential investments. However, it will also lead us to new ideas. Think, for instance, of a company's competitor that our analysis shows is even more attractively valued than the company we first set out to analyse.

3. Validating the Investment Case - Before making the investment decision we want to gain as much certainty as we can about the accuracy of our reasoning, the risks involved and our estimate of intrinsic value. We find that discussions with company management and other informed parties can be very useful in this process and will employ them regularly. If the investment case stands up to these final checks we will place the stock on our 'Buy' list, together with a maximum purchase price and a price target.

The investment process will lead to investments sharing many of the following value characteristics:

- a low debt level
- a high dividend yield
- a low price relative to the Free Cash Flow the company is generating
- a low price relative to those paid in recent industry transactions involving comparable businesses
- a low price relative to listed peers on criteria like Enterprise Value to Earnings Before Interest, Taxes, Depreciation & Amortisation (EV/EBITDA), EV/EBITA, and other industry specific measures
- a low price paid for the capital employed in a business (EV/CE) relative to the pre- and post-tax returns made on that capital (ROCE)
- a low price (i.e. big discount) relative to our calculation of a company's value derived from a cash flow analysis and Discounted Cash Flow (DCF) model

Information

Investors can subscribe or redeem (part of) their Fund holdings twice a month at the applicable Net Asset Value (NAV) without any associated transaction costs.

The Net Asset Value of the Fund is stated net of all costs, including management fee and accrued incentive fee, if any. The current NAV, the NAV history and the NAV dates can be found on the Fund's website.

Individual investors should note that the minimum initial subscription in the Citadel Value Fund (Class P shares) is EUR 10,000. The minimum subsequent subscription is also EUR 10,000. The minimum initial subscription for Class X shares is EUR 1 million.

For a prospectus, more information about how to subscribe or more background information, please refer to the Fund's website. On the website, you can also find recent newsletters including information on the Fund's portfolio and its performance.

www.citadelfund.com

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