



March 16, 2009

Dear Partners and Friends:

February and the first nine days of March saw new bear market lows for most global equity indices, as new economic data suggested that we are in the midst of the worst U.S. and global recession since World War II. The only major index to hold at or above its November 20, 2008, low (which was the date of the “old lows” for this bear market) was the NASDAQ100.

In the midst of this economic and market ugliness, I continue to be pleased with the way the *business fundamentals* are playing out for our core positions, and have been happy with the way some (but not all) of the stocks have been behaving so far this year. For example, even as global equity indices plumb new lows, Neptune has been hitting new recovery highs (and is now up 148.6% from its multi-year low of November 21, 2008), and Aeromechanical Services (with the help of a major fundamental development announced last week) is now up about 76% from its 52-week low.

Despite this, some of our stocks *have* been succumbing to the relentless beating of the overall market, and both the Northern Rivers Innovation Fund LP (“Innovation Fund”) and the Northern Rivers Innovation RSP Fund (“RSP Fund”) followed the market into negative territory, as seen below in the ‘1 month’ column.

	Average Annual Returns to February 28, 2009*							
	2009 YTD	1 mo.	3 mo.	6 mo.	1 yr.	3 yr.	5 yr.	Inception**
Northern Rivers Innovation Fund LP	-6.55%	-7.69%	-19.31%	-58.06%	-65.55%	-18.42%	-5.85%	7.83%
Northern Rivers Innovation RSP Fund	-8.98%	-7.58%	-20.01%	-56.95%	-65.69%	-18.10%	-7.27%	-7.27%

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

More on the market backdrop, and notable changes in the stance of some long-time bears

When the major indices hit their new bear market lows on March 9, 2009 the S&P500, NASDAQ and S&P/TSX were down (year-to-date in 2009) -26.2%, -19.8% and -16.8% respectively. The peak-to-trough numbers are at historic levels. For example, quoting Jonathan Chevreau in the March 14 edition of the National Post, “As of early March, the S&P500 index was down 61.4% peak to trough (adjusting for inflation). That compares to a 62.6% fall between 1969 and 1982. Before that? You guessed it: 79% after the Crash of 1929.”

Putting an exclamation point on these stunning figures, U.S. stocks (as measured by the Dow Jones Industrial Average) hit a new twelve-year low on March 9. This is a very unusual

occurrence: according to Thomas Lee of JP Morgan, 12-year lows have only been set twice before in the history of the Dow Jones Industrial Average: in April of 1932 and December of 1974. Perhaps importantly: the 12-year lows in April of 1932 were three months before the ultimate low of the Great Depression's bear market; and the 12-year lows in December 1974 corresponded precisely with the low point of the 1973-74 bear market. It would certainly be welcome if the 12-year lows seen in February and March of 2009 are similarly close to the ultimate low of *this* bear market.

Encouragingly, a few former bears have recently reversed their gloomy stances on equities. One of the most surprising changes came from Bill Fleckenstein, who ran a "bear fund" for thirteen years before closing it late last year, because he believes it is now "too dangerous" to bet on further significant losses in the equity markets.

Jeremy Grantham—long known as a perma-bear in financial circles because of his formerly grim outlook on stocks that stemmed back to 1999—also made a similar change in his long-term outlook. Last week in his most recent letter to his investors, he urged investors to start moving money from cash into stocks. He is making this recommendation despite the fact that he reiterates that his base case continues to be that the S&P500 will ultimately hit 600 before this bear market is finally over. "Remember that you will never catch the low", and so make the shift from cash to stocks in "a few large steps", instead of all at once, he urged in his letter.

Another shift from bear to bull was made by Steve Leuthold who manages \$3.2 billion out of Minneapolis. After scoring a large positive return in his "Grizzly Short Fund" in 2008, he has now actually asked investors to stop buying that fund because he expects the bottom has either been put in, or is not far off. He strongly believes that now is the time to buy equities because investors have become far too pessimistic about the economy. In a television interview, he said something that was quite refreshing to hear, given the relentless stream of comparisons we now hear about today versus the Great Depression: "These comparisons people make with the Great Depression are totally out of touch with reality, and pretty stupid. We've been in much worse, much more panicked and more scary situations in the U.S." Of course, we will eventually know with perfect hindsight who is right—the Depression-istes or investors like Mr. Leuthold. Although in my last letter I made it clear I believe comparisons with the Great Depression are far overdone and very likely inappropriate, I am also not prepared to be as unequivocal in my views, given how wrong I got the macro backdrop in 2007 and 2008.

The remainder of this letter will focus on a number of significant business developments in three of our core positions. I will resume next month with the in depth review of our core holdings, specifically the investment hypothesis behind our position in Neptune.

Aeromechanical Services (AMA) has seen two company-transforming developments recently
I) The most important is probably the deal announced on March 4 with Sierra Nevada Corporation (SNC). SNC is an outsource-manufacturer for the military and aerospace verticals, with revenues in the billions of dollars, and a globally respected franchise in these areas. There are three main aspects to the deal. SNC will:

- 1) pay AMA an upfront license fee and a royalty on all future sales of afirs™ Uptime™¹ technology and products SNC sells into the global military market, for the manufacturing license and for the sales and marketing rights;
- 2) contribute funds, personnel and expertise to the design of AMA's future afirs™ airborne technologies;
- 3) share other revenue opportunities with AMA resulting from SNC's sales of afirs™ to military organizations.

The significance of this deal is difficult to overestimate:

First, it gives AMA an immediate cash infusion which solves working capital problems which could have developed over the next six months in the absence of this deal.

Second, it solves two LONGER-TERM working capital issues that AMA has struggled with, namely i) the deal obviates the need for AMA to tie up working capital in inventory, and ii) the deal greatly reduces AMA's research and development ("R&D") expenses, because SNC will be sharing their personnel, expertise and technical resources with AMA for R&D going forward.

Third, SNC becomes a powerful channel for sales, specifically into the global military market, a market that AMA had only just begun to penetrate.

Fourth, SNC is very excited about the opportunity to sell AMA's fuel management program, as evidenced by this quotation from Greg Cox, Corporate Vice President of SNC from the March 4 press release: "We believe that the afirs™ Uptime system can bring high value to our military customers in terms of operational control, readiness improvement, maintenance planning and Operational and Support (O&S) cost savings. We anticipate that the recently introduced fuel savings capabilities of AMS' products should be of great interest to military organizations facing unprecedented demands and cost pressures."

II) AMA's recently introduced fuel management program (mentioned above): I recently attended a seminar about this program that was given by AMA for existing and prospective customers. I came away very impressed by many aspects of the program, including:

- 1) Most importantly, AMA had a reference customer there attesting to a powerful ROI for airlines considering this program: even at today's fuel prices, the savings range from \$50-\$200/flight-hour, on 3,000-4,500 flight-hours/year/plane. This yields a savings of \$150,000 to \$900,000/year/plane. (Note: Jacques Kavafian, Research Capital's aerospace analyst who was also at the seminar, stated that an airline CEO cannot ignore any program that saves even just \$25/flight hour, so a program that offers savings in the \$50-\$200/flight hour range is obviously extremely compelling.)
- 2) Even customers that had already implemented their own fuel management programs appeared to understand how AMA's program could save them at least an incremental \$30+ per flight hour if implemented on top of their existing programs.

¹ afirs is a trademarked acronym for "Automated Flight Information Reporting System". The system involves installation of a communications node on an airplane, which gathers information of all types from an aircraft (including real-time voice, and data from a myriad of on-board sensors), and transmits it to users on the aircraft and users on the ground. Utilizing satellite-based systems, it allows aircraft operators to manage and monitor aircraft operations anytime, anywhere, and in real-time.

- 3) Even though AMA will be hosting similar seminars in different parts of North America (and the world) over the next year, customers and potential customers came to Toronto from headquarters as far away as Montreal and Las Vegas.
- 4) The synergies between afirs™ and the fuel management program were obvious: for existing afirs customers, it was very clear that the fuel management program was a very easy “bolt-on” monthly recurring cost piece, on top of what those clients were already paying on a monthly basis for afirs; for *potential* afirs clients that were “on the fence” about the ROI of afirs on its own, it was clear that some of these prospective customers were likely to adopt afirs PLUS the fuel management system because of the incremental ROI from the fuel management program.
- 5) From customer questions/reactions/statements, it was very clear that sales will be forthcoming from that seminar.

Webtech Wireless announced they have completed the pilot phase with GNP, the Mexican insurance company that is controlled by Carlos Slim. A few points about this deal:

- 1) My contact at Prolog indicates that GNP expects to be able to roll-out to about 800,000 of GNP’s 1.3 million customers within five years, and get to over 350,000 within three years. They are targeting 50,000-100,000 in the first twelve months of the roll-out, with the first of the roll-out orders no later than the end of March. Using these numbers, and a per unit figure that takes into account the high volumes, I still arrive at an estimate of between US\$6 million and US\$25 million/year in revenue to Webtech.
- 2) For those concerned that Webtech will end up with a problem in Mexico like they had in Brazil the first time around with Volkswagen Brazil, it is important to know that GNP is paying Webtech directly for the units.
- 3) This deal has a material monthly recurring revenue component for Webtech.
- 4) Note that it is significant that GNP is a Carlos Slim-controlled insurance company: he was involved in the process of approving the move to full roll-out; he also controls many other business interests in Mexico, including TelCel (with which it would be reasonable to expect a deal modeled on the AT&T/WEW deal before too long), and various businesses that have truck and car fleets that could benefit from The GNP/Webtech offering.

Neptune announced that they received “Novel Food” and “PARNUTS” approval in Europe

I will save an explanation of the significance of this development for the next letter in which I plan to focus on the investment hypothesis behind our investment in Neptune. In the meantime, the impressive performance of the stock in the face of crashing markets so far this year would appear to be telling us that investors “get” the importance of this development.

The road ahead: I plan to play more of a catalytic role in realizing value from the portfolios

Of course, I promise to continue closely following the fundamental developments at our investee companies, the developments at their competitors, and in their industries as a whole. I will continue to relay important fundamental developments and their implications, so that you can understand how it is that I can continue to assert that, regardless of what is happening with their stocks, the business fundamentals of our holdings continue to improve. But the next 6-12 months will also see me assume more of a “catalyst” role for the companies within the portfolios. I will be

doing things like introducing Neptune to early backers of big winners of the past such as Esperion, KOS Pharmaceuticals and Martek, all of which relate to at least one of Neptune's three divisions. I will introduce all of our core holdings to U.S.-based research analysts, and in the interest of realizing value from the private part of our portfolio, I will attend a couple of private equity conferences, where I hope to meet private equity groups such as the one that just invested \$8 million into one of our private companies.

So again I say: based on facts such as those discussed in this letter, I can do nothing but resolve to persevere, believing that we will ultimately thrive again, and work to realize the value that I know is being created by the companies in these portfolios.

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.

The Innovation Fund and the RSP Fund invest 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 funds normally follow 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 funds 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.