

RNS Euro. Eq Tranche Inc EET Investment Update
May 4 2007 7:00

RNS Number:0929W
European Equity Tranche Income Ltd.
04 May 2007

For immediate release on 4 May 2007

European Equity Tranche Income Limited ("EETI" or the "Company")

Investment Update

EETI announced on 22 March 2007 that the Italian government had proposed a change in the law relating to early repayment charges on mortgage loans which, if it came into effect, could have an adverse effect on future income from the Company's Italian mortgage loan portfolio. Although the new law provides for the elimination of all prepayment charges for the early redemption of new mortgages only, the Italian government also asked the Italian Banking Association to agree with the Italian Consumer Association what should be done about mortgages currently in existence. The decision to eliminate charges on new mortgages has no material impact on EETI, but the proposal to, in effect, introduce retrospective legislation on existing mortgages had the capacity to impact the Company, and we have made verbal and written submissions to various authorities opposing this. Regrettably, it has now been announced that the Italian government intends to introduce maximum prepayment penalty charges on existing variable rate mortgages. Those charges will be limited to 0.5% which compares with current prepayment penalties in the range of approximately 1% to 3%. There will also be limitations on fixed rate mortgage prepayments but EETI has no exposure to this market.

The Company has three Residential Mortgage Backed Securities investments in Italy, comprising some 43 per cent. of its investment portfolio, and this change in the rules particularly affects one of these investments. The Company's Investment Manager estimates that the change will result in a reduction in a range of approximately Eur 2.8 to Eur 4.0 million to the aggregate book value of these investments, the final amount being dependent on detailed clarification with the Trustee and other parties to the RMBS investments as to the precise implications of this decision. Accordingly, the Company will be taking an exceptional charge to its results for the quarter ending 30 June 2007. This estimated loss is calculated as the difference between the current book value and the fair market value. The fair market value is calculated as for a fixed

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income security, by discounting expected cash flows (including redemption charges at the new rate) at the internal rate of return expected on the investment as at the purchase date. The exceptional charge compares with the Company's current earnings rate of approximately Eur 2 million a quarter, based on the 3 months to 31 March 2007.

The Board of EETI has carefully considered the appropriate action in response to this wholly unexpected and, in its view, unjustified action and is currently reviewing its options to mitigate this loss. The Board believes it should be considered a one off, exceptional item, as the Company's overall portfolio is performing well and, in total, has been earning at a higher rate than predicted by the Investment Manager's internal models. The Board is also aware that many of the Company's shareholders have bought shares for their potential dividend yield. Taking these factors into account the Board has decided, in the absence of unforeseen circumstances, to target a quarterly dividend of Eur 0.02 per share until the Company has restored its net asset value to its latest pre dividend net asset value of Eur 1.0003 per share.

The time it will take the Company to restore its net asset value will depend to some extent on the pace it gears up its asset base. The Company's Investment Manager continues to be shown a large number of potential investments and the Board is confident that the Company will be able to steadily increase its portfolio without any deterioration in total returns or asset quality. Discussions are also continuing to increase the Company's leverage.

In its prospectus the Company stated that, in the absence of unforeseen circumstances, it had a target dividend of Eur 0.12 per share for the year ending 30 June 2008. In light of the retrospective action of the Italian government, this target is no longer appropriate and the Company intends to revisit its target dividend guidance following the build up of its investment portfolio as referred to above. However, the Board remains confident that the original philosophy on which EETI was founded remains sound. The Board believes that EETI's asset quality remains strong and, furthermore, has no exposures to those parts of the market such as sub-prime lending and non-conforming loans which are currently causing problems elsewhere.

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The company news service from the London Stock Exchange

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