ANTARES INVESTMENT MANAGEMENT

VALUE PORTFOLIO

The Antares Value Portfolio focuses on companies that, in our analysis, are underpriced in the stock market relative to their underlying worth as businesses. Our strategy aims first to protect investors' capital by not overpaying for a given company - holding fixed income or cash when bargains cannot be found - and second, to grow that capital through share price appreciation as the company's value gets properly recognized within the equity market.

MANAGER COMMENTARY

The concept of "intrinsic value" measures what an investment is worth in, and of, itself.

I have been reading and thinking about intrinsic value lately. According to the Oxford dictionary, the word intrinsic means "belonging to the essential nature of something". Synonyms of intrinsic are built-in, inherent, and innate. Intrinsic value then, can be said to be "the measure of what something is worth in, and of, itself". For investors, intrinsic value can be said to be the measure of what something is worth because of what it has inside of itself that can be turned into cash.

A hypothetical simple business has two aspects to intrinsic value: its equipment (example: a donut-making machine) and in what it produces (in this case, donuts).

For example if you are the owner of a machine that cranks out donuts, you have two sources of potential cash. Either you use the machine to make donuts and sell them, or you sell the machine itself. So there is value in the machine itself (provided a willing buyer is available) as well as what the machine can produce...the donuts that can be sold. Both are potential sources of cash.

How much is the machine worth to a potential buyer? A buyer, like the seller, also has the same two potential sources of cash in the future: selling the machine at some point in the future, or selling the donuts the machine can produce.

Dollars to donuts, the investor who pays a price below the intrinsic value has a margin of safety in the event things do not go as planned.

From the above we can see that the intrinsic value of the machine is still in place no matter who owns the machine. The only difference is that the intrinsic value of the machine has shifted from the seller to the buyer. The buyer now owns the machine and all the future potential cash flows, either from selling the machine or the donuts. The seller receives cash today and forfeits all future cash flows; the source of the intrinsic value. Even if the buyer lets the machine sit in the garage for a few years, it can still be a good investment provided they are able to sell the machine for more than they paid. The lower the price paid, the more likely the buyer will make money, or at least break even, on the machine itself. One can say there is intrinsic value in the donut machine because it can be turned into cash at some point by selling it.

However, in most cases, the buyer is not looking to buy and sell donut machines (though I expect there is a market for this somewhere), but is instead looking to make money by selling donuts. The machine is simply what is needed to make the donuts. In this case, the intrinsic value comes from all the future cash flows from selling donuts for as long as the current owner owns the machine, plus what they can sell the machine for in the future.

So how much is the machine worth? That all depends on how many donuts it can produce and how much you can sell them for. If the price of donuts is high and the cost of the machine is low, it is likely worthwhile to produce as many donuts as possible and sell them. If the price of donuts declines enough, it may be best to sell the machine and collect the cash that way.

One surefire way to ensure that the buyer makes money on their foray into the donut business is to buy the machine at a price that is low enough that, even if the donuts don't sell, they can still sell the machine at a higher price than they bought it at. Even better is when the machine can be purchased at a price below its intrinsic value AND the price of donuts is high. Profits can be made by selling the donuts, and an extra profit can be made when the donut entrepreneur retires and sells the machine to someone else.

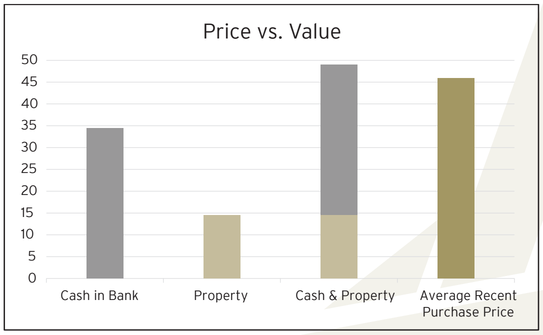
Taro's share price is lower than the value of its cash on hand and its real estate.

In Graham's words, "price is what you pay; value is what you get". Our goal is to pay a price that is lower than a company's intrinsic value.

The above example may be hypothetical, but a similar real-life opportunity presented itself to us in recent months. The opportunity was one I felt we needed to act on. I think you'll see why.

An ownership stake of a generic pharmaceutical company, that has been in business for over 50 years, recently became available for an extremely low price. The company produces various generic medicines, is profitable, and has the highest profit margins amongst its competitors. Further, the company has no debt and has an exorbitant amount of money in the bank.

We were able to purchase additional shares in this company, Taro Pharmaceutical Industries Ltd., for your account at a price that is LESS than the combined value of the cash in the bank and the value of the buildings it owns. In other words, even if the business stopped selling medicine and closed its doors, we, the owners, could sell the machines and the buildings and distribute to each shareholder more cash than the price just paid. You may be interested to know that the buildings and machinery are located in desirable locations close to the Toronto Airport and in New Jersey. These are areas that have seen significant growth in real estate prices in recent years.



Source: Bloomberg, Antares Calculations

There is intrinsic value in the buildings and machinery by themselves, and there is intrinsic value from using those assets as long as they are used to make medicine that can be sold at a profit. Those profits can then be used to expand the business, buy out competitors, or pay dividends to the owners…you. There is an expectation that generic medicines will be purchased for many years due to an aging population, and all those future profits have tremendous financial value.

But even if that does not happen, having paid less than the current value of the cash and real estate provides protection. And not having any debt, means the company cannot be forced into bankruptcy. Opportunities like this do not come often, but we are constantly on the lookout for opportunities where we can pay less for something than its intrinsic value. Benjamin Graham, Warren Buffett's professor at Columbia University, said that "price is what you pay; value is what you get". In this case, I believe we received greater value than the price paid.

Thank you for your continued trust.

Gerry Bettig, CFA

VALUE PORTFOLIO

The Antares Value Portfolio is available to investors within a Separately Managed Account ("SMA") that holds securities directly, and through the Antares Value Pool ("Pool") which is held in the accounts of multiple investors. Data presented refer to the Pool. SMAs are customized and therefore their holdings and weights may diverge from those within the Pool. Sources for the data include: Bloomberg, NDEX, and Antares calculations. Unless otherwise stated, all data are as at quarter end.

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