

Turtle Creek Equity Fund

2009 Letter to Unitholders

Fellow Unitholders,

While an annual letter is, by definition, about the last 12 months, we observe that viewing investment performance in calendar years is arbitrary. Indeed, using any 12 month period to talk about investment returns makes no sense since the time period is much too short to draw any meaningful conclusions about the merits of an investment strategy. But in the case of the year 2009, this is especially true - the period from mid 2007 to the end of 2009 must be viewed in its entirety.

With this in mind, the first half of 2009 continued the turmoil that began in 2007 and intensified in late 2008. In the early part of 2009, the stock market continued its collapse, hitting bottom in March. At that point, the U.S. equity markets had declined by about half from their highs in 2007 - not your 'garden variety' market correction. Since then, the markets have recovered from their lows quite powerfully, but only enough such that for 2009 in its entirety, the S&P 500, for example, was up only 8% (in C\$). The market must still rise 38% in order to regain its previous high set in 2007.

During this turmoil, our decline was similar to the broader market. This is not surprising given that we were fully invested in the spring of 2007; and we don't regret this decision since it is impossible to know when a market is going to collapse. We are not market timers and are skeptical of anyone's ability to consistently do so. In this view we are not alone; all serious long term investors share this belief. We strive to be fully invested - by far the best way to generate wealth over the long term is to own the common equity of excellent companies. So long as the risk adjusted returns are better than being in cash (treasury bills), we will be fully invested. Only once in the life of Turtle Creek (during 2000 when we were as much as 33% in cash) have we held significant cash balances and we suspect that this will occur rarely in the future.

While our decline was similar to the market's, our recovery has been much more pronounced, with Turtle Creek Equity Fund rising 147% in 2009. Our 'eye popping' return this year was required for us to recover to our 2007 highs and, indeed, at the end of 2009 we sit at an all time high that is comfortably above our previous high in 2007.

We are often asked: "How have you managed to recover so well; the market is still substantially down - have the share prices of all of your companies fully recovered?" In fact, the share prices of the great majority of our portfolio companies are still well below their highs of a couple of years ago. Rather, Turtle Creek's substantial outperformance is attributable to our **investment process** and our **long term focus**, each of which are described, in turn, below.

Investment Process

The investment process which generated our returns in 2009 has been in place since the founding of Turtle Creek in 1998. Our process has three steps: (i) identify the right companies; (ii) get to know those companies extremely well; and, (iii) build and maintain an optimal portfolio from those companies.

Despite our strong performance, the share prices of the great majority of our portfolio companies are still well below their highs of a couple of years ago.



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Step 1: Identify the Right Companies

Our investment process starts by choosing the right companies. Perhaps the single most important decision we make is which of the companies in our universe deserve our ongoing time and attention. We strive to select good companies - sound businesses with strong management that drive their intrinsic value higher over time, even in difficult periods like the credit crisis we recently endured. During this crisis, many companies went bankrupt and many more were forced to issue equity at very low prices. In contrast, we owned companies that had (and continue to have) strong balance sheets and that, in many circumstances, were able to take advantage of the financial crisis to build long term value, either through reinvesting in their businesses or by making strategic acquisitions.

Step 2: Get to Know the Companies Extremely Well

After choosing the right companies on which to focus, we spend considerable time and effort formulating and maintaining a view of each company's value. Our background, skill-set, and approach - spending our time on the right things - differentiate us from other investment managers. We enjoy the long and hard process of really understanding a company. We believe that our discipline and the depth of our analysis is rare.

Step 3: Build and Maintain an Optimal Portfolio

Having spent the time to understand each of our company's value, we then construct an optimal portfolio. Simplistically, our optimal portfolio is diversified over about 25 companies in largely un-related industries with weightings chosen to achieve the highest intrinsic value (the present value of all future cash flows). Changes to our portfolio over time are primarily driven by our response to changes in traded prices - the cheaper a company gets the more of it we own, the more expensive a company gets, the less we own. 2009 was a great example of this - we were able to buy companies at stunningly low prices - funded by selling companies that were less cheap.

Long Term Focus

While our 2009 returns were exceptionally strong, we remain, as always, focused on long term value creation. At the end of 2007 and again at the end of 2008, both years in which our unit price declined, we stressed in our annual letters the importance of taking a long term view. The letters for both years indicated that the intrinsic value of the Fund had increased and that these increases would inevitably lead to an increase in our unit price over time. In 2009, intrinsic value increased again, such that over the three-year period we have roughly doubled the intrinsic value of the Fund. This doubling has come from a combination of owning companies that have done a great job of managing through the last few years and from our ongoing reweighting amongst our companies.

Looking at the long term, which for us is now 11 years, we have increased our unit price 21 fold, a compound annual return of 32%. During the same period the Russell 2000 has only generated a 2% compound annual return, with a dollar invested 11 years ago now being worth only C\$1.30. Other total return indices, such as the S&P 500, have actually generated negative returns. No wonder so many market pundits are referring to the past ten years as "the lost decade".

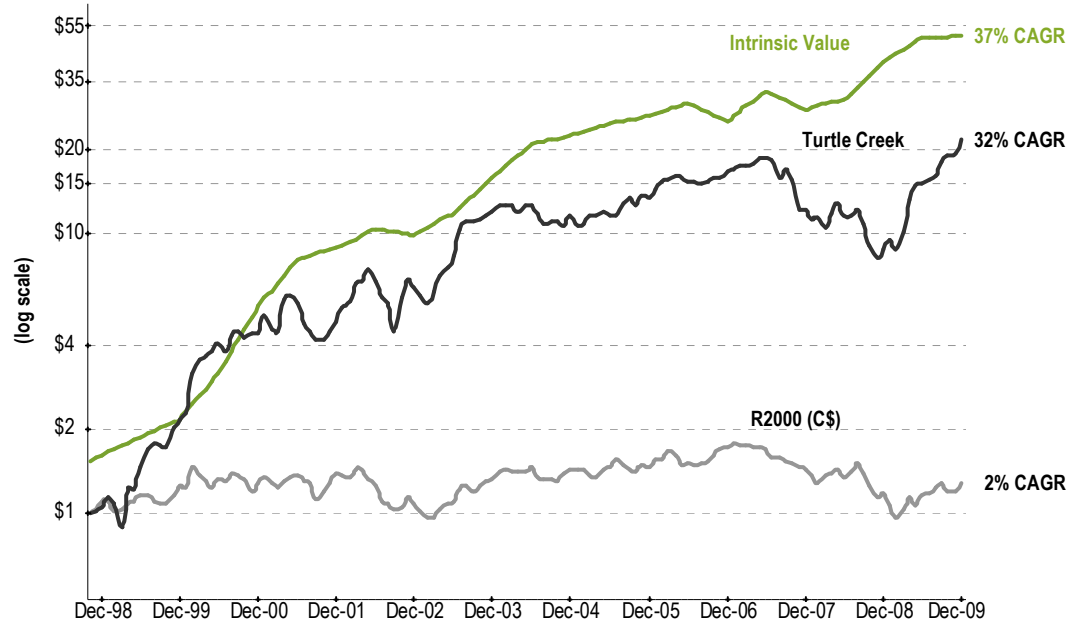
Turtle Creek's substantial outperformance is attributable to our investment process and our long term focus.



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Turtle Creek Intrinsic Value and NAV vs. R2000 (C\$), Since Inception*



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We have generated these returns with, in our opinion, a risk profile that is no greater than - and arguably lower than - the broad equity markets. As we indicated in our September 2009 Thought Piece, "Up the Creek", for us, risk is not short term price volatility but rather is the chance of permanently losing money (a decline in intrinsic value).

Looking Forward

After a period of strong performance such as we have enjoyed in 2009, we are often asked: "Is it a good time to invest in Turtle Creek?" We hope that by reading this letter, you now understand that trying to "time" the perfect entry point for an investment is fraught with difficulties. We take a long term view. We make no prediction as to the short term direction of the markets - our view is that it is impossible to successfully make such predictions. We don't engage in market timing and we are not trying to guess what others are going to do. We just own companies - we have the perspective of business owners rather than speculators. Given our approach and our principles, we believe that Turtle Creek is well positioned to earn superior returns. By choosing the right companies, understanding their value and constructing the optimal portfolio, we will continue to grow our intrinsic value - leading to further increases in our unit price and your wealth.

Your Partners at Turtle Creek

* Performance data for Turtle Creek reflect a linking of exactly ten years of the actual returns of the Founders' Fund for the period November 1, 1998 through October 31, 2008, with the actual returns of the Turtle Creek Equity Fund (TCEF). TCEF was created to continue the investment strategy of the public equity investments of the Founders' Fund. The Manager believes the performance of the Founders' Fund should be combined with the performance of TCEF to properly present the Manager's track record. The Founders' Fund is an Ontario Trust, created in September 2000 as a successor to a pooled investment arrangement that was formed on November 1, 1998 (collectively the "Founders' Fund"). In late 2003, the Founders' Fund began to make allocations to private investments. Absent these investments in private companies, the returns of the Founders' Fund would not have been materially different. Past returns are no guarantee of future results.

