Scion Value Fund, A Series of Scion Funds, LLC
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October 2, 2001

Dear Fellow Members:

During the first nine months of 2001, the Fund appreciated 10.98% net of all actual and accrued expenses and performance allocations. Since its inception on November 1, 2000, the Fund has appreciated 18.31% net of allocations and expenses.

	2001 YTD	Since Inception[1]
Scion Gross[2]	+13.49%	+22.84%
Scion Net[3]	+10.98%	+18.31%
S&P 500	-20.39%	-26.33%

[1]Inception November 1, 2000
[2]Return before 20% performance allocation and expenses
[3]Return after 20% performance allocation and expenses

Again, I will continue to advise that whatever numbers you see before you on your capital account statements, they should not be compounded into the future indefinitely. The portfolio is a fairly concentrated one, and significant volatility is to be expected. I fully expect and recommend that members of this investment vehicle judge my performance over a period of five years or greater. This will prove to be the most fruitful and enjoyable manner in which to participate in the Fund.

The Third Quarter

In the second quarter letter, I made light of the investment industry's fascination with the quarter as a unit of time. Indeed, Scion Capital, as a California registered investment advisor, is required to provide you a report on a quarterly basis at minimum. Therefore, the quarter has become the fabric of our lives regardless of my opinion on the matter. Normally, I write these letters with the standard disclaimer, as in the paragraph above, that the timing of report is rather arbitrary – and that very little predictive value can be conveyed in simple quarterly performance numbers.

It is fair to say, however, that September proved a unique month in stock market history – overshadowed only by its unique place in human history. The tragic events of September 11th have caused performance during this third quarter of 2001 to be particularly irrelevant to the task of measuring investment skill.

That is, the ability to take such a quarter's performance and extrapolate it into a general summation of the investment manager's ability is fraught with even greater difficulty than usual. To this end, however, my position has been that the narrative of the quarterly report ought provide some aid to such an evaluation, and my efforts on this front follow.

The Portfolio

All major stock market indices saw significant declines during the third quarter. The Dow Jones Industrial Average, the most venerable of the group, lost 16%, its worst quarterly performance since 1987. The Nasdaq Composite, a recent favorite, lost 31%. The S&P 500 Index, the modern standard, fell 15%. And the Russell 2000, a small cap benchmark, lost 21%.

The Fund fared comparatively well, but I have to say such comparisons are not necessarily valid. The general market decline was not the reason for downward fluctuation in the Fund. Indeed, the results of the third quarter have no more reason for correlation with the market than the results of the first half of 2001. Rather, the Fund fell because I simply chose several key stocks that declined in price during the quarter. Any correlation with the indices in terms of direction and magnitude is largely coincidental. Certainly, in large part, the price declines of portfolio holdings do not reflect any similar deterioration in intrinsic value. And because the Fund has added to several of these decliners, the Fund is more valuable now than one quarter ago.

So, with this preface, I will review several specific reasons for the third quarter performance that you see on you account statement. For this was one quarter in which run-of-the-mill market volatility was not the culprit.

First and most important, the Fund has been averaging down in a stock, purchased during the quarter, which has fallen tremendously out of favor over the past couple of months. In a steep decline throughout July and August, the stock found the week after the markets re-opened particularly brutal as panicked sellers found relatively few buyers. Very few investment funds would want this stock on their books at the end of the quarter. Indeed, as the quarter came to a close, the stock came under renewed selling pressure, presumably as other investment funds worked to "window dress" their portfolios for public viewing. Some element of early tax-loss selling may have played a role. As well, it appears a very large institutional investor, having used the stock as collateral for a loan, has disclosed that it is dumping several weeks' worth of volume -with apparent disregard for price. All of these factors were detrimental to reported third quarter performance, and quite beneficial for the Fund. This position now ranks as among the largest in the Fund.

The future performance of this position will have absolutely no correlation with either the performance of the general market or further terrorist attacks. At quarter end, however, the position sat at a low point, trading at a valuation of just 3/4 the free cash flow of the trailing twelve months. And unlike many businesses that have faded rapidly during 2001, this business achieved record free cash flow yet again during the first half of 2001.

I will note that the prospects for a recovery in this position during the fourth quarter are wholly in question. However, over the next year or two, and especially over the next five years, there is a very high probability of substantial gains as a result of this investment. Such gains would be largely irrespective of the status of any economic recovery, or lack thereof.

This one position, while a very significant drag on the third quarter performance numbers, did not account for the entire decline. The events of September 11th affected the portfolio as well. Unlike one fund manager who found himself holding a fortuitous top four – a defense electronics manufacturer, a videoconferencing company, a medical company involved in the treatment of depression, and a bible publisher – I cannot claim that the Fund was particularly well-positioned, in terms of short-term price performance, for incomprehensible human tragedy involving commercial jumbo jets as weapons of mass destruction.

Specifically, you should understand that the largest holding in the Fund on September 11th was an airline stock. Breaking with tradition, I feel I should explain this position in a bit of detail. For no matter how strenuously I emphasize that this was a rational decision, buying an airline stock rarely looks like a good idea – especially in retrospect, after the seemingly inevitable monstrous loss has been realized. The rationale for buying this airline stock, and for patiently growing it into a very large position, is provided in the Appendix, attached.

The effect of our national tragedy on the market value of the portfolio was not limited to this one airline holding however. The Fund held two hotel stocks on September 11th – one of which was, and is, among its top five holdings. I will not reveal the name of this company here, as I do hope it continues to fall – thereby providing the Fund an opportunity to add to the position. Hotel stocks ranked with other travel-related industries and airlines as among the worst performers in the wake of the September 11th tragedies. In several cases, the short-term reaction was entirely unjustified, as long-term intrinsic value was not significantly impaired. The Fund's largest hotel holding is one such business, and I expect the Fund to receive full value for the shares in the future. Such recognition had simply not arrived by quarter's end.

As well, another hotel stock held in the Fund's portfolio, though not among the top 5 holdings, fell over 30% in the aftermath of September 11th. It now trades at the value of the free cash on its books, meaning an international hotel franchise lacking any recourse debt now goes for free on the stock exchange. Publicly traded real estate has always been neglected, but this is ridiculous. I fully expect it will recover and ultimately head much higher over time. The stock rarely trades, but if I am successful in my efforts to acquire more of this stock at these prices, the Fund will participate to a much greater degree on the way up than it did on the way down.

Finally, the portfolio has generally held relatively illiquid stocks for the balance of the year. The logical reason for this is that the more liquid, larger capitalization stocks had remained stubbornly overvalued since inception of the Fund. The logical consequence, however, is that the portfolio is susceptible to short-term downside volatility in times of rampant market fear. With all seriousness, a 2500 share sell when no one is looking could torpedo the apparent market value of several of the Fund's holdings. Such volatility in no way impacts the intrinsic value of the portfolio, and rather provides opportunity. In one case, this volatility has allowed the Fund to build a smaller stock position into significant size at a free cash flow yield approximating 20% - and at a price that is only half its private market value. Just ask the three separate financial buyers who bid to buy the company outright earlier this year. A tight financing market stymied these efforts. The value remains – and will be realized by the markets in good time.

Towards the very end of September, I allocated capital to several larger capitalization stocks as they fell to levels that implied extraordinarily high long-term returns. Indeed, I have been very happy to pick up several consumer franchises, with ever-widening competitive advantage, at discounts that imply virtually no growth going forward. Given the quality of these companies – and the natural ability of these companies to raise prices at a rate greater than inflation - such discounts imply an unrealistically low valuation.

Terrorism, External Shocks, and Risk

A portfolio manager must understand that safeguarding against loss does not end with finding the perfect security at the perfect price. If it did, then the perfect portfolio would likely consist of one security. Rather, to the extent possible, I have the responsibility to structure the portfolio such that if any of a number of unforeseen events occur, that I do not lose the whole, or even a significant portion, of the clients' money. To do this, I seek to minimize the correlation between the intrinsic values of the various securities held in the portfolio.

Minimizing this correlation involves a bit of diversification among industries. Minimizing this correlation does <u>not</u> involve straying from sound principles of securities analysis. Including speculative or overpriced stocks in the portfolio simply to diversify against the impact of an array of possible external shocks is simply irrational given the relative odds involved. Moreover, minimizing this correlation does not require a portfolio of more than fifteen or so stocks. Therefore, a relatively concentrated portfolio may still offer decent protection against unforeseen adverse future circumstance.

Although it so happened that on September 11^{th} the Fund's largest position was an airline, and that another large position was a hotel stock, the impact of this tragedy should not, in the long-term, prove significant to the Fund's performance. The principles by which I invest served the Fund well during the recent turbulent time, and I expect that these principles, applied consistently, will continue to serve the Fund well – whatever additional shocks the future may hold.

On Portfolio Upgrades

One reason that several of the Fund's illiquid common stocks fell during the quarter is that many value managers, who might hold similar stocks, saw the opportunity to "upgrade" their portfolios during mid-late September. That is, acting on the fact that larger, well-known companies were recently trading at steep discounts to historical prices, portfolio managers dumped their illiquid, ignominious stocks and rushed into these more popular but depressed stocks. The phrase "I am upgrading my portfolio" became one I heard frequently among fellow portfolio managers as September came to a close.

In order to apply this technique to the Fund's portfolio, the existing securities and the securities to which one might upgrade, would have to come to some sort of equilibrium in terms of value offered. This most certainly has not been the case, at least not on any widespread basis. Indeed, the very fact so many investors acted rather eagerly to upgrade has recently pushed the value differential that much further in favor of current portfolio holdings. As a result, the time to exit such positions is certainly not the present.

Another issue I have with this sort of thinking is probably best summarized by the word "Ick." Ick investing means taking a special analytical interest in stocks that inspire a first reaction of "ick." I tend to become interested in stocks that by their very names or circumstances inspire an unwillingness – and an "ick" accompanied by a wrinkle of the nose - on the part of most investors to delve any further. In all probability, such stocks will prove fertile ground for the rare neglected deep value situations that could provide significant returns with minimal risk, and minimal correlation with the broad market. Occasionally, well-known stocks fall into the "ick" category, and it is at those times that I become interested.

Finally, I suspect that many who are actively upgrading their portfolios are doing so because they fear missing either a major market rally or the next bull market. With stocks in general having come down fairly far, the feeling a bottom is near may be fairly pervasive. The optimal way to participate in a market rally, by definition, is to buy the better-known stocks that either are in the major indices or are comparable to those that make up the indices. However, doing so exposes one to the risk that one is wrong on the direction of the market. To my knowledge, such a hazard has proven notoriously difficult to avoid. In any case, the goal, always, of intelligent investing is not to mimic the market but rather to outmaneuver the market.

This is not to say that I am not a fan of larger, well-run businesses with fantastic economic characteristics and durable competitive advantage. I have a list of about eighty or so stocks that represent businesses with very decent and predictable long-term business characteristics. At the right price, I would like to include any one or more of these stocks in the Fund. Of course, what I consider the right price seems ridiculously low given where most of these stocks have been priced in recent years. When these stocks come to my prices, then I will consider adding them to the Fund. But only because they represent absolute value, and not because of any desire to "upgrade the portfolio" into either more palatable or more market-responsive stocks.

Also on this subject, I should note that recently, as many well-known companies saw their stocks fall drastically, a select few made it to my buy prices. Those that did were added to the portfolio on the sole criterion of absolute value. The vast majority of popular stocks continue to be valued as popular stocks rather than as real businesses. Certainly, in the broader market, many stock prices overestimate the permanence of the underlying businesses.

Summary

As I have noted in previous letters, I will always choose the dollar bill carrying a wildly fluctuating discount rather than the dollar bill selling for a quite stable premium. This will often result in surprising quarterly results. To the extent prudent, I will attempt to explain surprising results when they occur. During the third quarter we saw an attempt to buy a cheap security become a process of averaging down into what is now, apparently, the most undervalued security available on any exchange. We saw investors start to dump illiquid small capitalization stocks using an order process that may be summarized as "Just get me out of this stock!" And to top it off, we saw a human tragedy of rare proportion directly and negatively impact the market values of several of the largest portfolio holdings of the Fund – with surprisingly little offset.

Thus, a confluence of happenings seems to have knocked the Fund for a decent price decline in just three months time. However, my entire net worth resides alongside your investment in the Fund, and I neither bemoan these recent short-run declines nor fear long-term impairment of my net worth. On the contrary, I am enthused that the market is offering up values on a scale not seen previously during the Fund's existence. Moreover, the Fund holds significant cash and sources of cash to put to work in such an environment.

Policy Matters

The minimum initial investment for new members is $250,000, and the next investment period starts January 1, 2002. Current members may contribute a minimum additional investment of $50,000 as frequently as monthly. For regular accounts, no additional paperwork is necessary to make an additional investment. Simply let me know your plans, and I will ensure you have the correct wiring instructions, or the correct address if mailing a check.

For IRA accounts, additional investments entail similar paperwork as for the initial investment. To start the process, please call me first.

Attorneys have updated the offering memorandum and operating agreement of the Fund in order to adjust the minimum investment from $100,000 to $250,000. As well, the documents were amended to provide more clarity on expenses. While certain powers and expenses were clarified, no additional expenses or powers were awarded to Scion Capital. Updated versions of these documents are enclosed with this quarterly report. Please file them for future reference.

I continue to maintain the vast majority of my net worth, and the whole of my family's investment account, in the Fund. And I continue to earn a paycheck only if I achieve a return on your capital in excess of the hurdle rate. My interests remain very much aligned with yours.

Please feel free to contact me if I have not been clear on a matter discussed above.

Sincerely,

Michael J. Burry, M.D.
Scion Capital, LLC