January 25, 2018

Dear Fellow Investors,

If you want to have the quarters where the partnership is up substantially, you must accept the periods where the partnership is down 10% or more, since it is almost impossible to have one without the other. In 2017, the S&P 500 was up 12 months in a row, but our partnership was not. We are trying to buy companies where we look at the long-term risk/reward equation and say "this is so favorable that it just makes no (insert expletive) sense." However, just buying into favorable risk/reward situations does not mean that as soon as we start buying the shares, the price will begin to reflect the opportunity. Sometimes investments get more "favorable" before they become profitable. Sometimes the risk emerges and not the reward. Sometimes I am just wrong. With outperformance comes periods of underperformance. Fortunately, 2017 was profitable, but in "Game of Thrones" parlance, "Winter is Coming." We will be at this long enough that we will have our losing quarters and our losing years: it is part of the journey. In the fourth quarter, the partnership gained approximately 7% on a net basis, bringing 2017 cumulative returns net of fees and expenses to approximately 48%. Returns will vary by investor class and subscription timing, so please check your individual statements for specific returns.

WAITLIST FOR THE FUND

In the Q1 2017 letter, and at our annual meeting, I indicated that if and when the fund reached $80M in AUM, we would pause and evaluate if and how we would further grow the fund. Our goal is not to be the largest fund. Our goal is to compound your family capital and my family capital at the highest rates possible for the longest time possible. Well, we have reached that point and will take the pause that I committed to. All commitments currently in process this quarter will be accepted. New outside investors who are not already in process this quarter will be placed on a waiting list, and we will decide how to proceed in April. In the meantime, while referrals are always appreciated, let's take a pause on those as well.

TOP 5 POSITIONS

Fiat Chrysler (FCA) – Despite an almost doubling of the share price in 2017, I believe that there is still value to be had in Fiat Chrysler. In 2018, it is likely that the company will spin off its parts business, revealing the underlying value, reducing gross debt, and becoming net cash positive. Further, we should see operating leverage as earnings continue to improve after a multi-year period of investment. The company just announced earnings today and provided guidance for 2018. The shares trade for less than €20, yet guided to over €4 of cash flow for the year and ended the year with net cash of more than €2. At current prices we will end the year with a greater than 20% FCF yield, which leaves a lot of room for multiple expansion for a company that will benefit from tax reform, substantially reduce its gross debt, and have new product and product mix tailwinds. Keep in mind, 2018 will be Sergio Marchionne's last year as CEO and the automobile industry has several negative attributes, including high-capital intensity, cyclicality, high fixed costs, low returns on invested capital, and product obsolescence. It is unlikely that we will be owners forever, but since a lot of good news is likely in store for the company this year, it remains our largest position.

EnviroStar (EVI) – In the last letter, I discussed the shortcomings of a short report released on EnviroStar and postulated that we might one day thank the author of the report for creating a buying opportunity. That has in fact

turned out to be the case thus far because the share price has recovered from below $25 to above $35. In December, I had the opportunity to go down to Florida to attend the EVI annual meeting, where I met the CEOs of companies EnviroStar has acquired. EnviroStar has been executing a "Buy and Build" strategy, buying successful operators in the commercial laundry distribution space and paying for the companies with a combination of cash and stock. The CEOs typically stay on to run their companies as divisions of EnviroStar. This roll-up strategy does not rely on synergies through cuts or integration. Rather, the belief is that EnviroStar can help build these acquired companies. Quite frankly, if you can use stock trading at 15X+ to buy companies at 5X, the build part does not need to work for the financial model to work, but the returns and quality of the underlying company are much better if it does – and spending time with the underlying CEOs increased my conviction that it can. Each CEO is pursuing strategies that either were not viable for the previously smaller entity or are directly borrowed from another EnviroStar company. More important than these individual strategies was the quality of the executives themselves. These were CEOs running growing and profitable businesses; they did not have to sell to EnviroStar. Each CEO had a slightly different rationale for selling, but the themes were: wanting to be part of something larger, expecting their business to prosper through the relationship, and believing that EVI is the future in their industry. Teams matter, culture matters, incentives matter. EnviroStar has a really interesting combination. Obviously, the annual meeting is a dog and pony show and only a small window into a company, so all of the data collected is taken with more than a grain of salt, but I continue to believe that Henry Nahmad has a real shot at continuing to buy and build his way to a substantial business.

ETSY (ETSY) – The thesis here is unchanged: Etsy is a valuable two-sided marketplace providing value to merchants who can sell items on an inexpensive platform and consumers looking for a more personal alternative to Amazon. The company has become increasingly focused on profitability and has dropped numerous projects that were not core to providing a better product for creative entrepreneurs (sellers) or buyers on the site. Further, they have restructured engineering resources to allow for faster innovation. Etsy's decision to drop their in-house CRM (customer relationship management) software and transition to Salesforce is an example of this reorientation. Similarly, they will migrate from three internally operated data centers to Google Cloud, which brings cost and functionality advantages. All of these changes seem quite positive as it is hard to argue that Etsy should be running its own data centers. In his book "Good to Great," Jim Collins has a notion that to transition from good to great, there is a flywheel that starts slowly and through consistent small actions momentum is built. It appears Etsy's CEO is committed to a more focused and efficient enterprise, and each one of these actions is a push on the flywheel. It will be interesting to see how much momentum the company can generate.

TripAdvisor (TRIP) – A portion of our TripAdvisor thesis is busted/wrong/kablooey – the execution issues in the hotel section are not as trivial as I previously suspected. While the year over year numbers were positive, they are hardly heart-warming. The company is supposed to be "lapping" last year's poor earnings, which were caused by self-inflicted wounds. However, I think the customer value proposition and opportunity to improve monetization, as well as the opportunities to build their strong "in destination" business provide multiple paths to significant returns.

Interactive Brokers (IBKR) – As a customer and long-time shareholder, Interactive Brokers occupies a portion of the Greenhaven Road portfolio that I hope Greenhaven Road occupies in your portfolio – buy, hold, and forget about. Yes, I look at the monthly metrics and listen to the conference calls and buy shares on large declines, but the best thing we can do here is absolutely nothing. The quality of management is well into the top 1% of teams we

GREENHAVEN ROAD CAPITAL

have seen, incentives are aligned with 75%+ insider ownership, there is a very long runway for growth with no additional capital, the value proposition to customers is excellent. Interactive Brokers came back into the top 5 of the portfolio through a combination of price appreciation and share purchases. The company continues to add new accounts at a 20%+ per year clip. If and when volatility increases and trading volumes increase, Interactive Brokers will benefit. Until investors want to pay higher commissions and higher interest rates on margin portfolios, being the low-cost provider with scale presents Interactive Brokers with a tremendous ongoing opportunity.

SHORT INVESTMENTS

We ended the year with limited short exposure, as we harvested losses on our largest index shorts. We remain short ETFs targeted at short-term traders, as well as one bond fund where the underlying interest rates being received relative to the risk being assumed does not pass my common sense test. Rates may not rise and risk premiums may not increase, but the situation feels asymmetric as they cannot go much lower and they can sure go a lot higher.

EARLY? WRONG? - YATRA

Clearly, a lot went right in 2017, but one of our holdings, Yatra declined significantly. We began buying shares last year above $9 and continued to buy more above $10 per share. Our last purchases this month were for less than $7. As you may remember, Yatra is an OTA (Online Travel Agency) that trades in the U.S. on the NASDAQ, but operates in India. I discussed YATRA in great detail in a presentation that can be found on our website (www.greenhavenroad.com). At the time of our first purchase, the core thesis was two-pronged. First, Yatra came public through the SPAC (Special Purpose Acquisition Corp) process and was virtually unknown to U.S. investors – interest could be garnered with even a bare-bones investor relations effort. More importantly, Yatra would benefit from a number of secular tailwinds that were India-specific. As U.S.-focused investors, it is easy to forget what real economic growth looks like. India is not hoping for 3% GDP growth; they are enjoying real 6-8% growth, and travel is growing at almost double that rate as it is one of the first consumption items for a growing middle class. Further, online travel bookings are growing faster than the travel industry as a whole, given growing penetration of internet connectivity and smartphones. The setup seemed very favorable. Yatra was valued at a fraction of Make My Trip (MMYT), the largest OTA in India, while benefitting from all of the same secular tailwinds. In addition, Yatra has a greater emphasis on corporate travel, which has less couponing/discounting and allows Yatra to build a relationship with corporate travelers who, given their economic position, are also most likely to travel personally. To date, there has been a complete disconnect between Yatra's stock price and the company's performance. In the last quarter earnings, revenue (less service costs) was up 46% year over year, margins improved, and EBITDA was up 50%. Still, the stock price has declined by more than 30%. The current year enterprise value to revenue ratio is less than 2. We have been buying shares all the way down. In the opening paragraph, I said we are looking for situations where the risk/reward seems so favorable that it makes no sense. In the case of Yatra, for less than $200M (ex cash), we can buy the #2 player – with its strong brand, largest hotel inventory, and long-term corporate travel contracts – in a geography and industry with very strong secular tailwinds. I like our chances, but to date, Mr. Market "is not believing." I think we are just early, but it looks and feels a lot like being wrong. We have not sold a single share or warrant.

It should be noted that last week, Norwest Ventures, which was a 20% shareholder in Yatra, filed that they had exited their position. Their selling pressure may have contributed to the recent price declines. Time will tell.

THE PARTNERS FUND UPDATE

As discussed in the previous two letters, the Partners Fund is a separate Fund of Funds focused on managers running concentrated portfolios with reasonable amounts of capital, large personal investments, strong track records, a history of original thinking, and a focus on asymmetric opportunities. These are funds with similar structures and strategies to Greenhaven Road Fund 1 (the fund you invested in).

In the previous letter, I tried to reassure you that the Partners Fund would be a good use of my time, and I used a story about fishing with my daughter to illustrate the benefits of using expertise like sonar, live bait, and an experienced captain if you want to actually catch fish instead of just sitting in a kayak dangling hot dogs in the spot of your five-year-old daughter's choosing. Let me try to highlight another potential benefit of operating the Partners Fund alongside Fund 1 through another child-focused story.

While at friend's house for a barbeque last summer, it became clear that my friend's nine-year-old son had developed a ping pong obsession and would play all comers. Always one for a game, I played little Nate (and I mean little). While I beat Nate fairly easily, given his age, it did not take a ping pong analyst to figure out that Nate had talent and desire, and he would eventually be a real challenge for me to beat. When the fall came, we returned to my friend's house for another family event, and it became clear that Nate had three things I did not have: an always accessible table in his basement, endless time to practice, and a new custom paddle with the words "NATE THE GREAT" on one side and "HOUSE OF PAIN" on the other.

Let's just say the results were not pretty: the nine-year-old gave the forty-something multiple beatdowns. The losses to Nate gnawed at me for weeks because so many of my mistakes were avoidable. Seeking redemption, I decided to use the one thing I had that Nate did not have: a credit card. I took a ping pong lesson at a New York City ping pong club. It was by far the best $90 I have spent this year. Many of my mistakes came from trying to translate tennis to ping pong. My positioning at the table, forehand swing, backhand swing, footwork, and analysis of when and how to attack were all right for tennis and wrong for ping pong by varying degrees. However, because I had a lot of foundational knowledge and reasonable hand-eye coordination, a few tweaks made an enormous difference.

In investing, I am a generalist, which affords me the ability to search across industries and geographies, combing through the largest opportunity set. There are also specific niches where I benefit from collaborating with other investors. The Partners Fund can facilitate these collaborations. For example, when investing in SPACs, Eric Gomberg of Dane Capital simply has superior pattern recognition. He understands the SPAC process and the SPAC ecosystem so well that he analyzes not only the data but also its absence of data, and helps translate my general knowledge into the SPAC ecosystem.

Another example could be the Indian market, which is very attractive. There are four times as many public companies in India as in the United States, and the growth rate is 3X ours. Further, there are several nascent industries that will take hold as the middle class grows, and the "professional investing class" is less developed. To date our forays into India have been frustrating at best (as evidenced by current holding Yatra). I could easily see the Partners Fund investing in an India-focused manager because it is such a target-rich environment, and, as an ancillary benefit, I would get a "ping pong" lesson or two from the manager along the way. This would not and does not relieve me of the responsibilities of doing all of our normal diligence, but it would increase the likelihood of success and help us avoid failure.

The Partners Fund began operating on December 1 with investments in several managers I have collaborated with and respected for years. Through January 1, approximately one-third of Greenhaven Road Fund 1 limited partners, including my family and the Royce family, are participating in the fund. Reactions from Fund 1 investor have ranged from "I am glad you are doing the Partners Fund, but it is not right for me," to "I love the fund – it makes me want to add capital to Greenhaven Road as I think it gives you a structural advantage."

We raised substantially more assets than I thought we would in the first few months, and we have enough capital to be a meaningful limited partner for a number of emerging managers. For those who did participate, there will be a separate Partners Fund letter (shorter, I promise). For those of you who did not participate, I remain as convinced as ever that the existence of the Partners Fund will benefit Fund 1. We will be hosting an event, not yet scheduled, where Fund 1 investors and Partners Fund investors can meet the managers we have invested in. I am eager to share this talented group. Please reach out to Ally (investorrelations@greenhavenroad.com) with any questions or for fund documents. We will be opening the Partners Fund to outside investors March 1st.

DARK COMPANY REVEALED: SCHEID VINEYARDS

In the last letter, I wrote in intentionally vague terms about a "dark company" in which we were purchasing shares. The term "dark" means the company is currently exempt from filing financial statements with the SEC but is still publicly traded on the OTC (over the counter) market. I came across a description of this company in the Q2 2017 letter from Maran Capital, which is run by Dan Roller, who I met several years ago at the Value X Vail conference. In his quarterly letter, Dan did not give the company name since he was still accumulating his position. He did, however, give some high-level details of the company profile. Armed with the knowledge that this was a 40-year-old, family-controlled, California-based company, with a sub-$50M market capitalization, growing revenue, a double-digit free cash flow yield, and significant real estate on the balance sheet, I set off to test my Bloomberg/Google skills to find the company. I could not figure it out.

There was an insurance company that fit almost all of the criteria, but I knew it was not the company that so excited Dan. I tried different databases. After an hour, I tried the telephone, reaching out to Dan directly, since we had shared ideas in the past. The answer was Scheid Vineyards (SVIN). Over a couple of days of conversations, it became clear that Dan had done a lot of work on Scheid to validate the asset values, and that he had originally heard about the company from Aaron Edelheit of Mindset Capital, another Value X attendee who had also clearly done substantial due diligence on the company. They agreed to share their work on the company with the understanding that I would not discuss it publicly until they had discussed it publicly, and I agreed I would share my diligence and any insights with them. Aaron has just presented Scheid at the Manual of Ideas 2018 Best Ideas conference, and wrote a long report now posted on mindsetcapital.com, and Dan posted a presentation on Marancapital.com so the cat is out of the bag and I am free to share.

The diligence level for me to get comfortable enough to invest our money in a "dark company" with no analyst coverage and no conference calls or investor presentations is higher than what I might require for a traditional investment, since the risk of fraud is multiples higher than a non-dark company. Additionally, because of the current lack of liquidity in the shares, a decision to own Scheid is much closer to a marriage than a date. With a friendly introduction from Aaron, a shareholder, I was able to spend two days in California visiting the company and meeting with the CEO, CFO, head of manufacturing, head of product, and Chief Marketing Officer, in addition to several phone conversations with the founder and board member Al Scheid. I toured the production facility, visited the

tasting room, drove the vineyards, and looked at 10 years of audited financial statements. I don't want to make a practice of owning dark companies, but I became comfortable enough through the diligence process to own Scheid Vineyards.

In my opinion, Al Scheid – the patriarch of Scheid Vineyards – is a wise allocator of capital. He may not be Henry Singleton (if unfamiliar with the name, I recommend looking him up), but he has played the capital allocation game quite shrewdly in the case of his wine business. Mr. Scheid formed a partnership in the 1970s, Monterey Farming Corporation, which bought agricultural land in Monterey County, California. At the time, his company grew grapes and sold them, crushed, by the tanker load to large vineyards. This was not a large value-add business. Rather, its primary purpose was to generate tax losses for wealthy investors. Over time, as land values increased, Al bought out his partners (who had been invested for those tax losses) and eventually took the company public as Scheid Vineyards in 1996, using IPO proceeds to acquire and develop more land. In the wake of the Enron accounting scandal, Congress passed the Sarbanes-Oxley Act, which dramatically increased the reporting requirements for listed companies. At that point, Al Scheid decided the company should "go dark" and stop reporting to the SEC as the costs of compliance were not justified for his business, especially because the brunt of the financial burden fell on him as a substantial owner. In the years after the financial crisis, Al used internally generated cash to repurchase a significant number of shares. He also used debt (sub 4% interest rate) to build a state-of-the-art production facility. In summary, the Scheid family has sold partnership interests, bought out partners, issued equity, bought back shares, bought land, sold land, and assumed debt. Al Scheid has run every major play in the capital allocator playbook, and. in the process. the company has evolved from a tax shelter selling crushed grapes to a vertically integrated wine company that owns the land, processes the grapes, and bottles wine all in a single location. This multi-decade evolution is the corporate equivalent of going from a caterpillar to a butterfly.

While you would not know it from Bloomberg because the financials are not available there, last year Scheid Vineyards made over $3 per share and added over $1.2M to inventory with a value of almost another $1.50 per share. The company also provisioned for a higher tax rate than it will likely pay going forward under the new tax plan, so that could add another $1 per share in earnings. So, at the prices we started purchasing shares, Scheid was trading at less than 10X adjusted earnings. As the share price has increased, so has the multiple. From a historical earnings perspective, Scheid does not pass the "this makes no (insert expletive) sense" valuation threshold I mentioned in the beginning of the letter. Even in an expensive market, it is not hard to find shares that are trading for 15X adjusted earnings; however, as is often the case with businesses our partnership owns, there is a lot that is not evident from a final EPS number. We will discuss shortly why Scheid's future earnings could be better than historical earnings, but first let us look at the assets.

Scheid Vineyard's financial statements indicate property, plant, and equipment of $86M, offset by $80M of short- and long-term debt. Again, the financial statements are not very interesting. Even if we could screen for this company on Bloomberg, the balance sheet would likely make it a big fat pass. However, the land value on the books is based on historical values, not market values. When we do a bottom up analysis of the assets, the company owns 1,892 acres of land in Monterey County that is planted with vineyards (current value $40K+ per acre). The company has long-term leases on another 1,842 acres of land in Monterey County that is also planted with grapes (current value $20K+ per acre). Scheid has $75M invested in a production facility, plus $49M in inventory, $.5M in cash, and 123 acres of non-agricultural land next to a school in Greenfield, CA that is in the process of being zoned for commercial and residential development (current value $100K+ per acre). When you combine all of

these assets and subtract the $80M in debt, you get an asset value of $168M, or $191 per share. Our cost basis in our Scheid shares is less than 1/3 of a conservatively estimated net asset value, and probably closer to 1/4 of the actual asset value. For good measure, the asset value should be growing, and the company is profitable.

Earlier, I said that I was looking for situations where the risk/reward equation makes no (insert expletive) sense: it is just too favorable. Buying an asset at somewhere between 25 cents and 33 cents on the dollar qualifies for me. Simply appreciating to replacement value would be a tripling in share price.

Stepping back from the asset value and returning to the earnings potential of the company, Scheid Vineyards has been working its way up the value chain from a grapes-growing tax shelter to a comprehensive wine producer. As you can imagine, the margins and profits for selling a tanker load of crushed grapes to Kendall Jackson Vineyards are a fraction of what Kendall Jackson receives for selling branded products in stores at $20 per bottle. Scheid grows enough grapes to produce 2 million cases of wine per year. Over the last several years, with the construction of their production facility and a shift in focus, Scheid has begun to emphasize finished goods over selling inputs. Finished goods can take several forms, from the highest margin Scheid Vineyards branded wines, to wines produced on a private label basis for supermarkets such as Kroger, to the lowest margin wines produced for captive audiences such as cruise lines and airplanes. In 2016, Scheid Vineyards sold 500,000 cases of finished goods generating over $23M in revenue. Going from $0 revenue to $23M in finished goods revenue in 6 years is impressive, with limited additional capex and remaining profitable along the way. Going forward, with very manageable capex, the company could eventually sell almost all of its production as finished goods. This would dramatically improve the revenue, margins, and profitability of Scheid Vineyards, and make last year's earnings look irrelevant and today's share prices look like a bargain. The grapes are in hand, and the production capacity expansion is straight forward and manageable. The question is, can they get to 2 million cases of demand for their products? Discussions with all levels of management make it clear that the transition to finished goods is a vision shared by all, and there are multiple levers to pull, including product, marketing, and distribution. In fact, just this month the company announced a new distribution partner that they are very excited about. To be clear, I think we are paying zero for the earnings growth call option of a successful continued migration towards finished goods, because the company is trading for a fraction of its asset value.

One of the reasons I believe this opportunity exists is because the company is "dark" and motivated investors – like myself – with substantial resources could not find or understand the company until Dan Roller and Aaron Edelheit held my hand and walked me through the opportunity. Fortunately, in recent years, the reporting requirements for small companies have gotten significantly easier than they were initially under Sarbanes-Oxley when Scheid Vineyards decided to "go dark." It would not surprise me if the company files in the future. In fact, for the first time in several years, the company put out a press release at the end of the second quarter highlighting results. However, the press release only told part of the story; it was only by looking at the financial statements, sent to me as a shareholder, that I could see the inventory buildup and actually understand the financial results. As the company continues its evolution towards selling more and more of its grapes as finished goods, a higher share price that would likely come from removing the dark status could be highly beneficial. The company could use its stock as currency and buy an established brand to speed the transition.

Scheid Vineyards' strategy will take years to play out. Currently, there are many days where zero shares trade, but when they do, they are trading at one-third of replacement value. This is a family-controlled company, with a long

history of thoughtful capital allocation operated for the long term, not managed by hired executives trying to massage quarterly earnings. I suspect that, over the next five years, they will buy another company, or if valuations are too stretched, they could sell the entire company since Al Scheid is a pragmatic capital allocator with a history of buying when the buying is good, and selling when the selling is good. We are a top 10 shareholder who will be a holder while this all sorts out.

NEW POSITION: BLUELINX HOLDINGS (BXC)

My parents live in a summer community near some very wealthy people. From my visits there, I have learned that rich people can have great yard sales. When I am at home and I see a yard sale, I keep driving. Cheap junk is still junk. When I am visiting my parents, I stop for yard sales. The fancier the house, the harder I slam on the brakes. Really wealthy people selling stuff to create space in their house tend not to be the most price-sensitive sellers. Bargains can be had.

It turns out private equity (PE) funds can have pretty good yard sales as well. This fall, $30B PE firm Cerberus was selling its final holding in their 2004 vintage fund. They had owned the company for more than a decade, and holding on to it was all that was keeping them from wrapping up the fund. Their holding was valued by the market somewhere north of $40M, which is a lot of money to most individuals, but to a firm managing $30B, it is one-tenth of 1%, or a rounding error. The brain power and effort to squeeze the last additional dollars out of one-tenth of 1% is better spent on larger holdings with more promise and longer time horizons. After more than a decade, the rational and responsible act for Cerberus was to cut the cord. They hired advisors and checked all of the fiduciary boxes, and then held their yard sale, which in this case was a secondary offering at 20% below an already depressed stock price. The company in question is BlueLinx Holdings.

BlueLinx is a building supplies distributor that was started in the 1950s as a division of Georgia Pacific, meant to distribute Georgia Pacific products as well as to store excess inventory. Put simply, the company's facilities have been – and are currently – larger than they need to be given the distribution volumes. In 2004, Georgia Pacific sold BlueLinx to Cerberus, who took the company public in shortly thereafter. In 2006, Cerberus put additional debt on the enterprise secured by the real estate in the form of a 10-year loan with significant pre-payment penalties. This effectively tied the company's hands with respect to sale leasebacks or other ways to monetize the real estate. Not surprisingly, a highly levered building products distribution company did not fare well during the housing crisis. Macro issues coupled with an ill-fated decision to centralize the sales force created operational challenges for BlueLinx. Shares traded from a high of $150 in 2004 to a low of $4 in 2016.

There are, however, signs that there is a turnaround underway with three primary drivers. First is the continued strengthening in new home starts, which is out of the company's hands. By most estimates new home starts are still approximately 20% below normalized rates. In the short term, new housing demand will be further bolstered by post-hurricane rebuilding efforts in Florida and Texas. The second leg of the turnaround relates to improved sales efficiency and improved margins as the company shifts its emphasis from volumes to profitability. As a point of reference, their primary competitor – Huttig Building Products (HBP) – has margins almost double those of BlueLinx. I am not holding my breath that BlueLinx will improve so dramatically, but there is clearly some opportunity here. Aiding this effort, the company has unwound the aforementioned unsuccessful sales force centralization attempted by former management.

The final, and most important, leg of the turnaround is being driven by asset sales. Before our purchase, the company had sold 13 sites for proceeds of $67M, which was 4X the value at which the sites were carried on the books. Since our purchase, the company has sold an additional four sites for $110M. BlueLinx currently owns 33 distribution centers totaling almost 6 million square feet, and has stated that sales could effectively double with virtually no increase in its footprint. Now, this does not mean that the company half of the distribution centers can be eliminated – proximity is important for building supply distribution companies – but it does imply that there is extra square footage that is under-utilized and not properly valued in the GAAP financial statements.

Again, distortions in the GAAP financials help to create the opportunity. In the last quarter's financial statements, all 30+ of the owned buildings and land were on the books, net of depreciation, for $85M, yet the company just sold four sites for $110M. The GAAP financials simply did not – and do not – reflect the market value of the land or the fact that there is tremendous excess capacity not needed to run the business in its current state. These sales have allowed for substantial deleveraging, as the company just paid off its legacy mortgage from the Cerberus days. My very rough estimates, following the sale of the properties and repayment of the debt, the company has approximately $200M in debt, $100M in payables, and $30M in pension obligations for a total of $330M in obligations (bad stuff). Fortunately, it also has the remaining properties, which are likely worth between $250-300M, plus $170M in receivables and $200M in inventory. In terms of asset value, there are approximately $670M in assets and $330M in liabilities – north of $300M in net "good stuff" with less than 10 million shares outstanding. With more than $30 per share in "good stuff," our purchases for less than $9 per share pass my "it makes no (insert expletive) sense" test.

For good measure, the management team appears quite competent and is pulling on the right levers. The CEO recently said, "the Company's portfolio of owned real estate continues to provide financial strength as a source of liquidity for additional debt reduction and operational and strategic opportunities in the future." I suspect that the strategic opportunity in the future will be an acquisition which will utilize their existing unused capacity. Given the assets BlueLinx owns, I believe the downside is limited. Combined with the housing tailwinds, margin expansion opportunities, and acquisition opportunities, the upside is substantial.

To give credit where credit is due, I was introduced to BlueLinx by Andrew Jakubowski who runs Adstella Investment Management. Andrew was able to explain the opportunity to me in ways that even I could understand. I got further exposure to the company at Furey Research Partner's Hidden Gems conference.

K1s

For U.S.-based investors, we expect draft K1s to be ready at the end of March.

OUTLOOK

The challenge with having an industry or economic view is that you can be right on the trend and wrong on the stock price. If I asked you in 1981 what would happen to cigarette consumption over the next 35 years given the ban on advertising, multiple tax increases, anti-smoking campaigns in schools and on TV and the overwhelming evidence of negative health impacts? You probably would have correctly predicted a decline in consumption. As my favorite Twitter personality, author and investor Morgan Housel has pointed out, U.S. cigarette consumption has dropped 44% since 1981 AND Altria stock is up 71,000% since 1981. Investing is hard.

Thus, with the caveat that I prefer to focus far more on the companies than the macro, I do not understand the logic of the government's decision to cut corporate taxes and increase deficits when unemployment rates are hovering around 4%. In my opinion, now is the time to pay down debts and address entitlements. However, Congress has done what they have done. The lower tax rates and boost to the economy are likely a tailwind for the months to come. Counter-balancing these tailwinds is the fact that the S&P 500 has gone up 22 of the past 23 months and volatility is non-existent. I have little doubt that eventually we will have a 10%+ drawdown and that drawdown will create opportunities.

As I ended the last letter, "when the market does decline and volatility reappears, wonderful opportunities will be created. During periods of stress, balance sheets are ignored, multiples compress, and bad news is assumed to last in perpetuity. We need to have some securities that we can easily sell to take advantage of the opportunities that will be created. Fortunately, we do." We will continue to invest with a long time horizon like it is our own money – because it is. Thank you for the opportunity to grow your family capital alongside mine.

Sincerely,

Scott Miller

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