VLTAVA FUND

TWO – ONE – ZERO.

Dear shareholders,

In the fourth quarter of 2012, the fund's NAV increased by 1.8% quarter on quarter, and thus by 1.3% for the year as a whole.

Perhaps you are wondering why our result was not better given that the past year was actually quite favourable for equities. Last year we made an investment error which cost us approximately 8% in yield. A detailed description follows.

Our investment error last year

In the past six years we spent a lot of time and effort searching for attractive investments in the metal extraction sector, focusing mainly on companies extracting copper and nickel. We analysed 113 of the most important projects under construction or in planning. We mapped their capital spending, operating expenses and anticipated production. From this data we then estimated how much copper and nickel would have to cost over the long term for these projects to be at all sensible, to bear reasonable returns, and sufficiently to satisfy market demand. Armed with this "incentive price", we were looking for the most attractive extraction companies and investments.

Our investment results were mixed. Some were good, others disappointing. The more we came to know this industry, the more we inclined toward the opinion that in general it is not a favourable one from an investment perspective, is too risky, and that it is better to avoid it entirely. We gradually terminated our investments in extractors and by early 2012 only one remained – the Canadian Baja Mining. We believed (in retrospect, mistakenly) that it was a promising exception. We were not alone in this belief. Baja Mining owns the El Boleo project, which constitutes a large deposit of copper, cobalt, zinc and manganese in Mexico. Thirty per cent of the project is owned by a Korean consortium with state participation and the rest is co-financed by US and Canadian state institutions. We visited the company's management at its headquarters in Vancouver, and we were in contact with them at least 20 times during the period when we held the shares. It was not enough.

As project construction neared its culmination last year after many years of preparations, it transpired that the construction would cost about 20% more than budgeted. Baja Mining was not able to raise the money quickly and had to transfer most of the project to the Korean consortium. The Baja Mining shares responded with an immediate and sizeable price drop. This all happened at the turn of April and May.

In looking at the development of the fund's NAV during 2012, you can see that we had two bad months – April and May. This is largely due to Baja Mining. The El Boleo project is continuing and will very probably be completed, but Baja Mining's shareholders have lost the majority of their investment.

The entire matter greatly disappoints us, because it distorts an otherwise agreeable year and a number of good investments and transactions we made are therefore not evident.

The return on the fund's portfolio for the 7-month period from the collapse of Baja Mining up to the end of 2012 had been 16.1%. Unfortunately, this good result from the remaining and new investments disappears when one views the year as a whole. We made two mistakes in 2011 and one last year. We believe that we will confirm this trend this year: two – one – zero.

Changes in our portfolio

In addition to the remaining Baja Mining shares, we sold one other position.

Apple. Yes, we owned stock in Apple. For the whole of 18 days. Apple shares underwent a large price correction and at one point we had the impression that a number of investors were selling their shares even against their will. We wanted to benefit from that. We bought a medium-sized position in Apple shares and soon sold it with a gain of 9%. This is not a typical trade for us, and for two reasons. First, our opinion of Apple is rather negative and its future seems to us entirely unpredictable. Second, we do not favour such short-term investments. We mostly buy assets with the perspective of holding them for years rather than days or weeks. Nevertheless, we are not blind to market developments and when it seems that the scales are markedly tipped in our favour, why not take advantage? In any case, this will constitute a rare exception; we have no intention to reorient ourselves in such direction.

On the short side, we closed a position in Athenahealth with a 31% gain.
We added four long positions. The US market responded negatively to Obama's re-election, and its correction brought with it several attractive opportunities. Three companies are new to us. They are from the technology, finance and retail sectors. The fourth company we have already held in the past, and we do so now for the second time. In all cases, we expect double-digit annual yields from the holding period.

What will the future bring?

We do not know, of course, but we are aware of certain circumstances that may influence it. We are living at a time when interest rates are at their lowest point in history. These are helping over-indebted states to better carry this burden, and in some cases even to survive. **It is possible that the period of low rates will continue for some time still to come, but it clearly represents the greatest risk for investors in the outlook.**

Valuations of all (not just financial) assets are determined by interest rates. As soon as these begin to rise, there will be great pressure for asset values to depreciate. This pressure will not affect all assets in the same way. Assets with fixed yields (such as bonds) may be decimated, as will assets with no yield (such as gold). Individual equities will be affected differently, as these are assets with variable yields.

Companies owning real assets will fare the best, because their cash flows tend to grow in periods of long-term increased inflation. Companies with low indebtedness and those whose profits will markedly increase due to higher interest rates will also fare well. Most companies in our portfolio have at least two of these three characteristics and thus provide some protection against the loss of value in real money terms through higher inflation.

Current portfolio

The market currently values our portfolio at approximately 9 times the earnings of the past 12 months. This means that for the last year the net profit of our companies was 11% of their market capitalisation. In our opinion, that is a lot and it does not correspond to the quality and prospects of these companies. This number especially stands out in comparison with interest rates that are a almost zero. **By our estimate, the fundamental value of our shares today is about one-third higher than are their current prices.** The fundamental value is not static, however, but develops gradually. In the case of our portfolio, it has been growing rather solidly. At the end of this year, it will be on the order of 50% higher than today's prices. This should create sufficient upward pressure on the prices of our assets.

Our portfolio has fared much better than last year's overall result suggests. From the numerous conversations we have had with you, our shareholders, we feel that you know it as well. Last year's influx of investors and new money into our fund – the largest in the last four years – is further evidence of that. We thank you for your patronage and wish you all the best in the new year.

Daniel Gladiš, January 2013

The information contained in this letter to shareholders may include statements that, to the extent they are not recitations of historical fact, constitute "forward-looking statements" within the meaning of applicable foreign securities legislation. Forward-looking statements may include financial and other projections, as well as statements regarding our future plans, objectives or financial performance, or the estimates underlying any of the foregoing. Any such forward-looking statements are based on assumptions and analyses made by the fund in light of its experience and perception of historical trends, current conditions and expected future developments, as well as other factors we believe are appropriate in the circumstances. However, whether actual results and developments will conform to our expectations and predictions is subject to a number of risks, assumptions and uncertainties. In evaluating forward-looking statements, readers should specifically consider the various factors which could cause actual events or results to differ materially from those contained in such forward-looking statements. Unless otherwise required by applicable securities laws, we do not intend, nor do we undertake any obligation, to update or revise any forward-looking statements to reflect subsequent information, events, results or circumstances or otherwise.

This letter to shareholders does not constitute or form part of, and should not be construed as, any offer for sale or subscription of, or any invitation to offer to buy or subscribe for, the securities of the fund.

Before subscribing, prospective investors are urged to seek independent professional advice as regards both Maltese and any foreign legislation applicable to the acquisition, holding and repurchase of shares in the fund as well as payments to the shareholders.

The shares of the fund have not been and will not be registered under the United States Securities Act of 1933, as amended (the "1933 Act") or under any state securities law. The fund is not a registered investment company under the United States Investment Company Act of 1940 (the "1940 Act").

The shares in the fund shall not be offered to investors in the Czech Republic on the basis of a public offer (veřejná nabídka) as defined in Section 34 (1) of Act No. 256/2004 Coll., on Capital Market Undertakings.

Historical performance over any particular period will not necessarily be indicative of the results that may be expected in future periods.