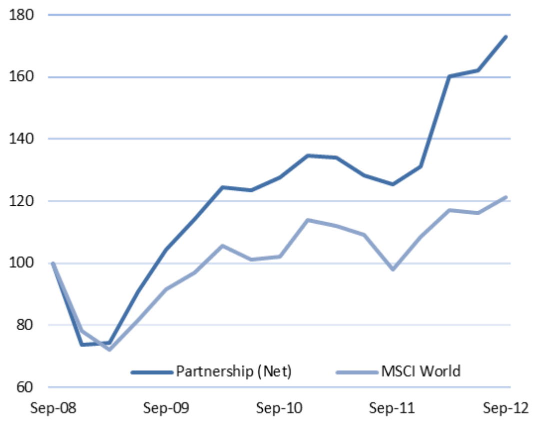
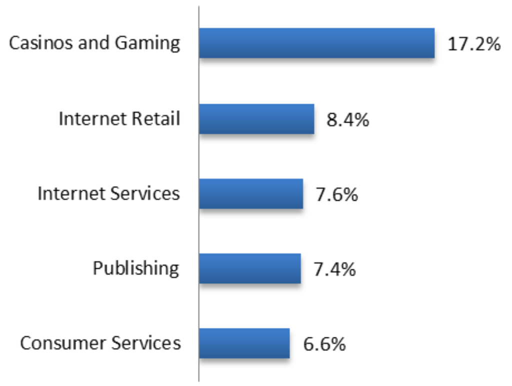
CORE PORTFOLIO Q3 2012

Performance			EUR[1]	Index
Inception Date:	01 October 2008	**Quarter**	6.8%	4.5%
Portfolio Style:	Value / Total Return	**Since inception (annualized)**	14.7%	5.0%
Manager:	Robert Leitz	**Since inception (cumulative)**	73.1%	21.4%

Performance in EUR



Top 5 Positions



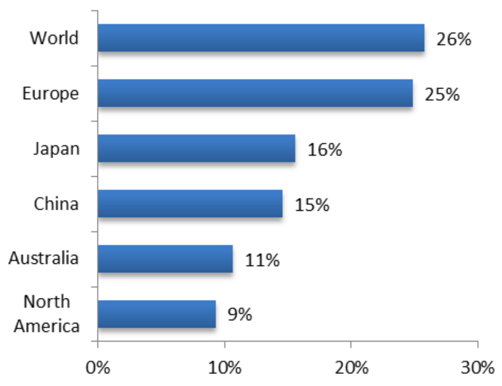
Market Review

- Markets rose strongly during the third quarter. Belief that central banks were prepared to help flagging global growth drove risk appetite, and indeed the US Federal Reserve (Fed), the European Central Bank (ECB) and the Bank of Japan (BoJ) announced substantial supportive measures in September.
- US data was mixed, but markets were encouraged by signs that the housing market was recovering. In Europe, yields on Spanish bonds hit dangerously high levels at times, as social and economic problems in Spain's regional administrations worried investors. For the most part, however, markets largely ignored the continued turmoil in the eurozone, focusing instead on central banks' easing measures.
- Manufacturing data out of China disappointed, while second-quarter GDP came in at 7.6%, the slowest growth rate in three years. India's GDP was better than expected, and a raft of government reforms boosted equity markets, while Brazil announced an infrastructure investment scheme to boost growth.

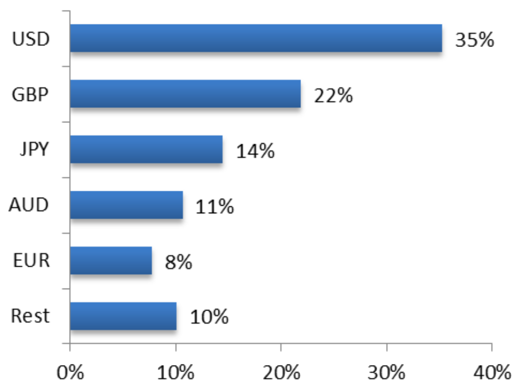
Portfolio Review

- The portfolio posted strong gains, above those of the index, driven mostly by its largest position.
- I exited two positions, Munich Re and Sun International. I sold Munich Re because my investment thesis had changed and I was able to find a more attractive opportunity elsewhere. I sold Sun International, a very small legacy position, to clean up the portfolio and recycle proceeds into a bigger position, even though Sun is currently trading at what I believe is an attractive market valuation.

Geographic Breakdown by Revenue Markets



Geographic Breakdown by Listing Currency



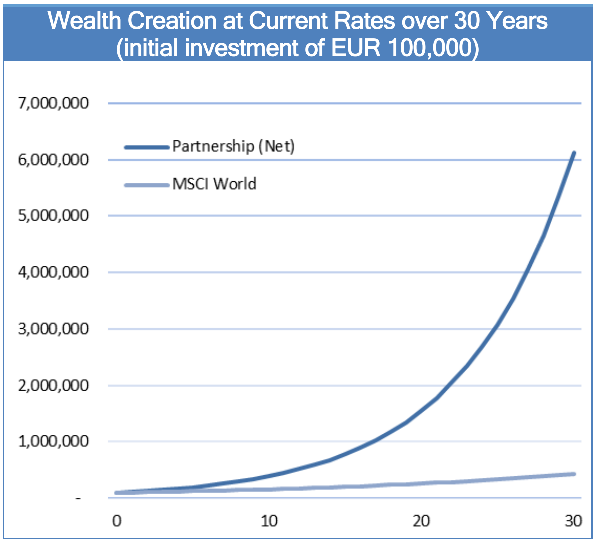
[1] Net returns: after all costs and fees (no management fee, 25% performance fee for returns greater than 4% p.a., high watermark)

QUARTERLY REVIEW

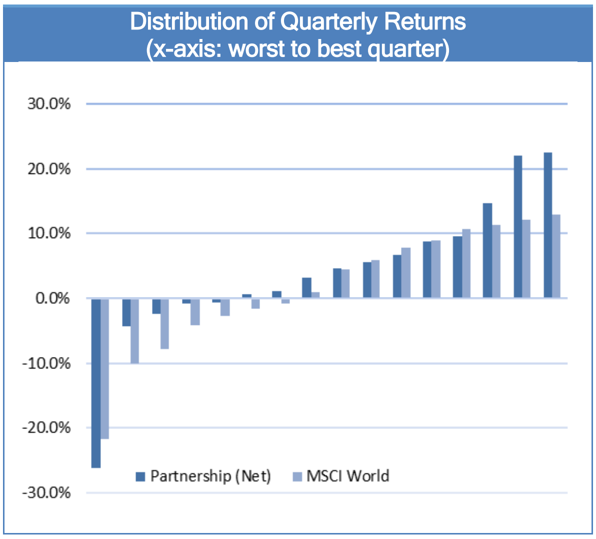
For the quarter ended September 30, 2012, the portfolio returned net +6.8% in EUR (+9.1% in USD). Since inception on October 1, 2008, the portfolio has generated net cumulative returns of +73.1% in EUR (+62.6% in USD) and annualized net returns of +14.7% in EUR (+12.9% in USD). At iolite, we consider long-term absolute performance far more important than relative performance against a benchmark.

Let me start this letter with a joke (don't worry – it will be my only attempt at being funny and my only mention of the macro environment in this letter): Ben Bernanke walks into an Italian restaurant and orders a large pizza. The waiter asks him if he wants the pizza cut into 6 or 8 slices. Bernanke says: "8, I'm feeling really hungry today."

Four Years in Operation



The core portfolio just completed its fourth year since inception, perhaps a good time to look back and analyze performance to date. I am proud to be able to report that the portfolio has been compounding at an average net return to clients of 14.7% in EUR since inception. This is after all fees and expenses. If the portfolio were to continue to grow at this rate, its value would double every 5 years, and in just 30 years, an initial investment of EUR 100,000 would turn into EUR 6,122,130 (or 60 times the original investment). Over the past four years, the portfolio has also significantly outperformed the MSCI World Index, with a cumulative net return of 73.1% for the portfolio vs. 21.4% for the index. While past performance is not an indicator of future performance, I hope this initial success will continue and that the rate at which I am compounding my investors' savings will stay close to the current rate.



From a statistical perspective, the portfolio had more positive quarters than the index (11 of a possible 16 vs. 9 of 16) and demonstrated good overall downside protection. Generally speaking, the portfolio performed relatively better when the market was down and slightly worse when the market was up. This aligns nicely with the expectations set by my role model, Warren Buffett. He stated from the beginning that value strategies would outperform the market in downturns (given the higher margin of safety applied by value investors) but also underperform the market in upswings (because value investors seek to avoid overhyped stocks).

Portfolio Construction

I was able to welcome a number of new clients in the third quarter, all with separately managed accounts. Please let me talk a bit about the advantages and disadvantages about running managed accounts.

A managed account is an account opened in the name of a client and managed by iolite with a limited power of attorney. Managed accounts are easy to set up and they provide maximum transparency to the investor - my clients can look at their portfolios at any given time and they can then quiz me on the positions I am putting on. Overall, this is a pragmatic and relatively cheap way for us to set up investment vehicles as long as iolite's assets aren't yet sufficient to justify a proper fund structure.

However, managed accounts also pose some disadvantages to clients and to iolite. For example, depending on the size of the account, I might not fully replicate the Core Portfolio in order to keep trading fees low. This increases the tracking error, and fewer positions generally also mean higher volatility. So, while I can't guarantee that my clients' accounts will look and perform like the Core Portfolio, I can guarantee that I will almost always only buy positions that are in the core portfolio and that I deem most attractive given current market pricing and environment. I am quite confident that over time, the swings in performance between the Core Portfolio and other accounts level off, however – and this is mainly to manage expectations – short-term swings are likely.

Case Study: Digital River

This month's case study (attached) is a write-up that was also published in the Manual of Ideas www.manualofideas.com, a value-oriented research magazine that I can highly recommend as a great source of investing ideas. I consider this write-up a good insight into my thought process when making investment decisions and hope you enjoy reading it. As always, I welcome your feedback and I would be happy to discuss this further with you.

Outlook

So what's my take on the markets? Well, I continue to find new investment opportunities. While no single opportunity yet strikes me as a sure 10-bagger, I have found many opportunities with possible annual returns greater than 15% (my requirement for committing capital). Therefore, at the moment, my greatest difficulty is not finding opportunities but choosing between the 30-50 good ideas I have found when I only want to hold 10-20 positions in the portfolio. In any case, I am a buyer in today's market as I have identified ideas that could generate satisfactory returns - I would put my last savings into the Core Portfolio if markets were to experience a sharp drop. In a market downturn, most of my good ideas would turn into very good ideas. The secret: lower prices for unchanged intrinsic values.

I am happy to answer your questions and see assets grow.
Please spread the word!

Robert Leitz

Closed Positions

Position	Sector/Industry	Listing Currency	Absolute Return	IRR
Munich Re	Reinsurance	EUR	9.3%	4.3%

The company engages in the insurance and reinsurance businesses. It is widely considered to be one of the best-run reinsurance companies in the world and is commonly also considered a smart play on emerging market growth. At initial purchase in 2008, the company was returning about 10-15% of market capitalization to shareholders annually, partly through buybacks and also through cash dividends. I increased the position substantially in 2010 when I heard Warren Buffett was buying the stock and I could add to my position at less than what he paid. Since 2010, earnings and payouts have been disappointing. The company is still returning 5% cash dividend yields at current prices, but it has stopped buying back shares. I therefore decided to exit the position and I invested the proceeds into situations I deemed more attractive.

In addition, over the last two years and as I have gained a better understanding of the insurance industry, my view on reinsurance companies has also become less bullish. While I still consider reinsurance businesses to be great vehicles for money managers (they can provide a leveraged and long-term capital base at zero or negative cost), I wonder how badly the business model will suffer from the absence of industry tailwinds that boosted returns from 1975 to 2010.

The success of an insurance company depends on two factors: underwriting performance and asset management performance. Underwriting performance is dependent on the actuary's risk/premium assessment – ideally, total claim payouts and operating expenses should be less than total premium income. Asset management performance is driven by the returns an insurance business generates on its float. Float is the amount of money on hand at any given moment that an insurer has collected in insurance premiums but has not paid out in claims. If underwriting performance is breaking even, the float comes free of cost. It is as if someone gives you money to invest for free but also allows you to keep all capital gains as well.

During the mega-debt cycle of 1975-2010, inflation and yields were coming down on a broad basis. This meant that underwriting performance as well as asset management performance benefited from substantial tailwinds. Regarding underwriting performance, policies were assessed at high inflation assumptions and lower actual inflation meant lower payouts. Regarding asset management performance, fixed income investments benefited from high coupons and rising bond prices.

I would argue that those times are now over. Operating performance might suffer in an increasingly inflationary environment, and most insurance companies today are earning hardly anything on their huge fixed income portfolios. In fact, their fixed income investments might be subject to significant impairment risk (defaults or inflation). If yields were to go up from today's extremely low rates, bond prices are likely to drop substantially. I would also like to point out that insurance businesses are also subject to fraud and Ponzi scheme risks: as long as a company can grow total assets, it might be possible to hide significant underwriting risks as well as poor asset management results.

Position	Sector/Industry	Listing Currency	Absolute Return	IRR
Sun International	Casinos and Gaming	ZAR	3.7%	0.9%

The company develops, manages and operates hotels, resorts, and casinos in sub-Saharan Africa and Chile. At purchase, I considered this investment a play similar to a leveraged buyout in a growing economy. I expected the company to benefit from EBITDA growth (growing economies, inflation-protected revenues) and accompanying dividends or buybacks driven by ongoing re-leveraging of the company based on steady EV/EBITDA multiples. While management and capital allocation remains good, and while I consider the company to be fairly valued for a long-term investor, my return requirements have gone up and I rate some of the stock's risks higher now than I did in 2008. Overall, this legacy position was very small and I just considered other opportunities more attractive.

Returns are based on local currency; the exchange rate at purchase was about equal to that at exit.

PERFORMANCE & BENCHMARKING

%	in EUR				in USD			
	Portfolio Net[2,3]		MSCI World DM		Portfolio Net		MSCI World DM	
	quarter	cum	quarter	cum	quarter	cum	quarter	cum
Q4 08	-26.2	-26.2	-21.6	-21.6	-26.3	-26.3	-22.2	-22.2
Q1 09	0.7	-25.5	-7.8	-27.7	-4.6	-29.7	-12.5	-31.9
Q2 09	22.6	-8.9	13.0	-18.3	29.9	-8.7	19.7	-18.5
Q3 09	14.7	4.5	12.2	-8.4	18.4	8.1	16.9	-4.7
Q4 09	9.5	14.5	5.9	-2.9	7.8	16.5	3.7	-1.2
Q1 10	8.8	24.5	8.9	5.7	4.1	21.2	2.7	1.5
Q2 10	-0.7	23.6	-4.2	1.3	-10.1	8.9	-13.3	-11.9
Q3 10	3.2	27.6	1.0	2.3	15.5	26.1	13.7	0.1
Q4 10	5.7	34.8	11.4	13.9	3.3	30.3	8.1	8.3
Q1 11	-0.5	34.1	-1.5	12.2	4.3	35.8	4.3	12.9
Q2 11	-4.3	28.3	-2.8	9.1	-1.9	33.3	-0.3	12.6
Q3 11	-2.3	25.4	-10.0	-1.9	-9.9	20.0	-17.1	-6.6
Q4 11	4.6	31.1	10.7	8.6	1.2	21.5	7.1	0.0
Q1 12	22.1	60.1	7.8	17.1	27.5	54.9	10.9	11.0
Q2 12	1.2	62.1	-0.8	16.2	-3.8	49.0	-5.8	4.5
Q3 12	6.8	73.1	4.5	21.4	9.1	62.6	6.1	10.9

	EUR Portfolio Net	EUR MSCI World DM	USD Portfolio Net	USD MSCI World DM
1-Year	38.1	23.7	35.5	18.8
Annualized	14.7	5.0	12.9	2.6
Total	73.1	21.4	62.6	10.9

[2] Net returns: after all costs and fees (no management fee, 25% performance fee for returns greater 4% p.a.)
[3] Q4 09 – Q4 11 restated

Investment Approach

"Price is what you pay, value is what you get." [Charlie Munger]

"You will not be right simply because a large number of people momentarily agree with you. You will not be right simply because important people agree with you. You will be right, over the course of many transactions, if your hypotheses are correct, your facts are correct, and your reasoning is correct." [Warren Buffett]

A share represents a fractional ownership of an underlying business and a bond is a loan to a business. Therefore, in the medium to long term, the performance of shares and bonds correlate with those of the underlying businesses.

I see myself as a value investor. That is, I invest in what I consider undervalued securities instead of betting on the development of the market as a whole. I buy securities if the market price is below my fair value estimate. I do not believe in timing the market as this would be speculation. Neither do I believe in overweighting certain countries or industries simply to beat a certain index. I avoid leverage and try to minimize complexity (such as derivatives or complex capital structures) in order to provide better protection from permanent capital loss.

My goal is to generate sustainable market-beating absolute returns with a few select value investments. It will always be difficult or near impossible to exactly predict when these undervalued securities will reach fair value - in some cases the progression could be very fast, but in many cases it could take years. Therefore, investors need to be patient and should have a long-term horizon. In my mind, a track record of at least three years is required to draw conclusions about the qualities of a portfolio manager. Financial markets are very volatile and what may appear to be a trend, even over a couple of years, can sometimes be misleading.

Key Benefits to Clients

1. **Low/no management fees.** It is not unheard of in the fund management industry for investors to be charged 2-4% of their assets for the privilege of having their assets managed by some bank employee. At iolite, the maximum fixed fee that you would pay is 1%.
2. **No performance fees without sustainable capital gains.** iolite only makes money if the client makes money and only charges a performance fee if the portfolio exceeds the last high plus a 4% hurdle.
3. **Client portfolios are modeled after the portfolio manager's personal account.** At iolite, we eat our own cooking.
4. **No leverage, no margin loans, no complexity.** At iolite, we try to keep things simple and stick to time-tested value investing strategies.

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Value-oriented Equity Investment Ideas for Sophisticated Investors

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"If our efforts can further the goals of our members by giving them a discernible edge over other market participants, we have succeeded."

Investing In The Tradition of Graham, Buffett, Klarman

Year V, Volume IX
September 2012

When asked how he became so successful, Buffett answered: "We read hundreds and hundreds of annual reports every year."

Top Ideas In This Report

Also Inside

About The Manual of Ideas

Our goal is to bring you investment ideas that are compelling on the basis of value versus price. In our quest for value, we analyze the top holdings of top fund managers. We also use a proprietary methodology to identify stocks that are not widely followed by institutional investors.

Our research team has extensive experience in industry and security analysis, equity valuation, and investment management. We bring a "buy side" mindset to the idea generation process, cutting across industries and market capitalization ranges in our search for compelling equity investment opportunities.

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- ► MOI Signal Rank and top holdings of 50+ superinvestors
- ► Screening 800+ superinvestor holdings
- ► 20 companies profiled by The Manual of Ideas research team
- ► Proprietary selection of Top Three candidates for investment
- ► Plus: Exclusive interview with Alan Zafran of Luminous Capital
- ► Plus: Exclusive interview with Brian Boyle of Boyle Capital
- ► Plus: Exclusive write-up by Robert Leitz on Digital River

Superinvestor holdings profiled include Aeropostale (ARO), Apache (APA), Brookfield Asset (BAM), Colfax (CFX), Cooper (COO), FLIR Systems (FLIR), General Motors (GM), Heineken (HINKY), Humana (HUM), Lazard (LAZ), Marriott Vacations (VAC), Marvell Technology (MRVL), Phillip... ...ble (PG), Range Resources (RRC), Ro... Thermo Fisher (TMO)...

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- ► Tom Russo d...
- ► Lisa Rapuano ...

Inside:

Exclusive Write-up on Digital River (DRIV) by Robert Leitz

With compliments of The Manual of Ideas

Robert Leitz on Digital River

The following investment thesis is authored by Zurich-based value investor Robert Leitz, founder and portfolio manager at iolite Partners. He has previously worked at TPG Credit, Goldman Sachs, and KPMG.

"Over the last five years, the company has averaged sales of $380 million and owner earnings of $80 million (20% margin) on tangible assets of $50 million."
[market value: $540 million]

Investment Thesis

Digital River is a solid company in a competitive but growing industry and benefits from high scalability. It provides end-to-end global e-commerce solutions, such as online shops with integrated payment systems, and generates a substantial majority of its revenue on a client revenue-share basis. Despite a concentrated customer base and short-term contracts, the company is in a good position to benefit from the growth of online retail and some customer stickiness. Over the last five years, the company has averaged sales of $380 million and owner earnings (OCF less capex) of $80 million (a 20% margin) on tangible assets of $50 million.

With a recent market cap of $540 million, the company trades at 80% cash to market cap, 130% cash and investments to market cap, 2.0x EV to owner earnings, and 6.5x market cap to owner earnings. The company recently announced a buyback program of $100 million, almost 20% of market cap. It is difficult to put a number on the shares' fair value, as it is sensitive to the use of cash going forward. However, if DRIV maintains the current sustainable leverage level of 4.3x gross debt to owner earnings and keeps utilizing cash in a shareholder-friendly way (buybacks or value-adding acquisitions), the stock should return more than 15% annually over the next few years.

Business Overview

DRIV was founded in 1994 and is headquartered in Minnetonka, Minnesota. It provides end-to-end global e-commerce and marketing solutions to a range of companies in software, consumer electronics, gaming (computer and video) and other markets. The company's services include:

- design, development and hosting of online stores and shopping carts,
- store merchandising, order management, payment processing and product delivery (digital and physical)
- online marketing and paid search programs, and
- website optimization, analytics and reporting.

It generates a substantial majority of revenue on a revenue-share basis: if it manages an online store for a client, it receives a percentage of the selling price of each product sold at that online store. Sales outside the U.S. accounted for 47% of total sales in the first half of 2012.

Customers

Customers have included many of the largest software, consumer electronics and gaming companies as well as major retailers of these products. The list includes Allume Systems, Autodesk, CompUSA, Computer Associates, Canon, Electronic Arts, Hewlett Packard, Lexmark, Microsoft, Nuance, Symantec, and Trend Micro. In 2010, the company entered into an agreement with Microsoft to build, host and manage the Microsoft Store, an e-commerce store that supports the sale and fulfillment of Microsoft and third-party software as well as consumer electronics products to customers globally.

Competition: Strong and Diverse

- Clients' in-house development, e.g. Symantec migrated its online store to an internally developed system in 2009
- Other providers of e-commerce solutions, e.g. cleverbridge, eBay, Avangate, asknet, Arvato, Amazon and Buy.com
- Companies that provide technologies, services or products that support the e-commerce process, e.g. CyberSource (Visa) and PayPal
- Web infrastructure companies seeking to expand their offering, e.g. Network Solutions, Akamai, Yahoo!, eBay and Hostopia.com
- Disruptive technology or new e-commerce models, e.g. Apple app store
- Companies that offer various online marketing services, technologies and products, e.g. ValueClick and Microsoft Advertising

Recent Events

"The company recently announced a buyback program of $100 million, almost 20% of market cap."

Q2 results missed management's revenue guidance, and the stock traded down 25% from $17.79 to $13.32 in a day, marking a nine-year low. I believe the market overreacted to the news, considering the company's stable revenue and earnings history as well as the low market valuation. DRIV now anticipates 2012 adjusted earnings of $0.96-1.08 per share on revenue in a range of $378 million to $390 million. The prior outlook was for adjusted earnings between $1.20-1.28 per share on revenue of $402-409 million.

Digital River – Financial Overview

($ in millions)	FY Dec-02	FY Dec-03	FY Dec-04	FY Dec-05	FY Dec-06	FY Dec-07	FY Dec-08	FY Dec-09	FY Dec-10	FY Dec-11	LTM Jun-12	Valuation 5-Year Avg.
Revenue	77.8	101.2	154.1	220.4	307.6	349.3	394.2	403.8	363.2	398.1	400.7	381.7
EBITA	4.8	21.7	43.0	75.4	79.7	81.5	80.0	71.1	20.8	38.5	36.2	58.4
OCF (incl. Interest)	17.6	47.8	85.1	119.8	117.5	146.4	95.2	137.1	57.8	94.8	69.8	106.2
Capex	-5.2	-6.3	-9.3	-8.3	-15.9	-18.7	-26.9	-31.9	-18.6	-23.9	-20.9	-24.0
Owner Earnings	12.3	41.6	75.9	111.4	101.6	127.7	68.3	105.1	39.2	70.9	48.9	82.2
Working Capital (ex Cash)	-19.9	-32.5	-66.5	-93.0	-89.0	-115.5	-131.1	-141.6	-138.0	-178.6	-97.3	-97.3
Cash	-41	-102	-128	-132	-390	-382	-490	-393	-565	-497	-422	-422
Investments	0	-30	-164	-221	-236	-316	-103	-135	-274	-322	-307	-307
Debt	0	0	195	195	195	195	195	9	354	354	354	354
Net Debt	-41	-132	-97	-157	-431	-502	-399	-519	-485	-466	-375	-375
Diluted Shares Out (m)	26.8	33.1	38.5	41.4	44.6	45.9	42.1	37.7	38.3	37.5	33.6	33.6
Price (USD)	13	22	33	30	56	33	24	27	35	15	16	16
Market Cap	348	727	1,272	1,243	2,500	1,515	1,011	1,018	1,342	563	537	537
EV	307	595	1,174	1,086	2,069	1,013	612	499	857	97	162	162
EV/EBITA	63.8 x	27.5 x	27.3 x	14.4 x	26.0 x	12.4 x	7.7 x	7.0 x	41.1 x	2.5 x	4.5 x	2.8 x
EV/Owner Earnings	24.9 x	14.3 x	15.5 x	9.7 x	20.4 x	7.9 x	9.0 x	4.8 x	21.8 x	1.4 x	3.3 x	2.0 x
Market Cap/Owner Earnings	28.2 x	17.5 x	16.8 x	11.2 x	24.6 x	11.9 x	14.8 x	9.7 x	34.2 x	7.9 x	11.0 x	6.5 x

Investments: As of June 30, 2012, the company had $275 million (fair value) or $289 million (cost basis) of total investments of $307 million as available-for-sale investments. Breakdown at fair value: $170 million corporate bonds, $51 million auction-rate securities, $38 million U.S. government-sponsored entities, $14 million asset-backed securities, and $2 million public equity investments.

Negative working capital: The company partly finances itself with negative working capital. Given historic numbers and DRIV's business model, current levels seem sustainable and unthreatening. However, year-end cash figures are overstated by around USD 60-80m given a seasonal working capital peak.

"The company offers an attractive full-service package. Customers can significantly reduce or eliminate upfront and ongoing hardware, software, maintenance and support costs associated with developing, customizing, deploying, maintaining, and upgrading an e-commerce solution."

Highlights

Good value proposition: The company offers an attractive full-service package. Customers can significantly reduce or eliminate upfront and ongoing hardware, software, maintenance and support costs associated with developing, customizing, deploying, maintaining, and upgrading an e-commerce solution.

Market tailwinds: The U.S. Commerce Department reported that e-commerce sales in 2011 rose 16% compared to 2010. Online retail is and will remain a growing market for years to come.

Customer stickiness: Clients face certain hurdles when moving to another provider, such as general set-up inconveniences, business interruption risks, or technical switching costs and difficulties.

Scalability: The business is highly scalable and a customer's sales increase has an immediate impact on Digital River's bottom line.

Inflation protection: The revenue-share contracts with online retailers would likely lead to higher revenues in an inflationary environment.

Buybacks: The company is utilizing its strong balance sheet to buy back shares at a very low market valuation.

Risks

Customer concentration: Sales of products to Microsoft accounted for 28% of revenue in 2011. A limited number of other software and physical goods clients contribute a large portion of revenue. In 2009, Symantec, accounting for 25% of revenue at that time, elected not to renew its contract with Digital River and migrated its online store traffic to an internally developed e-commerce system.

Possible value-destroying acquisitions: Acquisitions are a key element of the strategy. In the last five years, the company has acquired or invested in 11 firms.

Taxation of repatriated cash: 44% of cash is held in international subsidiaries.

Cash restrictions: As of June 30, 2012, $64 million of auction-rate securities recorded at $51 million fair value could not be sold due to market illiquidity.

Capital allocation: Aside from current buybacks, management has a somewhat poor capital allocation track record. Two convertible bond issues in 2004 and 2010 were meant for acquisitions that never materialized. Stock-based compensation has averaged $20 million annually over the last five years.

"Aggressive buybacks at the recent low market valuation could turn this stock into a double- or triple-bagger within a two- to three-year timeframe."

Conclusion

Digital River is a stable and capital-efficient company in a competitive but growing market. The company is moderately leveraged, and its recent market cap is lower than gross cash holdings plus investments. Returns to shareholders will depend largely on the company's use of cash going forward.

Aggressive buybacks at the recent low market valuation could turn this stock into a double- or triple-bagger within a two- to three-year timeframe. Even if the most bullish scenario does not materialize, the company's strong balance sheet as well as its solid free cash flow generation should be sufficient to lift the stock from current levels in a meaningful way going forward.