

Letter to Shareholders 2005

Dear Investors and Partners

Our return on shareholders' funds for 2005 was 28.08 %, including reinvested dividends. This is a very satisfying rate of return. Compared to the return of the international stock markets, measured by the MSCI World Index, of 26.51 %, it is also satisfactory. From inception of the fund until the end of 2005 our return on equity has been 21.82 % p.a., against a return for the MSCI World Index of 8.26 % p.a. in the same period.

Similar to previous years we would like to repeat that investment performance should be measured over several years. We believe that a period of 5 years would be appropriate given the way we invest. For a period of 10 years we expect to see a satisfactory return - both in absolute and relative terms - representing both fat and lean years. We will not be able to predict when these years will happen nor how fat the fat years will be or how lean the lean years will be. The success or failure of each investment will be determined by the following three indicators: purchase price, intrinsic business value and realized selling price in the long term and not by what happens to the market price meanwhile.

In last year's report we mentioned that the difference between the annual return of the fund and the general stock markets is bound to be smaller and this would probably take place through a smaller annual return for the fund and a higher annual return for the MSCI World Index. The difference has become smaller but with both rates of return at a higher level. With our focus on providing an absolute return, we are pleased with this higher level, and in the short term it has improved our financial health.

However, it does not change the fact that we have to moderate our expectations for future rates of return. We have benefited from exceptionally high returns in the fund during the last 3 years which, with the optimism we experience today and the positively derived valuations in the stock markets, we cannot expect in the future. In step with increasing stock markets, the supply of underpriced companies will decrease. It has been a very long time since we last experienced such a low level for companies satisfying our investment criteria.

Objectives

Our financial objective is to maximize the long-term average annual return on shareholders' funds while minimizing the risk of permanent loss of capital. We do not measure the financial success of the fund by the size of the fund's assets.

We are attempting to attain this goal by investing in both quality companies and ordinary companies with a market value at least 40 % under their intrinsic business value. We would prefer a portfolio with the first type of company since these companies have continually increasing intrinsic business value. If we have made an investment with a margin of safety of 40 %, then we have nothing against the market price not reflecting this condition on an on-going basis. It would even be better for us if the market value fell still further, allowing us to add to our investment at a greater margin of safety. Ultimately, we will be favoured by a market price that reflects the intrinsic

business value. We do not wish to worry about the quarterly or annual trends, but rather focus on the actions that will maximise long-term value for us.

Unfortunately, it happens still less often that we are able to invest in such companies at the right price. It is more often the case that ordinary companies, for some reason or another, are able to be bought with the requisite margin of safety. In reality, this is the bread and butter of our business.

Results for the year

The return of the fund derives from higher intrinsic business value of the fund's "subsidiaries" or companies in which the fund has invested and the narrowing difference between these companies' intrinsic business value and the value that the stock market chooses to set for them. As you know, the last value is the emotionally affectable. Most of the return is, however, derived from a narrowing safety margin.

In general, the increase in market value of the individual companies in the portfolio has been broadly consolidated. A number of companies have achieved market prices close to their intrinsic business value, so they have been sold off on a current basis. Also this year, the fund has experienced a flow of incoming capital, which has only been invested in those of the portfolio companies that still have a large safety margin. We have not made any further investments in a number of the portfolio companies that have grown considerably in recent years but not yet reached their intrinsic business value. Thus, they have become diluted and weigh less in the portfolio. This means in reality that we have commenced to reduce our portfolio of such companies.

Today, the portfolio is composed of 36 companies with the top 20 positions altogether accounting for 88% of the invested capital and 75% of the fund's total assets. Our liquidity ratio increased from 4.3% at the end of 2004 to 15.3% at the end of 2005. Our average liquidity ratio for the year was 11.1% and the invested portion of the portfolio reached a return of approx. 32% in 2005.

As you know, the fund's sectoral and country distribution only reflects what we find are interesting investment objects that satisfy our investment criteria. We do not manage the fund's sectoral and country distribution actively, although we would feel bad about having the entire portfolio placed in only one place. This means that the fund can be profoundly biased in relation to the sector and country distribution of the general stock markets represented by the MSCI World Index. In the short term (1 to 2 years), it may produce considerable differences in the current value development between the fund and the general stock markets. For instance, we saw a huge difference in 2003, i.e. a highly positive difference. There may also be years when the return of the fund is below the return of the stock markets.

At the end of 2005, the distribution was as follows:

<u>Region</u>		<u>Line of Business</u>		<u>The Fund's 5 largest positions</u>	
Far East (Japan)	40.6 %	Financial activity	45.3 %	Mitsui Sumitomo Ins.	8.00 %
Europe	37.1 %	Consumption-related	27.6 %	DEPFA Bank Plc.	6.99 %
North America	7.0 %	Industry	8.1 %	Takefuji Corp.	6.60 %
Liquidity	15.3 %	Other	3.7 %	Fairfax Financial Hold.	5.84 %
		Liquidity	15.3 %	Carl Allers Est.	5.41 %

Japanese insurance

Our Japanese investments, at 41%, still constitute a large share of the portfolio. In general, our investments in Japan have benefited significantly from the growing international focus on Japan's stock market. The recovery of the economy, partly due to the reforms in recent years and more focus on creating shareholder value, has attracted more foreign investors. The number of mergers and acquisitions among Japanese companies is reaching new peaks, which helps stimulate the activity on the Japanese stock market. Our Japanese insurance companies experienced a very strong increase in market prices triggered by underlying, profitable operations and large stockholdings. They still constitute a decent share of the fund's Japanese investments.

The Japanese insurance companies are still overcapitalized. They have far more equity than they actually need for sensible operations of their underlying business. When we initiated our investments in these companies, it was like purchasing an insurance company and getting a mutual fund on top for free. Or buying a closed-end investment fund and getting an insurance company thrown in. The increase in the value of the Japanese stock market has had a positive influence on the value of the stockholdings in the insurance companies and has also contributed to increasing their total intrinsic business value.

In the meantime, we have also witnessed the beginning of a change in management's approach to shareholders. Although it is happening slowly, we see a positive trend towards reducing this overcapitalization in the long term by bringing down their large stockholdings. A part of this released capital is used to buy back own shares, increase dividend payments and grow the insurance business in the Far East region outside Japan's borders in the form of acquisitions and partnerships. We appreciate the companies' spending of excess capital to buy back own shares if it is done at market prices below the intrinsic business value. Although we are generally more sceptic of spending capital on expansion by the acquisition of other companies, this is where in the long term we will find the growth in business value. Due to the strong financial foundation of our insurance companies, we would like to see more emphasis on buying back own shares as such a placement of their funds, with the current valuation, will give us an immediate increase in value. There should also be sufficient capital to pursue long-term goals for expansion in the region.

But the process has been started, like we saw it in the early 1990s in Denmark and the rest of Europe, which is encouraging. It is the small signs throughout a number of years that define the conclusion at the end of a period. In our own small arena in Denmark we have seen many examples of well-run overcapitalized companies changing from the early 90s until today from not wanting to spend excess capital on buying back own shares to being in a situation 10 to 15 years later of both having reduced their share capital and made their business grow. They are still well-run and well-consolidated and the stockholders have become dramatically better off. It is this process that has started in Japan for some companies in general and our insurance companies in particular.

Financial business

During the period when we initiated investments of the fund's resources from the summer of 2002 to the spring of 2003, we discovered a vast number of companies in industrial production which satisfied our investment criteria. It was probably the generally declining stock markets and the expectation of a long economic decline that provoked such underpricing. As a result of the increasing stock markets and return of economic growth the pricing of these companies has gone

up. Some of them have been sold off and others have slowly become diluted and today they make up a smaller share of the fund than they did in 2002/2003.

On the other hand, the share of financial companies in the fund (banks, finance companies and insurance companies) has increased from 22% at the end of 2002 to 45% at the end of 2005. As a result of our focus on having fewer companies within the last 2 years and the fact that the safety margin has remained large, investments of the fund's resources in these companies have risen.

The benefit of financial business is that profits are counted in real money and not paper money earmarked for reinvestment in capital assets in order to remain competitive. Profit is profit when it can be measured on the bank account. Future liabilities disguised as profit can be tempting in the short term. In the long term it generates low or ordinary return at best.

Current situation in the stock market

Faith, hope and charity are beautiful concepts in life. In the brave world of the stock market they should be treated carefully and vigilantly. It is not that we are trying to predict the trends of the stock markets. It is a meaningless exercise that we do not spend our resources on. We concentrate on finding underpriced companies with sufficient safety margin.

But the market no longer pays about 4 times for cyclically depressed operating profit of a company producing white goods, kitchens and doors, for instance. It now pays around 13 times cyclically increased operating profit for the same company, expecting eternally increasing earnings and high long-term return on capital within these industries. What happened to the Chinese threat?

Optimism rules and why not? - As you know, investors only receive 4% on bonds. On the stock market it seems to be "easy" to earn money. The European stock markets saw a decent increase in 2005 but especially the fringe markets attracted a lot of attention with increases of 221% in Kazakhstan, 306% in Lebanon and 1,584% in Zimbabwe. This blessing and satisfying sensation gives us reason for concern. We believe that it is the faith in eternally increasing profit and rising stock markets that will ultimately cause trouble.

Optimism in itself is not bad, of course. If we find an underpriced company that satisfies our investment criteria in a positive market, we will be happy to invest in it. But the combination of highly valued stocks, optimism and the fact that we have seldom found it this difficult to find underpriced companies tends to hamper our enthusiasm. Many years of experience tells us that there is shadow in paradise as well. We do not want to hunt for stocks in expectation of being able to or having to "follow suit" with the stock markets. We have our doubts and from experience we find wisdom in the saying: "Results often follow – when adrenaline flows".

In contrast, the pessimism on the stock market we experienced from autumn 2002 to spring 2003, nourished many investment ideas. During that period our liquidity was under 1 % when the market offered us companies – extraordinary as well as ordinary – whose share prices were markedly lower than the value of these companies to a private owner. Those are the times when you should press the accelerator. In our experience, periods of this kind occur several times over en fairly small number of years, represented by fairly large segments of the general stock market, different sectors or just individual shares. We will experience these periods again. After the dry season comes rain.

Carl Aller's Etablissement A/S

What is it then we are expecting to come our way? We want to invest in companies holding assets that are priced lower on the stock market than the value of such assets to a private owner. It can be companies that we value primarily from a statement of the worth of the assets less liabilities in the event of liquidation. Or companies that have a high return on invested capital. The first category is our scrapheap, which includes both poor-performing and ordinary companies that due to short-term lack of interest fail to attract the market spotlight. This lack of acceptance put pressure on these companies' market prices. The other category includes companies that dominate their market, which gives them a natural monopoly-like situation and thus the ability to achieve an extraordinary return on capital. Such companies are seldom at levels low enough to make us interested, but when it happens the way is paved for a very long period with exceptional annual returns.

We own companies (or parts of them) which manufacture cars, cigarettes, washing machines, pharmaceutical package solutions, radiators and rubber hoses. Companies engaged in lending, insurance and publication of newspapers and glossy magazines in genres from diet recipes to more intriguing and challenging topics. We described the latter in our Letter to Shareholders for the first half of 2005 in the form of Carl Aller's Etablissement A/S (CAE). We first became familiar with CAE like anyone else presumably, when as children we saw our mothers and grandmothers reading and exchanging magazines published by CAE. In the early 90s one of us reinforced the interest since we also invested in the company for the first time.

Carl Aller was the youngest among his six brothers and sisters. In his biography about Aller, John Lindskog writes that already at the age of 14 Carl Aller was interested in the technical side of printing and in 1871, when he was 26 years old, he was the proud owner of a certificate as a skilled lithographer. A H. C. Ørsted bursary was the first support for young Carl and his newly wed wife Laura whereby Carl Aller's Etablissement was established in 1873. The original idea was to establish only a printing business but the following year CAE published Nordisk Mønster-Tidende, which is now Denmark's oldest weekly magazine, Femina. Later came Illustreret Familiejournal and the way was paved for a successful magazine publishing group. With market share of approx. 60%, CAE has a leading position on the Nordic magazine market today. In Sweden and Denmark alone, the market share is a monstrous 84% and 71%.

In November 2003, we invested some of the fund's resources in CAE for DKK 16,000 per share. For this price we received DKK 17,400 in cash and securities (which had increased to DKK 21,500 in 2005) and on top an operational and not too funds-intensive share which generated operating profits of DKK 1,640 in 2003, rising to DKK 2,840 in 2005. CAE shows a consistently high return on capital employed and generated a return on this capital of 149% in 2005. With a price of DKK 38,500 at the end of 2005, the price development of the CAE stock has made a decent contribution to our good performance the last couple of years.

Originally, we had an idea that the price would increase in line with the annual increase in equity over a period of ten years. Together with the future annual dividend, the long term return would be satisfactory on the basis of this trend alone. On top of this, we had the "free" option that, over time, the shares would be revalued, which could give us a return that would be close to extraordinary rather than satisfactory. We do not try to time an acquisition. We will invest when the safety margin is sufficient. We may hold an investment for many years before it is revalued. The development has been faster than we expected although the stock price continues to be below the intrinsic business value of the company.

Bad ideas are born good, II

Once again we have had the bad luck of demonstrating failing professional skills. We have made two investments that have gone wrong or did not turn out fully as we expected. Tecumseh Products Co. (TP), a producer of small motors, pumps and compressors, and Natuzzi Spa. (Na) the largest Italian manufacturer of furniture. Both companies seem to have been exposed to the very same competitive threat that led to our final sale and loss on Montefibre in 2004, namely China's skilful, industrious and low-cost work force.

Throughout a number of years, TP has been fighting other Western based competitors, who have been much faster at moving out their production. In 2002, TP spent a large part of its capital on the acquisition of an insolvent competitor, which eventually turned out to be good money thrown after bad. Together with increasing raw material prices, which have not been covered by product price increases, and aggravating competitive conditions, this is well on the way to wrecking the company. Today, actual ownership survives on the mercy of the financing sources.

Na is the world's leading manufacturer of leather furniture. Since Na was established in 1959, it has rolled out its products in Europe and the USA and obtained decent market share. The furniture is manufactured in the Apulia and the Basilicata regions in the south of Italy where the company has been able to produce at good price levels for many years, and together with beautiful design and sales to a wide audience it gave Na a high operating margin and a high return on invested capital. Today, the broad market is drowning in high-quality products and good design from China, which has hit Na - even with an American consumer on steroids.

High long term return on capital should, of course, be achieved either as a low-cost producer in an industry or by branding where the consumer unconsciously craves for an identity match between his or her own image and the product's image. Na does not want to remove its production from Italy and it seems to show that Na has ended up in the midst of a transformation between being a low-cost producer and brander selling to a more narrow segment with more purchasing power. In all circumstances, Na is sharing its profit with the Chinese, so the same historically high return on invested capital will be threatened in the future.

Like Montefibre Spa. it has been relatively small entities in our portfolio which should not be regarded as a justification of the investments. But again we should be asking ourselves: why did we want to be there when we did not place more funds in these companies? We came out of TP with zero, which shows the value of investing at a low price in the first instance and Na with a loss of 17%. Henry Ford once said: "Failure is only the opportunity to begin again more intelligently". We have to work some more on the latter.

Other information

In some contexts it may sound as if we repeat ourselves when we describe how we consider the fund and our partnership. However, we believe that the information is important and similar to previous years, we would like to describe it. Existing investors should feel free to skip this.

We consider the fund a kind of holding company whose goal is to maximize the long term value. Our job is to allocate “the company’s” capital in underpriced, well capitalized companies throughout the parts of the world where democracy and capitalism go hand in hand. The capital is placed in companies belonging to ordinary industries that are comprehensible to us. Provided always that there is the requisite safety margin in the individual investment, we prefer companies with high return on invested capital. Alternative placement is carried out among average companies - again provided that they offer the requisite safety margin.

The fund is a possible means to use for the allocation of excess capital to another placement than bonds. A capital allocator for companies and private investors who want to place part of the long-term capital that will not be reinvested in the operation of their own business or passively in bonds.

We thank you for entrusting us with your funds. We would also like to thank those of you who have recommended other investors to invest with us. We are focusing on the investment process and not on marketing. The growth of the fund’s assets should only be achieved on the basis of long term, satisfactory return and the consequent mouth-to-ear effect. As we have mentioned before, we make long term investments why we do not find that it serves any purpose to make comments on a quarterly basis. However, there might be situations when we find it appropriate to inform you about specific issues between the annual reports and half-year reports. If your certificates are registered, this information will be submitted to you automatically.

We try to attract investors who understand our investment philosophy and approach through our communication and attitude and share our expectations for long term return on investments. We would feel bad about having potential investors investing with false expectations.

This year we would like to thank our administrative partner BI Management and custodian bank, Ringkjøbing Landbobank, for the smooth and professional work they have carried out. Decisions to place investments are only half of the result, the other very important half is the practical execution and administrative management.

We are looking forward to seeing you at the Annual General Meeting on 27 April 2006 at 3 pm at Hotel Frederiksdal. The size of the dividend for the financial year 2005 is DKK 7.00, which is deducted from the price the day after the General Meeting. The dividend comprises DKK 1.60 for taxation on equity income and DKK 5.40 for taxation of capital income.

If you have any questions, or if you find any of the points in the report unclear, feel free to contact us at any time.

March 2006.

Yours sincerely

Kim Håkonsson

Ole Nielsen
Chairman

Claus Terp