

Emerging Value Capital Management, LLC

152 West 57th Street
Floor 46
New York, NY, 10019
Tel1: 312-363-8599
Tel2: 212-277-5607
Fax: 212-974-1850

March 2009 letter to investors

Dear Partners and Shareholders,

Following is our sixth monthly letter to investors. In previous letters, I discussed our long term market outlook, our strategy for preserving capital and managing risk, our general investment framework, the importance of focusing on long term results and why contrarian investing is so difficult. In this letter I will discuss the importance of conservative investing, avoiding catastrophic losses, and the two different types of "Margins of Safety" that we look for.

As always, I am happy to speak with partners (and potential new partners) so please do not hesitate to call me with any questions, thoughts or comments.

Fund Performance:

During March 2009, EVCM Fund returned an estimated +6.3% (net to investors). During this same time period, the S&P500 (SPY) returned approximately +7.6%, and the MSCI All Country World Index (ACWI) returned approximately +9.2%.

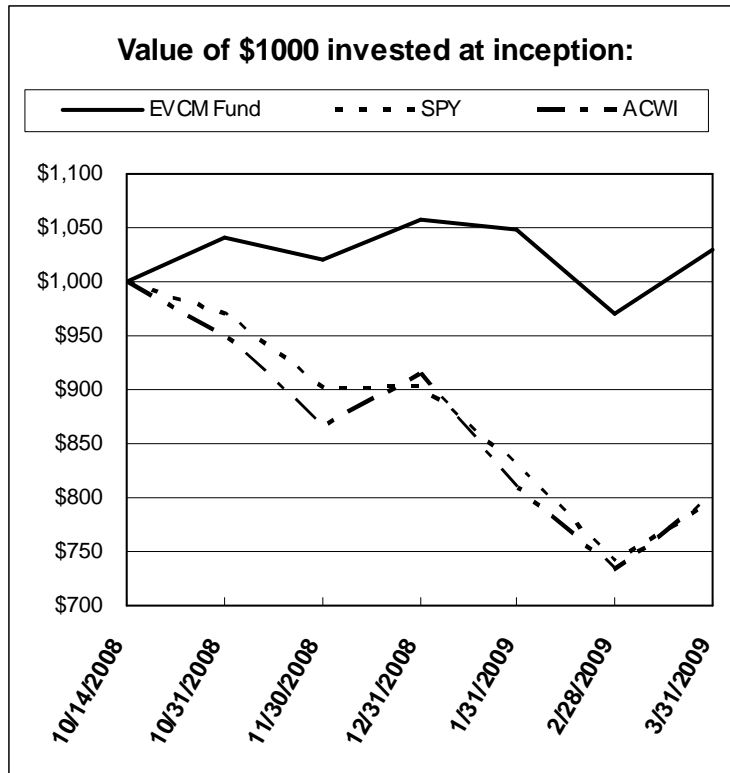
Since inception (10/15/2008), EVCM Fund returned an estimated +3.3% (net to investors). During this same time period, the S&P500 (SPY) declined approximately -20.4%, and the MSCI All Country World Index (ACWI) declined approximately -20.1%.

March was a good month for EVCM. Despite our very conservative positioning, we managed to almost keep up with the strong market rally. After the brutal declines of 2008 and early 2009, a market rally was overdue. However, given the severe problems still facing the global economy as well as the bad GDP and first quarter earnings results that will likely come out soon, I would be surprised to see the rally sustained. As always, our fund is positioned conservatively, with capital preservation remaining our top priority.

As before, I caution investors not to focus on monthly returns (monthly results are mostly random and should not be extrapolated). Rather, I hope you will evaluate my performance over a multi-year period.

| | March 2009 | 2009 YTD | Since Inception (10/15/2008) |
|-------------------------------------|------------|----------|---------------------------------|
| EVCM – Net to Investors | +6.3% | -2.6% | +3.3% |
| S&P500 (SPY) | +7.6% | -11.9% | -20.4 % |
| MSCI All Country World Index (ACWI) | +9.2% | -12.6% | -20.1% |

*Please note that individual investor net returns will vary due to the timing of one's investment. The results reported above are unaudited estimates and may be subject to change.



Conservative Investing:

Rule No.1: Never lose money.

Rule No.2: Never forget rule No.1

– Warren Buffett

When we launched EVCM fund in mid October 2008, I felt very lucky to have avoided most of the “market carnage” of the previous year. Little did I know how much more “market carnage” was to come in the months ahead. With the S&P500 (SPY) and All Country World Index (ACWI) both down over 20% since we launched, we have managed to protect our capital and even make a small profit. I believe this is a testament to our conservative approach to investing (which I discuss below) and to our disciplined risk management framework (which I discussed in our November 2008 letter).

But why is it so important to invest conservatively? Shouldn't we take on a little more risk to try and obtain higher returns? Maybe even use a little bit of leverage? Should capital preservation always be our top priority?

The world is a dangerous place for capital. Inflation, expropriation, revolution, currency devaluation, industry declines, wars, natural disasters, depressions, market meltdowns, black swans, theft, fraud, and taxes all pose a constant and lurking threat to growing (or even just maintaining) wealth over time. In any given year, the probability of disaster is small. But over many years and decades anything that can go wrong eventually will. Avoiding catastrophic losses when things go wrong can only be achieved by investing conservatively and without leverage.

As long as we can stay in the game, the long term power of compounding will work in our favor. A 5% real annual return will multiply our money over 11 times in 50 years. A 10% real annual return will multiply our money over 117 times in 50 years. Earning 15% annual returns over any extended period of time will make us very wealthy. But having even one single year with catastrophic losses undoes years of great performance. Simply put, the key to amassing wealth over time is avoiding catastrophic losses and never having to start over from scratch.

I continue to search for (and find) high return investment opportunities for our capital. However, I will never knowingly expose us to even a small risk of catastrophic losses. I will do my best to make sure that our portfolio can always survive the next disaster that (sooner or later) will strike. We must always be vigilant against the scenario pictured below.



Circa 1929: "\$100 Will Buy This Car Must Have Cash Lost All On the Stock Market" (Wall Street Journal, October 11, 2008)

Business (Internal) Margin of Safety:

Confronted with a like challenge to distill the secret of sound investment into three words, we venture the motto, MARGIN OF SAFETY.

– Benjamin Graham, the Intelligent Investor, Chapter 20.

Value investing can be practiced in many different forms and with many different variations. Yet there is one thing that all value investors have in common. We always require a margin of safety in our investments. We seek to invest in financial assets (usually businesses) at a price that is significantly lower than the conservatively estimated intrinsic financial value of these assets. This difference between the price we pay and the intrinsic financial value of the assets we invest in is called the margin of safety.

Why is having a margin of safety so critical?

First, the margin of safety provides our expected upside. We hope that over time “Mr. Market” will recognize the true intrinsic value of our asset or alternatively that we will benefit from this intrinsic value over time via dividends.

Secondly, and more importantly, the margin of safety protects us from mistakes and misfortunes. Determining the intrinsic value of a business is part science and part art. Experienced value investors know that their estimate of intrinsic value for any asset is at best an educated guess with a fairly wide margin for error. Furthermore, business conditions (and intrinsic values) can deteriorate. Managers will make foolish decisions, competitors will try to steal market share, markets go into recession, etc. A wide margin of safety in the price we pay protects us from the valuation mistakes that we will inevitably make and from the misfortunes that will inevitably strike our investments.

For example, if we think a business is worth between \$100 to \$120 per share, and we then buy it at \$50, we will still do fine even if the business ultimately turns out to be worth only \$80.

I believe that requiring a large margin of safety in the price we pay, while critically important, is only half the story. To be conservative value investors we must also demand a margin of safety in the operations, finances, and management of the businesses themselves.

For example, a highly levered financial institution might have \$5 of equity supporting \$100 of assets. If we purchase this business at \$2.5, we certainly have a very wide (50%) margin of safety in the price we paid. But in fact, we are not safe at all. The business itself has no financial margin of safety. If the value of its assets decline by just 5%, its equity (and our investment) will be wiped out.

A second example is of a product manufacturer with narrow (2% - 3%) profit margins. With such narrow profit margins, even a small increase in costs or a small decline in market prices could completely eliminate the businesses profitability.

In my experience, we will rarely find a meaningful business margin of safety in businesses that:

- Are highly levered
- Have thin profit margins
- Require constant fast paced and risky innovation just to stay competitive
- Heavily depend on one or two key managers
- Have few (concentrated) customers or suppliers
- Require constant and continuous access to the capital markets
- Have no defensible competitive advantages

No matter how cheap they are, these types of businesses will always be inherently more risky. Over time, anything that can go wrong will go wrong. And when things go wrong, businesses that lack internal margins of safety get badly hurt.

In contrast, at EVCM fund we seek to invest in businesses with wide internal margins of safety. Businesses with wide profit margins, little or no debt, substantial cash in the bank, a diversified base of suppliers and customers, a deep management bench, etc, will usually have a tremendous internal margin of safety. These businesses have the financial and operational flexibility to overcome almost any challenge and will likely grow larger over time as their competitors (who lack a business margin of safety) succumb to various problems.

Investment Analysis: Berkshire Hathaway:

In my opinion, one of the safest investments that we own is Berkshire Hathaway (BH). It is the holding company managed by Warren Buffett since 1965. Entire books have been written about Berkshire Hathaway so I cannot do it justice in this short write-up. I will, however, try to present a brief high level overview.

Berkshire Hathaway is comprised of 3 major "parts": 1) Insurance subsidiaries, 2) A collection of wholly owned businesses, and 3) A portfolio of stocks and bonds.

1. The main insurance subsidiaries at BH are Geico, BH RE, and General RE. Geico is a direct seller of property and casualty insurance, and is one of the best managed and lowest cost providers of vehicle insurance in the USA. BH RE, managed by Ajit Jain, is one of the worlds most innovative and disciplined reinsurance operations. General RE is a well managed large international reinsurer. While most insurance operations experience an underwriting loss over time, BH insurance subsidiaries are so disciplined and well managed that in his 2008 annual letter, Mr. Buffett wrote that he expects them to earn an underwriting profit over time. This means that BH will essentially be paid to hold other people's money (insurance float). At year end, BH's insurance float was almost \$60B, and it will likely grow over time.



2. BH owns a collection of good operating businesses that Mr. Buffett has purchased over the years. These include (just to name a few) Benjamin Moore, Business Wire, Clayton Homes, Dairy Queen, FlightSafety International, The Marmon Group, Shaw Industries, Iscar, MidAmerican Energy, Nebraska Furniture Mart, NetJets, See's Candies, Wesco Financial Corp, and many more. In aggregate, these businesses earned almost \$4000 per BH share in 2008. While they will probably earn a little less this year due to the weak economy, their combined earnings power over time is comfortably above \$4000/ share. Note that this is a thousand fold increase from about \$4 per share in earnings in 1965 when Mr. Buffett took over.



The greatest honor of my life – Lunch with the master – Mr. Warren Buffett. 2005 – Chicago Booth MBA class trip to Omaha.

3. Finally, BH owns a portfolio of stocks, bonds and cash equivalents. Included in this portfolio are some of the world's greatest businesses such as Coca-Cola, American Express, Proctor & Gamble, Kraft, J&J, Sanofi-Aventis, Wal-Mart, Tesco, Wells-Fargo, and others. This portfolio was worth about \$122B at year end 2008, with about half of it being financed by the insurance float. The portfolio has probably declined slightly since the end of 2008 and is likely worth about \$75K per BH share today.

BH has a fortress like balance sheet, with the insurance float essentially providing a form of costless (and permanent) leverage. Mr. Buffett is probably the most conservative, talented,

ethical, and capable manager in the world of business. Despite managing one of the world's largest and most successful companies, his annual salary is only \$100K, and he does not award himself any stock options or other forms of company financed perks. Mr. Buffett built BH in such a way that it could survive almost any conceivable disaster. For example, BH's insurance subsidiaries regularly exclude coverage in the event of nuclear terrorism unless they are specifically paid extra for such coverage. Another example is Mr. Buffett's avoidance of all but the safest of derivatives following his warnings several years ago that derivatives have become "financial weapons of mass destruction".

Since Mr. Buffett took over, BH's book value has grown at a compounded rate of over 20% per year vs. less than 9% for the S&P500. Even in 2008, which was a very difficult year, BH's book value declined by less than 10% which is a testament to the diverse earnings power and recession resistance of BH.

Valuing BH is fairly straightforward. Assigning a conservative 8X multiple to the operating business earnings (\$4K/share X 8) and adding in the current per share value of the securities portfolio (\$75K/ share) gets us to about \$107K value per share. This assigns no value to the expected growth in insurance float over time, to the expected future underwriting profits, and to the exceptional management and capital allocation abilities of Mr. Warren Buffett. Currently trading at about \$90K per share, BH shares are cheap, but are not extraordinary bargains. Yet given that BH is one of the safest and best managed companies we know of, we continue to hold it as a safe "core" holding.

Great businesses, like Berkshire Hathaway, are rarely cheap and almost never become extremely cheap. Nevertheless, they can provide good returns while being safe core investments. The internal business margin of safety (as defined above) that BH possesses is exceptional. When investing in great businesses, we typically look for a long history of profitability, high free cash flows, a strong balance sheet, permanent competitive advantages, resistance to recession, and good management. BH provides all of these and more.

Conclusions:

Demanding a large margin of safety in the prices we pay as well as in the operations, financials and managements of the businesses we invest in, ensures that we can always stay in the game. Like all investors, we will experience both gains and losses over time, but as long as we do our job correctly, the losses will be rare, and will never be catastrophic. Remaining focused first and foremost on capital preservation, we are slowly and carefully constructing a portfolio of exceptional businesses that should do very well over the long run.

At EVCM we consider it a great honor and solemn duty to protect and grow your capital. We always remember that many of you (including myself) have a large part of your life savings invested in the fund. We strive to treat our partners and shareholders the way we would like to be treated were our positions reversed.

Please feel free to share this letter with prospective new partners and with other interested investors. Also, thank you for the referrals!

Sincerely Yours,
Ori Eyal
Portfolio Manager

Disclosure:

This document does not constitute an offer to sell or the solicitation of an offer to purchase any security or investment product. Any such offer or solicitation may only be made by means of delivery of an approved confidential offering memorandum. Past results are no guarantee of future results and no representation is made that an investor will or is likely to achieve results similar to those shown. All investments involve risk including the loss of principal.

An investment in the Fund may be deemed speculative and is not intended as a complete investment program. It is designed only for sophisticated persons who are able to bear the risk of the substantial impairment or loss of their investment in the Fund. The Fund is designed for investors who do not require regular current income and who can accept a certain degree of risk in their investments. Prospective investors should carefully consider the risk factors specified in the Offering Memorandum before making a decision to invest in the Fund.