



September 14, 2009

Dear Partners and Friends:

August was a month that saw a significant divergence between the performance of the Northern Rivers Innovation Fund LP (the Innovation Fund) versus the Northern Rivers Innovation RSP Fund (RSP Fund): the Innovation Fund was down 8.33%, while the RSP Fund was up 1.94%.

	Average Annual Returns to August 31, 2009*							
	2009 YTD	1 mo.	3 mo.	6 mo.	1 Yr.	3 Yr.	5 Yr.	Inception**
Northern Rivers Innovation Fund LP	16.04%	-8.33%	0.62%	22.93%	-48.44%	-18.84%	0.47%	10.03%
Northern Rivers Innovation RSP Fund	23.07%	1.94%	7.49%	35.21%	-41.79%	-15.57%	1.02%	-1.37%

**Northern Rivers Innovation Fund LP inception date: May 8, 2001.
Northern Rivers Innovation RSP Fund inception date: March 1, 2004.

The divergence is explained by the disparity in position concentration between the two funds and the difference in level of diversification between the two funds: 1) positions in the RSP Fund are not allowed to be more than 10% of the market weight of the Fund; 2) the weights of Neptune and Webtech in the Innovation Fund are more than double their weights in the RSP Fund, and 3) NTB and WEW were down 16% and 21%, respectively, in August.

It should be noted that the performance of NTB was not out of line with what one might expect of a stock consolidating a move into the \$2 to \$3 range from a 52-week low of \$0.37. I view what has happened to the price of WEW since the announcement of the acquisition of Grey Island as (*extreme*) short-term pain for mid- and long-term gain—a gain that should start manifesting itself about a month from now, after October 15, when the Grey Island shareholders are expected to approve the transaction.

It should also be noted that if WEW and NTB perform as I expect they will between now and year-end, the Innovation Fund should end up posting a stronger 2009 than the RSP Fund (although the RSP Fund will have had a good 2009, too). To illustrate, allow me to share the following thought experiment: what would happen to the total market values of the LP and RSP funds if WEW and NTB end the year where I expect they will, *all else being equal*? The answer is quite startling: the total market value of the Innovation Fund will have increased by more than 40% from current levels, while the total market value of the RSP Fund will have increased by about 16%¹.

¹ These figures are derived using September 8, 2009 closing prices as the starting point, and \$2.50 for WEW and \$4.00 for NTB as the year-end prices.

If the Grey Island acquisition is so good for Webtech, why has the stock been so badly hurt?

In my last letter, I wrote of the many positives of the acquisition. A few bear repeating here:

- 1) When one applies the metrics provided on the conference call from Friday, August 7, and in their post-deal investor power point, one arrives at a three-year annualized growth rate of over 40% for newco, and 2010 adjusted EPS in the 12¢ to 15¢ range.
- 2) With WEW now trading in the \$1.00 to \$1.10 range, the P/E on estimated 2010 earnings is now in the 7x to 9x range. For a company growing at over 40% organically, that gives a PEG ratio (popularized by Peter Lynch) of less than a quarter (which is unusually low, and therefore, unusually attractive).
- 3) The combined entity will have about \$2 million per month in recurring revenue, or \$24 million annually. (The company becomes breakeven on a cash flow basis from recurring revenue *alone* when recurring revenue hits \$2.3 million per month.)
- 4) The transaction essentially doubles the size of Webtech's revenues on a trailing basis, and is accretive to WEW's EPS, CFPS, RevPS and cash/share from day one.²
- 5) The combined entity will have about 75,000 telematics subscribers from day one, with a total of 67,000 monthly pay subscribers, plus 8,000 enterprise subs with FedEx which pay fees annually. Once Webtech signs the next (and much larger) division of FedEx, it should cement the combined entity's position in the top twenty (maybe even top ten) of *full-service* telematics providers on a global basis.
- 6) Management is sticking with guidance for over 40% per year annual revenue growth; this was their guidance from before the deal was announced, and is now their forecast for after the deal closes. (Actually, running the numbers from the power point shows 45% growth.)
- 7) Grey Island's \$12 million in cash and equivalents as of March 31, 2009, strengthens an already solid Webtech balance sheet.
- 8) This transaction should prove to be a catalyst to get US brokerage firms and institutions involved with the stock.

And yet the stock has fallen from a pre-announcement close of \$1.46 to a close of \$1.03 from this past Friday, for a total decline of almost 30%. How could that have happened if this acquisition is as good for Webtech as I believe?

There are two primary reasons for the stock's fall:

- 1) The stock took an extra hit (after originally falling from the \$1.40 to \$1.50 range, to the \$1.20 to \$1.30 range) when an adjustment to the "exchange ratio" was announced in favour of Grey Island. Therefore, Webtech shareholders go from owning about 69% of the combined entity to about 66% of the combined entity. Although this would not seem to merit another twenty cents being taken off WEW, the math of the arbitrage simply resulted in a further hit to WEW.
- 2) The stocks of acquiring companies in M&A deals almost always fall—even when the deal is clearly accretive! To illustrate this point, on the next page, I will take readers through what happened to the stock of SXC Health Solutions (SXC on the TSX) after SXC announced their deal to acquire National Medical Health Card (NMHC on NASDAQ).

² If one does the math as if the entities were combined starting January 1, 2009.

What happened to SXC in the 18 months after the company announced the acquisition of NMHC may provide a useful road-map for Webtech's stock

The stock closed at \$15.90 the day before the NMHC acquisition was announced. Within three days of announcing the deal, the stock had fallen to \$13.46, representing a decline of over 15%. The stock eventually bottomed closer to \$11 (representing a total decline of about 30%), but then started a climb back up toward the upper \$13 range, as the closing date for the deal approached. On the day before the closing was announced, the stock closed at \$13.87, and it proceeded to jump by almost 25% (to \$17.26) in the week after the deal closed. Sixteen months after the deal closed, SXC closed at \$44.76, giving SXC a four-fold rise off its bottom; a significant portion of that four-fold increase can be attributed to synergies of the acquisition.

The initial declines in SXC occurred *despite* the fact that the acquisition was *clearly* accretive: both companies were profitable before the acquisition, and cost synergies were easily demonstrable, and *still* SXC declined substantially in the month after the deal was announced. One of the points of this exercise is to stress that what happened to SXC (and now WEW) is (unfortunately) *normal, and not a sign of a bad merger*. The stock of the acquiring company *normally* declines 10%-30% after the acquisition is announced, as hedge funds short the stock of the acquirer and buy the stock of the company being acquired. It should also be noted that the stock of the acquirer always “pops” after the acquisition closes, as the stock is “released from the trap” of the arbitrage trade. In Webtech's case, the transaction is scheduled to close shortly after the Grey Island shareholder vote on October 15, 2009, so the day of Webtech's “pop” is getting closer.

If the SXC roadmap continues to play out for WEW (as it has so far, with both SXC and WEW declining about 30% in the month after their respective acquisitions were announced), what does this suggest about the performance of WEW going forward from here? If acquiring Grey Island is as good for Webtech as the acquisition of NMHC was for SXC, then last week's close of \$1.03 should be pretty close to a bottom for the stock, and the stock should be able to start inching back up toward \$1.20 as the Grey Island shareholder vote on October 15, 2009 approaches. If WEW reacts to a successful closing of the deal in the way that SXC reacted to the successful closing of its deal, then WEW should hit the \$1.50 area within a week of the closing of the deal; and, if WEW is able to match SXC's post-deal performance, we should see WEW in the \$4 to \$5 range within 16 months of the closing of the deal. WEW in the \$4 to \$5 range fits nicely with my expectations.³

The most important take-away is that this acquisition *is* a positive for Webtech, (with many benefits to be realized over the next eighteen months) but that the stock is essentially trapped in an arbitrage until the deal closes. That is, the stock will be released from the captivity of the arbitrage shortly after October 15, just over one month from now. At that point, the stock should pop nicely

³ In the last letter, I wrote: “If Webtech can announce the next FedEx divisional win before the Grey Island acquisition closes (as I expect), and if a US brokerage firm partners with Webtech this fall (as I expect), then I would not be surprised to see WEW trading on high volume in the \$2.50 to \$3.50 range by the end of October, with much higher prices ahead as the company realizes on the business, cost and capital markets synergies of the acquisition over the coming eighteen months.” The damage caused by the adjustment of the exchange ratio (both in terms of time lost and in terms of psychological damage to the market for WEW) probably means that a new, more reasonable expectation would be the \$2 to \$3 range by the end of November 2009.

as it goes back to reflecting fundamentals, and the stock should once again be able to react very positively to events such as the announcement of a win with the second (and much larger) division of FedEx.

Next month, I will begin reviewing the fundamentals of stocks in the portfolio that have not been discussed in a while

I am not particularly happy with having to devote another letter discussing the Webtech-Grey Island merger, but the nature of the events which have unfolded simply demanded it. I look forward to discussing the implications of the many positive developments which have occurred at Aeromechanical recently, and I look forward to digging back in to Vendtek, as we near the time that that stock will resume trading.

Thank you again for your patience and trust. I am working hard to catalyze the value that I believe is being created by the companies in these portfolios, and I believe that the fruits of some of this hard work will begin to be reflected over the coming months.

Best regards,

A handwritten signature in black ink, appearing to read "Hugh Cleland". The signature is fluid and cursive, with a large initial "H" and "C".

Hugh Cleland, CFA
Portfolio Manager

*Commissions, trailing commissions, management fees, performance fees and expenses all may be associated with investment funds. Please read the offering memorandum before investing. The indicated rates of return are the simple returns (YTD, 1 mo, 3 mo, 6 mo) or the historical annual compounded total returns (1 yr, 3 yr, 5 yr, and since inception). All returns are net of fees but do not take into account sales, redemption, distribution or optional charges or income taxes payable by any security holder that would have reduced returns. Investment funds are not guaranteed, their values change frequently and past performance may not be repeated. Commencing January 1, 2009, performance fees of 10% of net return above hurdle rate were paid by the Partnership. The Fund invests primarily in North American equities with a sector focus on technology, healthcare and resources. Geographic and sector allocations may, however, vary significantly over time. Investments made are primarily in small cap companies believed to be trading at a discount to their intrinsic value and which offer innovative products and services and a sustainable competitive advantage. The Fund normally follows a more concentrated investment approach where the manager may overweight selected core holdings and industry sectors in which the manager has particular conviction and/or specialized expertise. The Fund may engage in short selling and may also use specified derivatives, such as calls and puts, warrants, index futures and exchange traded funds. In addition, the Fund is permitted to hold private entities that are not included on any public markets or indices. This may result in portfolio weightings and investment performance being substantially different from that of the S&P/TSX Composite, TSX Venture, Dow Jones Industrial or other market indices.