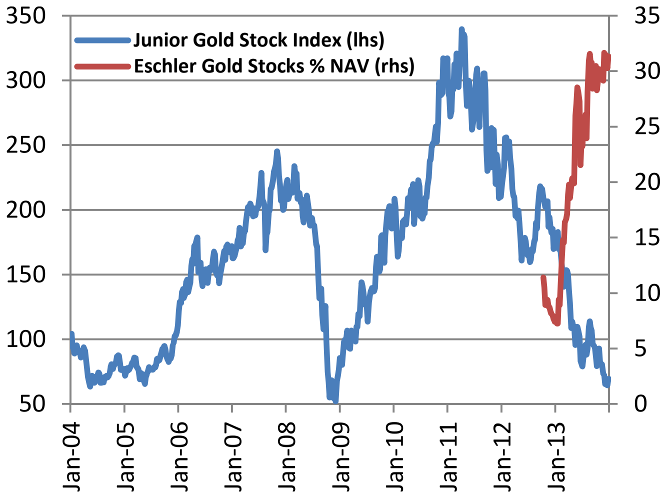
Eschler Asset Management LLP

Eschler Recovery Fund SP
www.eschlerasset.com

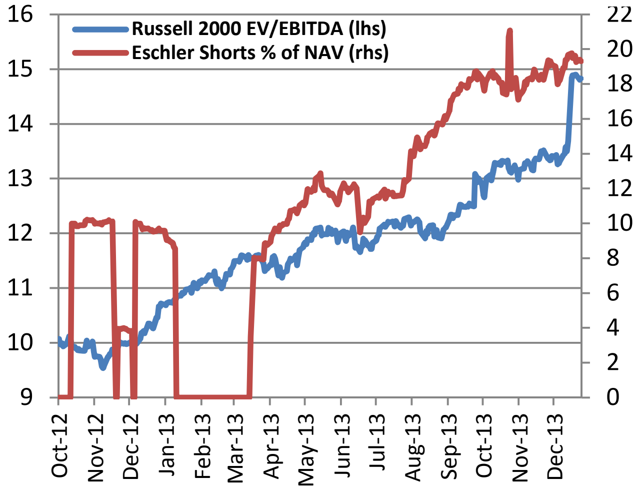
Dear Partners,

Eschler Recovery Fund returned +8.51% since inception on 8 October 2012 through year-end 2013. The period is best explained by robust returns in the fund's traditional long equity positions (see next page) offset by losses in gold stocks and single stock shorts. The new capital I deployed during the year was primarily in the latter two areas, where opportunities appeared attractive. Today, while the portfolio retains over four times more long exposure than short, shorts are now one-fifth of capital up from zero a year ago, while gold stocks are one-third of capital compared to less than one-tenth a year ago. In hindsight, I built these positions up too fast, with resulting mark-to-market losses. The rationale for tilting toward these areas remains sound, though, and my expectation is that these losses will reverse in due course.

Junior Gold Stocks: Buy Low...



Short Position: Sell High...



I find solace in the conviction expressed by the late banker Shelby Davis who said, "*You make most of your money in a bear market, you just don't realize it at the time*." Because, boy has it been a bear market in gold stocks and shorts! The gold stock indices were down 55-60% in 2013 while the average midcap short was probably up, what, 45%? Stepping back, junior gold stocks are down 80% over three years (-40% cagr) while the Russell 2000, my hunting ground for shorts and now trading at a nosebleed 40x P/E, is up 150% over five years (+20% cagr). Against this backdrop my recent returns have stagnated. In fact, my positioning has been so fundamentally at odds with the prevailing market mood that I take some satisfaction in at least keeping my head above water in 2013. It is pleasant to see 2014 off to an auspicious start with the fund up 195bp in the first two trading days of the year bringing the inception-to-date return to +10.6%.

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A note on strategy: I run a value-oriented investment program invested in a limited number of high-conviction ideas. The focus is on asset-rich recovery situations where earnings power appears mispriced. My business analysis at times combines not only company-specific, but also macro factors. At the company level I am particularly interested in businesses in harvest mode, focused more on raising returns on capital than growth at any cost. At the macro level, certain of my investments seek to answer questions such as: If US natural gas is under-priced, who is best positioned? If alternative reinsurance is up-ending the reinsurance industry, who can benefit? How can I gain exposure to discounted real assets within listed vehicles, such as to quality beachfront property? If the Fed's exit from QE is not smooth, is there a way to protect the portfolio and position for gains without further increasing shorts? Etc.

While few in number, my holdings, by design, give the portfolio the diversity it needs. I maintain low gross exposure, never more than 125% of capital (longs plus shorts), and cap aggregate shorts at 25% of capital as well. These self-imposed limits are based on hard-won experience. They give me the staying power to buy low (or short high), if necessary withstand considerable pain and, not least, survive mistakes. Clearly, a "melt-up" environment (or "melt-down" in the case of gold stocks!) presents challenges to this approach. My returns have and will likely continue to deviate from the broad market averages. But the goal of concentrating, keeping gross leverage low and leaning against the conventional wisdom when the odds favour doing so, is to produce a higher return than the market on a three-year rolling basis, with less risk of permanent capital loss.

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While we wait for better times, it is worth highlighting that the fund's fee structure provides zero compensation to the manager for returns below a 6% hurdle in any calendar year: Investors pay no management fee, while the manager earns one-quarter of profits in excess of 6%, with a perpetual high water mark. I can't think of a better way of truly aligning interests. My personal liquid net worth comprises a large percentage of fund capital and I am intent on growing it without taking undue risk.

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Review of material activity over the past 14 months:

Core Longs	Date of Purchase	Return on Cost	% NAV
InfuSystem Holdings	Dec 2012	+53%	6.2%
Chesapeake Energy	Oct 2012	+54%	9.6%
Dolphin Capital Investors	Oct 2012	+45%	10.2%
Fairfax Financial	Oct 2012	+16%	7.8%
Vinaland	Apr 2013	+12%	10.3%
Markel	Sep 2013	+12%	11%
Gold Stocks	2013	-17% (median) -17% (average)	31%
Shorts	2013	-16% (median) -30% (average)	-21%
Sold Out Longs			% NAV (at sale)
Armanino Foods	July 2013	+59%	2.4%
Greenlight Re	Sep 2013	+20%	9.2%
FBOD Liquidating Trust	Dec 2013	+48%	4.2%
Junior Gold Stock ETF	Jun 2013	-43%	13%

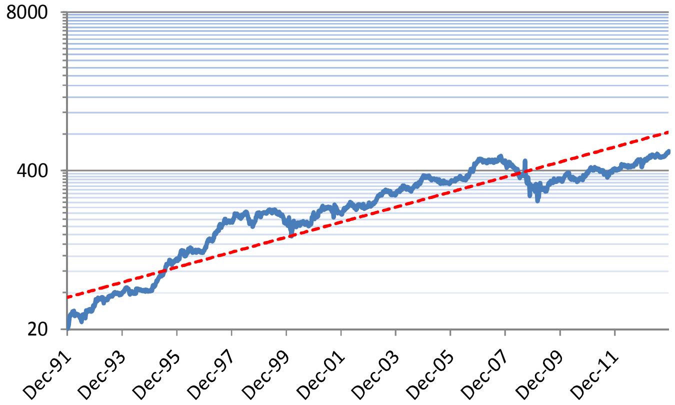
Other than the aforementioned focus on gold stocks and shorts, I only made one large change to my core holdings during the year, switching out of Greenlight Re (GLRE US) into Markel (MKL US). GLRE is the reinsurance vehicle David Einhorn set up in 2004 to create a new permanent source of capital for his hedge fund. By reinvesting shareholders equity *and* float into the Greenlight Capital hedge fund, GLRE generates a leveraged return on the underlying hedge fund. In my original thesis for GLRE

I targeted a fair value of 1.2x price/book having purchased at 0.97x price/book in December 2012. By September of this year, however, GLRE had risen 20% over nine months to 1.15x price to book, new information had surfaced that lowered my conviction at the margin, and I had found something that appeared even better. During the summer I met with the consultant who helped GLRE get off the ground in 2004 and one thing he said struck me. I had assumed GLRE would judiciously expand balance sheet leverage (the lowest in the industry) from less than 0.5x up to 1x reserves to equity as underwriting and investment returns improved. But since Greenlight Capital is effectively closed to new money, he noted that isn't likely. The investment portfolio cannot accommodate increased capital. This finding led me to believe that part of my thesis may not be valid. Improving investment and underwriting results would not necessarily benefit from the higher degree of financial leverage that I assumed appropriate. Book value per share would thus compound at a lower rate than expected (albeit in all likelihood still at a faster rate than investors in the underlying Greenlight Capital fund would enjoy), yielding a lower fair value.

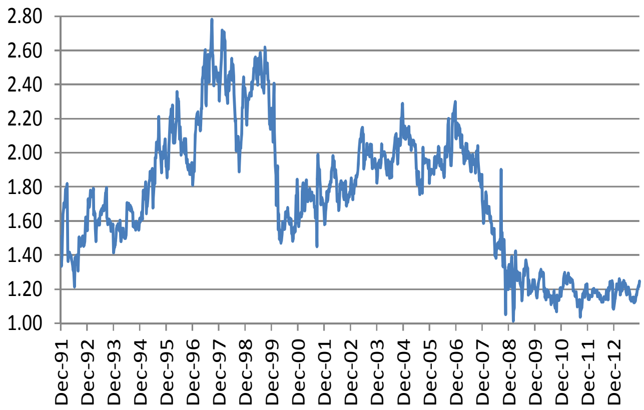
Why was Markel better? Markel is a midcap specialty insurer with a strong underwriting culture and investment trackrecord. Having attended the majority of annual investor meetings in Omaha over the past decade, I have an appreciation and respect for management. In my view, three strengths make the company unique: 1) A strong market position in niche excess and surplus lines (think equestrian risks, or insuring summer camps, taxi cabs etc.) requiring specialist underwriting expertise and where long-term relationships really matter. While the insurance industry is competitive, Markel has demonstrably created a moat here. 2) A consistently strong investment trackrecord spanning two decades under the stewardship of CIO Tom Gaynor. Over the past decade, Markel has returned 9% in stocks, 5% in bonds and just over 6% overall. 3) A business model that optimizes these strengths: Markel has historically generated an underwriting profit over the cycle, producing zero-cost float which it then invests in a mix of stocks, bonds and whole businesses (Markel Ventures). In the past, Markel has generally run with 2-3x reserves to equity and has invested up to 100% of shareholders equity in stocks. What this produces is a high-teens growth in book value per share over time. More recently, Markel has made a transformational acquisition of Bermuda reinsurer Alterra. This deal opens up the alternative reinsurance industry to Markel, and has materially increased float providing Tom Gaynor with a huge bond portfolio that he can gradually re-allocate into stocks.

How do I value Markel? Since 1991, Markel has traded on average at 1.7x book value. The premium to book has diminished in recent years perhaps because balance sheet gearing has come down (though adding Alterra's float has brought leverage back up). A good way to value Markel is the way Warren Buffett suggests shareholders value Berkshire Hathaway: If Markel can break even on underwriting, you can take total investments per share [$1,033 per share pro forma for Alterra], and add Markel Ventures to that [conservatively 1x price sales = $43 per share]. Since Markel also consistently generates underwriting profits over a cycle, these can be capitalized at a normalized multiple as well [150-300m of expected normalized underwriting profit x 10 = $107-214 per share]. Going forward, book value growth will remain a good proxy for intrinsic value growth, but I believe intrinsic value is increasing faster than book as Markel grows and leverages its strengths. For example, Markel's 100%-owned businesses within Markel Ventures, where free cash flow is more relevant than book value, are going to grow as a percentage of the investment mix. Putting it all together, Markel's intrinsic value may well $1,180-1,290 per share or 2.5-2.7x current book value per share of $470. This implies upside of 105-120%. Markel traded well above 2x book from '95-'00 and from '03-'07 so this is not implausible, especially as Markel's franchise value appears to be increasing. Also, a rising investment allocation to equities could drive faster compounding of book value per share thereby hastening multiple expansion.

Markel Corp: Long-term winner



Markel Corp: Historically Cheap at 1.25x book



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Outlook

Beneath the surface of a pedestrian result to date, the fund's core positions offer good forward prospects, having cheapened vs the broader market over the past six months. The portfolio has exposure to four themes, in order of size: 1) Decimated gold and silver stocks; 2) a number of single stock shorts with asymmetric fundamental downside risk; 3) two closed-end funds each trading at half of NAV; and 4) two insurance holding companies capable of compounding book value per share at 15-20% annually yet trading at only 1.2x book. The fund's engines could roar into action at any time. The two external variables that could hasten positive results would in all likelihood be more volatility in the broader stock market or a recovery in gold and silver, or both.

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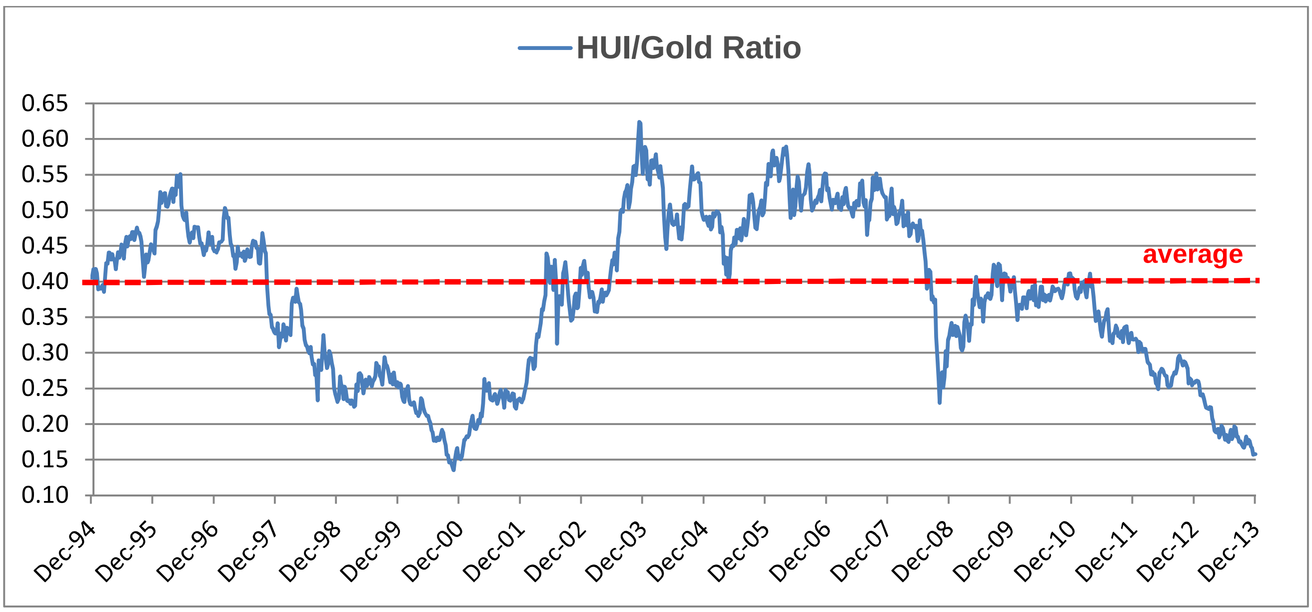
I would like to direct my remaining words back to where I started, that is, by providing further rationale for some of my gold stock and short ideas. The fund's gold stock holdings have been marked down to what appear to be fire sale levels. By averaging down, though, I now have a positive return on about half of my gold stock holdings. I foresee a time in the not-too-distant future *when gold stocks are possibly the only stocks going up in the entire market.* For my macro view on precious metals and investment approach to the sector, please read this commentary from six months ago. I would note that gold stocks are now as cheap vs gold as they ever have been:



At the stock level, what types of opportunities am I finding amidst the precious metals rubble? Here is a snapshot of my two most recent purchases.

Detour Gold (DGC CN) has built the largest new gold mine in Canada on-time and on-budget. The mine poured its first gold this September. Detour spent $2bn to build a mine that now has 15.6 million 2P reserves; a 21.5 year mine life; life-of-mine cash costs of $750/oz and all-in-sustaining costs of $1150-$1250/oz; and normalized annual production of over 600,000 troy ounces. For an investor of a bullish persuasion toward gold, Detour offered a cheap price, rapid growth in cash flow and financial gearing. At the fund's cost of $3.69 per share, Detour shares had fallen 90% over two years. The market cap was $510m and the enterprise value was $920m. The multiple of enterprise value to replacement cost was thus 46%. At a $1300/oz gold price, Detour could earn EBITDA of over $300 million next year, implying a forward EV/EBITDA multiple of <3x and net debt/EBITDA of <1.5x. 90% of debt matures in 2017. With operational breakeven around current gold prices, Detour is also very operationally geared to rises in the gold price. At 1x enterprise value to replacement cost, Detour's equity value per share would be $11-12. At 5x EV/EBITDA, shares would trade at $9. Detour is 2.3% of fund capital.

Silver Wheaton (SLW US) is simply the best precious metals business model I've been able to find after researching the sector all year. SLW is the largest silver-streaming company in the world and the second-largest by 2P reserves after Fresnillo. SLW is the fund's largest precious metals position at 6% of capital. It offers high margin leverage to silver, visible production growth without associated development capex and the highest quality proportional silver reserves in the industry. SLW also has lower operating costs than the silver ETFs, pays a dividend and is by far the most liquid, go-to equity in the industry.

70% of global silver supply is mined as a by-product by companies for whom silver production is non-core. The market does not give credit to these companies for their silver output. Mining companies with silver by-product can pre-fund development by selling their future silver output to SLW. In exchange for an upfront payment and a commitment to buy a customer's future silver output, SLW locks in silver at an advantageous cost of $4/oz. Customers then spend the capital to grow silver by-product production, not SLW. SLW's current annual proportional silver production is 32 million oz, with locked-in growth to 42.5 million oz by 2017 for which SLW will only make $490 million in upfront payments.

Uniquely in the precious metals industry, SLW is a buy-and-hold growth investment that generates an attractive return on equity. It is also very straightforward to value given its fixed costs, highly visible growth, locked-in capex and 10 year valuation history. At fund cost of $20.10 per share in December, SLW was 58% off its 2011 highs and traded at 15x trailing twelve month EV/EBITDA. But recent weakness belies a powerful long-term equity story: SLW is up 424% over the past nine years in its current form (20% cagr), leveraging silver's gain of 167% by a factor of 2.7x. Here are a range of (approximate) fair values for different silver prices assuming 12x (historical trough), 15x (5-year average), 26x (10-year average) and 42x (historical peak) EV/EBITDA in four years.

Equity Value per share in 2017

EV/EBITDA	Silver Price $20/oz	$30/oz	$40/oz
12x	18	32	46
15x	23	41	59
26x	43	74	105
42x	72	122	172

Cumulative 4-year upside

EV/EBITDA	Silver Price $20/oz	$30/oz	$40/oz
12x	-14%	56%	125%
15x	13%	99%	186%
26x	110%	260%	411%
42x	251%	494%	737%

4-year share price CAGR

EV/EBITDA	Silver Price $20/oz	$30/oz	$40/oz
12x	-4%	12%	23%
15x	3%	19%	30%
26x	20%	38%	50%
42x	37%	56%	70%

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Below is a snapshot review of select shorts in the portfolio.

A £2.6bn market cap online grocery delivery service which has generated negligible profit over the past decade, has consistently missed the original forecasts made at listing in 2010, relies heavily on a third-party relationship that may terminate in 2017, faces material competition from four larger online delivery platforms financed by profitable national supermarket chains, and trades at 60x EV/EBITDA and 3.5x EV/sales, having risen +427% in 2013.

An $8.2bn market cap multi-level marketing firm whose blistering growth over the past year is directly the result of a pyramid scheme fraud the company has perpetrated in China, where multi-level marketing firms are expressly forbidden. This US-headquartered firm is also subject to the same FTC risk as Herbalife but trades at a 28x ttm P/E compared to Herbalife's 15x. Shares have risen +276% in 2013 and insiders are selling aggressively.

A $3.3bn one-product pharmaceutical company who appears to be engaged in a scheme to defraud Medicare by charging tens of thousands of dollars for an unpatented drug that has been around since the 1950s and has been replicated synthetically and sold in international markets by a foreign company for mere dollars per dose. The company has just purchased this foreign firm to eliminate potential competition in the US, but the SEC and DOJ are now investigating. US private insurers have begun to withdraw reimbursement. Shares have risen +105% in 2013.

An $11.2bn market cap single-pack coffee manufacturer who has lost key patents covering its single-serve brewer technology. A closed-loop razor/blade model has thus been opened up to third-party single-pack competition that is rapidly under-cutting pricing and margin. This company's year-on-year revenue growth rate is slowing and it is now turning into a low-margin manufacturing company, yet trades at 22x P/E. This company's disclosure has worsened and financials have become more complex over the years, and an unresolved SEC accounting investigation is still ongoing.

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I look forward to updating you on the fund in one year's time. In the meantime, please contact me in London on +44 20 7659 4007 or at theron@eschlerasset.com if you would like to discuss anything. Also, please visit www.eschlerasset.com to view the updated fund presentation, factsheet, offering memorandum and due diligence material; just click through the disclaimers. Audited accounts for the period 8 October 2012 through 31 December 2013 will be available in the first quarter of 2014.

Last but definitely not least, I would like to thank you for your continued support over the past year.

Sincerely,

Theron de Ris
Portfolio Manager
6 January 2014