FRONTAURA

FRONTAURA CAPITAL LLC
FRONTAURA GLOBAL FRONTIER FUND LLC

# Quarterly Letter – 2010 Q1

After a Q4 pause, Frontaura in Q1 returned to the double-digit percentage gains of the two middle quarters of last year. Granted, Q1's 10% rise did not match our 28% and 17% gains of those two earlier quarters, but this quarter perhaps felt more sustainable. It was less a rebound from a financial panic induced oversold condition and more a positive response to good earnings and the slow, gradual flow of money into overlooked and underappreciated frontier markets.

On a total returns basis, the S&P 500 gained 5.4% in the quarter, while—other than frontier markets—international stocks generally had a modest Q1. MSCI EAFE (developed countries other than the US and Canada) gained only 0.9% while MSCI EM (emerging markets) gained 2.4%. The MSCI Frontier Markets index beat us slightly, 11.4% to 10.1%. We'll give ourselves a pass on this because we did state in last quarter's letter that after we bested this index by 26 percentage points in 2008 and 34 percentage points in 2009, it might be past due for better performance against us, for a while anyway. The factors driving our return were different from those driving the index, making our similar returns somewhat coincidental, as we'll discuss later.

Figure 1 summarizes our returns and those of the indices cited by year. Figure 4 on the last page of this letter shows our returns by month.

**Figure 1**
**Frontaura Global Frontier Fund LLC**
**Performance[1]**
**31 March 2010**

| Period | Frontaura | S&P 500 | MSCI EAFE | MSCI Emerging | MSCI Frontier |
|---|---|---|---|---|---|
| 2008 | - 28% | - 37% | - 43% | - 53% | - 54% |
| 2009 | 46% | 26% | 32% | 79% | 12% |
| 2010 Q1 | 10% | 5% | 1% | 2% | 11% |
| Inception to Date | +18% | - 20% | - 29% | - 20% | - 41% |

## Fundamental Outlook

We met with, or heard investment presentations from, nearly 100 companies in Q1 across more than two dozen countries. We visited companies in Bangladesh, Bulgaria, Croatia,

[1] Returns commence 1 November 2007. Frontaura returns are net of all fees, for an investor joining the fund at inception and making no further contributions. Investors joining on other dates or making additional contributions may have different returns. Index returns are in US dollars on a total return basis, net of any withholding tax.

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Cyprus, Macedonia, Romania, Serbia, and Slovenia. Further, we attended investment conferences in Egypt, with companies present from the Middle East and North Africa region; London, with companies present from sub-Saharan Africa; and New York City, with companies present from Pakistan. Summarizing all of these meetings in a few bullets, we conclude that for most frontier companies:

- **The world did not end.** 2009 was not as bad as we and others feared it would be one year ago. For a quantitative look at this, see our February and March monthly comments where we summarize 2009's better-than-expected earnings results for many of our portfolio holdings.
- **The panic is over.** With hindsight, the events of the last 20 months for frontier companies were simply a temporary demand freeze caused by a global financial panic, and unlike in the developed world, it appears there may not be lasting effects. The exceptions to this are overleveraged companies or businesses that relied on overleveraged customers—for example, Dubai real estate developers and construction firms.
- **The outlook looks good.** 2010 looks to be a good year as businesses continue to return to normal. This "normal" for frontier companies may not be the boom period of 2007 and the first half of 2008, but neither will it be the "new normal" of diminished growth that may persist in the developed world as it works off its debt overhang. "Normal" going forward for frontier companies may in fact mean normal—not too frothy and not too gloomy. Of course, some areas such as Eastern Europe will still see subdued growth, but this is the exception more than the rule within our portfolio.

We feel good overall about our portfolio and the returns outlook. We committed more personal capital to the fund in March and have been encouraging our existing investors to do so as well. Our decision resulted from seeing a plethora of bargains in the portfolio and concluding that our best opportunity to make personal investment gains was in our own fund, even with our NAV at an all-time high and our personal commitment to our fund already significant. Despite steady inflows at the beginning of each of the first four months of this year, our cash is virtually nil, as we finished both February and March with only 1% cash. We used the cash we had to buy stocks with the biggest discounts to intrinsic value; most recently at roughly 25% to 50% off what we think they are worth. We have numerous other positions, trading at less than our estimate of intrinsic value, which are under our target weights because we ran out of cash before we could top them up.

The portfolio trailing PE ended March at 8.8 with a price/book of 1.5 and a 5.9% dividend yield[2]. In contrast, trailing PE ratios on the S&P 500, EAFE, and MSCI EM average roughly 20 with price/book around 2.0 and a dividend yield in the 2%-3% range. With starting valuation one of the most important determinants of future return, our portfolio carries a strong advantage over other global equity areas. Combined with a decent fundamental outlook at the company level and our exposure to many of the fastest growing economies in the world, the investment case for Frontaura remains strong.

[2] Because we calculate everything on a trailing 12-month basis, this yield does not include announced increased dividend payouts that have not yet gone ex-dividend.

What could go wrong? While there are numerous risks at the country level, diversification across 21 countries from different regions mitigates this some. Inflation is one risk common to many emerging and frontier market countries that is not an immediate threat in the developed world, although it could be longer term. Beyond this, for now, we're focused most on global macro events such as those we have discussed in recent quarterly letters. Greece and the rest of the European PIIGS are the world's top macro concern now. We have too much euro-currency exposure to ignore this. Our Eastern Europe presence is nascent but growing (see discussion below), and the West African franc, the currency of Cote d'Ivoire and Senegal, is pegged to the euro. Deciding that we did not want Greek sovereign risk in our frontier markets fund, we began to hedge our euro currency exposure in Q1. At quarter end, 19% of our portfolio was either in the euro, a euro-pegged currency (the West African franc), or an Eastern European currency that is more correlated to the euro than to the US dollar. As of this writing on April 10, we have hedged this euro currency exposure completely. Ideally, we should have done this sooner but most important is that we have done it.

Should a negative global macro event occur (e.g. Greek default, Paul Krugman induced trade war with China), it will be interesting to see whether markets again hammer equities from the emerging and frontier countries that have reasonable debt levels more than they punished US stocks, as occurred in 2008. Or, alternatively, will investors, having observed how these countries were actually less affected than the developed world in the last crisis, view them differently this time and spare them a brutal flogging? Frankly, we have no idea. We hope we do not soon get an answer to our question! Nevertheless, we think our portfolio, which lost less than the S&P 500 in 2008, should be somewhat resilient given its low valuation level.

**Portfolio Highlights**

At quarter end, we held 35 positions in 21 countries. We continue to weight our highest conviction names more heavily. Our five largest country weights comprise 61% of the portfolio, while the 10 largest make up 79%. Our 10 largest positions are 55% of the portfolio; our top 20 are 83%. Figure 2 shows our portfolio mix and statistics.

We increased our presence in Eastern Europe, primarily adding Serbia to the portfolio. We made our first European investment in neighboring Montenegro in Q4. We prefer to nibble around the edges of frontier Europe in the areas that get the least attention, rather than focus on the larger countries. Countries like Serbia tend to have lower valuations and better long-term growth prospects because of a lower starting point. Serbia's per-capita GDP is only now roughly back to where it was in 1989 when communism collapsed and before it started four disastrous and losing wars against the countries of former Yugoslavia. We think it's inevitable that Serbia's living standards will converge toward its neighboring countries over the next generation. Last quarter we termed our Montenegro position as more of a one-off than a broad move into the region, although we said it might be possible to find other one-offs. That is exactly what has happened, with a series of cheap one-offs becoming a broader move. Each of our four holdings in Eastern Europe trade at either a PE of 5 or 6; three of the four have double-digit dividend yields. Eastern Europe is now 6% of our portfolio. We expect this percentage to increase.

In last quarter's letter, we said that we'd like to regain exposure in Bangladesh, a country we fundamentally like. We traveled there during Q1 but could find nothing that passed our value screen. The market's been on a tear, up 62% in 2009 and another 23% in Q1 2010[3]. Most stocks are overpriced, in our opinion. A government amnesty program where previously undeclared income can become clean if tax evaders funnel it into the stock market has certainly not hurt market valuations! This supportive program will end this year.

**Figure 2**
**Frontaura Global Frontier Fund LLC**
**Portfolio Mix and Statistics**
**31 March 2010**

| Country | Holding |
|---|---|
| Qatar | 17% |
| Sri Lanka | 14% |
| United Arab Emirates | 13% |
| Zambia | 10% |
| Cote d'Ivoire | 8% |
| Botswana | 5% |
| Senegal | 5% |
| Colombia | 4% |
| Tanzania | 3% |
| Serbia | 3% |
| Pakistan | 3% |
| Ghana | 2% |
| Egypt | 2% |
| Montenegro | 2% |
| Zimbabwe | 2% |
| Iraq | 2% |
| Philippines | 2% |
| Uganda | 1% |
| Vietnam | 1% |

| Industry | Holding |
|---|---|
| Banks | 28% |
| Consumer Staples | 16% |
| Consumer Discretionary | 15% |
| Telecommunication Services | 11% |
| Industrials | 6% |
| Insurance | 5% |
| Diversified | 5% |
| Asset Management/Brokerage | 5% |
| Specialty Finance | 4% |
| Oil Marketing | 3% |
| Cash | 1% |

| Portfolio Statistics | |
|---|---|
| Portfolio Price to Earnings | 8.8 |
| Portfolio Price to Book | 1.5 |
| Portfolio Dividend Yield | 5.9% |
| Return on Ending Equity | 24.8% |

Security selection continued to drive our returns. This is best represented by Figure 3 that shows our five best and five worst performing countries in Q1 and the MSCI total return for these countries. Our best performers are fared better, usually much better, than the MSCI index for that country. Conversely, our worst performers fared worse than the corresponding MSCI index. Finally, we had no exposure at all to MSCI's five best

[3] The Dhaka Stock Exchange General Index is up 579% from the end of 2002 through March 2010. These figures probably overstate returns because they include IPO performance measured from the IPO price, not an actual traded price, as if all investors can get access to all IPOs. Many Bangladeshi IPOs have enormous first-day trading gains and the newly public companies can be sizable relative to the total market. Nevertheless, the market likely performed well under any method of index calculation.

performing frontier countries in Q1—Ukraine, Estonia, Nigeria, Romania, and Kuwait, all up between 18% and 49%. We suppose this shows there are many ways to make good returns in frontier markets. MSCI's top performing countries are still rebounding from terrible hits they took in 2008 (e.g., Ukraine lost 84% that year). We avoided the declines (except for small exposure to Nigeria), so we don't feel too bad about missing the rebound.

Our 41% gain in the UAE results from our largest holding and only UAE position, Kingdom Hotel Investments (KHI). About two-thirds of this gain occurred after it received a cash buyout offer from its majority owner (ultimately Prince Alwaleed of Saudi Arabia) for $5.00 per share. This price, 28% below book value of $6.97 per share, is too low in our opinion. The stock once traded above book and we expected it to reach book value again, after having plummeted to $1.00 per share in December 2008. This is the second time that a majority owner took away some of our expected upside through a buyout (the prior situation being PLDT's buyout of Pilipino Telephone that it announced March 2009). This illustrates a pro and a con of investing in a majority-owned company—the owner may be supportive of the price and may offer an exit, but that exit may not be at the price that patient, long-term holders like us desire.

**Figure 3**
**Frontaura Global Frontier Fund LLC**
**5 Best and Worst Performing Countries**
**2010 Q1**

| 5 Best Countries | | | 5 Worst Countries | | |
|---|---|---|---|---|---|
| Country | Frontaura Return | MSCI Return[4] | Country | Frontaura Return | MSCI Return[4] |
| United Arab Emirates | 41% | 7% | Iraq | -12% | -- |
| Sri Lanka | 35% | 4% | Vietnam | -10% | -3% |
| Pakistan | 24% | 10% | Columbia | -8% | 10% |
| Ghana | 23% | 22% | Tanzania | -7% | -- |
| Montenegro | 19% | -- | Botswana | -7% | 5% |

We note with humor a news item we saw Friday, April 9 in *The Wall Street Journal* reporting how firms such as Citibank and Credit Suisse were closing their equity research offices in Karachi, Pakistan's financial hub. As a contrarian indicator, we find this a bullish sign that the Pakistani market may continue its good Q1 performance. We remarked over a year ago that MSCI's decision to kick Pakistan out of its Emerging Markets index at the end of 2008 (it is now in MSCI's Frontier Market index) was likely a buy signal. That transpired, with the MSCI Pakistan index gaining 89% on a total returns basis in 2009.

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[4] MSCI country indices stated on a total return basis with dividends net of any withholding tax. We show "--" if MSCI does not have an index for a given country.

When we started the fund, we intended to have only 20-25 positions. Now that we have 35, it may appear we have strayed from our intent, but realize that our 10 smallest positions are only 8% of the portfolio. Initially our number of positions began to creep up during the financial crisis as, becoming more risk adverse, we tended to initiate new positions more at a half position size (e.g. 2.5%) rather than a full 5% position size. As we live with a stock, we may raise its weighting to 5%. We discussed in last quarter's letter that at times we have erred too much on the side of caution and would have been better off weighting some bargain positions more heavily from the start. There's a tradeoff between gaining more certainty and losing some of the upside from a mispricing that may not persist for long.

Why do we keep 10 positions that total only 8%? Some are positions that have appreciated beyond our buy point but have not yet reached our sell point. We have a buffer between our buy price and our sell price so that we are not schizophrenically buying one day and selling the next. As assets have increased, the weighting of positions in the buffer zone reduces. Related to this, when our ideas exceed the funds we have to invest, which is the case now, we prioritize our buying so that we buy the stocks trading at the biggest discount to our estimate of intrinsic value. Therefore, the weighting of a stock that is below our estimate of intrinsic value could fall, if an even bigger value is available. This factor appeared in Q4 as a period of intense research kept uncovering new bargains and it continued in Q1 as we added five new names to the portfolio, generally trading at big discounts. Finally, there are a couple positions that have been difficult to buy in the size we want, but we will keep trying. And on the flip side, given the high trading costs and taxes that could occur, we see little merit to eliminating a small position that is below our sell point just to reduce our total position number (unless trading them out allows to buy something with much larger appreciation potential after accounting for trading costs and taxes). We'll keep these small positions until their price rises to our sell point, or until their discount to intrinsic value increases to where we would buy more.

**Management Company News**

On January 1, we launched Frontaura Global Frontier Fund Offshore Limited, a Cayman Islands feeder fund to our main fund, to allow non-U.S. investors and US tax-exempt investors to invest more easily in us. About one-half of new dollar inflows year-to-date through April 1 have come into this offshore feeder. We continue to manage only one pool of money, thus the sole investment of the offshore feeder is in our original fund, Frontaura Global Frontier Fund LLC. Including April 1 joiners, we now have 45 outside investors, with assets ending Q1 2010 at four times our level of one year ago. Unfortunately, SEC look-through rules mean we are closing in on the maximum number of investors we can accept, and thus we are likely to raise our minimum again to $1 million for new investors. Therefore, anyone thinking of investing a lesser figure for the first time should do so immediately. This increase will have no effect on existing investors. Follow-on investments can continue to be for any amount $10,000 or more.

We continued to gather media mentions in Q1, appearing on Bloomberg TV and in *The Wall Street Journal.* In addition, for those who missed it, we published Frontaura Observer #17 last week on Venezuela. All media citations and everything we have ever written (past

Observers, quarterly letters, and monthly comments) are on our website. E-mail us if you need a password.

We wish to thank everyone who has followed us and shown an interest in our frontier fund. We especially want to thank our growing list of clients, who have been loyal and generous in helping us grow our business. In closing, we will reiterate a final time that despite strong performance, we continue to believe the return outlook for our fund is good, and we would encourage both existing and potential clients to follow our lead and consider contributing to our fund. With our favorable valuation levels and a superior growth outlook, we expect to outperform other equity choices that exist.

Regards,

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**Figure 4**
**Frontaura Global Frontier Fund LLC**
**Monthly Performance**
**31 March 2010**

| | Jan | Feb | Mar | Apr | May | Jun | Jul | Aug | Sep | Oct | Nov | Dec | YTD | ITD |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 2007 | | | | | | | | | | | 0.4% | 1.6% | 2.0% | 2.0% |
| 2008 | 0.7% | 0.6% | -0.1% | 3.4% | 3.9% | -1.0% | -0.8% | -2.2% | -7.9% | -17.5% | -10.7% | 1.4% | -28.1% | -26.7% |
| 2009 | -2.0% | -0.4% | 0.7% | 7.7% | 14.4% | 4.1% | 1.4% | 4.7% | 10.6% | -1.4% | -0.2% | 0.2% | 46.0% | 7.0% |
| 2010 | -0.9% | 4.2% | 6.6% | | | | | | | | | | 10.1% | 17.8% |

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