

BAOBAB
GLOBAL FUND



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		Other currency equivalent				
		USD	EUR	GBP	BWP	ZAR
12 months	Net to investors	20.9%	10.3%	8.8%	30.1%	25.7%
	Index*	17.7%				
9.70 years-compounded (22 Apr 1997 - 31 Dec 2006)	Investment officer (full service track record - net to investors)	16.0%	14.9%	14.2%	21.7%	20.9%
	Index*	4.4%				
	NAV	\$191.81				

*Weighted index, according to the percentage of assets invested in specific markets. Currently the index comprises the S&P500, FTSE100, TSE300, Nikkei 225, Hang Seng and Dow Jones Commodity Indices.

Letter to shareholders:

Mistakes

"If I had to live my life again, I'd make the same mistakes, only sooner."

-Tallulah Bankhead (1903 - 1968)

Blackjack

We do not gamble but there are important similarities between gambling and investing. One can learn a great deal from studying gambling; a good book on gambling's relationship with investment is *Fortune's Formula* by William Poundstone. It is illuminating to focus beyond the work you do to arrive at an investment decision and only focus on your decisions as a group. I now have 10 years under the belt and am operating in the shadow of a giant of a mentor, actually several of them, so this year we sat down and worked through my investment decisions over the decade. For example I took my first purchase price of an investment (usually there are several tranches of buying) and compared it with the share prices one year later and three years later. The results showed that I bought too early. I was very good with averaging down in the cases where the stock was pummelled after my initial purchase, but it showed that I had a tendency to go in too early. This is a mistake, one I did not know I made and - here comes the tough part - one I could only find out about after I made it for several years. You need a solid data series to expose this one. Well, maybe not 10 years worth!

The main aim of doing all these sobering exercises is to figure out what your edge is and very importantly, how you should weigh accordingly. Basically, it is possible to make money when I am right only 1 out of 10 times as long as I put 90% of my money on the bet I win. The converse is also true. The trick is to know what your edge is, when you have it and to put the right percentage of your money on each bet/investment. The MOST IMPORTANT mistake to avoid is to over-bet, because that will wipe you out. Well in our case that is close to impossible (not impossible) to be wiped out, but a mistake can put us back many, many years. My results showed that I was weighing too much due to my preference to target a 10 stock/10% each model portfolio. I should be able to attain better results by moving closer to a 20 stock/5% portfolio. In practice the weightings is not so simple, but the logic holds.

Mistaking movement for progress

I think there is a good case to be made that I was not sitting still enough last year. I now have tremendous resources at my disposal and I can probably be forgiven for acting like a kid in a candy store. I made several trips to Europe, mainly the UK and to the US. On the one hand, we can question whether this was effective use of my time and efficient use of the resources, but on the other hand, a good foundation was laid for the future. I established very valuable relationships and met with many managements, which can be very useful. Still this year I want to think a bit harder before hopping on a plane to spend a week in Europe or at least prepare better to ensure that I maximize my time away from the office.

A decade of investment

It is hard to believe that we have been going for almost a decade. It seems like only yesterday when I plonked down a desk in my cousin's living room with the aim of turning my hobby into something resembling full time employment. About a year later, I rented my first office space (a room in a friends' house for about \$16/month). I believe that experience was the cornerstone of our frugal approach to operating costs at Baobab and today we still spend virtually nothing in direct costs like rent, telephone bills, salaries, etc. This is the result of being able and fortunate.

However, we have been lucky in attracting an outstanding group of investors, which together make up the Baobab family.

This is a good time to take a step back and remind you of the big picture. We have a partnership approach to what we do; a partnership between you and myself. Now we all know that Rob and Hubert play a critical role in this business, but when it comes to the investment performance the buck stops with me. This is the case in good years and bad (in case you have forgotten about 2005). Anyway, you invested in Baobab for two reasons,

1. either you had excess capital,
2. Or a need for diversification.

My reason for being here is threefold,

1. I have a fixed cost to what I do, so taking partners on board is a way of leveraging returns on the fixed cost,
2. I have not yet found another way of having more fun than I do by investing our money,
3. And in the long run my financial interest in Baobab will be channelled to the bottom rung of society.

So here we are with our pot of money, which we call Baobab. Our financial aim is to maximise the returns, right. Well yes and no. In simplistic terms the answer is yes, but holistically the answer is no. Baobab is not merely a brutal exercise in capitalism where we try to squeeze every drop out of the lemon. We are thinking more along the lines of planting orchards.

"A man has made at least a start on discovering the meaning of human life when he plants shade trees under which he knows full well he will never sit." - D. Elton Trueblood

It does not matter which of the two reasons mentioned above underlies your decision to invest in Baobab, you still did it because you wanted to create some kind of opportunity for yourself or someone else in the future. For most of you, this relates to financial security in retirement or securing the best possible future for you and your family. For a lot of us this relates to our children. I could care less about the ski trips and fast cars you want, we can pay for those with earnings other than from Baobab. I am only concerned with ensuring Baobab lives up to its name and become the tree that our children can sit under. Baobab in the Botswana context also aims to go much further than that.

"If you plan for a year, plant a seed. If for ten years, plant a tree. If for a hundred years, teach the people. When you sow a seed once, you will reap a single harvest. When you teach the people, you will reap a hundred harvests." - Kuan Chung

We have been working on a concept for some time to export value investment into the Botswana education system. It is still very early days, but our plan is slowly taking shape.

However, never mind how ambitious all our plans, it all turns to dust unless we maintain and improve on our core competency; the ability to,

1. ensure safety of principal,
2. Earn an above average return on said capital.

We do this by sticking to the following principles, which have been our guiding light since day one. We make long-term investments in businesses and these businesses must,

1. Be simple and understandable
2. Earn an above average return on shareholders' equity
3. Not utilize excessive debt
4. Have a consistent operating history
5. Have favourable long-term prospects
6. Not earn significant revenue in a country of which the currency is unstable over the long-term
7. Have an owner-orientated management that we trust and admire
8. Have management that owns a significant stake in the company

Warren Buffett states that *'If principles can become dated, they're not principles'*, which leave little room for excuses to not stick to our principles. Yet you will be surprised at how agile I have been in manoeuvring in that small space. It is true that we are often not able to tick all eight boxes for each investment, but overall we have done a good job of sticking to the above.

Here follows a collection of quotes that is very reflective of what we have done over the 10 years.

"To invest successfully, you need not understand beta, efficient markets, modern portfolio theory, option pricing or emerging markets. You may, in fact, be better off knowing nothing of these. That, of course, is not the prevailing view at most business schools, whose finance curriculum tends to be dominated by such subjects. In our view, though, investment students

need only two well-taught courses - How to Value a Business, and How to Think About Market Prices.

"Your goal as an investor should simply be to purchase, at a rational price, a part interest in an easily-understandable business whose earnings are virtually certain to be materially higher five, ten and twenty years from now. Over time, you will find only a few companies that meet these standards - so when you see one that qualifies, you should buy a meaningful amount of stock. You must also resist the temptation to stray from your guidelines: If you aren't willing to own a stock for ten years, don't even think about owning it for ten minutes. Put together a portfolio of companies whose aggregate earnings march upward over the years, and so also will the portfolio's market value."

--Warren Buffett, [1996 Berkshire Hathaway Shareholder Letter](#)

"Confronted with a challenge to distill the secret of sound investment into three words, we venture the motto, Margin of Safety."

--Ben Graham, [The Intelligent Investor](#).

Don't Confuse Growth With Sustainable Competitive Advantage

"The key to investing is not assessing how much an industry is going to affect society, or how much it will grow, but rather determining the competitive advantage of any given company and, above all, the durability of that advantage. The products or services that have wide, sustainable moats around them are the ones that deliver rewards to investors."

--Warren Buffett, [Fortune magazine](#), 11/22/99

Keep It Simple!

"Our investments continue to be few in number and simple in concept: The truly big investment idea can usually be explained in a short paragraph. We like a business with enduring competitive advantages that is run by able and owner-oriented people. When these attributes exist, and when we can make purchases at sensible prices, it is hard to go wrong (a challenge we periodically manage to overcome).

"Investors should remember that their scorecard is not computed using Olympic-diving methods: Degree-of-difficulty doesn't count. If you are right about a business whole value is largely dependent on a single key factor that is both easy to understand and enduring, the payoff is the same as if you had correctly analyzed an investment alternative characterized by many constantly shifting and complex variables."

--Warren Buffett, [1994 Berkshire Hathaway Shareholder Letter](#)

Arguments for Buying Great Businesses

"We continually search for large businesses with understandable, enduring and mouth-watering economics that are run by able and shareholder-oriented managements. This focus doesn't guarantee results: We both have to buy at a sensible price and get business performance from our companies that validate our assessment. But this investment approach -- searching for the superstars - - offers us our only chance for real success. Charlie and I are simply not smart enough to get great results by adroitly buying and selling portions of far-from-great businesses."

--Warren Buffett, [1991 Berkshire Hathaway Shareholder Letter](#)

"An alert investor who has held a good stock for some time usually gets to know its less desirable as well as its more desirable characteristics. Therefore, before selling a rather satisfactory holding in order to get a still better one, there is need of the greatest care in trying to appraise accurately all elements of the situation."

--Philip Fisher, [Common Stocks and Uncommon Profits](#), p.81.

"The investor cannot pinpoint just how much per share a particular company will earn two years from now. As a matter of fact, the company's top management cannot. Under these circumstances, how can anyone say with even moderate precision just what is overpriced for an outstanding company with an unusually rapid growth rate? If the growth rate is so good that in another ten years the company might well have quadrupled, is it really of such great concern whether at the moment the stock might or might not be 35% overpriced? That which really matters is not to disturb a position that is going to be worth a great deal more later."

-- Philip Fisher, [Common Stocks and Uncommon Profits](#), p.83.

"Even the most thoughtful and steadfast investor is susceptible to the influence of sceptics who yell 'Sell' before it's time to sell...We've all been taught the same adages: 'Take profits when you can,' and 'A sure gain is always better than a possible loss.' But when you've found the right stock and bought it, all the evidence tells you it's going higher, and everything is working in your direction, then it's a shame if you sell. A fivefold gain turns \$10,000 into \$50,000, but the next five folds turn \$10,000 into \$250,000. Investing in a 25-bagger is not a regular occurrence even among fund managers, and for the individual, it may only happen once or twice in a lifetime. When you've got one, you might as well enjoy the full benefit."

-- Peter Lynch, [One Up on Wall Street](#), p. 253.

Ignore Macroeconomic Factors

"We try to *price*, rather than *time*, purchases. In our view, it is folly to forego buying shares in an outstanding business whose long-term future is

predictable, because of short-term worries about an economy or a stock market that we know to be unpredictable. Why scrap an informed decision because of an uninformed guess?

"We purchased National Indemnity in 1967, See's in 1972, Buffalo News in 1977, Nebraska Furniture Mart in 1983, and Scott Fetzer in 1986 because those are the years they became available and because we thought the prices they carried were acceptable. In each case, we pondered what the business was likely to do, not what the Dow, the Fed, or the economy might do. If we see this approach as making sense in the purchase of businesses in their entirety, why should we change tack when we are purchasing small pieces of wonderful businesses in the stock market?"

--Warren Buffett, [1994 Berkshire Hathaway Shareholder Letter](#)

"We will continue to ignore political and economic forecasts, which are an expensive distraction for many investors and businessmen. Thirty years ago, no one could have foreseen the huge expansion of the Vietnam War, wage and price controls, two oil shocks, the resignation of a president, the dissolution of the Soviet Union, a one-day drop in the Dow of 508 points, or treasury bill yields fluctuating between 2.8% and 17.4%.

"But, surprise - none of these blockbuster events made the slightest dent in Ben Graham's investment principles. Nor did they render unsound the negotiated purchases of fine businesses at sensible prices. Imagine the cost to us, then, if we had let a fear of unknowns cause us to defer or alter the deployment of capital. Indeed, we have usually made our best purchases when apprehensions about some macro event were at a peak. Fear is the foe of the faddist, but the friend of the fundamentalist.

"A different set of major shocks is sure to occur in the next 30 years. We will neither try to predict these nor to profit from them. If we can identify businesses similar to those we have purchased in the past, external surprises will have little effect on our long-term results."

--Warren Buffett, [1994 Berkshire Hathaway Shareholder Letter](#)

Welcome Market Declines

"[Many] investors who expect to be ongoing buyers of investments throughout their lifetimes...illogically become euphoric when stock prices rise and unhappy when they fall. They show no such confusion in their reaction to food prices: Knowing they are forever going to be buyers of food, they welcome falling prices and deplore price increases. (It's the seller of food who doesn't like declining prices.) Similarly, at the Buffalo News we would cheer lower prices for newsprint - even though it would mean marking down the value of the large inventory of newsprint we always keep on hand - because we know we are going to be perpetually buying the product.

"Identical reasoning guides our thinking about Berkshire's investments. We will be buying businesses - or small parts of businesses, called stocks - year in, year out as long as I live (and longer, if Berkshire's directors attend the séances I have scheduled). Given these intentions, declining prices for businesses benefit us, and rising prices hurt us.

"The most common cause of low prices is pessimism - sometimes pervasive, sometimes specific to a company or industry. We *want* to do business in such an environment, not because we like pessimism but because we like the prices it produces. It's optimism that is the enemy of the rational buyer.

"None of this means, however, that a business or stock is an intelligent purchase simply because it is unpopular; a contrarian approach is just as foolish as a follow-the-crowd strategy. What's required is thinking rather than polling. Unfortunately, Bertrand Russell's observation about life in general applies with unusual force in the financial world: 'Most men would rather die than think. Many do.'"

--Warren Buffett, [1990 Berkshire Hathaway Shareholder Letter](#)

"Price fluctuations have only one significant meaning for the true investor. They provide him with an opportunity to buy wisely when prices fall sharply and to sell wisely when they advance a great deal. At other times he will do better if he forgets about the stock market and pays attention to...the operating results of his companies."

--Ben Graham, [The Intelligent Investor](#), p.109.

Own a Concentrated Portfolio of Companies You Understand Deeply

"The percentage of investors who own 25 or more different stocks is appalling. It is not this number of 25 or more which itself is appalling. Rather it is that in the great majority of instances only a small percentage of such holdings are in attractive stocks about which the investor has a high degree of knowledge. Investors have been so oversold on diversification that fear of having too many eggs in one basket has caused them to put far too little into companies they thoroughly know and far too much in others about which they know nothing at all. It never seems to occur to them that buying a company without having sufficient knowledge of it may be even more dangerous than having inadequate diversification."

-- Philip Fisher, [Common Stocks and Uncommon Profits](#), pp. 108-9.

Basket approach

It is important to note that from time to time you will find that we own more than 25 stocks in the portfolio. Currently we hold 39. However, we hold only 20 positions. This sounds a bit like mental gymnastics, does it not? Well we have sound reasons for distilling several stocks to one position. An example of this (my facts is probably slightly off) is what

Buffett did a number of years ago in South Korea. He took the stock manual, flipped through it in about 4 hours and bought around 20 stocks by the numbers. He did not do what Fischer recommends above, which is to delve down into the nitty gritty of the stocks. You need to diversify against your ignorance, but you rely on the numbers to pull you through. This approach is particularly useful if you want to get into stocks with a small market cap. Currently we hold such a position.

Divestments

We continue the sobering exercise of following our divestments for three years. We try to keep things simple. Therefore we only record the date and market value or per share value at date of sale and compare it with the value at yearend. As soon as three years has passed since we sold the investment it is dropped from the list. We calculate the average of the change in value and compare that with the historical compound growth rate of Baobab. We can only feel comfortable with our divestment decisions if it underperformed our long-term compound growth rate. Two years ago, it was not the case and divestments were listed under *mistakes*. So why do we not have it listed as a mistake again this year? Two reasons: Krispy Kreme and Markel Corp, because if you strip these two out then the average drops to 9%, which comfortably underperforms my long-term average. Krispy Kreme is a company, which did not offer safety of principle at the time we sold it. In retrospect, I still hold that view and the fact that the share price moved against us has not change my view. Markel Corp is an outstanding company, which is an unfortunate casualty of our growth. It ended up being a very small part (considerably under 1%) of our portfolio. It just did not make sense to hold it anymore considering the size. I am well aware of the risk of trying to explain away my mistakes, but I do believe my reasoning is sound in this case.

Investment	Date Sold	Valuation at sale	Yearend valuation	% Compound growth
Clinton Cards (UK)	Aug-04	£0.81	£0.61	-9%
Natuzzi (Italy)	Jul-05	8.95	8.51	-2%
MCI (US)	Mar-05	23.00	20.65	-5%
Regent Inns (UK)	Jul-05	£0.80	£0.89	5%
Delta (UK)	Mar-05	£1.09	£1.59	21%
Krispy Kreme (US)	Feb-06	6.66	11.1	67%
Humboldt Wedag Int (US)	Jun-06	26.95	40.08	49%
Markel Corp (US)	Jun-06	337	480	42%
Mercury General Corp (US)	Jun-06	55.75	52.73	-5%
Sasamat Capital Corp (US)	Jul-06	3.05	3.45	13%
JJB Sports Plc (UK)	Jul-06	1.8	2.35	31%
Glorious Sun Enterprises (Hong Kong)	Sep-06	3.8	3.64	-4%
Average				16.78%

Canada

"The more I know the more I realise how little I know."
- Socrates

2006 was a learning experience of note. To be frank, I enjoy it more to stand at the bottom of a ladder than at the top. I just love the challenge and if I was thinking, in 2005 that I was getting to the top of the ladder after many years of practicing the art of value investment then 2006 only showed me that I simply reached the bottom of another very, very long ladder. I find it immensely satisfying and consider myself very fortunate to be in the midst of such an outstanding group of investors. The knowledge is there for the taking and resources and freedom to get on with the job is amazing. It is obvious that I can carry on quite a bit more about my work environment, but let the following suffice. It is impossible for me to have more fun than I am currently having.

View on the market

In 2005 we continued our 100% success rate in predicting the markets. Our prediction for 2007 is the same as last year and we expect to be right once more.

The markets will go up or down

Thank you note

Thank you to Rob and Hubert for an outstanding year and especially to my family, which showed tremendous support and unfailingly cheered me on. If you want to thank anyone, thank them.

God Speed,

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

Martin van Blerk
1 March 2007

Note: Audited Financial statements are presented separately and only to investors.