



21/04/2005

Unaudited results for 3 month period ending 31 March 2005		
1 st Quarter	Net to investors	1.5%
	Index*	-1.6%
7.9 years-compounded (22 April 1997 - 31 March 2005)	Investment officer	17.9%
	Index*	1.7%
	NAV -	\$167.43

*Weighted index, according to the percentage of assets invested in specific markets. Currently the index comprises the S&P500, FTSE100, TSE300, Hang Seng and Dow Jones Commodities Indexes.

“Any unleveraged business that requires some net tangible assets to operate (and almost all do) is hurt by inflation. Businesses needing little in the way of tangible assets simply are hurt the least.” - Appendix to 1983 Berkshire Hathaway shareholder’s letter.

Letter to investors:

Inflation has been on my mind a lot over the last two years. The dollar is the reserve currency of the world and the US has been ‘printing’ dollars as if it is going out of fashion. The vast majority of currencies try to stay ‘competitive’ with the dollar, therefore I believe good odds exist for a period of above average inflation.

The following brilliant piece, regarding inflation and goodwill, is taken from the 1983 Berkshire Hathaway annual report.

“That probability exists because true economic Goodwill tends to rise in nominal value proportionally with inflation. To illustrate how this works, let’s contrast a See’s kind of business (See’s Candy Shops is a Berkshire owned business) with a more mundane business. When we purchased See’s in 1972, it will be recalled, it was earning about \$2 million on \$8 million of net tangible assets. Let us assume that our hypothetical mundane business then had \$2 million of earnings also, but needed \$18 million in net tangible assets for normal operations. Earning only 11% on required tangible assets, that mundane business would possess little or no economic Goodwill. A business like that, therefore, might well have sold for the value of its net tangible assets, or for \$18 million. In contrast, we paid \$25 million for See’s, even though it had no more in earnings and less than half as much in “honest-to-God” assets. Could less really have been more, as our purchase price implied? The answer is “yes” - even if both businesses were expected to have flat unit volume - as long as you anticipated, as we did in 1972, a world of continuous inflation.

To understand why, imagine the effect that a doubling of the price level would subsequently have on the two businesses. Both would need to double their nominal earnings to \$4 million to keep themselves even with inflation. This would seem to be no

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great trick: just sell the same number of units at double earlier prices and, assuming profit margins remain unchanged, profits also must double. But, crucially, to bring that about, both businesses probably would have to double their nominal investment in net tangible assets, since that is the kind of economic requirement that inflation usually imposes on businesses, both good and bad. A doubling of dollar sales means correspondingly more dollars must be employed immediately in receivables and inventories. Dollars employed in fixed assets will respond more slowly to inflation, but probably just as surely. And all of this inflation-required investment will produce no improvement in rate of return. The motivation for this investment is the survival of the business, not the prosperity of the owner.

Remember, however, that See's had net tangible assets of only \$8 million. So it would only have had to commit an additional \$8 million to finance the capital needs imposed by inflation. The mundane business, meanwhile, had a burden over twice as large - a need for \$18 million of additional capital. After the dust had settled, the mundane business, now earning \$4 million annually, might still be worth the value of its tangible assets, or \$36 million. That means its owners would have gained only a dollar of nominal value for every new dollar invested. (This is the same dollar-for-dollar result they would have achieved if they had added money to a savings account.)

See's, however, also earning \$4 million, might be worth \$50 million if valued (as it logically would be) on the same basis as it was at the time of our purchase. So it would have gained \$25 million in nominal value while the owners were putting up only \$8 million in additional capital - over \$3 of nominal value gained for each \$1 invested.

Remember, even so, that the owners of the See's kind of business were forced by inflation to ante up \$8 million in additional capital just to stay even in real profits. Any unleveraged business that requires some net tangible assets to operate (and almost all do) is hurt by inflation. Businesses needing little in the way of tangible assets simply are hurt the least. And that fact, of course, has been hard for many people to grasp. For years the traditional wisdom - long on tradition, short on wisdom - held that inflation protection was best provided by businesses laden with natural resources, plants and machinery, or other tangible assets ("In Goods We Trust"). It doesn't work that way. Asset-heavy businesses generally earn low rates of return - rates that often barely provide enough capital to fund the inflationary needs of the existing business, with nothing left over for real growth, for distribution to owners, or for acquisition of new businesses. In contrast, a disproportionate number of the great business fortunes built up during the inflationary years arose from ownership of operations that combined intangibles of lasting value with relatively minor requirements for tangible assets. In such cases earnings have bounded upward in nominal dollars, and these dollars have been largely available for the acquisition of additional businesses. This phenomenon has been particularly evident in the communications business. That business has required little in the way of tangible investment - yet its franchises have endured. During inflation, Goodwill is the gift that keeps giving. But that statement applies, naturally, only to true economic Goodwill. Spurious accounting Goodwill - and there is plenty of it around - is another matter. When an overexcited management purchases a business at a silly price, the same accounting niceties described earlier are

observed. Because it can't go anywhere else, the silliness ends up in the Goodwill account.

Considering the lack of managerial discipline that created the account, under such circumstances it might better be labeled "No-Will". Whatever the term, the 40-year ritual typically is observed and the adrenalin so capitalized remains on the books as an "asset" just as if the acquisition had been a sensible one."

God Speed,

A handwritten signature in black ink, appearing to be 'M. van Blerk', written in a cursive style.

Martin van Blerk