



**The McElvaine Investment Trust**

**Annual Report**

**2008**

## **The McElvaine Investment Trust (“the Trust”)**

*The McElvaine Investment Trust is a RRSP eligible fund. The Trust was formed on September 27, 1996 with the following philosophy:*

- 1. Highly satisfactory longer-term performance can be achieved by focusing on companies selling below net asset value.*
- 2. The purpose of an investment vehicle is to make money not to own stocks. This is an important distinction because it means the Trust will only invest when presented with an attractive situation.*
- 3. As there are few good ideas, there are times when concentration may be helpful.*
- 4. An incentive fee structure rewards performance not asset growth.*

*There are 4 different series of the Trust. You may refer to the current offering memorandum for a detailed discussion of each Series, but very simply:*

- Series A: Was established in March 2009 and pays a 1% service fee.*
- Series B: The majority of our investors, including Tim, currently own these units.*
- Series F: Was established in January 2008 to allow investors with advisors to hold their units in fee for service accounts.*
- Series X: Formerly called Series A units.*

## Performance Summary as of 31Dec08

### The McElvaine Investment Trust<sup>7</sup> Series B

Year (Period)	Pre-fee Return <sup>(1)(2)</sup> - Series B Units	Net Return <sup>(1)(3)</sup> - Series B Units	Index <sup>(4)</sup>	Average Cash Balance <sup>(5)</sup>
2008	-47.8%	-48.8%	-33.0%	6%
2007	1.0%	0.6%	9.8%	9%
2006	15.1%	11.9%	17.3%	11%
2005	22.9%	17.2%	24.1%	13%
2004	11.3%	8.6%	14.5%	23%
2003	36.5%	28.2%	26.7%	14%
2002	5.4%	5.0%	-12.4%	5%
2001	37.2%	28.0%	-12.6%	2%
2000	24.6%	19.2%	7.4%	9%
1999	38.8%	29.5%	31.6%	26%
1998	21.3%	16.6%	-1.6%	27%
1997	16.8%	12.8%	15.0%	59%
12 Year Compound	12.3%	9.0%	5.2%	
\$100 invested Jan97 is now		\$259	\$183	

Notes:

- (1) The “Pre-fee Return” and “Net Return” information includes distributions reinvested in additional units.
- (2) “Pre-fee Return” is our estimate of the increase in the asset value of the Trust during the period after the deduction of all expenses, other than the management fee and performance incentive fee, and applicable GST. The Pre-fee Return gives you the best indication of how the Trust’s investments have performed. However, the “Net Return” is a better indicator of the returns actually earned by investors.
- (3) “Net Return” is our estimate of the increase in the net asset value of the Series B units during the period, which is based upon the fees in effect prior to January 1, 2008. No Series A units or Series F units were issued during the periods shown. The Net Return for each series of units will differ since the fee and expense structure for each series units differs.
- (4) As the Trust invests primarily in Canadian securities, we have compared its performance to that of the S&P/TSX Composite Total Return Index. This index tracks changes in the share price of 300 of the largest companies (by market capitalization) listed on the Toronto Stock Exchange (and includes the return from reinvested dividends). These companies represent a broad range of industries. The Trust may often invest in small-cap and mid-cap companies that are not included in the S&P/TSX Composite Total Return Index, and therefore, other indices may also be appropriate comparisons for the Trust.
- (5) “Average Cash Balance” is our estimate of the average of the month-end cash and short-term bond balances held by the Trust. We have included this to allow you to assess how the Trust was invested in order to generate the returns shown. For example, the 1997 Pre-fee Return of 16.8% was earned while the portfolio was on average only 41% invested.
- (6) This Performance Table excludes the three months from 27Sep96 to 31Dec96 (start-up period). During this period, the Trust returned 3.1%
- (7) **It is important that you understand that performance is yesterday’s news and you should be careful about using it as a guide to tomorrow. The figures above are unaudited and in many circumstances, simply our estimates.**

### *My Commitment to Reporting*

*In the pages that follow I have tried to present the material I believe is important for you to assess the job I did. In other words, I have tried to put myself in your shoes and thought about what I would need to see to understand the performance of my investment. I hope I have done this in a fashion that neither trumpets my successes nor hides my warts.*

*You will find this report includes:*

- 1. A general discussion of the issues affecting the Trust.*
- 2. A specific discussion of the Trust including:*
  - i. a review of pre-fee returns to show you how the portfolio performed.*
  - ii. a reconciliation of pre-fee returns to your return to allow you to understand the expenses you paid and thus how the fund return became your return.*
- 3. The Statement of Net Assets and Schedule of Investments for the Trust.*

*This report will not include a detailed discussion of our holdings. I have no intention of trying to sell you on each holding of ours. While the enclosed Schedules of Investments list the majority of our holdings, I believe a discussion of each not only has the potential to make me look quite foolish but also would not be in our best interests as partners. I do assume on these matters you trust my judgment and will hold me accountable each year for the collective performance of these individual decisions.*

*Finally, I work for you. If you believe there are items or issues I have not discussed but you would like to see covered, please let me know*

*Having said all of this, our lawyers and accountants say we need a disclaimer so here it is:*

### **Warning label**

First and foremost, I caution you that all figures are my estimates. Secondly, I want to stress that all figures in the body of my report are unaudited. Audited Financial Statements have been sent separately to all partners. Finally, some of my comments could be considered predictions. While my statements are made with the best of intentions, history has shown I am often quite wrong.



*"We used to be an investment club. Now we're a support group."*

## **To my Partners:**

We are in an extraordinary period and I have certainly done extraordinarily poorly. I owe you an explanation and it will follow in the next couple of pages. As I have said in the past, I have virtually all of my personal investments in the Trust. I eat my own cooking and am your partner, not a disinterested fund manager.

I do not want to suggest that all is doom and gloom. I will spend part of this letter talking about what we own. Hopefully by the end you will share my enthusiasm for the future although I do acknowledge I have a lot to do to earn back your trust.

## **What is the world is going on out there**

There has been a lot of discussion in the press about the economy. The financial system seized up in the fall. The thaw will take some time. Traditionally banks have moved through periods like this by generating significant net interest income. This allowed them over time to absorb loan losses and repair their balance sheets. Funding difficulties in the fall delayed this process as everyone was competing for deposits. Interest margin is now returning and spreads are widening.

The news flow will be volatile, meaning some days the news will be positive and people will be enthusiastic; some days it will be negative and people will be pessimistic. This range of emotions should continue to give us stuff to do as people may be more focused on the next move rather than the underlying value of a company. My focus is whether we have a margin of safety in our specific investments. I call this “bird in hand” investing. I comfortable operating in this type of environment and would hope our returns will reflect this.

## **Where are we now**

I want to start off talking about where we are. I am not trying to minimize last year’s performance but rather want to let you know what I see at this moment.

Our portfolio at 31Mar2009 looks approximately as follows:

Glacier Media	15% of net assets
Indigo Books	14%
EGI Financial	8%
Timberwest (units & debentures)	8%
Sotheby’s	7%
Rainmaker Entertainment	7%
7 other Cdn holdings	17%
7 other US holdings	9%
Cash and net working capital	15%

I know I don't usually discuss in detail what we own. I am excited about our holdings but my lawyers always want a disclaimer from me. My disclaimer is: the Trust owns these holdings so clearly I believe in them. Having said that, if you decided to invest directly in any of these, please do your own work!

These are our top holdings and why I like them:

<i>Company</i>	<i>Business</i>	<i>Margin of safety</i>	<i>Owners or managers</i>	<i>Tim's comments</i>
Glacier Media 31Mar09 price: \$1.81	Community papers, agricultural publications	<ul style="list-style-type: none"> <li>• Presence – revenue of \$250M</li> <li>• Debt about 2.2x EBITA</li> </ul>	Owners - insiders own 33% of Glacier and company has been repurchasing shares	Glacier trades about 6x 2008 net income. Its business generates significant free cashflow and has modest debt.
Indigo Books 31Mar09 price: \$11	Cdn retailer of books and gifts	<ul style="list-style-type: none"> <li>• Presence</li> <li>• Location of stores</li> <li>• Scale</li> <li>• \$100M net cash</li> </ul>	Owners – insiders own about 70% of Indigo and Indigo repurchased shares in the fall	Indigo has over \$100M in net cash or about \$4 per share. This suggests it's current stock price is less than 5x earnings.
EGI Financial 31Mar09 price: \$7	Non-standard insurance	<ul style="list-style-type: none"> <li>• Strong balance sheet</li> <li>• Management</li> <li>• No majority owner</li> </ul>	Owners and an issuer bid was put in place in Dec2008	Book value exceeds \$10. I have a lot of respect for the management team.
Timberwest Forest 31Mar09 price: \$2.93	Freehold timberland of 796,000 acres on Vancouver Island	<ul style="list-style-type: none"> <li>• Presence – large timber holdings</li> <li>• Bank debt of less than 10% of estimated net asset value</li> <li>• No majority owner</li> </ul>	Managers with limited recent insider purchases	We own both debt and units of Timberwest. On a NAV basis, Timberwest's bank debt is less than 10% of NAV. My estimate of NAV substantially exceeds the current price.
Sotheby's 31Mar09 price: \$9	Auctions fine art, antiques & collectibles	<ul style="list-style-type: none"> <li>• Presence – 50% of high end art market</li> <li>• Substantial hidden real estate value</li> <li>• No majority owner</li> </ul>	Managers although numerous recent insider purchases	I estimate the value of Sotheby's working capital plus its offices in NYC and London less all net debt substantially exceeded our purchase price of \$7.60. We got the business for free.
Rainmaker 31Mar09 price: \$0.80	Animation	<ul style="list-style-type: none"> <li>• Technology</li> <li>• No majority owner</li> </ul>	Managers with owners on board	I am Chairman of Rainmaker so I will not make any comment.

We did make a number of changes in the Trust over the last year or so, including disposing of a significant portion of our investment in Sun-Rype Products and a portion of our investment in Newfoundland Capital (we sold the balance of our Newfoundland Capital shares in early 2009).

In the first quarter of 2009, we roughly doubled our investment in Timberwest by participating in a convertible debt rights issue. In addition, we substantially increased our investment in Sotheby's. Both are what I would term "trophy type" properties. I think our cost is significantly below their intrinsic value.

Recently, our cash position rose modestly as we disposed of a number of securities including GMP Capital, Canaccord Capital and McGraw Hill. I am still finding a number of interesting

investments. For example, as I write this we are buying shares of a service company for less than the value of its cash and investments so we are paying less than zero for its business. In addition, we have been looking at debt of distressed companies. At the moment, we do not own any distressed debt but this is not for want of trying. It is a good time to be a value investor.

### **Our return for 2008 – Series B units**

For the Trust, our return for the 12 months ending 31Dec2008 after all fees and expenses was negative 48.8%. By comparison, the S&P/TSX Composite Total Return Index (including dividends) for this same period was negative 33.0%.

### **What happened, Tim?**

No excuses; it was a bad year. To illustrate our performance, I have expressed the details as a percentage of our 2008 opening Series B net asset value. I should caution you that these figures are my estimates and are unaudited.

Returns from Investments	-47.6%
Operating expenses	-0.2%
Taxes paid	0%
	-----
Return pre-management and pre-incentive fee	-47.8%
Management fee	-1.0%
Incentive fee	0%
GST (tax) on fees	0%
	-----
Net return to you	-48.8%

Breaking down our Returns from Investments further, I estimate the impact from various investments as follows:

Glacier Media	-8.9%
Citadel Broadcasting	-7.0%
Rainmaker Entertainment	-6.2%
Canwest	-4.4%
Friedman, Billings, Ramsey Group (FBR)	-4.3%
EGI Financial	-2.6%
Maple Leaf Foods	-2.4%
Village Farms	-1.8%
Newfoundland Capital	-1.8%
Other securities	-6.5%
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Return from securities	-45.9%
Impact of currency hedging	-1.7%
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Return from investments	-47.6%

I was reasonably pleased going into 2008 as we had avoided the areas of foolishness. We had not invested at silly prices in oil stocks or commodity companies and we had not chased financial stocks. It is therefore disappointing that we experienced such poor results in 2008.

The volatility of a number of our holdings such as Glacier Media, EGI Financial, FBR, and Village Farms frankly surprised me. I believe the BMO Nesbitt Burns Canadian Small Cap Index had a decline of some 46.6% in 2008 however I would have thought we would have done substantially better. Nevertheless, I do believe the decline in our prices was much more significant than the change in underlying value. In other words, over the last year, our margin of safety has increased.

Citadel and Canwest were errors in judgment as both had significant debt levels. While I still believe Citadel had merit initially, I made two significant mistakes: one, I bought too large a position and two, when things did not proceed as planned, I should have reduced our position. Both of these represent monies lost.

I scaled back on our currency hedging earlier in the year. While our results do show a modest loss on forwards, we would have had an underlying gain in the securities themselves. In other words, I use forwards to reduce currency exposure and not to take it. At this time, our USD investments are completely hedged back into Canadian dollars. This is our standard position.

We of course experienced some redemptions in 2008 however this activity did not cause us any difficulty. More importantly, I appreciated the number of positive comments I received from our partners. Thank you for your support and your trust.

## **Recent developments**

The vast majority of partners of the former LP are now owners of the Trust. We hope to clean up the tag ends over the next 6 months or so. This “merger” process, in retrospect, was extremely costly to me personally and probably unnecessary. You will be pleased to know I don’t plan to discuss this again in the future!

You may recall for the majority of our history I have operated the Trust “on the side” while I acted as a portfolio manager for Mackenzie Financial via Cundill. This worked well for us as it allowed the Trust to operate not as a capital raising “tool” but with a sole focus on performance.

I am going back to this model. The Trust is open and available for investment. I have decided, however, to get out of the marketing game and have entered into an arrangement with Mackenzie Financial to sub-advise one of their funds. This will allow the small retail investor to invest with Mackenzie and leave the Trust to those of you who are interested in joining me directly. I once again view the Trust as essentially my personal account and I would hope this will result in returns similar to those of its early days.

In March 2009, we parted ways with Geoff Castle. Geoff is very bright and I wish him the best in his future endeavours.

## **Personal investments**

As mentioned, I am not a pimp but your partner. My money is along side your money. In each of the last 4 months, I have, either directly or indirectly, added to my position in the Trust.

My primary assets are my investments in the Trust, my ownership of McElvaine Investment Management Ltd., any bank balance I may have, and my house. Outside of these, I own one Berkshire Hathaway B share (which allows me to attend the annual meeting) and some Rainmaker Entertainment shares (as a director, I feel I should own shares). My net worth is very much tied to how the Trust performs. In other words, your returns are my returns.

As discussed in the past, I believe our structure results in me making money when you make money and in me losing money when you lose money. I think our interests are aligned.

## **Acknowledgements**

When people ask me what things I have done right in business over the years, my first and only answer is hiring good people. Thank you, Kim and Diann.

As I have mentioned in the past, I am blessed to be doing something I enjoy for people I like and respect. Given the number of investment alternatives available in the market place, I consider myself very fortunate to have your trust. Thank you.

Tim McElvaine  
April 4, 2009

**Appendix ‘A’**  
**2000 Annual Report**  
**From the Toad Stool**

I want to talk for a second on certainty (or confidence level) and investing. I think this is especially important given our large holdings in several companies. As I get older in this business, I value certainty more and more. Let me clarify what I mean. I am not referring to a prediction of what is going to happen to the stock price. I am referring to certainty over the items I focus on. As discussed in the past, these are:

1. What I think the company is worth  
This is always a guess at a broad range. It does not depend solely on assets on hand.
2. How volatile I think this rough estimate of worth is  
This is a stress test of item 1. I think about the story of the three little pigs. The grass house and the stick house, from the perspective of a pig hoping for longevity, are much more “volatile” structures than the brick house.
3. Do I think management and the board are working for or against us.

Let’s take an example: Loewen Group. We purchased the senior bonds of this bankrupt funeral home business around 50 cents per \$1 face of bond. I am confident Loewen is a reasonable business that is worth more than we effectively paid via the bonds. I am comfortable with the proposed new structure of the balance sheet and of the business. I am positive Paul Houston and John Lacey will operate in a conservative and honest fashion both with us and with their customers. In other words, I am certain we have a margin of safety.

You will note I said nothing about return. I have no idea what the price will do. Certainty with me is not about price fluctuations, it is about the business and the Board. I do recognize there will be unexpected events. Further, there will be many occasions where I misjudge the risks. I do think, on average, we will do better focusing on those situations where we can be certain about the controllable factors.

## Appendix 'B'

### Tim's letter in the marketing package

#### Dear Potential Partner:


In this package, Kim, Diann and I have tried to provide all the information you require to make an informed decision. It is not an exciting package to read and we apologize in advance for that.

McElvaine Investment Management Ltd. is the Investment Counsel for two funds: The McElvaine Investment Trust (the "Trust") and a Mackenzie Financial fund. Please refer to Mackenzie's website for information on their fund.

This package deals with "our stuff" or, in other words, The McElvaine Investment Trust. The best place to start is how we view our relationship:

1. We view you as a partner regardless of the technical relationship. You contribute capital and I contribute investment advice.
2. The Trust is not a product and you are not our customers. We are not trying to "sell" you anything. We do not have a marketing department and a PR agency does not review our correspondence. We will be honest with you and will try to provide the information necessary for you to assess whether we are keeping up our side of the bargain.
3. As a partner, we ask you to be cognizant of your other partners. A partner who comes in for a "flip" does no one any favours (especially as it may be a flop). If you are not comfortable with what you read, please do not join us. I would hate for you to spend your time worrying about what I am up to.
4. We suggest the Trust be only a part of your investment portfolio. We do not expect the Trust to be a fund for all seasons. Quite often, in the past, I have been doing the rumba while the market is doing the waltz. It is not a pretty sight. During those periods, we do not ask that you enjoy the show but that you be patient.
5. In the words of Sonny & Cher, "you got me babe". What that means is the Trust is not managed by a committee; they are managed by me. Our money is invested in the Trust and my name is on the door. The good news and the bad news is you got me!
6. If you have any questions, please call or email. I am always delighted to talk with my partners. As stated in our 1998 Annual Report, I have been asked if it wouldn't be easier on the nerves to manage the money of people I didn't know. My response was and is simply that I prefer to be working for people I like and trust. This is an important aspect to me of having my own fund.
7. Please carefully read the Offering Memorandum. Pay particular attention to the *Risk Factors* section. It is important you understand what the fund is about before you invest.

I appreciate your interest.



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