ASKELADDEN CAPITAL – Q2 2016 INVESTOR LETTER
7/1/2016

Dear Partners:

There are not a lot of investment managers who would choose "caution" and "learning from failure" as the theme of their quarterly letter when they officially have their first round of paying clients signed (yay!) and investment performance is kicking butt. There are also not a lot of investment managers who would use a video game as an analogy for their investment process. In the end, though, there are not a lot of investment managers who look much like me – and both of my mentors have encouraged me to be me, whatever other people may think. So here's to that!

Despite a substantial double-digit cash allocation throughout the year and a portfolio comprised almost entirely of companies with net cash to modest leverage, we are up over 36% on a gross basis since inception on 1/11/2016[1], outperforming the S&P 1000 total return index, net of all fees, by approximately fourteen percentage points. Below is a compilation of various data you may find helpful.

	Since Inception, Actual	Since Inception, Annualized
Performance of S&P 1000 TR (our benchmark)	~ +15%	not meaningful
Askeladden Capital Partners Gross Performance	~ +36%	not meaningful
Gross Outperformance vs. Benchmark	~ +21%	not meaningful
Askeladden Capital Partners Net Performance (assuming 1.5% / 30%)	~ +29%	not meaningful
Net Outperformance vs. Benchmark	~ +14%	not meaningful
Fees Paid	~ +7%	not meaningful

Each investor's performance and fees will vary depending on their entry date into the fund; the results we present here are very approximate (hence the lack of decimal-point precision) and are intended as directional color rather than gospel truth. The numbers in the blue box are the most important – what you get to take home, and how much better (or worse) we're doing relative to the benchmark. For the purpose of evaluating the performance of your investment, please rely upon your monthly statements from Fund Associates and your annual audited statement and K-1 from Spicer Jeffries. Please remember past performance is NOT indicative of future results.

Fees in that table are calculated assuming the investor is a "qualified client" charged the standard 1.5% management fee and 30% performance allocation on any outperformance vs. the index. To reiterate, we believe this aligns our interests with yours, as I will earn substantial performance fees during periods when we do very well, and will not earn performance fees during periods when we're underperforming. In other words, if we don't do well, our fee structure is like a (somewhat expensive) mutual fund; if we do well, it converts to more of a hedge-fund like structure. Accredited but non-qualified clients are charged a flat 1.95% management fee since we cannot legally charge performance allocations. We wish we could, but… if I do my job, a flat 1.95% will likely be cheaper for you.

[1] This date is significant because I still get to say I started my hedge fund when I was 21. Three days to spare!

Additionally, considering the investment of my own money in the Partnership and the fact that substantially all of my and my family's net assets outside of the Partnership are co-invested in the same securities, I'm doing with your money what I am with my own. In fact, since your investment in the Partnership represents merely a modest portion of your net worth – whereas I run all of my family's money with the same investment approach – means that I am substantially more invested in this strategy, financially and personally, than any of you. As you know, I initially intended to invest the entirety of my personal net worth in the partnership, but was advised by several mentors who have been entrepreneurs to maintain easily-accessible liquidity for emergency situations. Nonetheless, over time, I anticipate that my investment in the Partnership will comprise an increasing percentage (and eventually the significant majority) of my investable net worth.

How Value Investing Made Me Better At Playing Madden

I would like to set our results in context by encouraging you to think of these results as A) primarily the result of luck and favorable timing rather than skill, B) unlikely to ever be repeated, and C) something which I'm trying not to get too excited/arrogant about, because that would be the quickest way to get in trouble.

To that end… storytime! (I'm a novelist; I can't help myself.)

During the month of June, my friend Todd roped me into playing a few friendly games of Madden NFL, which I hadn't played in over a year. For those who aren't familiar, Madden is a video game in which you simulate both the coach and players of a football team, calling plays and then executing them. To play with Todd, I had to purchase a one-month Xbox Live subscription which cost me ten dollars. Being a value investor who likes getting his money's worth[2], I promptly decided to make the most of my subscription by playing games competitively in the online matchmaking system.

You have to understand that I've never really enjoyed multiplayer online gaming, because in the most popular type of game (first-person shooters), if you can't hit buttons fast enough, or precisely aim for headshots, your strategy is mostly irrelevant. As a teenager, I had better things to do than get really good at killing imaginary pixelated aliens, so I've always been the worst person I know at such things (and thus didn't enjoy getting killed by other online players, nor the rude epithets that come with the territory.) I'm a decent shot with a real pistol, but with a virtual one, I turn into Cyril Figgis – I can't hit anything!

Madden, though, is different – if there's any game I could competitively excel at, it's that one. Why? You really don't have to press that many buttons – it's much more about strategy. Am I calling the right play in this situation? Am I throwing to the open receiver? Am I running to where there aren't any defenders rather than to where there are? Am I calling the right defense to undercut my opponent's favorite route that he always calls on third and short?

The interesting thing, though, is that when I originally got my Xbox a few years ago, I ended up playing over 100 games of competitive Madden over the course of the fall, and had a win ratio slightly under .500 – i.e., I lost a few more games than I won. In June, I played just over 20 games, and had a win ratio of .750 – that is to say, I won three times as many games as I lost.

Did I suddenly get better at football strategy? Not really. Did my conversion of faith from Chemex to French Press boost my caffeine levels and lend me heightened reflexes? Nope.

What changed is I became a better value investor – or at least a more prudent one. Many of you are aware that over the past few years, I made several portfolio allocation mistakes that ranged from annoying (American Capital) to quite costly (Orion Marine Group, Essex Rental). That isn't to say I didn't have my share of successes, too – but success is a lousy teacher.

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[2] Some of you will correctly note that this is an example of the "sunk cost" fallacy – once the subscription is paid for, the only relevant question when choosing whether to play or not play a game is whether that is the best use of my time. I decided the answer to that question was no, so despite having several weeks of subscription left, the Xbox is now buried in my closet so I'm forced to spend my free time on more highbrow pursuits.

Why? In investing, like in Madden, just because a play turns out well doesn't mean it was a good playcall. There's a correlation, but it's nowhere close to 1-to-1. Howard Marks, one of my favorite investors, described it this way in his book *The Most Important Thing*:

> *"In the investing world, one can live for years off one great coup or one extreme but eventually accurate forecast. But what's proved by one success? When markets are booming, the best results often go to those who take the most risk. Were they smart to anticipate good times and bulk up on beta, or just congenitally aggressive types who were bailed out by events? Most simply put, how often in our business are people right for the wrong reason?*
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> *The point is that even after an investment has been closed out, it's impossible to tell how much risk it entailed. Certainly the fact that an investment worked doesn't mean it wasn't risky, and vice versa. With regard to a successful investment, where do you look to learn whether the favorable outcome was inescapable or just one of a hundred possibilities?"* [3]

Tying this back into the Madden analogy, there are times when I've gone for it on 4th-and-30 from my own side of the field and (miraculously) completed a route that just barely got me the first down. That rare success doesn't mean, however, that it was a good decision to take that absurd risk – if you statistically analyzed it, the NPV-positive decision in that situation would always be to punt the ball away and play defense!

Indeed, the reason I've gotten so much better at Madden is that two years ago, I tried to force plays – I really wanted to complete a deep crossing route off play action without regard for the fact that my opponent kept calling all-out blitzes that would have made a quick slant or bubble screen more prudent. I called too many pass plays because they're sexier/more fun, even though a more balanced run/pass approach is much more likely to succeed. Two years ago, if I was behind, I started playing differently and taking more risks to try to get back ahead. [4]

I learned from that failure, and now try to be much more "zen" when playing Madden. In Madden and in life, I don't always succeed, but today, I try my best to take what the defense gives me… just like I do when I'm investing. I don't have my heart set on any particular play, or formation, or game plan. If you like to blitz a lot, I'll call a bunch of quick, high-percentage pass plays. If you drop back in coverage and sit on all my routes, I will run the ball up the middle five straight times until I force you to substitute some linebackers for DBs (at which point I will go back to eating you up with slants and in cuts.)

So it is with companies: I don't get my heart set on buying any specific company, and I don't start my day by "looking for investment ideas" – because, as I've discussed before, if you're a highly competitive, goal-oriented person (as I am), and your "goal" is to find ideas, then you're going to "find" some ideas whether or not they're there to find. The process continues to be to learn about companies that are interesting for one reason or another, and patiently wait for them to trade at valuations I find attractive in context of conservative estimates of their current and future earnings power.

This process can be random, and indeed, prior to Brexit, I will admit to being a bit frustrated – while being up 36% gross is a high-class problem to have, it also meant that a lot of the ideas I found attractive in the earlier part of this year were no longer worthy of incremental capital allocation. *Our exceptional performance so far this year has been almost entirely a function of luck, not skill.* I am quite pleased with the decisions I made on what to invest in (and perhaps more importantly what to pass on), but the next page overviews a few factors you should be aware of:

[3] "Understanding Risk" in Howard Marks' book "The Most Important Thing: Illuminated." pgs 50 – 51

[4] Psychologically speaking, this is referred to as "fear of missing out." Interesting read from Stanford here.

1. At one point in February, we were down nearly 10% (or perhaps over 10%; I don't really remember or care – good luck to anyone who asks me what my Sharpe ratio is…) As of 6/30, we are up 36% (gross). I don't feel like much has changed fundamentally with the companies I own – certainly not enough to justify a 40% swing in the span of less than six months. Our companies are doing just fine – pretty much what I expected – but what seems to have happened is their share prices have converged to fair value substantially more rapidly than I expected. I'll take it when I can get it, but usually, this process takes longer – often multiple years – and you should certainly not expect us to repeat this kind of performance.

2. While we cannot promise anything, we would like to remind you that our process is generally to look for investments that meet a 20% hurdle rate, with the knowledge that we will be wrong and bad things will happen in the world, reducing our returns from those we target. Indeed, I would be very happy if we were to achieve low-teens annualized returns over the long term net of all fees. (Such a performance would be an exceptional track record.) Would I like to do better than that? I'll try my best – but please keep your expectations realistic.

3. In the context of being a long-term value investor, mark-to-market performance during six months is relatively meaningless. Is it fun to be able to tell my friends and other investors I'm up 36% gross since inception? Of course it is! I'm only human. But just as I would ask you to have patience with me if we're down substantially (on an absolute or relative basis) for long stretches, I would also ask you to temper your excitement during the "good times" like today, and focus more on the fact that we're conforming to our investment process and that will hopefully generate superior long-term returns.

Our process continues to pay off: We utilized new capital from LPs to tax-efficiently liquidate positions that have run up – we still own them, but did not increase our allocation with new capital, locking in some of those gains without having to take the short-term capital gains tax hit. Concurrently, the Brexit (which, incidentally, has limited to no impact on the fundamental business prospects of our portfolio[5]) drove down prices of various companies which we are now happy owners of. Buys in Q2 (and into the current month) include:

1. Fogo de Chao (FOGO), the premier Brazilian steakhouse concept, which I have been following since prior to its IPO last summer, but did not buy because it simply wasn't cheap enough. FOGO has fantastic unit economics and is a nationally-recognized brand (validated in most regions of the country) that is quite underpenetrated, with only ~30 U.S. locations versus 120+ for more expensive concept Ruth's Chris (which is still growing). Even if you assume Fogo can only reach 80 U.S. locations (and not grow after that), and you significantly haircut management's expectations around new unit performance, we believe shares are worth \$16 - \$17 today and have been buying them around \$13.

2. Franklin Covey (FC), one of the leaders in corporate training. Franklin Covey has durable intellectual property around changing human behavior to improve performance, and has brought its content into the modern era with a Netflix-like subscription service that we believe will materially enhance the value proposition for clients and drive more (and stickier) revenue streams for FC. Without any contribution from this new go-to-market channel, and again significantly haircutting management expectations, we believe Franklin Covey shares are worth at least \$18 today, \$25+ within three years, and as such have been quite happily buying them near and below \$15 (really loading up below \$14 today). I've attached a more in-depth analysis of Franklin Covey if you're interested in seeing my analytical process hands-on.

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[5] Personally, I think Brexit is a non-issue, at least from the perspective of what we own (no English banks or anything). The bigger risk angle, to me, is in context of the upcoming U.S. election: are pollsters underestimating the strength of the global resurgence of populism? Regardless of which party ends up in office, if they are dragged toward protectionist policies by populist public sentiment, that would likely prove to be a significant negative for the U.S. economy.

3. CSW Industrials (CSWI), a diversified specialty chemicals / industrial products company that recently spun out of Capital Southwest, a local BDC. CSWI is a unique story in that it is a "new" public company with extremely limited investor following, and yet the businesses actually have a long public track record as part of Capital Southwest, so we can have more trust in their performance in various economic conditions. The valuation has declined over the past few months for no particular reason – in fact, management is guiding to substantial profitability gains as a result of synergies from a recent deal – and we believe non-cash amortization charges are obscuring the company's value. CEO Joe Armes is a long-time friend of my former boss, and I believe him to be a high-integrity guy who will make sharp capital allocation decisions. Without assigning any "platform" value for accretive deal-making, we believe CSW to be worth in the high $30s to potentially over $40 today, and have purchased a small position in the low $30s.

In each case, we would note that our small size is a competitive advantage vs. bigger funds – while trading liquidity in these names would not be sufficient to efficiently build (or blow out of) a position if we were running hundreds of millions of dollars, with our small capital base, liquidity is not a concern, and we can profit from names that larger funds overlook.

Just as important as what we're buying is what we're *not* buying. You have likely heard of my love affair with energy-focused industrial Dynamic Materials – and indeed, my day-trip to Houston[6] and subsequent facility tour (wherein I got to blow up a shaped charge) were very instructive and impressive. It's a high-quality organization from top to bottom – but at the end of the day, I just don't have enough confidence in oil prices to feel comfortable buying shares at $10, as the business would likely see further margin compression if the current energy environment persisted. If shares retreated back to $7, however, I'd be all over it like a fat kid on a pack of Smarties.

We exercised similar discipline on other names like America's Car-Mart – a unique used car dealer in rural Arkansas (long story as to how we ended up looking at it) where I like the company and management team quite a bit but am similarly cautious about the substantial industry-wide risks which may not be fully priced into the stock.

<u>Personal Update</u>

I've said it once and I'll say it again – analytics is easy; decision-making is hard. Part of my job is placing myself in the best position to make decisions. To this end, I feel obligated to inform you that while I am quite confident in the decisions I've made so far this year, there is still room to improve. Specifically, you know that I am one of the few investment managers who will explicitly tell you that I think you (and I) are both better off if I'm actively working on research 30 – 40 hours a week rather than 60 – 80 (which is the case right now.) I am exhausted and don't have time (or mental energy) to think about big-picture things like mental models from psychology or history.

I'm also, personally, in a somewhat risk-averse place right now – which may not be the best place to be. Just as swinging too often can be risky, swinging too infrequently can be risky – some investors believe if you never lose money, you're not taking enough risks. To that end, permabears who've been in cash and gold awaiting Armageddon have, by substantially underperforming any relevant index, likely permanently impaired their clients' capital just as severely as someone who actively lost money. We will continue to maintain a sizable cash allocation and patiently await new opportunities, although we bent a little on our hurdle rate for CSW Industrials.

As I discuss in my Form ADV and elsewhere, I've strived as hard as I can to minimize the number and severity of "agency problems" (conflicts of interest) between me as the investment manager and you as the client. Conflicts of interest are pervasive throughout the financial industry, to the detriment of investors. However, it's a trade-off – by not spending all my time trying to drum up capital and instead focusing on actual research, I'm financially worse off (in the short term). As you know, while I ramp AUM, I'm paying my bills by publishing research on Seeking Alpha.

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[6] Pro tip – don't ever drive from Dallas to Houston and back the same day – that was some kind of exhausting… at least I got a chili cheese fries at DQ out of it!

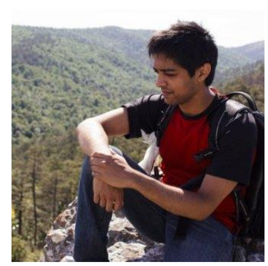
While this process is, on the whole, beneficial and synergistic, there are definitely specific cases where it represents a conflict of interest. Specifically, there are a number of companies where, if not for article-writing, I might spend an hour or two looking at it then decide (due to management, balance sheet, product, or so on) that it's not a worthy investment candidate. However, since I need to publish a certain amount of research to keep my cash flow statement for the month in the green, I have a bit of a "sunk cost" problem – if I've already spent X amount of time on something, I'm compelled to spend a little more to turn it into a publishable article.

I'm not a fan of doing this, so I'm investigating alternatives to be able to generate cash more time-efficiently. There are a few things (won't bore you with the details) I'm trying to do to reduce the time the article-writing process takes, and I've also applied to Manhattan Prep to be a GMAT tutor, which is quite lucrative on a per-hour basis ($100+) and would allow me to actually spend more time on research that mattered (even if I spent a few less total hours working on stocks).

I understand that many of you have your own idiosyncratic personal circumstances that have in some cases delayed your capital contributions, and that's fine – I'm obviously going to work on your timeline here. However, in the near term, to the extent that you can make your initial contributions in a timely fashion, it would certainly be helpful in giving me some breathing room financially speaking. If you could graph human stress as a function, I believe it would be exponential and not linear – beyond a certain threshold, things just get harder and harder to deal with – and while it may sound relatively trivial, especially since unlike me, y'all have already made plenty of money, I feel like my life would be a lot more relaxed if I had merely $5,000 - $10,000 less in annual net costs to fund (which equates to a modest $300 - $600K in incremental AUM, or a few of you writing me checks tomorrow instead of a month or two down the road).

In the longer term, you can help me by contributing incremental capital as well as by introducing me to your (accredited-investor) friends. Obviously, I expect to have to earn this trust, but many of you have already been generous in helping me meet potential investors, and I greatly appreciate that. My goal here is for Askeladden to do "what it says on the tin" and apply a thoughtful process quarter in and quarter out, patiently taking what the defense gives us and focusing on winning the war rather than the battle. I'd rather do my job – i.e. researching and making good decisions – and leave the marketing to satisfied clients who tell their friends.

Hopefully performance will continue to bear the fruits of our strategy, and that performance will attract additional client assets.



Westward on!

Samir

Your friendly local hedge fund manager

P.S. I know I promised in Q1 that future letters would be shorter, and I'm still working on that… but I sleep better at night knowing I was more transparent than less. You're always welcome not to read these. However, given that you're placing a lot of trust in me by investing your hard-earned capital with me, I want to help you understand what I'm doing and why.