January 30, 2016

Dear Limited Partners,

Two thousand fifteen marked our fifth anniversary as a fund. Over this five-year period, we have been able to outperform the S&P 500 and the Russell 2000 indices. Likewise, Greenhaven Road has returned more than 14% net of fees vs. 9% for the Russell 2000 and 12.5% for the S&P500 including dividends. Our three-year numbers are even better, with Greenhaven returning almost 50% more than the Russell 2000 and 35% more than the S&P500. For 2015 itself, we ended almost where we started -- the fund was up just over 1.5% for the year. This was in line with the S&P 500, and substantially ahead of the Russell 2000, which has a far greater overlap with our holdings. For those investors who joined the partnership later in the year, your statements will reflect a negative balance since we gave back gains over the course of the year. In keeping with our fee structure and agreement, I received no compensation because we did not exceed the 6% hurdle rate. In addition, with our high watermark, your funds will have to be restored before you pay any fees. As I write in almost every letter, we will have down months, quarters, and years. We cannot outperform every period, but hopefully over time our patience will be rewarded. As you will see throughout the letter, I think the fundamentals of the companies that we own are solid and over time our investments in these companies can realize significant appreciation.

EFFICIENT MARKETS?

There is a widely circulated belief that the market is difficult to beat because it is so efficient. I would argue that, over the short term, the opposite is true – the market is actually difficult to beat because it is incredibly inefficient and mis-pricings can be even more exaggerated in specific sectors. In 2015, if you removed the largest growth stocks (Facebook, Amazon, Netflix, and Google), the market actually declined 2.7%. In my mind, the volatility of the market is evidence of persistent mispricing. Simply put, over the course of a year, the high and low prices for many companies are so different that they cannot possibly reflect the value of the company over that timeframe. During any given year, the share price often zooms by the actual value of the company, only staying on fair value for moments.

Let's look at a couple of simple examples of companies that make up the larger "market." Hormel Foods has been in business for more than 120 years, selling a variety of food products, most notably Spam. In the last year, their overall sales are down slightly (less than 10%) and their earnings are up slightly (less than 10%). The 52-week low for Hormel was $50 and the 52-week high was $80. We don't own Hormel, and I am not completely conversant in the demand drivers for Spam or the inputs. Share price should be some proxy for business prospects going forward and assets already owned. Did the business prospects and assets of this 120-year-old company really change by 60% from the lows of $50 to the highs of $80? Was Hormel fairly

valued at each step along the way? Did the long term trajectory of Spam really change by 60% over 12 months?

Shortening the timeframe, a company that is on my watch list recently had a greater than 20% intraday swing in pricing and ended the day with virtually no price change. Did the company's earnings prospects really vary that widely over the course of an eight-hour trading day with no significant news released? You can play this exercise out by looking at share price and profits over time, and I think you will also conclude that the variability in prices is far greater than the variability in business prospects over a day, a month, and a year. With all due respect to the academics, I don't believe that markets are efficient, and the volatility - while painful - creates opportunity and also makes trying to outperform over very short periods of time a fool's errand.

FUNDAMENTALS MATTER

Even though we outperformed major indices over a three- and five-year period, we did not outperform every quarter, month, or year. In fact, during our first year in existence, we underperformed dramatically. It doesn't make it hurt any less, but we are in good company. A recent study by Research Associates looked at the 350 mutual funds available to investors in 1970; only 100 made it to 2014 with the other 250 funds closing or merging with other funds. Of the 100 that survived, 45 beat the market, but only three beat the market by more than two percentage points per year for the 45-year period. Even these three "superstar" funds that are in the top 1% of the funds from 1970 underperformed one-third of the time on a rolling three-year basis. What should you take from this? There are going to be times when you feel like a genius for putting a portion of your savings in Greenhaven Road, and there are going to be times when you don't – and that is okay. What I want you to feel is comfortable in our approach, which is concentrated on our best ideas, patient (low turnover), value-focused, with a preference for smaller companies where we can have a greater analytical edge, with aligned incentives (this is my life savings and I only make money with you).

As valuations fluctuate from undervalued to overvalued with the briefest of pauses at fairly valued, the rock that I have to hold onto is fundamentals like the balance sheet, earnings, cash flow, growth, and product cycles. Over time our 50-cent dollars will appreciate, or at least afford us a great enough margin of safety that we should get our money back. That is why research matters and knowing what companies we own and why we own them matters. We will make mistakes, but our buy/sell and hold decisions will be grounded in fundamentals that over time do matter.

GOOD DIFFERENT & BAD DIFFERENT

Included with this letter is a book that I read this past year, “Different: Escaping the Competitive Herd” by Youngme Moon. I will try not to spoil the book for you, but it does a great job of highlighting businesses that are intentionally different than their competitors and very successful. One business profiled is Ikea. When Ikea came along, they broke several rules of furniture retailing. Ikea doesn’t promise the furniture will last forever. They position it as a durable good with a life of a few years, greatly lowering the anxiety of the purchaser. According to the book, the average American will have as many wives as dining room tables (1.5) and has historically approached the table purchase with great apprehension. Ikea is different from traditional furniture retailers in multiple other ways, including the lack of hovering sales people. Ikea puts the burden on the consumer to transport the furniture home and assemble it. The company launched with only four styles of furniture, greatly reducing selection. Ikea was different in that it subtracted service, delivery, choice, and durability. Ikea added daycare, Swedish meatballs, and created a euro flavored “retailtainment” environment. According to the author, “Ikea has discovered the cool unapologetic contradiction. It is stingy, it is indulgent. It says yes; it says no. It strips things down; it sweetens them up.” Clearly Ikea understood that most retailers don’t have 50,000-square-foot stores without salespeople when they launched their stores. These differences are intentional choices. In many other areas, Ikea chose to be the same, adopting many of the best practices of the day used by their competitors. For example, Ikea uses a point-of-sale system and accepts credit cards. In dozens of areas, Ikea chose not to be different from their competitors in ways that have contributed to their success.

This highlights that there is a good kind of different and a bad kind. For instance, a car that does not turn right or does not have windows would be different, but most people would agree that would be “bad” different. The challenge in designing a business is to figure out where and how to be different. Where to be the same? Understand why you are different and what you are achieving by being different.

As Greenhaven Road has just celebrated its fifth birthday, it has been a period of reflection and planning. The goal is to keep and grow “good different” and get rid of bad different. My core belief is that the world does not need another asset-gathering, crowd-following, index-hugging fund, with fancy marketing and a false sense of risk management. The world doesn’t need more investment committees. I want to spend my limited time on this earth building something good different. I believe that a smaller fund is better because it increases the opportunity set. I believe that an investment team of one is the perfect size. I believe that when investing fundamentals matter, balance sheets matter, cash flow matters, management matters, and management incentives matter. I also believe that investing requires patience, because even though fundamentals matter, there can be long periods where there are disconnects – thus the capital to invest should be aligned with the strategy.

The design of Greenhaven Road reflects dozens of choices. I aligned incentives by being the largest investor. For me personally it is by far my largest liquid investment, and that is how I believe it should be. The alignment of incentives is deepened with a hurdle rate and a high watermark. You have to make money for me to make money. The choice to have a very broad mandate is intentional as well. I can invest in the smallest and the largest companies across geographies. We are not a U.S. small cap fund, which would be easier to describe. The flexibility on the investment front is important because I want a vehicle that can last decades, and I don't want my savings only in U.S. companies with market capitalizations below $5B or some other artificial constraint. Our vast opportunity set combined with the small size allows us to go off the beaten path of the S&P 500 while remaining concentrated. To quote a great value investor, Howard Marks, *"This just in, you cannot take the same actions as everyone else and expect to outperform."* Being different in the investment management business clearly has value. There are a lot of positives and I am proud of everything accomplished in the last five years. We are off to a good start.

Yet, there are a few areas that haven't historically been "good different," and I want to address them in the coming year. I firmly believe that the best investment decisions are made by an individual and not a committee. The best performing venture capital fund ever was headed by a team of one (Chris Sacca). The Buffet partnerships had a team of - you guessed it - one. This is not to say that other models cannot work – but for me it is the right size, and there are enough data points of success that I believe my running a one-man boutique is "good different." However, in this case, my version of good different comes with bad different. As a one-person boutique, in the unlikely event that I were to die, the closing of the fund would be a challenge. While that would not be my greatest concern as I would be dead, the fund has friends, family, and people's savings invested who deserve a better solution. As a one-person operation, it is difficult to require two signatures on money transfers and large checks. There cannot be a second set of eyes insuring compliance with the partnership agreement. One person simply cannot be two sets of eyes. Checks and balances are impossible to achieve as a one-person boutique. Lastly, while the fund has an auditor and a third-party administrator, I am currently the back office, which can take time away from my main function: adding value through investing. I add no value in the administrative sphere, but in the current arrangement, the investment team (me) is also the back office liaison. So these "bad" differences have been nagging at me for a while, and I have considered a number of solutions. Some funds hire an outsourced CFO, some funds hire an administrative team, some funds muddle along indefinitely and hope nothing happens. Each of these solutions is suboptimal, but so is the status quo. Fortunately, I think waiting to put a solution in place has paid off in spades. I have found "good different" in my email in-box.

STRIDE CAPITAL GROUP

Our website makes it easy for potential investors (as well as just about anybody else with an email account) to contact me. I get random emails all the time from people selling services I don't need or want, and offering business loans I never considered. One day last summer, I got an email from a Stride Capital Group saying "somebody" they respected forwarded us a letter you wrote, we would like to learn more, let's meet. One look at the Stride Capital's website and it was clear that an inquiry from Stride Capital should not be ignored if you are interested in hedge fund seeders. The Stride Capital team is flat out impressive. In fact, *Hedge Fund Marketing Weekly* named them a top five seeder.

What is a hedge fund seeder? When a fund launches on day one with a gillion dollars, very often there is a hedge fund seeder behind the launch providing dollars in exchange for a stake in the business. The new fund founder accepts the deal, because a fund that has money can more easily attract money. In addition, many fund models require scale. The typical fund template of two portfolio managers, three analysts, one CFO, one risk person, and a trader. The model also requires a lot of dollars to support it. The seeder hopes to get a positive return on their investment in the fund, but they really hope that the fund attracts billions of dollars and their equity stake in the fund is enormously profitable. Given that I have no interest in the typical fund setup and think that the best way to ruin a chance at delivering returns in this environment would be to try and invest billions of dollars, I never approached any seeder funds. After all, I am pursuing "good different" and seeder funds are part of a popular playbook. The good news was that an incredibly high quality firm wanted to meet and learn more about Greenhaven Road, the bad news was I was not interested in the seeding model.

I almost didn't go to the meeting. By definition a meeting with Stride has a low probability of success – they are even more disciplined than Greenhaven Road, and typically make one seed investment per year. However, Stride Capital is a couple of miles away from my office and I figured at the very least I would learn something about the seeding business, and confirm we had nothing to talk about. The meeting was a bit painful for me, because I was totally honest even though I thought I was giving answers they did not want to hear. My philosophy has been, "I don't have to make Greenhaven Road something that will appeal to everybody, I don't even have to appeal to most people – but if I am going to do this every day, it better appeal to me, and then my job is to find like-minded people who it also appeals to." The world is big enough, and I want to be small enough that the math can work. Thus, I was honest with Stride and said that I wanted to be a boutique. I was honest and said that I did not want a bigger team. I was honest and said that I did not want to raise a billion dollars. I was honest that, while my background has touches of traditional, such as a Stanford MBA and experience at a hedge fund, I never worked at Goldman, I never worked at a Tiger Cub (both attributes being typical of those that typically get seeded). The meeting was very polite and broad, and did cover areas that could be of interest

such as the portfolio, track record, and my operating background. The meeting ended with a "we will be in touch." I was out $3 for gas, $15 for printed materials and 90 minutes of my life.

About two weeks later, I got a call from Don Rogers, the founder of Stride Capital. He said, "You are not the typical seed candidate by any means because of your capacity limitation." I thought to myself it was a pretty good windup for the obvious parting of ways speech. Don then continued, "but the things that make you a poor fit for most seeders is what we believe gives you a competitive edge that we could envision backing." After getting my head around the fact that all of the nodding in the meeting may not have been just to appear to be polite, I started to listen. Don went on to describe his partner Mark Rubin, who had been the COO of two large hedge funds, and outlined a vision where I could remain a one-person boutique, but have the personnel and back office of a world-class fund. Our incentives would be aligned since Stride would make a significant investment in the fund and become the largest investor. Don went on to outline a number of benefits that Stride could bring that really piqued my interest and changed my conception of what a partner could do. Stride could free up my time for more research. They could also handle all compliance. Stride could provide checks and balances and redundancies not possible as a single operator. There would be no interference on the investing side, other than to make sure that I stuck to the constraints on concentration and security type that I selected when I created the partnership agreement. In other words, they would enforce the constraints I had already placed on myself. Any potential relationship would be subject to a prolonged diligence process. Don was calling to see if I wanted to start that dance and see if we could structure something that made sense.

That conversation was more than six months ago, and I will spare you all of the details and jump to the punchline. There is a decision-making framework first articulated by Derek Sivers and popularized by Tim Ferriss called Hell Yeah (https://sivers.org/hellyeah). Basically if you are considering a large decision and your reaction is not a "Hell Yeah!" – the answer is no. By only doing "Hell Yeahs," you avoid getting entangled in a series of compromises. I am trying to build Greenhaven Road to give me the best chance of delivering results over the long term. After a lot of reflection, I think Stride Capital Capital's involvement can take us to the next level, the arrangement is "good different," and is a "Hell Yeah!"

As a current limited partner, you should know that Stride Capital will be joining the partnership and will become the largest investor over the course of the next year. Almost immediately, they will be assuming the back office burden, and they will provide monitoring and redundancy that I want for my money and family and you should have for yours. For limited partners there is no downside that I can think of. We will have an enormous leap in back office capacity. I will give up some of the "upside" to Stride Capital, but gain a partner. As my daughter said, "Having most of awesome is way better than 100% of really good."

BUT ISN'T SMALL GOOD?

There is a conundrum in investing in that scale is typically the enemy of returns. Simply put, smaller funds have larger opportunity sets. A $5 billion fund simply cannot invest a meaningful percentage of the portfolio into a $200 million company. That being said, a $1 million, a $5 million, and even a $10 million fund is not a viable business. With our current fee structure in a year where we generate 10% returns - no small feat using limited to no leverage in a near-zero interest rate environment - Greenhaven Road would generate $100,000 in incentive fees (revenue) to pay a series of expenses before we ever get to salary. With no management fee, a high watermark and a 6% hurdle rate - on a risk-adjusted basis – Greenhaven Road is essentially a call option for me, not a business. Essentially, for Greenhaven Road to be viable in the long term, we need to be larger. The challenge is that as the fund grows, investments in the smallest companies are no longer possible. What is the sweet spot where the investment set is large and the fund is a healthy?

I have been looking at companies for a long time, and I cannot think of a single time I have been excited by a company with a $10M market capitalization. I am sure I have missed penny stock opportunities, but so rarely at those valuations are there real products, real teams, and real opportunities. The fundamentals are typically terrible. Giving up the ability to invest in the tiniest companies is not a sacrifice at all. Where would size negatively impact our returns? Currently three companies in the portfolio had sub-$100M market capitalizations when we initiated our positions, so while investing in the tiniest of companies is not attractive, being able to invest in the $100M market capitalization range is. Given a typical "starter" position is 5% of the fund, if the fund was $100M, a starter position would be $5M, so this starts to rule out companies under $100M in valuation with high insider ownership. I don't have a firm number on the optimal size of the fund, but in this environment, with the current investment style, I believe that the optimal size is somewhere below $200M.

At the same time, I want Greenhaven Road to be built to last. I want it to be a very viable and healthy endeavor at lower asset levels. As a result we are going to change the fee structure for new investors entering the partnership starting April 1. The changes will not impact any of the current investors (Founders Class). You will continue with the exact same fee structure that you signed up for.

NEW INVESTOR CLASSES

New investors to the partnership starting April 1 will have two choices: a "long term" class and a "liquid" class." The "long term" class is closest to what you have as Founders. The biggest change is that long term will in fact be long term – there will be a three-year commitment and a significantly higher minimum investment. Even though I think three years is a short investing

horizon, three years is a long commitment in the hedge fund world. Thus there will be no management fee, which is also very, very uncommon, particularly when paired with a 6% hurdle rate. This class of investors will provide a stable source of capital and allow me to invest with a very long time horizon, which is a huge advantage. The "liquid" option will have a lower minimum investment, but come with a 1.25% management fee and quarterly liquidity after a one-year lock up. The management fee income can pay for additional research resources and make the fund viable at much lower levels of assets. The management fee will allow us to be a smaller healthier fund. In order to balance the types of capital in the fund between "long term" and "liquid" I will have the ability to close a class at my discretion.

While these changes will have no impact on you as a current investor, I think it solidifies the foundation of Greenhaven Road. The new classes will provide a combination of long committed capital and fee-paying capital that will give us the greatest chances of success. It also allows us to remain smaller. I think the combination of the two classes are the ingredients we need going forward and will strengthen the foundation of Greenhaven Road. They are good different.

TOP 5 HOLDINGS

Company	Ticker	Description/Thesis
Fortress Investment Group	FIG	The share price is more volatile than the underlying business. There is downside protection with almost $3 per share in cash and investments and a strong alignment of management interests with common shareholders because management owns more than 50% of the common shares. There is also significant upside from performance fees on the $70B+ in assets under management. The company's move towards raising "permanent" capital through publicly listed vehicles is a very positive development as it eliminates the need to return fee generating capital at the end of a funds life.
Interactive Brokers	IBKR	Interactive Brokers is the low cost provider with industry leading margins, room for price increases, growing customer base, and attractive industry dynamics with large banks such as JP Morgan and Goldman Sachs exiting the primer brokerage business for small funds. Accounts continue to grow at 1-2% per month and there is a very substantial "white label" opportunity for the firm. The CEO has built the company from nothing and management owns 80% of the firm. The company has less than 1% market share with Hedge Funds and a substantial "white label/Introducing Broker" opportunity.
American International Group Equity and TARP Warrants	AIG	A leading insurance firm trading at 70% of a growing book value. If the company is able to continue to grow book value and the discount to book value diminishes with the passage of time this has the potential for a multi-bagger return without heroic execution required. The net result is an overcapitalized company with the ability to further reduce debt, pay dividends, and repurchase shares significantly below book value. The warrants are long dated expiring in 2021 and "in the money" representing an attractive risk/reward as the company grows book value and receives improved valuation metrics creeping back to book value. Activist investor Carl Icahn is now pushing for more aggressive management of the company.
Fiat Chrysler	FCA (BIT)	Arguably the cheapest large auto manufacturer with the best CEO. The company has engaged in a multi year process to acquire Chrysler and spinoff the luxury auto maker Ferrari. Ex Ferrari, which we sold in the beginning of the first quarter, Fiat trades at less than 3X EV/EBITDA with a reasonable growth profile. US auto sales could stay elevated at 15M+ for longer than many expect given the age of the fleet. As for the pools of self driving cars replacing auto ownership that bears opine on - segways are illegal in many cities - their vision is at least a decade away if it is ever achieved.
ChipMOS	IMOS	A semiconductor assembly and testing company that at the time of initial investment was trading at a trailing P/E of over 200 but less than 4 times cash flow. The company has a very complicated capital structure with the majority of value derived from a Taiwanese holding. As the value of the Taiwanese holding decreases the attractiveness of owning IMOS decreases. We exited the position shortly after the end of the quarter to pursue more attractive opportunities.

Above is a list of the top 5 positions at the end of the fourth quarter.

As discussed in the previous letter, our largest position remains **Fortress Investment Group,** which ended the quarter as a $5 stock with $2.85 in cash and investments and almost $1 in embedded incentives. The core business should earn 70 cents-plus this year and has just had its best year of raising assets in the last seven.

I just presented Fortress to the Manual of Ideas - Best Ideas 2016 conference. The slide deck is on the website (www.Greenhavenroad.com) in the Investor Letters section. The share price could double and still be reasonably priced in my opinion. I think there is similar upside for several other companies in the portfolio.

SHORT INVESTMENTS

The fourth quarter saw the rapid deterioration in price (a good thing) of Code Rebel which was described as the "worst" company in last quarter's letter from over $7 to under $3. Given the smaller sizing of individual short positions, it was not a huge contributor to performance but it was gratifying to see the disconnect between market price and actual value shrink. Over the course of the quarter, we also added a medical marijuana company of dubious pedigree and efficacy and a pipe company that is not current on its financial filings, has far more shares outstanding than initially appears, and trades at a premium to its peers – at least for now. We also shorted a real estate company with questionable accounting. These all remain small positions (less than 2%), and the fund remains long-biased. The ability to short allows us to take advantage of the occasional "worst" company that comes along as well as to reduce our overall exposure through the use of indices shorts.

TAXES – K1s

Our third party administrator, Halpern and Associates will be preparing K1s again this year for U.S. investors. They will be ready the first week of April. Unfortunately, because the partnership is invested in a limited partnership (Fortress Investment Group), our K1s cannot be completed until the Fortress K1 is issued. If you would like an estimated K1, they should be ready in mid-March.

OUTLOOK

At the risk of sounding like a broken record, I am fairly optimistic. The current fears of the day are related to China and low oil prices. China makes up less than 1% of U.S. exports, and while probably not growing at the stated 6.9%, the Chinese economy is growing. The stock market is 80% retail investors and there is extensive use of margin. There is even a disconnect between the Chinese stock market and the Chinese economy. How long will there be a link between the ups and downs of this poorly structured and poorly regulated stock market and the markets of the rest of the world? I don't know, but the world equity markets moving down in unison and

sympathy to the Chinese markets is a version of risk off that feels disconnected from fundamentals to me and should not persist. I recognize that the currency devaluation and slowdowns potential impact on commodities and partner economies is real – but don't accept that our portfolios ups and downs should be dictated by where the Chinese market closed which is a seemingly regular occurrence.

Similarly to the undeserved correlation between the world stock markets and the Chinese stock market, the current obsession with the price of oil feels very removed from the majority of our investment universe. I am not an energy analyst, but I can appreciate that the impact of lower oil is not universally good or bad. Like most events, there are positives (more money for consumers) and negatives (lower employment in oil services and reduced capital expenditures) – shifts in oil prices should not drive the prices of insurance companies and software companies for too long.

My biggest concern is that we are in a negative spin cycle. I don't have a great way to quantify this, but it feels like the negative element of each financial news story is emphasized right now to a greater degree than it was six months ago. A simple example would be a company that is restructuring. The headline will be layoffs, not increased earnings. If a company has strong earnings, the focus is on the guidance that disappoints. If guidance is strong, the focus is on the earnings. The benefit of the doubt is gone. With oil, as price declines, the decrease in rig counts and cap ex spending gets far greater attention than the billions of dollars saved by consumers. In sum, fear sells. I watch CNBC when the market is down three days in a row. These negative feedback cycles lead to compressed multiples investors are willing to pay for companies, which leads to price declines. In my mind the underlying economy remains vibrant, but the sentiment has shifted. This can lead to broad declines in assets, but also opportunities. The challenge going forward is to find the pockets where there are the greatest disconnects between the negative sentiment and the underlying fundamentals – because Fundamentals Matter.

Sincerely,

Scott Miller

NEW POSITION

ASSOCIATED CAPITAL GROUP - $29

In the words of Joel Greenblatt, “If you spend your time looking for and analyzing situations not closely followed by other informed investors, your chances of finding bargains greatly increases.” There are very few investment ideas that are off the grid. Companies typically have thousands of investors who have made buy decisions for a variety of reasons. Our latest purchase, Associated Capital, is truly a trip into the land of the unfollowed. There are no sell side analysts covering this company. Don’t get nervous, but at the time we made the investment, Google couldn’t properly find the company in the first 10 results. One proxy for company popularity is the number of followers the company has on a site called Seeking Alpha. A popular company like Apple has more than a million followers. Associated Capital Group had only 28, which is the lowest number I have ever seen. To date, as far as I know, there are no “write ups” on Associated Capital Group in places like Value Investors Club or Sum Zero. Associated Capital Group is doing little to raise its profile. They have attracted no sell side research. Their website has no investor presentation and their quarterly earnings release had no conference call. They also don’t seem to return emails from smaller funds (like ours). I think this company more than meets the Greenblatt criteria discussed above of a “situation not closely followed by other informed investors.” What is this mysterious company?

Background: Famed value investor Mario Gabelli has run a series of mutual funds through a publicly traded company known as GAMCO since the 1970s. GAMCO has been a great success, managing more than $40B in assets and buying buck bundles of GAMCO stock and building up hundreds of millions of dollars in corporate cash and investments. Similar to Fortress Investment Group, GAMCO was getting no credit from the public markets for its cash and investments. GAMCO was trading at similar multiples to comparable companies despite having more than half of the market capitalization of the company in cash and investments. Frustrated by the lack of recognition by the markets for all of the assets within GAMCO, Mario Gabelli decided to spin off the assets. The spinoff occurred on November 30. For each share of GAMCO a person held, they were given a share of Associated Capital (AC). Mario Gabelli now owns 75% of GAMCO and 75% of Associated Capital.

Sometimes when a company executes a spinoff, the new company is a “garbage barge,” where all of the bad businesses with poor growth prospects and emerging liabilities reside. Garbage barges at the right price can be good investments, but are rarely attractive. However, Associated Capital Group is definitely not a garbage barge. Mario Gabelli did everything he could to stuff Associated Capital with as many assets as possible. If it was valuable and not nailed down – it went into Associated Capital. As you will see, he even created things to stuff into Associated Capital. First, he spun off the cash from GAMCO into Associated Capital, which is simple

enough. Then he took the investments in GAMCO funds and put them into Associated Capital as well. It makes sense to take those assets out of GAMCO if the market is not giving GAMCO credit for holding those assets. Mario did not stop with cash and investments. Next he took treasury shares of GAMCO (shares that had been bought back but not retired) and placed them in Associated Capital. He placed as many shares as he could (4.3M) without triggering a tax event. These shares are liquid assets that can be sold by Associated Capital if and when they need cash. Lastly, in a stroke of financial engineering, they created a $250M loan from Associated Capital to GAMCO to be paid to Associated Capital over the next four years. As GAMCO pays off the loan, Associated Capital will fill its coffers with another $250M. On a per share basis, Associated Capital holds the following:

Holdings	Value (000)	Per Share	Notes
Cash	$ 363,055	$ 14.22	
Investments	$ 308,890	$ 12.10	
Shares of GAMCO	$ 150,000	$ 5.87	4.3M shares of GAMCO
Loan to GAMCO	$ 250,000	$ 9.79	Yields 4%
Receivables + Other	$ 58,924	$ 2.31	From brokers
Liabilities	$ (101,310)	$ (3.97)	Payables/Accrued Expenses
TOTAL	**$ 1,029,559**	**$ 40.31**	

The simple math is that with an average purchase price below $30, the value of our shares can appreciate 35% until we get to the adjusted book value of the company of $40 per share.

GAAP IS BORING BUT MATTERS

Careful readers will notice the words "adjusted book value" in the last sentence. Companies have to use Generally Accepted Accounting Principles (GAAP). Under GAAP rules, the loan to GAMCO, which is absolutely worth $250M, is not treated as an asset of the company. Because GAMCO is a related party, the loan, which is an asset, shows up in the equity section of the balance sheet and is excluded from GAAP book value calculations. As a result, the company screens poorly, because "book value" as defined under GAAP is just over $30 and excludes the loan. The good news is that this accounting anomaly will go away over the next four years. As the loan is repaid, the cash that Associated Capital receives will show up as an asset and be included in book value.

$1B HEDGE FUND

If one needs further proof that Associated Capital Group is not a garbage barge, consider that it was given two current operating businesses. One is a research business which generates $10M in revenue but is not core to the thesis. The other more important business is a $1B hedge fund previously managed by GAMCO will now be managed by Associated Capital. The fund is a merger arb fund which means it is intended to be "market neutral." The fund receives a

management fee as well as an incentive fee. This is an attractive scalable business. Given that we bought shares below the cost of the core assets like cash and investments, we are truly getting the hedge fund for free.

SEEDING BUSINESS

Why did Mario Gabelli stuff Associated Capital with assets? Part of the reason is that GAMCO was not getting credit for the assets. The other stated reason from the form 10 document filed with the SEC is the following, "The proceeds we receive pursuant to these transactions and the potential future sale of the former GAMCO treasury shares may be used to, among other things, provide seed capital for investment partnerships that we expect to form and, possibly, acquisitions, alliances and lift-outs and co-investing, as well as to fund shareholder compensation, including share repurchases and dividends." So Associated Capital Group is going to build out its seeding business. As banks reduce their proprietary trading activity, there are opportunities. Time will tell if Associated Capital Group is an effective seeder, but the set-up is excellent. Seeding is a very attractive business and Associated Capital Group has hundreds of millions of dollars to invest.

UNDER EARNING

Buying a dollar for seventy cents is a good start, but can the business make any money? Can we grow the dollar? The most precise answer in the case of Associated Capital Group is "probably." The company is currently under-earning. In particular, the $14 per share in cash earns zero in this interest rate environment. Of course, there is some risk with investing the money, but over time, should we be able to earn more than zero on the cash? I would argue yes. A second area of under-earning is potentially the $250M loan. GAMCO is paying 4% interest, which is not terrible in this environment, but if/when the money is used to seed new funds where we get the returns of the fund plus an equity interest in the fund, a return of greater than 4% is attainable. The $12 per share in investments lost money in the last quarter reported, but over the past 40 years, Mario Gabelli has made substantial returns for his investors. The hedge fund is potentially under-earning as well. The fund returned less than 1% last year, which means effectively no incentive fee. If the fund were to return 8% in a year (gross), it would add a little under $1 per share in revenue and grow book value by approximately 25 cents. In essence the hedge fund is asymmetric (meaning it has only upside) and can contribute to increase book value. The actual components of book value are cash, investments, shares of GAMCO, and a loan, which can all easily grow at 5%+ over time, but just getting to book value will provide 35%+ returns.

LIMITED DOWNSIDE

The shares are trading at a discount to book value. So what? Other companies do that. I would argue that, in this case, a discount is not warranted because of the quality of the assets. Unlike

banks there is not a huge portfolio of loans that we have no idea how to actually value. There is not some factory that we could not ever actually sell. Book value in the case of Associated Capital is all highly liquid and easy to value. The math for companies that can buy back their shares at a 30%+ discount is compelling. Perhaps it is not surprising that the only action taken by Associated Capital Group in its first 45 days as an independent company was to announce a 500,000 share buyback. With more than 25 million shares outstanding and more than 18 million of those controlled by Mario Gabelli, 500,000 shares is effectively 1/14 of the free float. With an average of 17,000 shares per day changing hands, 500,000 shares reflects almost 30 full trading days of volume. Can shares trade substantially lower than the $29 purchase price we have? Absolutely, and particularly for short periods of time (one to two years). Every GAMCO investor now has Associated Capital Group shares, which they may or may not understand and may or may not want. With the lack of investor outreach and education, there may not be a lot of natural buyers. Are the shares worth less than $29 in the long term? I doubt it.

I sleep well knowing that we bought a growing dollar for seventy cents that is being overseen by Mario Gabelli, who has a track record of value creation and hundreds of millions of dollars invested alongside us. He is crazy like a fox, and I would expect him to buy back shares at a measured pace trying to acquire dollars for far less while not moving the price aggressively higher. I would expect minimal share holder outreach for a long time.

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