

Mirzam Capital Appreciation Fund
September 2007 Fund Commentary by Albert Meyer

August was a gut wrenching month for investors. Late August and early September brought some relief, but lingering doubts about the impact of the sub-prime debacle left investors feeling cautious. Although the fund's performance has been positive during these turbulent days, it is far too early to focus on performance. Our investment horizon stretches far into the future. We like to acquire the "buy-and-never-sell" stocks. In doing so, we allocate capital slowly, but deliberately.

The inflow of funds this month – always a welcome sign – exceeded the rate at which we were able to allocate capital. Although cash holdings act as a drag on performance in an up market, it comes in handy as and when the market turns negative. The best time to buy is when others are selling. To do that, you need cash on hand. At month end, September 30, 2007, 77.4% of the portfolio was held in a money market account yielding 4.19%. The balance of the portfolio was invested in equities of which US equities made up 9.0% and foreign equities 13.6%. The average dividend yield on the equity portion of the fund's portfolio is currently 3.60% based on cost. The dividend yield based on the market value of the equity portfolio is 3.23%, reflecting the 11.3% increase or capital appreciation in the equity portion of the portfolio since inception until the close on September 30, 2007.

Last month we wrote a couple of paragraphs on Dell Computers. To clarify, it is not our intention to badmouth anyone in particular. Rather, we want to illustrate a point with reference to some real numbers that are readily available in SEC filings. Unfortunately, at times these numbers reflect unfavorably on the entity that publishes them. This is certainly the case with the topic under scrutiny this month. To keep our focus on the issues rather than on a particular company, we will hide the identity of the company in question behind the pseudonym, "Enigma."

If you believe management's earnings announcements and the subsequent media reports, "Enigma" is a very profitable company. Skeptical as we always are, we pulled the company's SEC filings, and in particular the balance sheet. Surprisingly, "Enigma's" balance sheet reports an "Accumulated Deficit" of \$617 million. In other words, the company has not been profitable since the day it was formed. It has also never paid a penny in dividends to shareholders. Believe it or not, "Enigma" has a market capitalization in excess of \$150 billion. Yes, billion with a "b."

What happened to the widely published profits of "Enigma"? First, understand that management has been very generous in handing out stock options to employees in lieu of cash wages. This practice created the illusion of profitability and left management with a choice: pay dividends or buy back stock. Management chose the latter. You see, it had to deal with a ballooning share count, the inevitable result of issuing approximately 1.8 billion shares to employees who cashed in their stock options. Unfortunately, management ran out of profits after buying back approximately 1.5 billion shares. In fact, management appropriated all the profits the company ever earned, plus another \$617

million as it helped employees turn their paper wages (options) into cash wages (the buybacks).

What shareholders need to understand is that these types of share repurchases or stock buybacks are nothing more than compensation in disguise. It works like this: You first inflate the share count by issuing stock to employees and then you scramble to mop up the dilution by buying back stock. At the end of the day, shareholders are no better off than they were prior to the stock issues and the subsequent buybacks. Consider the fact that "Enigma" still has another 1.4 billion options (23% of the current share count), coming down the pike. Why does this company command a \$150-billion plus market capitalization when the repurchasing of stock issued to employees seems to be its sole purpose? Stated another way, since inception the company has distributed all the profits it ever earned to employees through a marvelously deceptive practice of stock base compensation.

Here's the truly bad part of the above story, which explains why we are reluctant to name and shame the company. "Enigma," as we dubbed this company, recently announced an increase in its share buyback program, saying, "Today's decision to increase its share buyback program allows the company to continue to return cash to shareholders."

The truth is nothing of the sort. The buyback program sends a signal that the company is setting aside sufficient funds to enable it to buy stock at any time employees wish to sell. This helping hand provides much needed price support, because insiders are constant sellers of company stock. (Stock options are not yet legal tender at the mall.) This circuitous route of compensating employees returns cash only to a select group of shareholders, namely the employees. The company gets away with this misrepresentation because of (1) the way the accounting works, (2) the difficulty of tracking the cash flow and (3) because of the myth so readily believed by all, including the regulators, that stock buybacks are good for shareholders. After all, they "return cash to shareholders." Properly analyzed, the claim that "Enigma" returns cash to shareholders when it buys back its stock is a boldface lie, but don't expect the SEC to call them on it. On the other hand, be careful what you post on a Yahoo! Message Board. Stick to the truth. The SEC is watching and ready to pounce.

- Albert Meyer

Information provided with respect to the Fund's Portfolio Holdings, Sector Weightings, Number of Holdings and Expense Ratios are as of September 30, 2007 and are subject to change at any time.

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The Funds' past performance does not guarantee future results. The investment return and principal value of an investment in the Funds will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance of the Funds may be lower or higher than the performance quoted. Performance data current to the most recent month end may be obtained by calling (888) 693-8056.

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