

OH (NO) CANADA!

The Funds managed to hang in there over a choppy October. The Income Fund performed exceptionally well, while the Founders Fund (hedged more than usual) managed to eek out a small gain. With the US elections behind us, we decided to turn our attention to some adverse developments in the Canadian political scene for a change.

| Instrument (Inception) | October's Return | Year-to-Date | Compound Growth |
|---|------------------|--------------|-----------------|
| Venator Founders Fund (March 2006) | 0.4% | 25.0% | 12.2% |
| Venator Income Fund (August 2008) | 1.7% | 18.4% | 16.3% |
| TSX Composite (March 2006) | 1.1% | 6.5% | 3.8% |
| Russell 2000 (March 2006) | -2.2% | 11.8% | 3.1% |
| S&P Toronto Small Cap (March 2006) | -0.4% | -0.6% | 0.9% |
| S&P 500 (March 2006) | -1.9% | 14.3% | 3.7% |

Allow me to preface my monthly rant by saying that I have historically been a fan of the new Conservative party. I have voted for the Harper government at every opportunity. I have always believed them to be business friendly. I defended them when they killed the income trust model, on the grounds that the model gave public companies an unfair advantage over smaller private companies. I understood the recent stonewalling of both the Potash and TSX takeovers to foreign enterprises (OK the TSX was more of an Ontario government thing) in that when a company is granted a monopoly in a strategic asset by government decree, they were created unfairly in the first place, so I can understand why the government would be hesitant to see their unfairly created monopoly fall into foreign hands.

But when the government started holding up deals for "regular companies" I had a real problem. If you haven't already heard, the government has stalled the current pending acquisitions of both Nexen and Progress Energy because they can't figure out if the transactions are of "net benefit to Canada", whatever that means. Yes these companies operate through the extraction of resources on government land, but they bid on this land in an open auction and in the case of Progress, applied technology to shale gas to make it economically feasible, with money raised from shareholders.

This is a dangerous game the government is playing here. Without foreign buyers, the Ponzi scheme that we call our junior resource space is at risk of becoming exposed. We have a saying here at Venator: "generally speaking, the only thing resource companies produce that shows up on a financial statement is more shares outstanding". Most developing resource companies we see, if you really look at their financial statements (everyone is so focused on production and reserves that they rarely look at actual financial statements), seem to double their shares outstanding every three to five years, and have no FREE CASH FLOW to show for it. The game is to dilute your shareholders down in order to prove up existing land, rather than generate cash flow from it, in hopes some greater fool will acquire your money losing venture before anyone starts to expect the cash flow generating pot of gold at the end of the exploration rainbow to prove out.

Basically, what I am saying is that if foreign interests want to give us billions for unprofitable companies funded by private shareholders, what's the problem? They will still create jobs here, they will still pay royalties here,

and in efficient global markets they will be better off selling their production here (there is a cost of transportation). And if the government is going to throw up legal roadblocks through red tape, would be buyers might just decide that it's not worth the trouble of fighting with the government of Canada, even if these particular transactions end up going through.

Some of you may recall that we are quite excited for future prospects for natural gas. Oversupply concerns have sent this resource to a decade low while demand is set for a secular decade long increase; someone forgot to tell the market that this new supply comes at a fairly high cost. We have put our money where our mouth is on four fronts. Firstly, we owned Progress shares and bonds, the highest quality land base in the prolific Montney (we sold our positions when the deal was announced). Secondly, we own Birchcliff, the lowest cost producer in the area. Thirdly, we own Advantage, the cheapest stock in the Montney. Finally, we own Bellatrix, with a massive hidden gas resource in the emerging Duvernay field. None of these companies have any free cash flow (although Birchcliff has suggested that they will next year), but we do expect them to rise with a rising gas price, and they all have long lived assets so we can be patient.

So how have we reacted to this latest development that may very well have already cut the exit strategy for this market in half? Well, we have done very little thus far, in large part because we think the market will react favourably to higher gas prices this winter. Birchcliff, with its promise of free cash flow, and Bellatrix, who have proven to be very astute technical operators, are the two more favoured names in the portfolio. That being said, we felt compelled to sell our two year warrants in Birchcliff because with diminished prospects for a foreign acquirer, time may no longer be on our side on a limited life option-like investment. Basically, you need to be prepared to invest for the long term, or hope for a domestic, or at least North American acquirer.

As always, we reserve the right to change our minds.



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