January 25, 2010

Dear clients and friends:

**Re: LCM Annual Letter December 31, 2009**

It is a pleasure to be writing the second annual letter for Lewin Capital Management Ltd. In this year's letter I will talk about what LCM did in 2009, review our results, and discuss the role of economic forecasting in LCM's investment process.

Year in Review

This year was certainly a dramatic contrast to 2008. After last year's collapse, the market regained some of its losses and generally it was a lot easier to make money. LCM was able to identify several high-quality opportunities and put capital to work at attractive levels throughout the year.

2009 was a productive year for research. After examining many companies on a cursory level, LCM completed a thorough analysis of forty-five prospective ideas, including interviews with the senior management of over twenty companies. We ended the year with a number of good investments. With the exception of our one position that is in the process of being taken over, the investments we have made to date should translate into attractive risk-adjusted returns over the next several years.

LCM continues to follow a conservative, concentrated and disciplined approach, and the bulk of our energy in 2010 will again be directed toward the research and investing side of the business.

Results*

For the 2009 calendar year, we earned a return of 16.6%. This is a decent level of risk-adjusted absolute return, but lagged the market averages. The same patient and disciplined approach that kept us from losing money in 2008 held us back in 2009. Many of the best performing stocks in 2009 involved situations where the potential for incurring a permanent capital loss was very real. Above all, our focus continues to be to protect and grow your capital. LCM finished the year with a large cash position, which was a drag on returns as the invested portion of the portfolio was up 28.7%, not including dividends, in calendar 2009. This cash position is not an explicit call on the market, but rather a direct result of our disciplined and rigorous approach to investing capital. We expect to put more of our cash balance to work over time as we find opportunities that satisfy our criteria.

LCM has earned a cumulative total return of 20.5% since it was founded in 2008. This compares with losses of -14.6% and -6.7% for the Canadian and U.S. stock markets over that same period. Relative to a simple average of the Canadian and U.S. stock markets, LCM has earned 31.1% more than the market since inception. Our long term target is to earn an absolute return in excess of 7% per year on average, and in spite of the decline in the market since we started, we have achieved that goal.

The types of investments LCM has made range from out-of-favour cyclical companies purchased at fractions of book value to large global companies with dominant brands purchased at double-digit free cash flow yields. To date, roughly one-third of our ideas are based in the U.S., and two-thirds have originated in Canada, although this mix will shift around as it is not by design but rather a function of where LCM identifies opportunity. LCM has applied a higher hurdle rate to our U.S. investments to account for the uncertainty in the currency, but this has generally not limited our search. All of our positions have sound balance sheets and strong business models.

The Role of Economic Forecasting in LCM's Investment Process

Given the tumultuous events of the past two years, the economy is at the forefront of many clients' minds and thus it is worthwhile to discuss how the economy fits into LCM's investment process.

The role of economic forecasting in investing is often misunderstood. There is a belief that has been propagated by the investment industry that the best investors know what is going to happen next in the economy and they weave and bob around correctly anticipating the next corresponding move in the stock or bond market. Though this is a widely held view that makes for good press, predicting the economy is not a prerequisite for making money in the market.

There are two skills required in a successful investment process: 1) the ability to value a business, and 2) the ability to identify quality. In this letter, I will focus on the first factor. The ability to value a business is what makes investors money, and predicting the next move in the economy has surprisingly little to do with the valuation of businesses. Valuing a business requires some basic economic assumptions, yes, but typically it is what is assumed for the long term, not the next year or two, which has a bearing on what a business is worth. Understanding a company's business model and allocation of free cash flow are far more important. Below are three examples where relying on economic forecasting would have led an investor down the wrong path.

The first example applies to the economic situation that followed the tech bubble in early 2000. A few years ago, I had a conversation with a large east-coast investor who complained that he had called the economy perfectly, yet had not made a dime. His correct prediction was that the economy would slow after the tech bubble burst. This prediction led him to avoid economically sensitive "low-tech" stocks such as railroads and mines, as he incorrectly assumed a slowing economy would cause these stocks to decline. The investor did not make money because "low tech" stocks were precisely the right stocks to be buying at that time – in the wake of the new economy they were so cheap that their valuation trumped the slowing economy.

The second example relates to the steel industry in 2002. After two decades of declining steel prices and miserable returns on capital, most investors hated the sector and could list numerous reasons for never buying shares in a steel company. This pessimism created a situation where the lowest-cost producers with modern efficient plants and decent

balance sheets were selling for fractions of book value. In that instance, it did not matter what was occurring in the economy – valuations were so compelling that any economic scenario short of Armageddon would have earned you money.

The third example is more recent. During the financial crisis last year a prominent concern amongst economists was whether the economy was headed into a period of high inflation, or alternatively, whether a Japan-like deflationary spiral was about to sweep over the world. In the face of such a wide dispersion of outcomes, this might seem like an instance where making the correct economic forecast would be a necessary component for investment success. However, we purchased shares in a business this spring with stable revenues and dominant global brands valued at a 12.5% prospective free cash flow yield (our calculations). If an investor paid $100 for the whole company, after subtracting all of the relevant costs from revenues such as production costs, wages, marketing, interest and taxes and ensuring the plant was properly maintained, there would be $12.50 left over to take home every year in perpetuity. Given the pricing power inherent in their business model we viewed this as a 12.5% real (inflation adjusted) yield – i.e. any future inflationary cost pressures will be eventually passed on through higher prices. Due to the valuation and the quality of the business model, this investment was compelling in either scenario. If investors swing back toward deflation and the mindset that 4 to 5% is a decent rate of real return at some point in the next few years, we will make 2.5X to 3X on our investment. On the other hand, if inflation does indeed take hold, it will be a bumpy ride for all investments but over time we will likely earn 12.5% per year above inflation, which is also exceptional.

These are just three of the many examples we could cite illustrating why economic forecasting should take a backseat to valuation in a successful investment process. Investors should be looking for investments that will succeed regardless of what happens in the economy over the short-run. Ben Graham called this a “margin of safety.” If an investment thesis requires a precise short-term forecast of some economic variable, it is probably more of a gamble than a great idea.

Thanks to our early investors

Fees for investment management should be both fair and transparent, and should incentivize the correct behavior from your manager. A profit-sharing fee is a critical mechanism to incent your manager not to grow too big and sacrifice risk-adjusted returns in exchange for the fees for managing more dollars. If you accept the premise that good ideas are rare, and certainly the quantity of the best ideas available at the best prices is limited, then you get a bigger helping of them when you hire a smaller manager. That being said, LCM wishes to thank its early investors and waive the profit-sharing fees for all clients for calendar 2009 (these would have been included in your invoices in January 2010). We are thankful for your trust and appreciate your business.

What can clients expect going forward?

Clients can continue to expect that the level of due diligence and sophistication of our analysis is among the highest in the business. With a short list of investments, clients should expect nothing less. Our “narrow and deep” approach inevitably means that we

will not always own what is "hot" and, indeed, sometimes it may appear that the action is passing us by. Furthermore, to reiterate what we said last year, it is not realistic to expect that we will generate a positive return in all periods. What is most likely is that by following a concentrated approach, on an annual basis the results of LCM will look nothing like the market. None of these thoughts bother us. Although we expect that our performance will be different from the market from year to year, we anticipate generating returns in excess of 7% annually over the long term. With a bit of insight and some patience, the returns from exploiting opportunities using a concentrated approach will enable us to achieve our goals.

I wish you all the best in 2010. If you have any questions, please contact me at 604-868-4390.

Sincerely,

Daniel Lewin CFA
President

P.S. We now have a website - if you have a moment please check it out: www.lewincapital.com

[*] All stated returns are gross of fees. "Since inception" refers to the period from June 30, 2008 to December 31, 2009. The S&P TSX Composite Total Return Index is used to represent the Canadian stock market returns, and S&P 500 Total Return Index translated into Canadian dollars is used for the U.S. stock market returns. Returns for LCM are from a representative account as all client assets are held on a segregated basis. Small differences will occur between accounts due to rounding and the timing of cash flows. Please find attached the spreadsheet outlining the exact performance for your segregated account.