



## MANAGEMENT REPORT OF FUND PERFORMANCE

DECEMBER 31, 2012

## **THE RAVENSOURCE FUND**

*This annual management report of fund performance contains financial highlights but does not contain the complete annual financial statements of the investment fund. You can get a copy of the annual financial statements at your request, and at no cost, by calling 416 250 2845, by writing to us at Stornoway Portfolio Management 30 St. Clair Avenue West, Suite 901, Toronto, ON M4V 3A1, by visiting our website at [www.ravensourcefund.ca](http://www.ravensourcefund.ca), or the SEDAR website at [www.sedar.com](http://www.sedar.com).*

*Securityholders may also contact us using one of these methods to request a copy of the investment fund's proxy voting policies and procedures, proxy voting disclosure record, or quarterly portfolio disclosure.*

### **A Note on Forward/Looking Statements**

*This document may contain forward/looking statements relating to anticipated future events, results, performance, decisions, circumstances, opportunities, risks or other matters. Forward/looking statements are statements that are predictive in nature, depend upon or refer to future events or conditions, or that include words such as "may", "will", "should", "could", "expect", "anticipate", "intend", "plan", "believe", or "estimate" or other similar expressions. These statements require us to make assumptions and are subject to inherent risks and uncertainties. Our predictions and other forward/looking statements may not prove to be accurate, or a number of factors could cause actual events, results, performance, etc. to differ materially from the targets, expectations, estimates or intentions expressed or implied in the forward/looking statements. These factors could include, among others, market and general economic conditions, interest rates, regulatory and statutory developments, the effects of competition in the geographic and business areas in which the fund may invest, and the risks detailed from time to time in the fund's simplified prospectus. Forward/looking statements are not guarantees of future performance. For these reasons, it is important that readers do not place undue reliance on our forward/looking statements and should be aware that the Fund may not update any forward/looking statements whether as a result of new information, future events or otherwise.*

## **MANAGEMENT DISCUSSION OF FUND PERFORMANCE**

### **THE FUND**

The Ravensource Fund ("Ravensource" or "the Fund") is a closed-end mutual fund trust, the units of which trade on the TSX under the symbol RAV.UN. By way of a special meeting of unitholders, Stornoway Portfolio Management Inc. ("SPM") was appointed the Investment Manager to the Ravensource Fund effective July 1, 2008. SPM's responsibilities for Ravensource include the evaluation, selection and negotiation of investments, the ongoing monitoring and evaluation of such investments and the recommendation of the appropriate timing and structure for disposition of such investments.

### **INVESTMENT OBJECTIVE AND STRATEGIES**

The principal objective of Ravensource is to achieve absolute long-term returns, with an emphasis on capital gains, through investments in selected North American debt securities, creditor claims and equity securities. The investment objectives of the Fund are stated in detail in the Declaration of Trust and in greater detail on the Fund's website.

To achieve its investment objectives, Ravensource's investments fall primarily in three Strategies:

1. *High Yielding Securities*: investing in corporate debt, income fund units, or other securities that produce a sustainable high level of income for the underlying credit risk.
2. *Distressed Securities*: investing in corporate debt, creditor claims and/or equity securities of companies which are in, or perceived to be in, financial distress at a price materially different from what we believe to be the underlying fundamental value of the securities.
3. *Special Situations Equities*: investing primarily in Canadian and U.S. small- and mid-cap equities that have been identified as not only attractively valued but also with the catalysts to unlock value.

## **RISK**

Risks associated with an investment in the units of Ravensource are discussed in the Annual Information Form and in the notes attached to the financial statements which are available on the SEDAR website at [www.sedar.com](http://www.sedar.com) and on the Ravensource website at [www.ravensourcefund.ca](http://www.ravensourcefund.ca). There has been not been a change in the Fund's stated investment strategy or other changes that would materially affect the risk of investing in Ravensource during 2012. The Fund continues to be suitable for those investors seeking long-term capital growth, have a long term investment horizon and possess a medium to high risk tolerance to withstand the ups and downs that go along with investing in out-of-favor securities.

## **RESULTS OF OPERATIONS FROM JANUARY 1, 2012 TO DECEMBER 31, 2012**

Ravensource's net assets increased by \$1.76 million or 10.6% year-over-year as the increase due to the Fund's investment performance was partly offset by redemptions and distributions to unitholders. In 2011, Ravensource's net assets increased \$1.70 million or 11.4% primarily due to the \$3.59 million rights issuance in May 2011.

### **Investment Performance**

Ravensource Fund's net asset value per unit ("NAV") increased by 15.4% including distributions and after all fees and expenses in 2012. This compares favourably to the S&P TSX Composite Total Return Index return of 7.2%. In 2011, Ravensource's NAV per unit decreased by 3.4% versus the 8.7% decline in the S&P TSX Composite Total Return Index. All index and fund returns are calculated on a total return basis in Canadian dollar terms.

This year's performance was primarily driven by long-term investments – specifically, the bonds of Holloway Lodging, First Uranium and Specialty Foods Group – that were harvested during the year as key milestones were achieved and the value that was identified at the time of investment was realized. Investments in the shares of Pier 1 Network Enterprise and Jovian Capital also contributed significantly to 2012's performance.

### **Distributions**

Ravensource Fund's distribution policy is to make semi-annual distributions to unitholders in an amount to ensure that it does not incur any tax liability and to provide a reasonable yield for investors. During 2012, The Fund made semi-annual distributions of \$0.09 per unit on July 5, 2012, \$0.09 per unit on December 28, 2012, and \$0.27 per unit on December 31, 2012. Total distributions for the year amounted to \$0.45 per unit versus \$0.36 per unit in fiscal 2011. While distributions have increased 25% versus the 2011 level and 150% versus 2010, there was no change in Ravensource's distribution policy as the increases were necessary to maintain the Fund's non-taxable status. Accordingly, Ravensource investors should not expect the 2012 distributions to be maintained.

### **Redemptions**

Ravensource Fund offers an annual redemption privilege that allows unitholders to redeem 100% of their units for cash at a price equal to the Net Asset Value – adjusted to reflect expenses incurred to affect the redemption – as calculated as of the Annual Redemption Date. For further details, please refer to the Declaration of Trust which can be found in the "Key Documents" section of the Ravensource Website at [www.ravensourcefund.ca](http://www.ravensourcefund.ca) and on SEDAR website at [www.sedar.com](http://www.sedar.com). Redemptions for 2012 amounted to 1,400 units at a redemption price of \$10.72834 representing 0.08% of the total units of the Fund outstanding with a redemption value of \$15,021.

### **Fees and Expenses**

The annualized Management Expense Ratio ("MER") measures the amount of annual fund expenses expressed as ratio to average net assets. For the year ended December 31, 2012, Ravensource's MER was 3.14%, an increase of 97 basis points over 2011 levels of 2.17%. The increase in MER for 2012 is primarily a

result of increases in the incentive fee and professional fees moderated by a partial waiver of Management and Administration fees charged by the Investment Manager.

The Investment Manager received an incentive fee equal to 85 basis points of average net assets in 2012, while no incentive fee was earned in 2011.

Professional fees increased Ravensource's MER by 69 basis points in 2012 versus 2011. Ravensource will often incur professional expenses, especially in our Distressed Securities strategy, in the negotiation and/or protection of the Fund's investments. In 2012, legal expenses were particularly higher than normal due to Crystallex's CCAA insolvency proceedings, the negotiation of the amendment to First Uranium's bond indenture and conversion of Holloway Lodging bonds to units.

The increase in incentive fees and professional fees were somewhat offset by a 52 basis points decline in the management and administrative fees versus 2011. The decline resulted from SPM's policy to pass on the economic benefit of fees earned under the SFG Services Agreement by reducing the management and administrative fees charged to the Fund. See Related Party Transactions for more information on the SFG Services Agreement and on fees paid to SPM.

Ravensource's expenses consist of the management fee, administration fee, investor relations fee, incentive fee and other fund costs. Other fund costs include Trustee, Transfer Agent, TSX listing fees, taxes (including but not limited to GST/HST), interest and borrowing costs, accounting and audit expenses, fees and expenses of the Ravensource Fund' Independent Review Committee ("IRC") and legal costs.

## **RECENT DEVELOPMENTS**

### **International Financial Reporting Standards**

Prior to January 1, 2014, the Canadian Accounting Standards Board (AcSB) requires investment funds to adopt International Financial Reporting Standards (IFRS) as published by the International Accounting Standards Boards. Accordingly, the Fund will adopt IFRS in accordance with AcSB's plan. The impact to the Fund of adopting of these standards is not known at this time.

### **Harmonized Sales Tax ("HST")**

In 2013, three provinces – Quebec, Prince Edward Island, and British Columbia – will undergo significant changes to their sales taxes. Both Quebec and Prince Edward Island will harmonize their provincial sales tax systems with the federal GST, on January 1, 2013, and April 1, 2013, respectively. On April 1, 2013, British Columbia will replace the HST with the federal GST and its provincial sales tax. Implementation of these proposed changes may affect the amount of taxes paid by the Fund on its expenses and may therefore increase or decrease MERs.

## **RELATED PARTY TRANSACTIONS**

### **SFG Services Agreement**

The Fund has an investment in the securities of Specialty Foods Group Inc. ("SFG"). Additionally, another fund managed by SPM holds similar investments in SFG. During 2012, SPM entered into a services agreement with SFG (the "SFG Services Agreement") whereby SPM is to provide strategic advice and analysis to SFG and in return will earn a fee for these services. As per its internal policy and approved by the Fund's IRC, SPM reduced the management fees and administrative fees that it charges to the Fund in order to pass along the economic benefit of the fees earned. During 2012, SPM reduced management fees by \$49,720 and reduced administrative fees by \$26,772. SPM will continue to reduce the management fee and administrative fees accordingly for so long as Ravensource is invested in SFG securities and SPM continues to receive fees from the SFG Services Agreement.

### **Management fees**

The management fee payable to the Investment Manager is based on the Fund's average weekly net assets at the end of each week and payable on the last business day of each calendar month as follows:

<b>Average weekly net assets</b>	<b>Management fee</b>
Up to and including \$250 million	0.65% of net asset value plus HST
Between \$250 million and \$500 million	0.60% of net asset value plus HST
\$500 million and more	0.55% of net asset value plus HST

The management fees for 2012 amounted to \$77,681 (2011 - \$121,725). The Investment Manager reduced the management fees by \$49,720 due to the SFG Services Agreement. In the absence of the management fee reduction, total management fees for 2012 would have amounted to approximately \$133,865 (inclusive of HST).

### **Administrative fees**

Subject to the supervision of the Trustee, the Investment Manager agrees to be responsible for and provide certain administrative services to the Fund. The Fund will pay the Investment Manager a fee based on the Fund's average weekly net assets at the end of each week and payable on the last business day of each calendar month as follows:

<b>Average weekly net assets</b>	<b>Administrative fee</b>
Up to and including \$250 million	0.35% of net asset value plus HST
Between \$250 million and \$500 million	0.30% of net asset value plus HST
\$500 million and more	0.25% of net asset value plus HST

The administrative fees for 2012 amounted to \$41,828 (2011 - \$65,544). The Investment Manager reduced the administrative fee by \$26,772 due to the SFG Services Agreement. In the absence of the administrative fee reduction, total administrative fees for 2012 would have amounted to approximately \$72,081 (inclusive of HST).

### **Investor relations fees**

The Investment Manager is paid a monthly investor relations fee of \$1,000 plus applicable sales tax for unitholder reporting and other services provided under a service agreement. The aggregate investor relations fee for 2012 amounted to \$13,560 (2011 - \$14,331).

### **Incentive fee**

Investment Manager will earn an incentive fee equal to 20% of the amount by which the net asset value per unit at the end of the year, adjusted for contributions, distributions, and redemptions during the year, exceeds the net asset value per unit at the beginning of the year by more than 5%, plus any shortfalls from prior years. This fee is accrued monthly but calculated and paid annually. Incentive fees payable for 2012 amounted to \$148,162 (2011 - \$nil).

## FINANCIAL HIGHLIGHTS

### For the years ended December 31, 2008 to December 31, 2012

The following tables show selected key financial information about the Fund that are intended to help you understand the Fund's financial performance for the past 5 years.

<b>The Fund's Net Assets per Unit (\$) <sup>(1)</sup></b>	<b>2012</b>	<b>2011</b>	<b>2010</b>	<b>2009</b>	<b>2008</b>
<b>Net Assets, beginning of year</b>	9.74	10.45	8.01	5.63	9.46
<b>Increase (decrease) from operations:</b>					
Total revenue	0.62	0.50	0.36	0.36	0.41
Total expenses	0.32	0.21	0.29	0.16	0.15
Realized gains (losses) for the period	1.29	0.36	1.19	0.20	0.08
Unrealized gains (losses) for the period	(0.09)	(0.94)	1.36	2.14	(4.06)
<b>Total increase (decrease) from operations <sup>(2)</sup></b>	1.50	(0.29)	2.62	2.55	(3.72)
<b>Distributions:</b>					
From income (excluding dividends)	-	0.16	-	-	-
From dividends	0.34	0.14	0.04	0.03	-
From capital gains	-	-	-	-	-
Return of capital	0.11	0.06	0.14	0.15	0.09
<b>Total Distributions <sup>(3)</sup></b>	0.45	0.36	0.18	0.18	0.09
<b>Issuance of units <sup>(4)</sup></b>		0.15			
<b>Net assets, End of Period</b>	10.79	9.74	10.45	8.01	5.63

(1) This information is derived from the Fund's audited annual financial statements. The net assets per security presented in the financial statements differs from the net asset value calculated for fund pricing purposes. An explanation of these differences can be found in the notes to the financial statements.

(2) Net assets and distributions are based on the actual number of units outstanding at the relevant time. The increase/decrease from operations is based on the weighted average number of units outstanding.

(3) Distributions were paid in cash.

(4) Represents the negative impact on NAV per units from the issuance of units at a discount plus associated expenses.

<b>Ratios and Supplemental Data</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>	<b>2009</b>	<b>2008</b>
Total net asset value (000's) <sup>(1)</sup>	\$18,344	\$16,581	\$14,884	\$11,402	\$8,021
Number of units outstanding <sup>(1)</sup>	1,700,470	1,701,870	1,424,016	1,424,016	1,424,016
Management expense ratio <sup>(2)</sup>	3.14%	2.17%	3.15%	2.27%	2.05%
Management expense ratio before waivers or absorptions	3.63%	2.17%	3.15%	2.27%	2.05%
Trading expense ratio <sup>(3)</sup>	0.04%	0.07%	0.30%	0.17%	0.20%
Portfolio turnover rate <sup>(4)</sup>	28.55%	18.45%	37.02%	32.57%	28.45%
Net asset value per unit	\$10.79	\$9.74	\$10.45	\$8.01	\$5.63
Closing market price <sup>(5)</sup>	\$10.52	\$10.00	\$10.25	\$7.05	\$5.00

(1) This information is provided as at December 31 of the year.

(2) Management expense ratio is based on total expenses (excluding commissions and transaction costs) for the stated period and is expressed as an annualized percentage of daily average net asset value.

(3) The trading expense ratio represents total commissions and other portfolio transaction costs expressed as an annualized percentage of daily average net asset value during the period.

(4) The Fund's portfolio turnover rate indicates how actively the Fund's portfolio adviser manages its investments. A portfolio turnover rate of 100% is equivalent to the Fund buying and selling all of the securities in the portfolio once in the course of the year. The higher a fund's portfolio turnover rate in a year, the greater the trading costs payable by the fund in the year, and the greater the chance of an investor receiving taxable capital gains in the year. There is not necessarily a relationship between a high turnover rate and the performance of the fund.

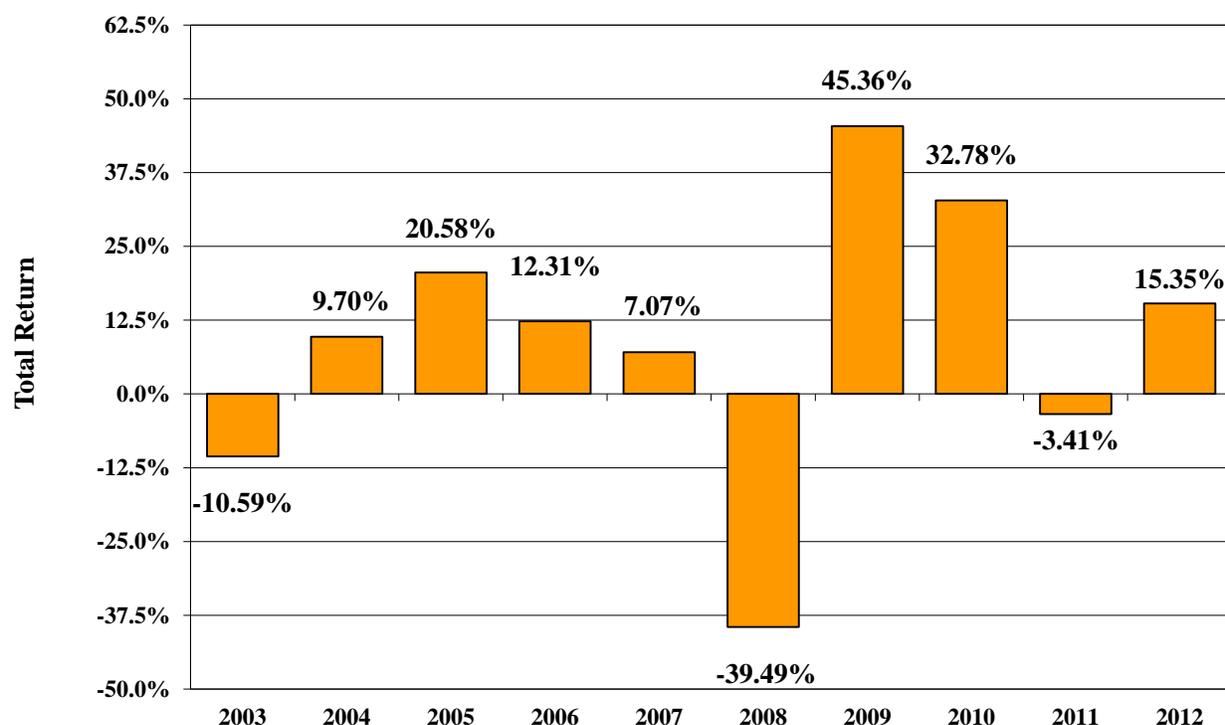
(5) The Closing market price refers to the last bid for a given period end.

## PAST PERFORMANCE

The following performance information assumes that all distributions made by the Fund are used to purchase additional units of the Fund and is based on the net asset value of the Fund, after all fees and expenses have been taken into account. Past performance is not indicative of future performance.

### YEAR-BY-YEAR RETURNS

The following bar chart shows the performance of the Fund for each of the financial years shown. The charts show how an investment in the Fund made on the first day of each financial year would have increased or decreased, in percentage terms, by the last day of each financial year.



### ANNUAL COMPOUND RETURNS

The table below compares the historical annual compound returns of the Fund to the S&P/TSX Composite Total Return Index ("S&P/TSX"), the S&P/TSX Small Cap Total Return Index, the BofA ML High Yield Master II Index and the DJ/Credit Suisse Hedge Fund Index (the "Benchmark Indices").

	1 Year	3 Years	5 Years	10 Years	Since <sup>(2)</sup> July 2008
<b>RavenSource Fund - RAV.UN<sup>(1)</sup></b>	<b>15.1%</b>	<b>13.5%</b>	<b>5.4%</b>	<b>6.0%</b>	<b>8.2%</b>
S&P/TSX Composite Total Return Index	7.2%	4.8%	0.8%	9.2%	0.1%
S&P/TSX Small Cap Total Return Index	-2.2%	3.4%	-0.5%	5.7%	0.2%
BofA ML High Yield Master II Index	15.6%	11.6%	10.0%	10.4%	11.5%
DJ/Credit Suisse Distress Hedge Fund Index	11.8%	5.7%	2.6%	8.7%	3.2%

(1) Based on net asset value per Unit, assuming all distributions are reinvested in Units at net asset value.

(2) Stornoway Portfolio Management was appointed as Manager of the RavenSource Fund effective July 1, 2008.

**Benchmark Indices**

The Benchmark Indices are comprised of widely-known, broad-based indices which have been selected for purposes of comparing the performance of the Fund and individually relate to the Fund's three various investment strategies. The Fund's performance may or may not correlate to any of these indices and should not be considered as a proxy for any of these indices. The S&P/TSX Composite Total Return Index is the headline index and the principal broad market measure for the Canadian equity markets. The S&P/TSX Small Cap Total Return Index is comprised of a representative sample of investable Canadian small cap companies. The BofA ML High Yield Master II Index tracks the performance of U.S. dollar denominated, below investment grade rated corporate debt. The DJ/CS Distressed Hedge Fund Index tracks the performance of funds that invest in distressed securities.

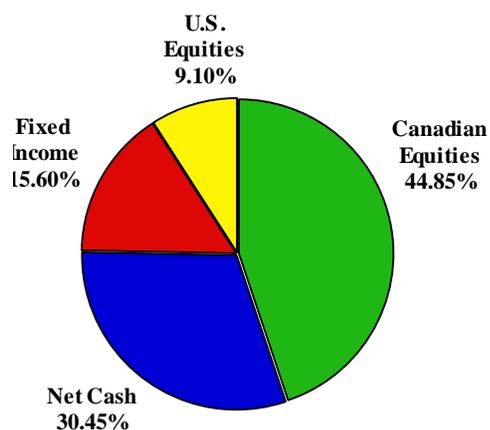
## SUMMARY OF INVESTMENT PORTFOLIO

As at December 31, 2012

By Industrial Group	% of Portfolio
Food Products	10.8%
Financial	16.8%
Conglomerate	13.5%
Metals & Mining	12.2%
Energy	10.3%
Real Estate	9.5%
Information Technology	7.5%
Paper & Packaging	7.5%
Media & Publishing	6.6%
Construction	1.6%
Industrial	1.6%
Retail	1.4%
Transportation	0.6%
Other	0.2%
<b>Total</b>	<b>100%</b>

Top 25 Holdings Issuer/Security	% of Net Assets
Net Cash *	30.45%
PlazaCorp Retail Properties Ltd	6.63%
Tuckamore 8% 2016	6.16%
Jovian Capital Corp.	6.07%
Crystallex 9.375% 2011	6.02%
Pier 1 Network Enterprise	5.22%
Specialty Foods Group Warrants	4.21%
Winpak Ltd.	3.64%
Clairvest Group Inc	3.25%
Genworth Financial Inc	3.05%
Cannacord Capital Inc.	2.57%
Ten Peaks Coffee Co Inc	2.28%
NuVista Energy Ltd.	1.86%
Chinook Energy Inc	1.74%
Fiera Sceptre Inc	1.62%
Supremex Inc	1.57%
Melior Resources Inc.	1.56%
Quad Graphics	1.46%
Ivanhoe Energy 5.75% 2016	1.33%
Glacier Media Inc	1.33%
Connacher Oil & Gas 8.75% 2018	1.12%
Canwel Holdings Corp.	1.11%
GLV Inc.	1.06%
Village Farms Income Fund	1.00%
Indigo Books & Music Inc	0.97%
<b>Total % of Net Assets</b>	<b>97.28%</b>

### By Security Type - % of Net Assets



By Investment Strategy	% of Investment Portfolio	
	2012	2011
Special Situation Equities	77.6%	61.5%
Distressed Securities	20.5%	24.0%
High Yielding Securities	1.9%	14.5%
<b>Total</b>	<b>100%</b>	<b>100%</b>

## **ADDITIONAL INFORMATION**

### **RavenSource Independent Review Committee (“IRC”)**

To adhere to National Instrument 81-107 and to provide an arms-length vehicle to deal with matters that involve potential conflicts of interest between the Fund and the Manager, RavenSource established and maintains an Independent Review Committee (“IRC”). The role, composition and responsibilities of the IRC can be summarized as follows:

- size of the IRC is 3 members that are independent from the Manager with no material relationships to the Manager;
- its mandate is to consider and provide impartial judgment on any conflict of interest referred to it by the Manager;
- when a conflict of interest arises, the IRC will review and recommend to the Manager what action it should take to achieve a fair and reasonable result for RavenSource;
- report to the relevant securities regulators any instance where the Manager acted in a conflict of interest matter in such a way that did not comply with conditions imposed by securities legislation or the IRC;
- meet at least annually with at least one of the meetings to be held “in camera”;
- for each calendar year, the IRC must prepare a report to the RavenSource Fund that describes the IRC and its activities for the fiscal year. This report is posted on the Fund’s website @ [www.ravenSource.ca](http://www.ravenSource.ca)

The IRC is comprised of Michael Siskind (Chairman), David Magahey, and Michael Gardiner.

### **Access to Information**

We continue to meet the requirements of National Instrument 81-106 and publish our 25 largest holdings quarterly and net asset value weekly. All of the key Fund documents along with further information on the Fund and the investment team that manages your investments can be accessed through our website ([www.ravenSource.ca](http://www.ravenSource.ca)). We are committed to keeping the website current and I encourage you to make use of this resource tool. In addition, we are likely to expand our current reporting to include periodic postings on subjects that may be of interest to unitholders expressed in a less formal manner than is appropriate for this document. Over time we have been mandated to tell you so much in the management discussion and analysis that your patience might be tested by greater length to cover discretionary subjects. Aside from the website, Fund documents can also be retrieved through SEDAR ([www.sedar.com](http://www.sedar.com)).

## **FUND INFORMATION**

### **Trustee, Registrar and Transfer Agent**

Computershare Trust Co. of Canada

### **Investment Manager**

Stornoway Portfolio Management Inc.  
30 St. Clair Avenue West, Suite 901  
Toronto, ON M4V 3A1

### **Auditor**

Deloitte LLP

### **Investor Relations**

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