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The President's Club
INVESTMENT LETTER

Urbana Corp: Buy
A bet on financials (at a steep discount)

It isn't often that the market serves up $1 for 63 cents, but just such a deal is available on **Urbana Corp. (URB.A-TO, URB.TO; $1.64)**, a closed-end fund with extensive holdings in financial companies.

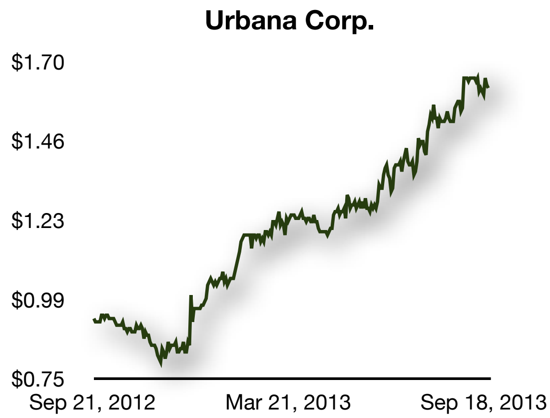
Urbana has one of the largest discounts to net asset value of any closed-end fund in the world, raising the obvious question: are the shares mispriced and therefore a compelling buy, or is the company damaged goods, with defects that justify its lowly status?

We have a bullish take on Urbana, viewing it as a value play with big upside potential. Even better, it is currently available at low enough valuations that investors have a margin of safety against large losses in case things go wrong. That's because the shares trade around $1.60 and have a break up value of $2.57.

First, a few words about closed-end funds. They're similar to mutual funds, except they issue shares that trade on exchanges rather than units that can be redeemed. This is why their shares can trade below or above their net asset value, as supply and demand for the stock causes prices on the market to fluctuate above or below their intrinsic value.

For investors, the main attraction is that closed-end funds are an overlooked part of the market, with almost no research coverage on the Street. Yet they often have top flight assets, available on the cheap for those willing to spend some time kicking the tires in this under followed sector.

Urbana, for instance, has a quarter of its assets in CBOE Holdings, the publicly traded commodity exchange that oversees futures on the S&P index. Another 10% is in NYSE Euronext, formerly the New York Stock Exchange, which is in the process of being taken over by Intercontinental Exchange. Another 40% of its holdings are in beaten down financials such as Bank of America, Citigroup, Morgan Stanley and Manulife, companies remain significantly undervalued due to lingering revulsion toward the sector because of the financial crisis.



Any investor considering U.S. banks or depressed life insurance shares should view Urbana as a cheaper alternative, providing exposure to these companies at far better prices.

Urbana also holds some long-shot, non-market-traded assets that could go nowhere, but then again could provide sizable upside should things go right. Among these is 3% of India's Bombay Stock Exchange, currently depressed because of that country's financial malaise and the flight out of emerging markets. It also holds 49% of CNSX Markets, an up and coming Canadian venture capital exchange.

It's worth mentioning that since Caldwell Financial began running Urbana's stock portfolio in Oct. 2002, returns have been 14.9 per cent compounded annually, handily beating most market indexes and all but the best hedge funds. Any performance close to this in the future by the firm's money management impresario, Thomas Caldwell, and investors should do very well, especially given the huge discount.

So what's not to like?

Urbana trades at a discount for a number of reasons. First, there is no analytical coverage, so no sell side analysts are pounding the table pointing out to clients the obvious bargain that is in plain sight.

The company was also clobbered during the financial crisis, as stock trading volume evaporated and investor interest in owning stock exchanges plummeted. For a time last year, investors were so disenchanted that Urbana's discount to net asset value reached a staggering 50%.

In common to mutual funds, closed-end funds also pay fees to the manager of their investments. Urbana's is 1.5 per cent of assets, but a favourable factor for investors is that it doesn't have extra fees tied to performance. The fee figure is higher than index funds, but reasonable compared to other active managers.

Another market worry has been Urbana's holdings in illiquid, non-traded holdings, such as the Bombay exchange. These are more difficult to evaluate and often more speculative. In all, 18% of assets are in this category. One of its holdings is 49% of boutique resource brokerage StoneCap Securities, to which it assigns a value of zero because of the firm's recent losses, although Urbana continues to value a $2.5 million loan to the company at around 90% of par.

A plus is that Mr. Caldwell has been furiously buying back piles of Urbana stock for cancellation, a huge benefit for shareholders and a cost to the manager in the form of lower fees. Oftentimes, closed-end funds are milked by managers for for the fees they generate. The more assets, the more fees, but Mr. Caldwell has done the right thing. He has bought back and cancelled 25.5 million shares in recent years, bringing the total outstanding to only 64 million.

All undervalued situations need a catalyst, and we think the aggressive buy backs are a reason the discount could narrow. We think a more appropriate figure for current conditions, given the non-market holdings, would be a 15 to 20%.

It's also likely that Urbana's stable of publicly traded companies, such as the CBOE and Manulife, will continue to appreciate in value as the sector continues to recover from the financial crisis. Investors should keep in mind that every share bought at $1.60 really places $2.58 at work, providing the delight of leverage to the upside should markets continue to rally.

Urbana has two classes of stock, one voting and the other non-voting. Except for the voting rights, the shares are identical, nearly always trade at the same price, and each can be bought.

There is a further upside catalyst. Just before the crash, at the peak of the mania for stock exchange investments, Urbana traded for a premium of more than 60% to its break up value. Investors buying then were clearly wrong (just as investors avoiding the stock are now wrong), but it's entirely possible that Urbana could again trade around break up value, if not at a modest premium over the next couple of years. If the CNSX takes off, which is possible during the next natural resources or tech boom, the value of the exchange will soar to many times the price Urbana paid. Ditto for the Bombay exchange. India currently is a mess and its stocks are down, but it's always best to buy when there is panic in the air.

Given the discount, one way to view Urbana is that investors are getting the CNSX, the Bombay exchange, and its other non-market traded securities for free, and its publicly traded stocks at roughly 20% off. Provided the market doesn't crater again, Urbana will be a winner and a delight to have in any portfolio.