VENATOR
CAPITAL MANAGEMENT LTD.

IF I HAD $1BB DOLLARS

November was yet another difficult month in a difficult environment. As the chart below indicates, our Hedge Fund fell approximately 13% while the Income Fund managed to decline less disappointing 5.6%.

Instrument	Monthly Return	Year-to-Date Return
Venator Founders Fund[1]	**-12.9%**	**-23.6%**
Venator Income Fund[2]	**-5.6%**	**-11.4%**
TSX Composite	-5.0%	-33.0%
Russell 2000	-12.1%	-38.2%
S&P Toronto Small Cap	-10.2%	-50.6%
S&P 500	-7.5%	-39.0%

1. *The performance of the Venator Investment Trust approximates the performance of the Venator Founders Fund.*
2. *As the Venator Income Fund was launched in August, 2008, YTD represents four months of performance. Benchmark results for the S&P/TSX Income Trust: Monthly Return -11.1%, YTD -32.9% (since inception of the Venator Income Fund).*

Venator Founders Fund:

The Founders Fund was hit exceptionally hard in the month relative to the market, as the last week saw a significant market rally that left our small cap companies in the dust. Indeed, going into the final five trading sessions, our Fund was down approximately 16% (while markets were down over 20%) but only managed to recoup 3% in the ensuing 15%+ market rally, despite a net 70% long position. We note that small caps did significantly underperform large caps in the month, and it was our Canadian small caps in particular that held back the Fund in the rebound. We believe this was largely due to Fund redemptions/liquidations overwhelming these less liquid stocks with "Sell" orders in combination with a continued disproportionate interest in resource stocks in Canada, as investors have a difficult time letting go of "yesterday's bubble" (remember it has been less than six months of Bear after 8 years of Bull in the resource market).

Venator Income Fund:

The Income Fund experienced a 5.5% loss in the month. Small cap apathy was part of the problem, but we also had one of our larger positions report a disappointing quarter, which accounted for approximately one-half of the loss for the month.

What The Heck Just Happened?!?:

This recent market drop has admittedly caught us off guard. Unlike previous market collapses, there was no massive run-up through the old highs (markets were fairly flat for the 18 months heading into August), and valuations weren't particularly high. In 2000, the most recent market crash, people were devastated by unsustainable valuations in technology stocks. Cisco going from 60x earnings to 20x earnings, dropping the stock by over 60%, was not the end of the world. As a former technology analyst I was able to find technology companies with high growth rates that traded at less than 15x earnings going into the crash, and those stocks came out significantly higher. Furthermore, you could have made money in virtually any sector outside of technology. But in this de-leveraging market, money is coming out, rather than shifting around. Simply avoiding financials and resources and hoping the money comes to the more neglected sectors is not working this time around. Maybe it is different this time, but people were losing their jobs and savings in 2000, too!

That being said, we failed to appreciate the effect that the current debt issues have caused for the market at large. Leverage, to the extent it is manageable and backed by strong free cash flows, has always been the hallmark of efficient companies (Biz school 101 – debt is cheaper than equity). However, in these times when the Street appears exceptionally concerned about access to capital, even debt amounting to 2x free cash flow can prove punitive. We were also caught off guard by the increased lack of interest in Canadian small cap non-resource companies, which we thought were at a point of maximum neglect for the previous two years. We failed to appreciate that solid growing (yes, they are still growing), free cash flow positive companies with little or no debt could fall from what we perceived of low valuations of 9x earnings, to lower multiples in the 5-7x earnings range.

IF I HAD $1 BILLION DOLLARS (where is Private Equity?):
It amazes us how shockingly wrong private equity got it -- levering up to buy low growth and efficiently operating business without much room for margin improvement at north of 20x earnings. We wrote about this over a year ago, suggesting that both the valuations paid and the leverage employed would result in a near impossibility of a decent return for their investors. But if there was the perfect business to get into right now, it would be private equity.

There are some great, non-cyclical, not very economically sensitive businesses out there that can be easily had for 10x earnings (which would amount to 50%-100% premiums to where these stocks are trading today). After stripping out some costs, Private Equity could yield 10%+ free cash flow yields *without taking on additional leverage*. We are aware that levering-up their investments is considered mandatory for Private Equity, and that they are effectively shut down due to the credit market slowdown, but in buying these companies, you can take a 10%+ free cash flow yield and wait for the credit markets to loosen up so you can lever them up later.

As an example, Pet Valu has long been a core holding of the portfolio. It's not great growth, but it does grow and its most recent quarterly earnings of US$0.45 easily beat our US$0.35 estimate (and were up 45% over last year). With 70% of their business coming from their private label pet food product, we consider this business to be fairly defensive. In a good market environment, investors would never have been willing to part with Pet Valu for 10x earnings, but in this environment that represents 80% upside from the current share price.

Another excellent example would be our largest holding, Futuremed Healthcare Income Fund. Futuremed is the market leader for providing disposables to nursing homes across Canada, with dominant market share in Ontario, Quebec and Alberta. This is a business we believe has near *guaranteed* growth of 8%+ for the next 10 years (again, not great growth, but growth you can count on regardless of the economy). We believe that Futuremed can earn as much as $1.00 per unit next year on a fully-taxed basis, putting the stock at 6.5x earnings with a 13% dividend. Give me 10x earnings (50% upside) and I might consider it.

These are just two examples of Private Equity "no-brainers", but hardly isolated ones within the portfolio. Just as low-growth and cyclical companies were not worth 30x earnings at the top, non-cyclical/defensive growing companies are worth more than the 5-7.5x earnings they are trading at today. Private Equity beware: investors will not be willing to take these prices forever.

Where we are Investing (and What we are Avoiding):

We have not dramatically altered the makeup of the portfolio. We got a little less short in mid-November and the Fund is now 90% long and 20% short for net market exposure of 70%. We have been adding to our growing healthcare investments and have purchased some selective US large caps that we believe have either good visibility, or internal controls that allow them to quickly adjust costs to revenues in the event of an up to 10% decline from 2008 revenue levels.

We continue to avoid resource stocks, as cycles rarely last three months (so don't expect oil to get back to $100.00, or even $70.00 any time soon), and these companies generally require debt financing to expand production of a depleting resource. We continue to avoid US financials, as they still remain drastically over-levered, and still need to dilute their shareholders on a massive scale though equity issues. We continue to avoid certain cyclicals in the industrial and retail sectors. While P/E multiples look low on the surface, we note that applying 2006 gross margins to 2008 revenues would yield some very expensive multiples. We are very aware that 10% revenue drops can cause 20%+ earnings shortfalls for many manufacturers. While recent market bottoms may have discounted overly pessimistic scenarios for many companies, we think the more cyclical parts of the economy could see much larger drops in profitability than current stock prices are discounting.

Thank-you for your continued support,

Brandon Osten, CFA
President, Venator Capital Management