2013 ANNUAL REPORT

Dear Partners,

The Centaur Value Fund produced a return of +2.0% net to partners in Q4 2013 as compared to a +10.5% return for the S&P500 index. For the full year 2013, CVF returned +9.5% net to investors versus +32.3% for the S&P500. The Fund's standard performance information is shown in the table below:

	Q4 '13	2013	SINCE INCEPTION
Centaur Value Fund – Gross Return	**+ 2.3%**	**+11.1%**	**+412.8%**
Centaur Value Fund – Net Return**	**+ 2.0%**	**+9.5%**	**+310.2%**
S&P500	+ 10.5%	+32.3%	+155.4%

The table above shows the performance of the Centaur Value Fund for various periods since the inception of the Fund on August 1, 2002. All CVF figures include the reinvestment of dividends. The Gross Return includes the impact of the standard management fees and expenses, but does not include incentive-based fees. Monthly and year-to-date figures are estimates and un-audited. Inception to date figures incorporate audited results from prior years and un-audited results from the current year. See the section entitled "Important Notes" at the end of this letter for more information.

***The Centaur Value Fund Net Returns reflects the experience of an investor who came into the Fund on August 1, 2002, and did not add to or withdraw from the Fund through the end of the most recently reported period. The reported net return figure includes the impact of all performance-based fees as well as high water marks in the cumulative return. However, each investor's individual return will vary depending upon the timing of their investment, the effects of additions and withdrawals from their capital account, and each individual's high water mark, if any.*

Q4 Update

The Centaur Value Fund finished 2013 with a +2.3% performance in Q4 and ended the year with a +9.5% return net to partners. Meanwhile, the broad stock market continued its year-long rally in the fourth quarter right up to the last day of the year, with the S&P500 finishing with a +10.5% return in Q4 and a +32.3% return for the year.

2013 Year in Review

The Fund entered 2013 with roughly 70% market exposure after a strong finish to 2012, and a reasonably good start resulted in the Fund's 8.5% gain through the end of May. Had the year ended then, we would have been satisfied with the performance of the Fund, not because we were keeping up with a hot market (we weren't) but because we were getting very decent returns with what we believed was a very low risk profile. Unfortunately for us, the year did not end there.

By the end of May, the Fund's net market exposure had declined to an all-time low of roughly 50%. This was due to the combination of our selling certain Fund holdings that we believed had become fully valued and an increased number of shorts and hedges in the portfolio as the rising market and growing appetite for risk drove many stocks to prices that we believed were unsupportable by the underlying businesses. The Fund would have been extremely well positioned at that juncture to exploit a material market correction if one had happened to come along.

It appeared initially that our conservative positioning would be rewarded when the market negatively responded to the announcement on June 19th that the Fed would begin to "taper" the massive $85 billion-per-month securities buying program universally known as QE. This announcement led to a four-day market sell-off that knocked about 6% off the value of the S&P500, but which had more significant effects on the bond market. It also caused considerable dislocation in markets that might have been thought to be unrelated to such an announcement, such as emerging market debt and precious metals, both of which sold off sharply. Stocks promptly recovered when Fed officials quickly soft-pedaled the taper announcement, ultimately delaying it until later in the year when the markets were apparently in a more accepting mood. Though the June sell-off was shallow and swift, we did manage to pick up a few new positions in that span that allowed us to increase the Fund's market exposure to just over 60% by the end of June. Unfortunately, our portfolio also suffered a 2.2% loss during that month due to a short position that went badly against us.

The brief "taper tantrum" in June was really the last whiff of fear that the markets would exhibit in 2013, though the S&P500 did show a small loss in August. We spent the remainder of the year struggling to find bargains as the market continued to rise. In the absence of conventional value, we made our second meaningful mistake of the year, which was our decision to invest in a struggling retailer that appeared to be in "turnaround" mode and which we judged to be trading cheaply on the metrics. The company had brought in a new management team with a track record that suggested a reasonable probability of success, and we felt that though the investment was riskier than our typical idea the pay-off in success mode might be multiples of our investment. After initially appearing to be turning the ship around, things turned ugly when the company reported a much worse-than-expected result for Q2, causing us to conclude that our thesis was unlikely to play out. This investment cost the Fund roughly 1.7% of performance and contributed to CVF's worst monthly showing of the year (-2.9% in August) which happened to be a rare losing month for the market as well. The stock market basically then went straight up from September through the end of the year, making the task of identifying bargains even more frustratingly difficult. We worked to maintain long exposure through year-end primarily by eliminating short positions and by slowing further sales unless we could rotate the exposure into something that was relatively cheaper. Largely, however, we found ourselves in a holding pattern in which most of our new research resulted in securities going on our "wish list" to buy at lower prices. All in all, it was a deeply unsatisfying year.

In terms of performance attribution, our long portfolio produced a return of roughly +16.5% on an estimated 70% average long exposure during the year, or roughly a 23% return on capital deployed. Our aforementioned ill-fated retailer investment cost us 1.7%, by far the biggest negative contributor on the long side. On the short side, we ran an estimated weighted average short exposure of 10% and cost the portfolio 4.5% of performance for a negative IRR of roughly 45% on our short exposure. A single position accounted for more than half of this loss. In retrospect, our biggest mistakes were sins of omission: there were several securities we could have bought but didn't in the hopes that they would get a little cheaper. We also sold certain holdings too soon. 2013 was a year where one had to stay in it to win it, and we didn't get the memo.

Update on Longer Term Performance

The table below presents the year-by-year performance of the Fund from inception through year-end 2013.

CENTAUR VALUE FUND RETURNS BY YEAR 2002-2013

YEAR	CVF Gross	CVF Net	SP500 % Chg
2002*	+13.7%	+11.4%	- 2.7%
2003	+33.5%	+28.3%	+28.7%
2004	+25.5%	+21.6%	+10.9%
2005	+18.6%	+16.3%	+ 4.9%
2006	+13.7%	+12.1%	+15.8%
2007	+20.0%	+17.2%	+ 5.5%
2008	- 6.9%	- 6.9%	- 37.0%
2009	+31.4%	+27.8%	+26.5%
2010	+16.9%	+14.4%	+15.1%
2011	-7.0%	-7.0%	+2.1%
2012	+12.4%	+11.6%	+16.0%
2013	+11.1%	+9.5%	+32.3%
TOTAL	**+412.8%**	**+310.2%**	**+155.4%**

** The performance shown for 2002 is from the inception of CVF on August 1, 2002 through December 31, 2002.*

Since the inception of the Centaur Value Fund on August 1, 2002 through year-end 2013, a period of just under eleven and a half years, the Fund has produced a 13.2% annualized return to investors net of all fees and expenses (but before taxes). Looking at it in dollar terms, $100,000 invested at the time of the Fund's launch on August 1, 2002 would have been worth approximately $410,220 after all fees and expenses as of December 31, 2013. For comparison, the same $100,000 invested in the S&P500 index fund would have turned into $255,400 at December 31, 2012, a cumulative return of 155.4% and an average annualized return of approximately 8.6%. Of course, individual partner results will be better or worse depending upon the dates invested.

The longer-term track record of the Fund remains reasonably strong, especially considering that the Fund has achieved its performance with much lower than 100% market exposure. Unfortunately, we've under-performed both our own expectations and the general stock market for the last three years. It is hard to know whether this recent slump is simply one of those inevitable stretches of under-performance that every active manager and strategy experiences, or whether it represents an indication that something has changed either in our execution or the market in general that has caused our particular investing approach to fail to keep pace. In looking at our specific decisions of the last three years, we certainly see many opportunities for better execution of our strategy and as we do every year we try to learn the lessons that can only come from another year of accumulated investment experience.

Know When to Hold Them

It seems clear in hindsight that our primary mistake in 2013 was not having been more aggressive in buying securities during the moments of genuine fear in 2011 and 2012. We were also guilty of selling many of our holdings too soon, particularly in the last quarter of 2012 and in the first half of 2013.

As we have described in earlier letters, our selling philosophy has always been to begin selling our holdings at the low end of the conservatively calculated fair value range and to be largely done selling by the middle of the range. The benefit of this approach is that it does not rely upon our ability to sell securities to irrational investors. Rather, we envision the buyer as a rational investor who demands a reasonable return, but that operates with a hurdle rate that happens to be somewhat lower than ours. We have referred to this selling approach as "capturing the low-risk arc of the available return" to acknowledge that we are not looking to capture the absolute maximum profit available on each of our investments. Our view has been that leaving some money on the table is rational if the incremental risk of capturing that extra return isn't required to generate a satisfactory outcome. In most environments, we have been able to identify cheaper securities to purchase within a reasonable amount of time after making sales, thereby replacing fairly valued stocks with undervalued stocks. This wasn't the case in 2013, as we struggled to replace stocks that we sold with newer, cheaper ideas.

We believe that it makes sense to refine our philosophy on selling our holdings by separating our holdings into two broad categories. One category would be the securities that we own primarily because of the price rather than the quality of the business. For this category, we believe that our traditional "low-risk arc" approach is absolutely the best way to go when it comes to selling our positions.

The second category would consist of our investments in higher quality, more reliable businesses where the business quality is the primary attraction. Such securities tend to be harder to acquire at under-valued prices simply because the market doesn't often allow such high quality businesses to become anything more than modestly discounted. Even so, we much prefer buying high-quality business at reasonable prices, because the higher quality means we can take larger position sizes and thereby deploy more capital. It seems reasonable to believe that we could benefit by holding our high-quality names a little further into the range of fair value than we would in the case of our lower quality names. Partly this change is the recognition that once an investment thesis starts to play out, the stocks tend to rise in price well beyond the mid-range of fair value, and often will push to the high end and beyond.

In looking at our history on such high quality ideas, we believe that virtually all of them could have been held at least to the mid-point of our fair value estimate and still resulted in very safe returns. In years such as 2012 and 2013, capturing an additional 10-15% return on several larger Fund investments would have made a meaningful difference in performance. A further benefit is that extending our holding periods a little longer on the highest quality names should reduce the number of new ideas we need to find in any given year to replace sold positions and maintain a more fully invested portfolio.

Value, Risk, and the X Factor

We are of the opinion that at its core traditional long-only value investing can be boiled down to two basic factors: the ability to value a business, and the ability to assess risk. We spend virtually all of our research time on these two topics, given that we think that with effort one can achieve reasonable skill at making judgments about them. But there is another factor that we've always known to be present and influential in setting short term securities prices, but which we have never considered essential for value investors with longer-term investment horizons: market sentiment.

One of the more interesting facets of market sentiment is the concept of the feedback loop, which is simply the idea that positive price action will often by itself cause increased buying, and that negative price action causes increased selling. George Soros refers to this factor as "reflexivity" and believes that if the feedback loop is strong enough, the effects can transcend simply driving short-term securities prices to actually affecting the underlying economic reality of the businesses involved and even the economy as a whole, as was the case in 1998 (for the positive) and 2008 (negative). Feedback loops are the most plausible explanation for the existence of financial bubbles and market crashes, which are not well explained by theories that purport the existence of well informed, fully rational market participants unaffected by emotion and folly.

It is important to acknowledge that market sentiment is not a factor that we have reliable tools to exploit beyond the standard value investing philosophy. In our case, this largely consists of trying to practice Warren Buffett's contrarian advice to "be greedy when others are fearful and be fearful when others are greedy" and working to avoid the classic behavioral mistakes. As a result, we tend to exclude market sentiment from our decision-making process and have instead relied upon our core skills of valuation and risk assessment to protect us from excesses caused by crowd behavior, regardless of whether those excesses turn out to be positive or negative for securities prices in the short term. If anything, we tend to run counter to the herd not for contrarian's sake but because we believe good investments often run counter to the trends of the moment.

However, it seems reasonable to believe that the impact of market sentiment has been amplified in recent years by the confluence of any number of potentially contributing factors. The volume of news and opinion that now exists in the financial media and on the internet is staggering. Price momentum is a core factor in many mechanical and algorithmic trading strategies. The recent trend underway towards ETF's and indexed products is likely another contributor to both positive and negative feedback loops in the markets.

But the real "X factor" is the extent to which quantitative easing and other stimulus programs introduced by central banks around the world have driven securities prices and by extension market sentiment over the past several years. Earnings growth does not appear to sufficiently explain the stock market's stellar performance in 2013, nor did it fully in 2012. In both years, the positive returns were driven primarily by higher earnings multiples, which is really just another way to describe positive sentiment.

By effectively driving investment-grade fixed income returns to unacceptable levels, the Fed's policies have left most market participants little choice but to take their chances with the stock market, leveraged real estate, or some other "equity-like" vehicle in order to meet their required return rates. It seems telling that the only real volatility in 2013 occurred when the Fed appeared ready to begin withdrawing stimulus, thereby threatening the perpetuation of the positive feedback loop. After a brief pause, the frenzy for stocks resumed once the taper was postponed and later reduced in scope. The result was a year-long positive feedback loop that drove stock prices higher with historically muted volatility.

It is perhaps a weakness of our approach to investing that we have largely ignored the impact of external forces such as QE in our efforts to focus exclusively on the factors that we believe should drive stock prices longer term, those being business fundamentals, valuation, and risk. We did not make a meaningful effort to gauge the effects of QE on the market, other than to consider it a wild card and a potential risk factor. We don't believe anybody really knows the effect of QE on real-world business fundamentals, and we certainly won't be the ones to figure it out. We suspect QE has played a huge role in the performance of the stock market of the last two years via the positive feedback loop mechanism. There are charts circulating in various media outlets that purport to show a near 100% correlation between stock market performance and the timing and magnitude of Fed securities purchases. We have concerns about what will happen when QE ends. We also have concerns about what will happen if QE continues.

Some Observations

With the markets having performed very strongly for the two years, we are finding it difficult to identify new investment opportunities that combine the elements of business quality and reliability with compelling valuations. In addition, there has been very little market volatility in the past year, and it has now been nearly two years since there has been a decline of 10% or greater in any of the major US stock market indices. We are also seeing many of the classic warning signs of stretched valuations and extreme risk-seeking behavior. Borrowing on margin to buy stocks is reportedly at record highs. There are many localized bubbles in the "hot" neighborhoods of the stock market such as biotech, social media, and cloud-based software services. The IPO market has been extremely buoyant, with 2013 seeing the most new issues floated in a single year in more than a decade. Six of these IPOs doubled on their first day of trading, something which has only happened eight times in the previous twelve years combined.

Outside of traditional capital markets there are signs of excess risk-taking and speculation as well. The electronic currency known as bitcoin rose in price from $15 to $1,000 during 2013 for reasons totally beyond our comprehension. A San Francisco-based start-up tried to IPO an NFL running back (later delayed due to injury).
If one believes to any degree that one should be fearful when others are greedy, then this would <u>not</u> appear to be a time to be especially greedy. The effects of positive sentiment aside, at what point are stocks priced for too little return and too much risk?

Lessons We Thought We'd Learned

We are obviously disappointed with the Fund's performance in 2013, though we believe that we made more good decisions than our performance would indicate. It is clear that we have been far too risk-averse in a market that has been defined by positive sentiment and rising stock prices. We know that our investors count on us to make the best of whatever environment the market throws our way, and we simply did not make enough of the opportunities that were available in 2013. It has admittedly come as something of a surprise to us that market participants have been willing to drive stocks back to historically high multiples after having so recently experienced the perils that come from the combination of easy credit and richly priced assets. We can remember exactly where we were sitting when we first read these words in the summer of 2007, another time when the stock market seemed like it might never go down again:

"When the music stops, in terms of liquidity, things will be complicated. But as long as the music is playing, you've got to get up and dance. We're still dancing."

—Chuck Prince, former Citigroup CEO, July 2007

It may be that the memories and lessons from managing money through two devastating bear markets in a single decade have stuck to us more indelibly than it has with others, despite the fact that we suffered far less than most in those terrible times. Perhaps this is itself a lesson. Maybe what we should have learned is that so long as the music is playing, Mr. Market will always choose to dance.

Regardless of how loud the music gets, we will maintain our focus on making the best decisions we can and work hard to identify compelling investments that meet our standards for value and safety. We expect the market to experience a few more bumps in 2014 than it did in 2013, and we are prepared to exploit whatever opportunities come our way.

Now more than ever, we are grateful for your continued confidence in us and in the Fund.

Respectfully yours,

Zeke Ashton
Centaur Capital Partners
1460 Main Street Suite 234
Southlake TX 76092
817-488-9632
817-488-9648 fax

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