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December 8, 1995

Dear Baupost Fund Shareholder,

We are pleased to report a gain of 7.91% for the year ended October 31, 1995. This result, while ahead of our self-imposed bogey of exceeding the return on U.S. treasury bills, falls considerably short of the performance of various U.S. stock market indices. The primary reason for our underperformance, of course, is that the Fund has relatively little exposure to the U.S. stock market.

The Baupost Fund is managed with the intention of earning good absolute returns regardless of how any particular financial market performs. This philosophy is implemented with a bottom-up value investment strategy whereby we hold only those securities that are significantly undervalued, and hold cash when we cannot find better alternatives. Further, we prefer investments, when we can find them at attractive prices, that involve a catalyst for the realization of underlying value. This serves to reduce the volatility of our results and de-emphasizes market movements as the source of our investment returns. Positions with catalysts tend to lag a rapidly rising stock market (like this past year's) and outperform a lackluster or declining one (like we used to have every few years!).

During fiscal 1995, the Fund profited in most areas of the portfolio. Our largest gains and losses for the fiscal year, both realized and unrealized, are presented in Table 1 on the next page.

This fiscal year was somewhat unusual for the Fund. While we are gratified with the number of important gains, only three positions provided profitability in excess of one million dollars during the year. Maxwell Communications was a large position in the senior debt of a U.K. insolvency. The value rose significantly after the company announced the first of three substantial distributions to creditors. Emcor and MBO both involve securities of post-bankruptcy companies that initially received little attention in the market.

We experienced four significant losing positions this year. The largest was a position in various equity and debt market hedges that mostly expired worthless. Our policy is to continue to protect ourselves from serious market declines through the purchase of out-of-the-money put options. While an expensive proposition in fiscal 1995, the cost was manageable when considered in the context of the entire portfolio. Obviously, in other market environments, our hedges will have a very different impact on overall investment results.

TABLE 1
The Baupost Fund
Largest Gains and Losses
For the Twelve Months Ended 10/31/95
(\$ in millions)

<u>Largest Gains</u>		<u>Largest Losses</u>	
Maxwell Communications debt	\$2.2	Various equity and debt market hedges	\$(2.1)
Emcor debt and equity	1.2	Playmates Toys equity	(1.2)
MBO equity	1.1	Dep Corporation equity	(0.9)
El Paso del Norte debt	0.8	Louise's debt	(0.8)
Basic Petroleum equity	0.6	Semi Tech Global equity	(0.4)
Todd Shipyards equity	0.6	TLC Beatrice equity	(0.4)
Viacom hedged strategy	0.5	Esco Electronics equity	(0.3)
QCF Bancorp equity	0.4	C-3 Inc. equity	(0.3)
DuPont equity and options	0.4	Carr Gottstein equity	(0.1)
Wells Financial equity	0.4	Eagle Picher debt	(0.1)
RJR Nabisco equity and options (net of hedge)	0.4	Fonciere Financiere equity	(0.1)
RIT Capital Partners equity	0.4	Hills Department Store equity & options	(0.1)

Our Playmates Toys position declined on the heels of disappointing first half 1995 results. We believe this decline will be more than fully reversed in the future based on improved business performance. At the current level, the shares trade at a price approximately equal to net current assets; the company is involved in a number of projects that could very positively impact results in the second half of 1995 and beyond. Dep Corporation, while statistically cheap, did not perform in accordance with our expectations. The company overpaid for an acquisition and their debt load from the acquisition left little operating flexibility. Louise's was another disappointment; the company failed to take advantage of a window one year ago to come public, and deteriorating results caused us to take a writedown on this position. Other leading declines, such as TLC Beatrice and Semi Tech Global, reflect temporary market fluctuations that have resulted in these undervalued situations becoming even more undervalued. We believe that both these situations have great upside potential with little downside risk. No other investment declines cost us more than 0.5% of our total market value.

Once again in 1995, the U.S. stock market has delivered investment performance appreciably ahead of underlying business results. Over the past thirteen years, the S&P 500 with dividends reinvested has delivered a compound annual return of 15.9%, the best such result ever. For the last five years, the S&P 500 has returned 17.2%, while the NASDAQ Composite Index has returned a staggering 25.7%. Assuming a 10% long term rate of return from equities, the NASDAQ would need to drop a whopping 49% tomorrow to simply return to trendline for the latest five year period.

Bulls will patiently explain that "it is different this time", pointing to low inflation, high corporate profits, increased productivity, world peace (sort of), reductions in government spending, and the like. Of course, any contrarian knows that just as a grim present is usually precursor to a better future, a rosy present may be precursor to a bleaker tomorrow. Without me listing all the things that could go wrong, simply consider that none of these virtuous factors are cast in stone. Just as seeds are

sown during the seven lean years that allow the seven fat years to ensue, so does the reverse hold true.

Anecdotally, too, this market is greatly overextended. People with no previous investment experience are starting hedge funds. Everyone seems to know someone who owns stock in a company that has just come public, not to mention the certifiable mania among the general public to own mutual funds and Internet stocks. Just a few days ago, the last remaining bearish Wall Street market strategist turned bullish, arguing that the "valuation paradigm" had changed.

Dangerous lessons are being learned by many investors. Warren Buffett has pointed out that legitimate theories frequently lie at the root of financial excesses; good ideas are simply carried too far. Today, virtually everyone "knows" that over the long-run, stocks will outperform other investment alternatives. Of course, almost no one thought of this as the market made cyclical lows in 1974 and 1982. So after a record-setting thirteen year bull market, proponents of this viewpoint are ignoring the high price they must now pay to purchase equities. Another dangerous notion is that dips in the market always represent buying opportunities. We firmly believe that one of Baupost's biggest risks, and, needless to say, that of other investors, is that we will buy too soon on the way down. Sometimes cheap stocks become a whole lot cheaper; it simply hasn't happened lately. (And when that happens, expensive stocks will fare far worse.)

We have said before and will repeat here that you do not really need Baupost to invest your money in bull markets. An index fund could likely perform better. The true investment challenge is to perform well in difficult times. It is unfortunately not possible to reliably predict when those times might be. The cost of performing well in bad times can be relative underperformance in good times. We have always judged that a worthwhile price to pay.

We remain surprised by the number of attractive opportunities we continue to find despite generally overextended market conditions. We believe that what we own is exceedingly cheap on an absolute basis, and that these holdings will perform well no matter what the broader market does. A number of our largest holdings at year-end have catalysts for the realization of underlying value, and should come to fruition in the relatively near future. Specifically, MBO Properties and Maxwell Communications remain in liquidation. El Paso is expected to emerge from Chapter 11 in the first quarter of 1996; we will receive new equity and debt securities in a reorganized company in exchange for our bonds. Carr-Gottstein Foods common stock and Southland Corp. bonds are both the target of tender offers. RJR Nabisco is under tremendous pressure by two corporate raiders to spin off its food business directly to shareholders, something the company indicated previously that it would likely do anyway. Falcon Cable recently announced that it was pursuing its sale, a year earlier than expected.

A number of our most undervalued holdings have no immediate catalyst for value realization. Allmerica Financial, the subject of a recent conversion from a mutual to stock insurance company, trades at a substantial discount to its peers. Semi-Tech Global sells at a 60% discount from its unleveraged, mostly liquid, asset value. TLC Beatrice's thinly traded shares sell at a large discount to its breakup value, as do the shares of Japan's Kirin Brewery. Recent legislation allowing Japanese companies to buy back their own shares may greatly benefit cash-rich Kirin. RIT Capital Partners continues to trade at a 35% discount from our estimate of net asset value. Several recent thrift conversions, including Trenton Savings Bank, Mississippi View Holding Company and Wells Financial, remain

bargain-priced compared to their underlying value. Emcor Group and Envirotec Systems bonds, trading at significant discounts to par, offer high current yields and good asset protection.

We continue to focus our attention on the avoidance and/or reduction of risk. We believe this can be done without sacrificing good, even excellent, returns over time. The return earned by the Fund in fiscal 1995 is well below our long term expectation, and reflects a combination of uncooperative market conditions for our type of securities (the cheap became cheaper) and (with the benefit of perfect hindsight) excessive caution, both in the form of hedging costs and relatively high cash balances.

We remain grateful for your ongoing interest, support and confidence in us. We continue to strive to deserve it. Please let any of us know if there is anything we can do to serve you better.

Very truly yours,

Seth A. Klarman
President

Average Annual Total Returns (1) For Periods Ended 10/31/95	<u>1</u> <u>Year</u>	<u>Life of Fund</u> <u>(since 12/14/90)</u>
The Baupost Fund	7.91%	14.91%

Total return is an historical measure of past performance and is not intended to indicate future performance. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost.

(1) Assumes reinvestment of all dividends.

**GROWTH OF AN ASSUMED \$50,000 INVESTMENT
IN THE BAUPOST FUND FROM 12/14/90 THROUGH 10/31/95**

[IN THIS PLACE IS A LINE GRAPH SHOWING THE GROWTH OF AN ASSUMED
\$50,000 INVESTMENT IN THE BAUPOSTFUND COMPARED TO THE S&P 500 FROM
12/14/90 THROUGH 10/31/95. THE PLOT POINTS ARE AS FOLLOWS]

	<u>S&P</u>	<u>THE BAUPOST FUND</u>
12/14/90	\$ 50,000.00	\$50,000.00
3/91	\$ 58,024.40	\$55,771.68
6/91	\$ 57,891.29	\$59,332.96
9/91	\$ 60,987.08	\$58,998.31
12/91	\$ 66,100.47	\$61,485.71
3/92	\$ 64,430.83	\$63,911.75
6/92	\$ 65,659.40	\$64,203.91
9/92	\$ 67,729.67	\$65,059.55
12/92	\$ 71,140.30	\$70,005.54
3/93	\$ 74,243.41	\$75,227.59
6/93	\$ 74,604.74	\$77,707.92
9/93	\$ 76,532.54	\$80,054.79
10/31/93	\$ 78,116.01	\$82,134.71
12/93	\$ 78,305.62	\$83,196.92
3/94	\$ 75,335.75	\$84,533.67
6/94	\$ 75,653.26	\$89,244.13
9/94	\$ 79,352.03	\$88,798.55
10/31/94	\$ 81,134.73	\$91,217.43
12/94	\$ 79,339.62	\$89,880.68
3/95	\$ 87,064.74	\$91,488.30
6/95	\$ 95,375.77	\$93,607.44
9/95	\$102,955.48	\$99,526.41
10/31/95	\$102,587.46	\$98,430.31

(1) Assumes reinvestment of all dividends.