Dear Partners,

YTD, ACP has returned approximately –3% net (negative three percent), compared to an approximately ~+5% (positive five percent) return for the benchmark S&P 1000 Total Return Index. On a since-inception basis, our fee structure has cushioned recent underperformance, as unpaid performance allocations were un-accrued.

	YTD 2017	Since Inception on 2016-01-11 (Annualized)	Since Inception on 2016-01-11 (Cumulative)
Askeladden Capital Partners (Gross)	-2%	+41%	+66%
Askeladden Capital Partners (Net)	-3%	+34%	+55%
S&P 1000 Total Return Index	+5%	+25%	+38%
ACP Net +/- To SP1000 TR	-8%	+9%	+17%

DISCLAIMER: Data is estimated, unaudited, and provided for directional color only. Past performance is not a predictor of future results. Amounts may differ due to rounding. We do not expect our future annualized returns to approximate our historical annualized returns due to factors including: worse luck, a larger asset base, elevated equity market valuations, fewer investment candidates that meet our qualitative and quantitative underwriting criteria, smaller position size limits than were in place during Askeladden's first year, and other miscellaneous items. Please consult your monthly statements from Fund Associates LLC or audited annual financials from Spicer Jeffries LLP for actual returns. For "Since Inception" numbers, Index performance is rounded to the nearest whole percentage point; ACP performance is rounded to the next lowest full percentage point. For YTD numbers, both are rounded to the nearest whole percentage point. Decimal points have been excluded so as not to convey a level of precision that these estimates are not intended to convey. Net returns are calculated assuming a hypothetical investor paid the standard fee structure of a 1.5% annual management fee and 30% of the outperformance, if any, vs. the S&P 1000 Total Return index, which was chosen because it has historically outperformed the Russell 2000 and most accurately represents our typical investment universe of small and mid-capitalization U.S. equities (i.e., those with a market cap of $10 billion or less). Individual investors' returns may differ from those presented here due to their date of entry into the fund or their specific fee structure (for example, accredited but non-qualified clients may not, by law, be charged a performance allocation, so they are typically charged a higher, flat management fee). Annualized/cumulative returns are calculated assuming an investor joined on the date of inception; YTD returns are calculated assuming an investor joined on January 1, 2017. Results are presented only for Askeladden Capital Partners LP and not for any of the separately managed accounts which Askeladden Capital Management LLC (the investment advisor to Askeladden Capital Partners LP) also oversees. While separately managed accouts are generally allocated very similarly to the fund, SMA clients' performance may differ based on factors such as: timing of account opening, tax considerations, specific client instructions, and manager discretion; therefore, SMA clients should consult their Interactive Brokers statements for specific performance information for their account. This is not an offering of securities or solicitation thereof; any offering of securities would only be made to accredited investors via a Private Placement Memorandum under Rule 506(c) of Regulation D, and any prospective partners who did not have a pre-existing relationship with Askeladden as of 1/18/2017 would be required to verify their accredited status with relevant documentation. This requirement does not apply to separately managed accounts. As Askeladden Capital Partners decided to rely on 506(c) rather than 506(b) as of 1/18/2017, any documents prepared prior to that date were not intended for public distribution and should be read accordingly. Askeladden Capital Partners, and SMAs that mirror its strategy, should be considered high-risk investments suitable for only a small portion of an investor's overall portfolio, as they involve the risk of loss, including total loss. Specific risk factors are enumerated in our Form ADV.

Portfolio Update: screaming… and then silence.

SETTING: TWO HAT-WEARING LLAMAS STAND ON A LIFEBOAT IN THE OCEAN, FAR FROM SHORE. "CARL," A DANGEROUS SOCIOPATH WITH A LONG HISTORY OF VIOLENCE, HAS, PRIOR TO THE SCENE, SUNK AN ENTIRE CRUISE SHIP ALONG WITH ALL OF ITS PASSENGERS, EXCLUDING HIS FRIEND / TRAVEL COMPANION "PAUL" AND THE LOVELY ELDERLY COUPLE FROM 2B (WHO, IT IS IMPLIED, CARL GRUESOMELY MURDERED PRIOR TO SINKING THE SHIP). IN-SCENE, PAUL HAS BEEN INTERROGATING CARL REGARDING HIS HORRIFYING AND INEXCUSABLE BEHAVIOR.

PAUL: You are just terrible today.
CARL: Shhhh… do you hear that? That's the sound of forgiveness.
PAUL: That's the sound of people drowning, Carl.
CARL: That! is what forgiveness sounds like. Screaming… and then silence.

- "Llamas with Hats 2" by FilmCow / Jason Steele (2009)

What does that riveting exchange from my favorite absurdist comedy sketch, circa junior year of high school, have to do with value investing? Well, not very much actually; I'm totally forcing the metaphor because a) that series has always made me laugh way more than it should given my moral standards[1], and b) I really like introducing section headings with quotes. But, if you'll indulge me, value investing (as measured by a mark-to-market track record) can often sound much the same: i.e. periods of screaming (excitement, whether good or bad)… and then silence.

[1] If you are "young" (biologically or at heart) and inclined to this sort of humor, I would recommend watching the first four in the series (of twelve total); "Llamas with Hats 3" is my personal favorite, with "Llamas with Hats 4" being a close second, although you kinda have to have watched 1 and 2 to fully appreciate the genius of 4. I think we can all agree that Episodes 5 – 12 rapidly get really weird and unfunny, like Amy Schumer. Or, weird-er, I guess, depending on your threshold for weirdness.

Right now's the silence; hopefully the screaming is to come (… in a good way, and now I'll put this tenuous metaphor out of its misery.) It would certainly be nice if I could earn a steady 7.3 bps per day, every day, ad infinitum, like sand in a never-ending hourglass[2]; unfortunately, that is pretty much the opposite of what I expect the future to look like, vol-wise. I've cautioned against extrapolating past results into the future; indeed, setting aside the post-election rally, returns have been much choppier since last summer. I'll go into more detail below, but summarily, on the basis of fundamental results at underlying companies, our year has been good. Yet, particularly on our two largest positions, the market has not (yet) rewarded us the way that I strongly believe it will.

To set the philosophical framework: continuing the sand-and-water theme, famous investor Donald Yacktman once used the metaphor of a beach ball forcibly held underwater to describe stocks where fundamental/intrinsic value was compounding, but the market wasn't cooperating: the bigger the gap between the depth of the ball (the stock price) and the rising tide (the intrinsic value level, in this metaphor), the bigger the necessary eventual explosion upward.[3] Of course, faster value realizations are better in the presence of a rich opportunity set (the equivalent of increasing inventory turns, in the context of an operating business). That said, our typical three-year underwriting horizon should normally prove sufficient to deliver substantial holding-period IRR.

To give you color on the underlying drivers of YTD and future returns, let's go through the portfolio one by one in order of current position size. All standard legal caveats about forward-looking statements apply.

<u>Franklin Covey (FC):</u> this is the gift that keeps on giving, in the sense that the company keeps exceeding my expectations, and the market continues to be utterly confused, providing us with repeated opportunities to increase our stake at absurdly attractive CAGRs (napkin math: >25% on a 3-year basis and >20% on a 5-year basis). Just two days ago, Franklin Covey reported a very interesting quarter wherein they reorganized their entire operational structure to take advantage of the runaway success of their new All Access Pass product offering, thereby adding ~10% to their current EBITDA on a go-forward basis, and improving their incremental margins on (substantial) future revenue growth by 300 – 400 bps. Yet the market, and even several of our friends who should know better, chose to focus on irrelevant temporal numbers (penalizing the company for slightly lower fuel efficiency during a period in which they're rebuilding the plane while keeping it smoothly flying at cruising altitude). Although we've earned a modest return on this position YTD, the price-value gap remains extremely wide and this will either play out as a near-to-medium-term home run or a tax-efficient long-term mid-teens-plus compounder. … or both.

<u>Liquidity Services (LQDT):</u> this is the test of patience. On the one hand, there's no indication that the company isn't what I thought it was (i.e., the market leader in a very large industry that they are disrupting). There are even green shoots insofar as their core (non-DoD) business has returned to solid organic growth without any benefit (yet) from meaningful platform investments over the past few years, and they are delivering reasonable growth numbers even *with* the DoD drag. That said, they remain in investment mode, and the market wants to see these investments pay off on the PnL and cash flow statement. I openly admit that I underestimated the time and expense that their transformation would take, although I don't have any disagreements with management's prioritization of getting it right over speed and near-term financials (there are echoes of FC, though the key difference is FC is generating a positive carry via strong cash flow). However, even to the extent that I underwrite the real "bear case" here, I can't come up with anything close to, let alone below, the current stock price – the decline year-to-date (which has

[2] 7.3 bps compounded by ~250 market days per year equates to 20% annualized gross returns, which is more or less my hurdle rate for securities and in theory my targeted minimum return if I always ran at 100% exposure and never made any mistakes (which, respectively, are a) not the plan and b) impossible). Readers are reminded that no guarantees are made as to future performance, etc etc.

[3] As with all analogies, this one isn't perfect: there is no actual *law of physics* that forces stock prices to converge to intrinsic value, as well as corner cases like takeunders and so on. But I've gotta come up with witty, share-inducing one-liners for the sake of content marketing here, so liberties are being taken with the specifics.

meaningfully weighed on our returns, largely offsetting strong gains from some other positions) is wholly unjustified by results. As one fellow shareholder (a deep value denizen) put it: if a deep value guy (him) and a much more quality-focused guy (me) can agree that a business is absurdly cheap… it's probably really, really cheap.

Secret Small-Cap 1: I'm keeping this one really close to the vest because a) it's small and illiquid, and b) I really want to add to this position over time. Summarily, the company has many of the factors we look for – a seemingly defensible, nichey business with technology leadership and recurring revenues; strong management with a focus on both operational improvements and smart capital allocation; etc. Results year to date haven't been terribly exciting, but the stock price represents a reasonable valuation on current results and a meaningful discount to any sort of future success. This is very much in the early stages of its lifecycle in our portfolio.

Secret Small-Cap 2: This one is less close to the vest, but still not one I want to shout about from the rooftops: it's a nichey technical-products company that reminds me a lot of Dynamic Materials (BOOM), which you may recall was a successful, albeit small, investment for us last year. This company is the clear technology leader / disruptor in a pretty "boring" industrial space; while its recent results have been optically unimpressive (top-line treading water), it's a tale of two drivers: the company has been rapidly expanding market share and entering adjacent markets, while its main end-markets have been imploding due to oil prices. As end-markets stabilize and recover, the company's latent growth potential will shine through. Every quarter I've followed the story, I've become more impressed with the company and its management, and while this has neither been a meaningful contributor nor detractor to this year's returns, it's a company that I expect will, at some point in the next 18 – 24 months, rerate very meaningfully and very rapidly (on top of strong organic growth in revenues and cash flow).

CSW Industrials (CSWI): patience is paying off as the company, earlier this year, announced its first acquisition in a while (they were on the sidelines given the frothy valuation environment) and more recently announced really robust organic growth from new product introductions (and likely some successful integration of previous acquisitions). I don't expect flashy numbers from CSW and wouldn't expect anyone else to either, but it's always nice to have some "sleep well at night" positions that will steadily accrue value year in and year out – my experience has been that really well-managed companies with strong product lines have a way of surprising to the upside, yet CSW does not sport the multiple premium that industrial businesses of far lesser quality and opportunity (ex. Tennant) often trade for.

LGI Homes (LGIH): this was a meaningful contributor to returns in the first half, as I utilized the early-year price weakness to meaningfully increase our position, and the company has since reported results suggesting that it's on track to do exactly what it said it was going to do. I've meaningfully reduced this position as the risk/reward has declined in attractiveness with the rapid rise in price ($28 to $40 since Feb), but it continues to be a modest holding.

Secret Small-Cap 3: I'm not really looking to add to this one, but need to keep it embargoed for a friend. This is a small position but one that has done well for us so far, as the company reported very strong results in our first quarter of following/owning it. Although the stock has approached my conservative estimate of fair value, I haven't trimmed much because it's likely to deliver a strong positive carry, with a lot of potential near-to-medium-term opportunities that I haven't really underwritten as part of my valuation. Given the strong base of recurring revenues, strong balance sheet, and improving cash flow dynamics, I'm willing to let this one play out.

USA Technologies (USAT): this one has been pretty volatile despite results that were very consistent with what we expected, providing numerous opportunities to trim and add that led to pretty solid contribution despite this never being a huge name in the book. Although excess returns on a go-forward basis now depend more on execution, I view the recent partnership with Ingenico as meaningfully positive, and given the company's strong base of recurring revenues, seemingly noncorrelated organic growth driven by an idiosyncratic technology adoption curve, and the likely operating leverage either as a standalone or acquisition target, I continue to own a modest position.

Fogo de Chao (completely exited): Usually I suck at timing, but even a broken clock gets lucky twice a day: I nailed this one, exiting the rest of our position above $16 prior to the THL secondary at $14. I haven't been in a hurry to repurchase because after taking time to think about it, while I think Fogo has great economics and is managed by a sharp team, they really have no control over the (truly terrible) restaurant macro, which injects a bit more downside risk here than in the other names I could allocate to at similar valuations. Moreover, THL's willingness to sell at a level well below what I think it's worth leads me to be incrementally more cautious around my assumptions, and not assign Fogo any of the modest "familiarity premium" that names I've owned previously might otherwise receive. I would be happy to rebuild our stake under the right circumstances; I just don't see those as of today.

If that was too much detail, the summary: I'm right where I want to be in terms of hit rate. Year to date, I've had a mix of strong positive revisions to expectations, mild positive revisions to expectations, a bunch of "exactly what I expected," and a couple "this pushes returns out to the right but doesn't cause me to reconsider my thesis." So far, so good; from a prospective returns perspective, if we continue to achieve that mix of fundamentals, then future gross returns should theoretically approximate underwritten IRR multiplied by net exposure – which, incidentally, is currently at around ~83 – 84%, having been in the high 80s for most of the quarter. As a reminder, I don't use leverage nor do I short, so our net exposure will be equal to 100% minus our cash position, which to my knowledge has remained double digit since inception.

The ongoing triumph of reason over emotion: how I got there (and you can too).

One of the problems with philosophizing (as I am wont to do) is that philosophy unpracticed is practically useless. I've previously opined (whined?) about the dime-a-dozen nature of spouted value investing platitudes, juxtaposed against the reality that actual implementation of saws that everyone knows ("be fearful when others are greedy," etc) tends to be a) really hard and b) not done nearly as often as said.

Occasionally, I get these overly ambitious ideas, like: I'm finally going to become fluent in a foreign language! Or: I'm going to write a book on some topic that interests me! I'm still hopeful on the latter at some point in the future, but for now I'll reduce my ambitions to a brief primer: *behavioral control in investing*, or in life, really; it's the same thing. I've talked before (and will talk again) about how I believe analytics is commoditized to a certain degree, and the real edge left in investing is primarily behavioral: everyone's focused on gathering data; *nobody's focused on judgment.*

Throughout my life, my struggles have never been with insufficient analytical firepower or insufficient data but usually with incorrectly parsing wholly sufficient data due to some sort of behavioral bias or emotional influence.[4] I've previously discussed some of the challenges that go along with being the manager of a breakeven startup business (to go back to the aircraft analogy: I'm trying to *build* a 737 on a Cessna frame while keeping it flying), and how I felt like emotional attachment to tangible goals (fund performance, capital raising, etc) was still a weakness I needed to improve upon. Summarily, I've made significant progress, in much the same way that I made progress with portfolio management and analytical framework last year: it's moved from being a conscious, thought-intensive process to something I've internalized, freeing up bandwidth for working on more important things.

[4] I've mentioned before, and elsewhere, that I process the world very differently from most people I know with my personality type and analytical capabilities, insofar as having a much higher degree of empathy and emotional involvement. I waffle about whether or not I should say things like "I struggled with anxiety and depression for a decade" (past tense, now, thankfully) because it's difficult for me to differentiate between potentially trendy pathologization of everyday worries and struggles now that mental health is (thankfully!) being destigmatized, and something that could actually have a clinical definition. Nonetheless, I was certainly *more* prone than most of my friends to such things, and paradoxically, that's resulted in me having a lot more control over my emotional state today, relative to most people I know/meet, because I found my breaking point relatively early and had no reasonable option other than to find strategies to address it. It's a bit like skating on thin ice – if you're heavy on your skates and fall in a few times, then figure out where not to go and how to skate better, you're now at less risk than the person for whom this has never been a problem because one day they will run into their perfect storm, reach that critical stress threshold that it's challenging to come back from, and they won't know what the heck happened or how to deal with it.

Here are three of the practical, applicable techniques which have really helped me reduce emotional influence and behavioral bias on my decision-making (again, both in investing and in my personal life):

1) Autodidactic cognitive behavioral therapy + base rates / "outside view" thinking.

No, this isn't about your mother, or your childhood. "Cognitive behavioral therapy" is a fancy name for a process of learning to identify maladaptive thought patterns that lead to undesired behaviors, and interrupting or replacing those thought patterns with substitutes that are more likely to lead to desired outcomes. For many mild behavioral or mood disorders, it is equivalent and often *superior* to the clinical outcomes of medication; for good decision making, it's the equivalent of adding 30 points of IQ. This can be done with the help of a professional therapist, but being A) an autodidact and B) a bit uncomfortable with the optics of seeing a therapist[5], it's something I've been working on solo with various degrees of intensity for the past few years. Here are the steps.

A) Identify a behavior that is undesirable and easy to fix (start simple) and figure out why you actually do it. This really just requires a bit of thought and self-honesty. Am I sending this sharply-worded email because it's going to accomplish my goals and lead anywhere I want to go… or because it blows off some steam?

B) Latticeworking mental models, think back on your life (as well as those of others) to figure out what behaviors and thought patterns are statistically most likely to lead to your goals, and pick those with the highest base rates of success. ("You catch more flies with honey than vinegar.") Also take the "outside view" rather than the "inside view," particularly if you're American and prone to focusing on / attributing outcomes entirely to individuals rather than circumstances – that friend / family member who you're upset with, was their hurtful behavior because they're an unthinking, uncaring person, or because they have their own stresses and were approaching the interaction with a very different schema than yours, thereby unable to anticipate how you would perceive their words and actions?

C) Integrate these realizations into your brain, being realistic about the level of effort required (high) and the amount of time it takes (often a lot). At first this is an active process (i.e., you actually have to think about it and follow through on it each time you're tempted to go down the wrong path), but over time it becomes a passive, automatic part of how you process the world. For example, in writing this letter, I wrote, then without having to really convince myself, decided to remove several of the more snippety / put-down-y sentences, that I knew I was writing because I *can* rather than because I *should*. Hopefully the next step is not writing them in the first place.

D) Rinse and repeat on other problems: nervousness before tests/meetings/interviews, demotivation due to perfectionism, overestimation of abilities in certain circumstances (athletic, sleep deprivation, etc), underestimation of abilities in certain circumstances (coping with adversity, acquiring new skills), etc etc etc.

E) Help other people you care about learn how to do this. Life works better when people make good decisions.

2) Structural rather than brute-force problem solving.

Life is a series of trade-offs; it's nice in theory to strive for a perfect world where we can achieve everything that we want to, but in reality we can only attempt to optimize for so many variables before running into constraints that prevent us from achieving others. To this end, I find that the solution to my problems is often not addition (of complexity or effort or whatever), but subtraction (of unnecessary things that are getting in the way of real priorities). When a research project isn't going well, it's usually not that I don't have enough information, but that *I'm asking too many questions* – trying to answer fifty things about thirty trivial questions, rather than the critical five things about the three truly important ones.

[5] I don't think this *should* be the case, but I think it still *is* the case, and it's something I never really figured out how to un-internalize, so. In retrospect, it probably would have helped a lot at certain points, but I'm living proof that you can get there on your own too.

I've written a lot about the severe flaws of the "grit" mindset on my blog, so I won't go there again; that said, it's worth recognizing that willpower is finite and stress is exponential, so often one of the easiest ways to solve a hard problem is by solving an easier one, or by structurally removing the hard problem in the first place. For example: I previously referenced that I was occasionally distracted by the cell on my master spreadsheet that compares my performance to the benchmark… *so I moved the cell reference and stopped tracking that information on a frequent basis because all it was doing was stressing me out.* As another example: I thought my personal challenges were way bigger than they actually were until I quit my job, launched Askeladden, and finally got a full nine hours of sleep a night. In both of these examples, nothing actually changed with regards to the underlying stress factor… but all of a sudden it became a lot less stressful. You're increasing your slack capacity to deal with hard problems by getting rid of the easy ones.

Finally, in reverse, adding barriers ("activation energy," as one psychologist refers to it) to things that you don't want makes them easier to avoid. Don't want to eat potato chips? Then stop beating yourself up over not being able to resist them when they're in the pantry, and *stop buying them.* Want to stop *buying* potato chips? Eat a full meal before you go to the grocery store, and all of a sudden they won't seem so appetizing. And so on.

3) Contextualization / demystification.

Circling back to point 1.b, one of the key "inputs" into being better able to approach the world is simply having more, and more broad, data about how it actually works. You can gain some of this experientially, but far more can be gained simply by internalizing *others'* experience, which is surprisingly easy to do (Amazon Prime, Google, etc) and yet is surprisingly rarely done (see: the number of bestseller purchasers who never claimed their free money).

A lot of this just involves some sense of *intentionality,* or *keeping your eyes open*. Compounding of knowledge works just like compounding of capital, and going through life with your eyes closed is the equivalent of never making any investments: you're just not going to get anywhere. It's easy to get caught up in the daily minutiae; the *who*, the *what,* the *when*, the *where*; the kinds of fill-in-the-blank answers you memorized (and promptly forgot) for freshman history class, the reason you *hated* that subject until you finally ran into a professor who bothered to get you to ask the only question that really mattered: *why*. Little kids are objectively pretty stupid, but they learn stupefyingly fast by asking that question over and over and over again (and then over again some more, three hours after you tire of hearing it).

And yet at a certain point, people – even *intelligent* people, *educated* people, people *who should know better* – they stop asking. They read the books their favorite value investing blog recommends, then have a conversation about the three obvious points wherein lots of heads nod as the real point passes through one eardrum and out the other; they work on the same ideas that everyone else does, and their DCF spits out a PPS 5% higher or lower, and they stop there without asking how the exercise they just did ties into everything else in the world, and in their life.

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The daily work is important, of course, but it's the meta-work that really *counts* if you do it right. You want to know why you should invest in Askeladden? It's not because I'm a better analyst than anyone else, in terms of reading a 10-K and throwing numbers at a spreadsheet. I'm not, honestly. But I am still that five-year-old asking *why*. I never get tired of it. It's one of my autotelic activities. That, more than anything else, has gotten me to where I am today, and hopefully it's going to get us where we need to be in 5 or 10 years. And if doesn't, you can bet I'll be asking…

… well, why not? And what should I do differently?

Westward on,
Samir

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