

Theta Deep Value Fund

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Quarterly Investor Letter – Q1 2007

Theta Capital Management

April 2007

Dear investor,

The Theta Deep Value Fund (the Fund) continued to perform well, generating 7.7% in the first quarter of 2007 to bring the performance since inception in July 2006 to 17.0%. Star performer during the quarter were the Paulson Credit Opportunities I and II funds which generated a blended return of 57% for the quarter on the back of a dramatic repricing of US subprime mortgage backed securities. Although we will see considerable (monthly) volatility from this fund, we also expect further significant gains going forward as actual losses in the underlying mortgage pool materialize.

We have added one fund as of April 1 (Sector Speculare III, active in oil exploration and production) and have decided to redeem one other fund (Jolly Rogers Activist Fund, Pirate Capital) as of July 1.

Following the 31st March opening, the Theta Deep Value fund has circa EUR 80 million under management. We have decided to offer investors one more opportunity to invest in the Fund on July 1st 2007, after which the fund will be hard closed. Our decision is based on the fact that we will not be able to invest in certain fund managers going forward as they themselves are hard closed. We want to maintain a significant exposure to those managers, one of the reasons being that some of them have pre-IPO investments carried at cost price. By closing the Fund, we will avoid diluting the interest and upward potential of existing participants.

In January the Fund returned -0.30%. As we mentioned in our last quarterly, we invested in Red Kite but managed to pick the worst possible entry point and the two funds we invested in lost 26% on our position during the month. However, on balance the Fund only lost 30 bps as a result of a solid performance of the other funds. In February, the Fund generated 6.8%. Most of this was driven by Paulson Credit Opportunities but also Red Kite rebounded nicely and managed to recoup around 30% of its January losses. Further strong performance were seen in our two emerging markets funds, despite the fierce sell off in global emerging markets, Montpellier and Greater Europe Deep Value. This underscores our point that returns in the Fund are predominantly driven by deal specific risk, rather than overall market movements.

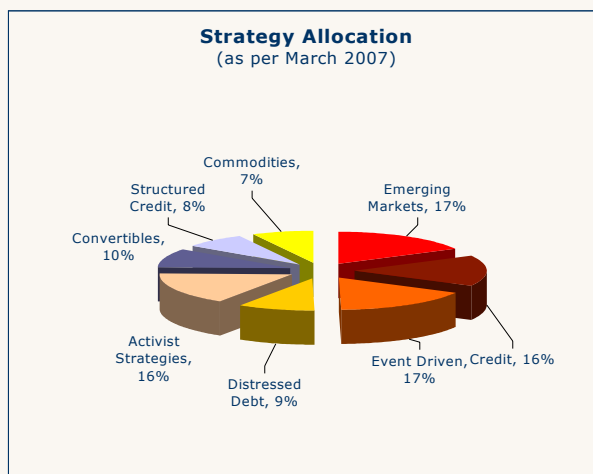
March had a somewhat quieter profile, generating 1.49%. Paulson Credit Opportunities lost some ground due to a technical rebound in the subprime segment and Eidesis lost ground as the most risky tranches in CDOs (which the fund is short) saw spreads tighten further. This is a fund that should benefit nicely if we see turbulence in the corporate credit market later this year, somewhat similar to what we've seen in the subprime mortgage market. Greater Europe, Jolly Rogers Activist, Red Kite and Ecofin all generated solid returns during the month of March.

Theta Deep Value Fund - Performance

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	2006
Net Performance							-1.41%	1.46%	-1.41%	2.55%	2.58%	4.19%	8.22%
Cumulative Performance							-1.41%	0.03%	-1.26%	1.26%	3.87%	8.22%	
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	2007
Net Performance	-0.30%	6.81%	1.49%										8.08%
Cumulative Performance	7.90%	15.24%	16.96%										

Note: As the fund's independent administrator provides an official NAV on a quarterly basis, monthly numbers are estimates provided by the manager.

Strategy Allocation	March 07
Emerging Markets	17%
Montpelier Fund	
Greater Europe Deep Value Fund	
Credit	16%
Paulson Credit Opportunities	
Event Driven	17%
Ecofin Special Situations Fund	
CIM Special Situations Fund	
Distressed Debt	9%
Camulos Partners Offshore Fund	
Activist Strategies	16%
Absolute Activist Value Fund	
Jolly Rogers Activist Fund	
Convertibles	10%
CQS Directional Opportunities Fund	
Structured Credit	8%
Eidesis Special Opportunities Fund	
ZAIS Matrix V	
Commodities	7%
Red Kite Metals Fund	
Red Kite Prospect Fund	
Total	100%



First Quarter 2007 Performance Review

The **Absolute Activist Value Fund** (Activist Investing) had a decent return of **5.5%** during the first three months of the year. The fund's AuM are now Euro 90m in a well diversified portfolio. The manager has been careful in adding new activist positions as risk-reward and valuation criteria were mostly not met. The AAV portfolio will continue to be operated as a long/short equity fund with individual stock shorts, index shorts and index options to reduce the net exposure of the fund. This strategy paid off nicely during the month of February when the fund was not impacted by the overall market volatility.

Some of the names that AAV has been active in include Algoma (the Canadian steel company), Secure Computing Corporation (US IT-security firm) and Comet (a Swiss high-tech company) where the fund has build a 13% stake. The partnership with Ceres will be used for example in the case of Comet as the manager feels that the company is not exploiting its full potential and Ceres will assist management in working on operational improvements within the company.

Camulos Partners Offshore Fund (Distressed Debt) had a solid quarter with a return of **5.9%**, generated in leveraged loans and distressed securities. The portfolio remains defensively positioned with around half the book in senior secured loans, around a quarter in distressed and around 15% in HY debt. The portfolio remains highly diversified as the managers are cautious on the overall outlook for their markets. Obviously, this also means that returns are well spread across its various holdings and there are no significant detractors and/or contributors to performance.

Camulos is launching a Special Situations Fund which will focus on less liquid, higher return strategies and will be far more concentrated and is as such more suitable for Theta Deep Value. We have therefore decided to subscribe to this new fund (the Camulos Special Situations Fund) and after having done further analysis on the Offshore fund have decided to invest in the Offshore fund through our Low Volatility fund rather than redeem.

The **CIM Special Situations Fund** (Event-driven) generated **6.1%** in Q1. During the first two months, performance was held back by the sharp sell-off in natural resources related stocks. As a reminder, CIM Special Situations Fund invests in three segments: 1) Natural resources related stocks, 2) Technology stocks and 3) Distressed situations. During the recent past, the fund's focus was primarily on the natural resources sector as the managers saw the best upside here and indeed the fund benefited from the boom in commodities over that period. Although they still see good upside in some natural resources-related stocks,

the manager has been increasing its exposure to the technology and distressed segments. Furthermore, the fund has used the volatility seen in the commodity segment to buy into some quality names which were sold off indiscriminately during the February market turmoil. Around 30% of the portfolio is currently in the technology sector, 19% is in the oil & gas segment, 17% is in restructuring and 12% is in Metals and Mining. Companies which contributed positively to performance in the first quarter were Stratex (the Gold company), Velti (Greek software developer), Mulpha (the Malaysian real estate company) and Advanced Engine (the Australian technology company). As you can see, a geographically diversified portfolio of rather eclectic investments.

CQS Directional Opportunities Fund (Convertibles) generated **4.7%** over the January through March period. The bespoke CDO tranches credit strategies remain the largest contributor to performance. During February, CDO equity tranches were put under pressure due to the widening of credit spreads. However, CQS generated a positive return due to a general repricing of crossover versus investment grade risk which worked well for the constructed portfolio. Convertible bond positions benefited in particular at the end of February and the beginning of March from the increase in volatility during that period. Around 50% of the portfolio is invested in Europe and around 50% in the Americas with a very small allocation to Japan.

Greater Europe Deep Value fund (Emerging Markets Equity) returned **21%** in the first quarter, seemingly immune to the turmoil that hit the Emerging Markets in the latter part of February. The fund has now generated 67% since its inception in August 2006. It should be noted that GEDV's non-listed investments, which represent around 20% of initially invested capital, are still carried at cost. After a strong performance of some of its electricity names, a position which it had been building up in the latter part of 2006, some profits were taken here. The manager continues to see very good upside in the second and third tier Russian companies which target the domestic market and thus should not be hindered by volatility in oil&gas prices and/or a possible global (US) slowdown. There seems to be a large discrepancy between the general bad perception of Russia and reality where the government has taken an extremely conservative fiscal approach using the high oil prices to boost its reserves. These reserves will be used by the government to keep the economy expanding and integrate Russia further into the world economy, even if the global outlook is less rosy than it is currently. Overall, the Russian market is valued attractively at around 7X earnings but GEDV is investing in companies trading at 2/3x earnings and the manager expects to double his investment on most of his holdings, including some of his blue-chip investments.

Ecofin Special Situations Utilities Hedge Fund (Event-driven) returned **4.7%** during the first quarter. During the quarter, the fund invested around 10% of its NAV in ITC Holdings Corporation. ITC is the only publicly traded pure play high voltage electricity transmission company in the US, with its core assets in Michigan. In the last 12 months, the company announced the acquisition of Michigan Electric Transmission company for US\$866m and of the transmission assets of Interstate Power & Light company for US\$750m. These two acquisitions will more than double ITC's original rate base and the company should see significant growth of that rate base and thus earnings going forward.

In Europe, the market placing by Babcock and Brown Wind Partners (BBW) and the release of an investor pack including an explanation of the financial workings of the US Production Tax Credit could enhance further investor understanding of Airtricity. Ecofin has a 16% stake in this Dublin based wind operator which has chosen the same financing route. Furthermore, the sale of Horizon Wind by Goldman Sachs could shed some more light on Airtricity's valuation.

The fund (closed to new investments) currently has around US\$625m AuM, with around 35% of its holdings in North America, around 40% in Europe ex-UK, around 17% in the UK and the remainder in the other parts of the world.

Eidesis Special Opportunities Fund and the **Structured Credit Fund** (Distressed Collateralised Debt Obligations). These funds had a difficult quarter, albeit seemingly mainly due to technical buying in the most risky CDX tranches (which Eidesis is short), generating an overall **loss of 1.3%** for the quarter. The technical buying drove down the price of CDX equity protection whilst overall CDX HY spreads widened. Whilst this has led to some mark-to-market losses for the portfolio, the manager very strongly feels that the value proposition of the trade is still intact. The manager expects that the ABS CDO downgrades will arrive in full force later this year. In his view, contagion to other CDO segments is then very likely as managers reduce risk and some forced selling driven by ratings downgrades will take place. Especially if this contagion were to be combined with a slowdown in corporate earnings and continuing unease about economic direction, the fund stands to benefit. Default rates need to remain well below historical norms in order for the buyers of structured equity and mezzanine tranches to be rewarded for the risk they have been taking on over the last couple of years. If defaults or default expectations were to signal a reversion to historical mean, the shake-out in the corporate debt segment will be equally spectacular as the one in the US subprime mortgage segment. The fund currently has capital commitments of US\$185m.

The **Jolly Rogers Activist Fund/Pirate Capital** (Activist Investing) had a difficult start to the year, generating just **0.8%** for the quarter. Performance was volatile over the quarter, losing 1.9% in January, 4.4% in February before gaining 7.45% in March.

Pirate Capital has been active in a number of names, in particular Aquila and The Brink's Company. In the case of Aquila, Pirate Capital is strongly opposing the proposed sale of Aquila to Great Plains Energy and Black Hills Corporation at what Pirate Capital considers to be a low price. Pirate Capital has taken the lead in trying to either nullify the deal or have its terms modified. In the case of The Brink's Company, the Pirate Capital principal has joined the board and will try to unlock value for Brink's share holders through for example improved financial discipline when it comes to the company's capital expenditure plans.

The Deep Value Fund had been set up for our highest conviction ideas where liquidity was a restraint when considering them for our other funds. In the case of the Jolly Rogers funds, our conviction has been severely tested since we invested in the fund given high volatility, mediocre performance, a SEC investigation and high staff turnover. Although it could well be that the fund is back on track, we have lost our full conviction and therefore have decided to redeem Jolly Rogers Activist Fund. We are considering several alternatives at the moment.

The **Montpelier Fund** (Emerging Markets Equity) returned **10.44%** in the first quarter. In January 2007 the fund had its 3rd capital call and the fund is now more fully invested, the cash balance falling to 9% at March month end from an average cash holding of 22% over the quarter. Its biggest exposure remains China. The fund benefited in the first quarter from investor attention moving from the fully valued large cap names to the attractively valued, faster growing smaller stocks, which are the focus of the fund. The fund's investments are split between fast growing private sector companies and H share listed companies. In the former case, developing close relationships with the founder/management is crucial as these companies evolve quickly and corporate governance issues are important. The need for capital from these fast growing companies means that the fund can acquire positions through private placements. In the case of H listed shares, the focus is on the asset injection from Central government owned parent companies into their listed subsidiaries. The fund focuses on stocks which benefit from the expansion into the less crowded Western areas of China and include agriculture, water distribution and infrastructure related holdings. In Egypt, the focus is more on companies that are successfully pursuing a regional strategy and are rolling out their

products and services into neighbouring companies such as Algeria, Egypt and Turkey. The Russian investments are concentrated in Unified Energy as the fund intends to be active in managing the assets which will be spun out of the holding company over the coming years. The Indonesian investments are concentrated within construction, telecoms and the palm oil business.

Currently the fund has USD325 million under management and we have been invited to participate in their capital raising of around US\$200m in April following which the fund will again hard close.

Paulson Credit Opportunities Fund (Credit) did rather well, generating a not unappealing **57%** during the quarter....The bulk of this was generated in February when the subprime train came off the rails. You may have seen numerous other comments from us during the last year on the subject as we were enthused by the potential upside that funds could generate from being positioned correctly once the technical flows supporting the market ran out. Furthermore, we saw the trade as a very good hedge for our portfolio and are therefore pleased how this theme has played out so far.

It is important to mention that the (major) correction in February was, in the opinion of the fund manager, only the beginning of a long-term correction. Ultimately, the manager expects the market for new subprime originations to shut down leading to a broad collapse in the prices of subprime mortgage securities. The manager is still strongly positioned to benefit from a continued deterioration in the subprime segment. At the moment, the belief is that the losses in the subprime pools backing such bonds will be much higher than the “BBB” subordination levels (which is 5% on average) and will be more likely to be in the double digit area. Profits will be locked in as either the CDS settle in cash or short positions are covered in the market. The best time for this is most likely when the bonds are downgraded and consequently dumped into the market by institutions whose regulatory guidelines prohibit them from holding non-investment grade securities.

Red Kite Metals Fund/Prospect Fund (Commodities) had a disappointing start in our fund, **losing** on average **16%** over the first three months. Following the drawdown in January, we have had extensive discussions with the managers to look at the loss attribution, the portfolio sizing, contracts traded and the overall team structure. On balance, our confidence in the managers is still very high. This is a very experienced team of traders with solid sources of information from their large physical trading activities which puts them at an advantage to many of their peers. Furthermore, the way they handled the drawdown and subsequently managed to recoup some of their losses compares favorably to how some of their peers had handled similar situations. And finally, given the performance profile of this fund (they were up around 180% in 2006 and around 100% in 2005), a correction was always likely at some stage. Annoyingly for us, it was exactly the wrong month. On balance, we remain confident that this team will be able to continue to generate outsized returns going forward, albeit with high volatility.

The month of January saw a large loss due to the decline in copper prices during that month which worked against the fund both on an outright position as well as a spread-trade. It is worthwhile remembering that in the past Red Kite has managed to generate good returns when prices moved down as well as up but clearly in this particular month they were positioned incorrectly. The fund reduced its exposure during the month but still managed to recapture some of the lost ground in February when both nearby and further-out prices rebounded. Copper and aluminum account for a large part of the fund’s exposure but the fund also trades nickel, zinc, tin, lead, gold and silver. The exposure to other base metals has been much lower also given the lower liquidity of these funds; precious metals exposure has been used to a limited extent as a hedge on the portfolio.

We have spread our investment over the more actively traded Metals fund, which concentrates on nearby contracts and the longer-term Prospect fund which will benefit from more structural/longer-term trades.

The **Zais Matrix V Fund** (Structured Credit / Distressed CDO's) has made a small capital call in the first quarter (around 10%) and expects to draw another 10-20% in the second and third quarter. As they indicated at the end of 2006, they indeed now see some opportunities in the ABS market which clearly has weakened in the first quarter of this year. ZAIS focuses on opportunities that return a substantial amount of the investment through upfront interest cash flow rather than the return of principal at some future date as they feel that these are still too speculative. Those deals that have benefited the most from this year's spread widening on the asset side whilst experiencing a lesser magnitude of widening in the liability pricing. With this strategy, ZAIS adheres to one of the old principles of banking: when risk is rising, cash is king.

New Allocations per 1 April 2007

Sector Speculare III (Event driven) is an Oslo based, 'best ideas' fund, focusing (at least at this stage) on oil exploration- and exploitation companies, some of them private companies with a targeted exit date. The fund manager sees particular good opportunities in the exploration part of the value chain which has been neglected by the oil majors who instead focused on returning capital to shareholders and improving their development & production capabilities. However, it is clear that with proven reserves of the oil majors under pressure, they will need to start investing again heavily in exploration in order to ensure future production. A good example of this is a highly experienced team from BP who has left and set up their own private company. Sector has provided a large part of the required financing for this company which will focus on exploration projects in Egypt, Kazakhstan, Nigeria, Brazil and offshore Columbia.

Furthermore, there are numerous private companies without production but with proven reserves, in particular on the Norwegian continental shelf. Finally, there are numerous AIM listed companies with simply the wrong shareholder base (a lot of quick money which moves out if there is a slight disappointment). Access to drilling capacity however is key, as all capacity for 2007 and 2008 is sold out. Sector wishes to get exposure to a large number of drilling holes in its fund (>100) and will therefore focus on companies with licenses for more than 10 holes. The key factors that Sector looks for to secure a successful drilling investment are : 1) assets (licenses), 2) ability to perform (i.e. access to drilling capacity), 3) strong management, 4) expected absolute return greater than 50% and 5) an exit strategy within 3 years. Sector hedges out the short-term oil price risk on investments.

The fund will be concentrated with around 10 names in the fund. The track record of the first two Sector vehicles Speculare I and II is impressive, returning most of their initial capital to investors in the first 12 to 18 months and an expected return of another 1-3X the invested capital over the remaining 24 months.

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