PRINCE HENRY NAVIGATOR I, II, AND III LLCS

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"Protecting And Compounding Capital Over Time By Operating In Inefficient Asset Classes And By Backing People Whom We Admire, Who Have Proven Competitive Advantages, And Whose Incentives And Interests Align With Our Own."

April 2012

Dear Fellow Navigator Investor:

Overview

In almost all of this letter, I will explain that Navigator and the funds in which Navigator invests spend the overwhelming amount of our time and our capital attempting to benefit from assets that are mispriced and which will, over a full investment cycle, eventually get the valuation that they deserve. In the section "Macro Hedging and Point Clear" I will discuss how Navigator seeks to protect against negative macro events, years like 2008, the current crisis in Europe, or worst case the paralysis of the entire global financial system.

In an attempt to make this update as digestible as possible the following video link provides a high level summary, but does not replace, the letter's content. (A special thank you to Navigator investor and Emmy award winning producer, Mike Cloonan, for the video.) Video link:
http://www.princehenrygroup.com/Navigator2012OverviewMed.html

Spitfire's Synopsis

As Julian Allen of Spitfire, one of Navigator's largest investments, observed in his year end letter (http://www.princehenrygroup.com/SpitfireInvestorLetter4Q2011.pdf) on December 30th 2011, in an article entitled the "Dangers of Market Herd Stampedes" the Financial Times wrote:

> "Record close correlations between stocks suggest that their due diligence into corporate fundamentals is minimal, and imply that mispricings abound. Rather than attempt to exploit such anomalies, investors are worrying about the macro environment, and trading via indexed investments."

A Bipolar Market

As the above quote in the Financial Times makes clear, today's environment features one overriding theme: everything is priced the same depending on the ebullient or depressed mood of the day. Wall Street pundits have labeled this phenomenon "Risk On, Risk Off". A bipolar market might better describe what is happening: one day investors collectively embrace risk and buy up almost all assets regardless of their quality then later, often in the exact same day, investors collectively focus on risk and sell off almost all assets.

<u>Temporary or Permanent?</u>

The right investment response to this bipolar phenomenon depends on whether this situation is temporary or permanent. I agree with Tom Russo's assessment that while, for a time, champ assets and chump assets may fetch the same prices, eventually, over a full market cycle, the champs will soar and the chumps will sink. As a reminder, Tom's Semper VIC Fund is one of Navigator's largest positions. Tom and Semper VIC have compounded capital at 15% since 1984 vs. 10% per annum compounding for the S&P 500. In a recent interview Tom concluded with this thought:

> "Recent commentary around Bill Miller's retirement *(Dan's note: Miller is another very successful investment manager)* suggested that investing today is a new game requiring a new set of tools. I believe pronouncements of a new era will prove to be as misplaced going forward as they have in the past. The work Bill did over his career – identifying great businesses trading at fair prices and lengthening out the time horizons to investors' profit- should remain a rewarding game going forward. That is the game that I attempt to play as well."

<u>Navigator's Positioning</u>

In the spirit of Tom's quote, I am taking advantage of today's inexpensive prices and Navigator's long time horizon to position Navigator to own the highest quality assets, ones that will survive and thrive whatever the future economic environment is good, decent, or bad. In addition, Navigator owns hedges or insurance policies that will only pay off if the world economic environment turns horrific. (Exhibit A shows largest and most important Navigator positions, the seven investments that have approximately 75% of Navigator II and III's combined capital.) As a reminder, liquid assets are valued at their market value while illiquid assets are valued at the lower of cost or market with the draconian condition that if value appears impaired at all, Navigator writes off 100% of the investment.

While I believe this investment strategy is the optimum one for Navigator, a long-term investment fund designed first to preserve capital and second to compound at attractive rates over time, the short term of 2011 was anything but enjoyable for many of Navigator's funds. (TriPro, Navigator's largest investment is, as discussed later, a notable exception.) Let me illustrate this short term pain with three data points from three of Navigator's best managed funds that I have the highest conviction will preserve capital and outperform the indices over time:

1. **Zeke Ashton's Centaur Value Fund** was down only 8% in 2008 a year in which the S&P 500 fell about 38%, yet in 2011 Centaur fell 7% a year in which the market was flat.
2. **Mohnish Pabrai's Pabrai Fund IV** fell 15% in 2011.
3. **Whitney Tilson and Glenn Tongue's T2 Fund** fell 24% in 2011.

All three of these funds are, in my view, extremely well positioned to thrive. However, none of them, or any of Navigator's other investments, are likely to thrive until markets begin to price assets in a differentiated fashion or as Warren Buffett observed years ago that "You cannot tell who is swimming naked until the tide goes out."

While one quarter does not tell us much, the results for the first quarter of 2012 are now in, and the T2 Fund rose about 25% vs. about 11% for the S&P. The assessment of T2's managers about their first quarter performance is especially interesting.

> "Some might say that we have a hot hand so far this year, but this would be incorrect. Our hands have been largely idle, as our portfolio today is nearly identical to the one that did so poorly last year. As we noted in our annual letter, time will tell whether we were wrong or just early on many of our favorite stocks – but the past quarter has provided some evidence for the latter."

Pabrai's Synopsis

Continuing on the theme outlined by the T2 Managers, Mohnish Pabrai's "General Comments" section in his Pabrai Fund's annual letter (http://www.princehenrygroup.com/l_010112.pdf) provides a wonderful synopsis for 2011 that applies to so many of Navigator's funds. Here it is verbatim:

> "All three funds underperformed the indices by substantial margins in 2011. It is our largest underperformance versus the indices in any year since inception. While it is best not to fixate on single year performance numbers, it is worth delving into the reasons why we were off by 14-30% against the indices last year.
>
> 2011 was a year when we were presented with some amazing opportunities by Mr. Market. We sold appreciated positions and took full advantage of the situation by investing in a few great businesses at big discounts to intrinsic value. And then we watched those prices drop further – pretty substantially – after we owned a full position.
>
> The funds put very significant amounts to work in businesses like Bank of America, Citigroup and Goldman Sachs. All of them, and others, ended the year well below our average buy price. The positions we sold either stayed flat or went up further – what else is new. As a result, we look pretty dumb – for now.
>
> However, I feel great about our situation. We made a lot of money in 2011. Those $$$ are just not visible today. The odds are very high that those dollars will be very visible over the next 1-3 years. We similarly made lots of money in Q408 and Q109 as the funds hit multi-year lows. We could not see it then, but it became apparent and fully visible in a few short months.
>
> From March 1, 2009 to Dec. 31, 2009, PIF3's per unit NAV went up by 157%. We hardly took any actions in that period to make that happen. We did take a lot of actions just before that period - between November 2008 and February 2009 that were fundamentally responsible for the dramatic rise."

Now that the first quarter of 2012 results are in, Pabrai appreciated about 21% in the first quarter of 2012 vs. about 11% for the S&P500.

Buffett: Time for Equities

I cannot improve upon what Mohnish Pabrai has written but I would add that Warren Buffett who very rarely states his opinion on how different investment asset classes are priced, and whose batting average over time when he does express such an opinion is about 100%, recently wrote this piece for Fortune magazine advocating that investors take advantage of the Lake Wobegon-like pricing conditions to put 100% of assets into equities. **http://finance.fortune.cnn.com/2012/02/09/warren-buffett-berkshire-shareholder-letter/**

Macro Hedging and Point Clear

Navigator is positioned in the way Buffett recommends. If, as has happened over every other market cycle, assets begin to get priced on their individual values, Navigator will do very well. Because Navigator is a diversified vehicle and because some investors, including my family and I have all or almost all of their investable assets in Navigator, Navigator makes extraordinary efforts to protect against market shocks.

Getting this protection in a form that one can have confidence it will work in a real crisis and also getting such insurance in a cost efficient manner is extremely difficult. If, for example, Navigator buys an insurance policy from a bank and if in the very crisis where Navigator needs the insurance policy to pay, the bank becomes insolvent, then such a policy is literally worse than worthless. How can that be? In such a scenario Navigator not only does not get paid from its insurance policy, but it suffers from having managed the rest of the portfolio believing that the insurance policy would pay off in a crisis.

In an effort to have the ability to buy the best hedges under the best possible terms, Navigator bought a stake in a company, Point Clear, which specialized in this area. Point Clear was led by Lyle Minton, whom many of you know and is a good example of what Navigator tries to do in "Backing People We Admire Whose Incentives Align With Our Own". As explained above, we knew that hedging efficiently was an especially difficult thing to do in the post 2008 investment environment. By investing in Point Clear I believed that Navigator could achieve two objectives:

1. Improve Navigator's own access to well designed and cost effective hedges.
2. Benefit by owning a piece of the hedges that Point Clear provided to other funds.

The first part of this strategy worked as Navigator has achieved access to past and current hedges that it would not have had without its investment in Point Clear. The second strategy produced revenues for Point Clear but it never produced enough revenue to cover the significant overhead expenses involved in running a hedging firm. Because of Point Clear's inability to reach a critical mass of revenues, it has failed as a standalone business. This failure has cost Navigator about of 6.4% of total assets in Navigator. This loss disappoints me greatly. I take full responsibility for making the unsuccessful investment and apologize for my misjudgment that Point Clear could generate enough interest in its hedging products to succeed as a standalone firm. For Lyle Minton's detailed Post Mortem on Point Clear, see
http://www.princehenrygroup.com/PCCMDissolutiondocFinal3-28-2012.pdf

The loss of this money has nauseated me in a very literal sense. That said, and fully admitting that I made a mistake with Point Clear, I still believe that making the Point Clear investment was the right decision for Navigator. Why? Am I talking out of both sides of my mouth? No I am not. While I deeply regret the loss, on a net basis, Navigator is better off because we made the investment. Specifically, Navigator now has approximately 2.5% of assets invested in insurance policies with another manager, Hayman Capital Management, which would not have occurred were it not for Navigator's investment in and association with Point Clear. This insurance policy with Hayman is like most insurance policies in that I hope that we do not end up needing it and do not collect on it. That said, I believe that in the event of a true global financial crisis this investment of 2.5% is likely to protect the other 97.5% of Navigator's capital in a way that we otherwise could not. Effectively, the hedge cost us 8.9% of capital, the 2.5% we have invested in the Hayman hedge and the 6.4% we spent on Point Clear which enabled the Hayman investment. This result was not my goal at the beginning: I wanted to earn a good return on the 6.4% we invested in Point Clear and believed that we could do so. Looking back, however, I feel better owning this Hayman hedge and having lost the Point Clear money than I would if we had all the money back (8.9% of Navigator's capital) but did not have any ability to buy effective insurance policies against massive disruptions in the global financial system.

The Catastrophe Insurance Dilemma

I have spent a tremendous amount of time before, during, and after the Point Clear experience thinking about the proper place, if any, of catastrophe insurance in a diversified long-term vehicle like Navigator. While I freely admit that Navigator attempts to be a conservative vehicle that believes to compound capital one must first preserve it, it is interesting for me, and I hope for you, to see how other managers that I respect balance this constructive tension between taking advantage of the mispricing of individual assets or trees while not getting burned if the entire forest, the global financial system, becomes an inferno. Zeke Ashton, the manager of the extremely successful Centaur Family of Funds recently discussed his own views on this topic in an article he wrote for Value Investing Letter, an industry trade publication. Zeke writes:

> "Where do we stand on this dilemma? Given the recent memories of the 2008 credit crisis, we believe that we simply can't afford to ignore the macro altogether. As this year (2011) comes to a close it seems very likely to us that the progression of the sovereign debt crisis will be a major driver of the capital markets for at least the next several years. We know we cannot predict how the crisis will play out, but we recognize it presents hard-to-quantify risks and at the very least will likely cause continued volatility as events unfold. As such, we need to be watchful for the sort of liquidity vacuum that we saw in 2008 and take steps to ensure that we build a portfolio that can withstand severe stress and potential disruptions to the capital markets. However, we need to be careful not to drift too far from our traditional strengths; there is also risk in deviating from an approach that has worked reasonably well for us in the past."

TriPro

Lest this update seem overly gloomy in the short term, TriPro, Navigator's single largest investment with about 20% of Navigator's assets, is posting phenomenal results. Here are the realized (Westhaven) and anticipated (Ridgecrest, Trinity, and Oak Tree) IRRs from TriPro's last four Navigator investments ready to be sold:

1. **Westhaven**: 33% IRR
2. **Ridgecrest:** 30% IRR
3. **Trinity:** 10% IRR
4. **Oak Tree**: 6% IRR

TriPro's managers, Eric Conner and David Schaper, deserve credit for doing an outstanding job. In fact, of the four deals above, I am most impressed by the 6% IRR because it was a project where many of our assumptions failed and Murphy's Law prevailed for a substantial period of time. To preserve capital in that environment is an accomplishment, to compound it is extraordinary.

These very positive points made about Eric and David, they are the first to point out that TriPro is benefitting from a surplus of capital in the market and from this trend of all assets pricing the same. Specifically, yields are so low that investors are very willing to pay for outsize yield. Since TriPro tends to sell properties offering attractive and sustainable yields, TriPro is receiving very compelling offers for its assets. In addition, TriPro is still able to buy quality assets cheap because:

1. TriPro is typically buying assets without any yield at all
2. TriPro is mining an asset pool targeted by a smaller number of investment buyers.

In fact, Eric and David say today is the best time in their careers to be purchasing C class multifamily properties in Texas. I have worked with them since 1995 and have never seen them so excited about investment opportunities.

As discussed in the reminder on valuation methodology above: unless they have been sold, Navigator values all of TriPro's appreciated assets at cost. Hence, the value to Navigator of TriPro's appreciated values is not reflected in a statement of Navigator's investment holdings seen in Exhibits A.

Recommendation

In addition, to taking advantage of market moves to buy the most attractive assets managed by the best managers and to add insurance against market catastrophe, now that Navigator II and III have the same investment period and life, I am recommending that we combine Navigator II and Navigator III into one fund. The funds are different because they were started at different times and because Navigator III can accept retirement money. Now that we have extended Navigator II's life to match Navigator III's life, there is no reason to keep the funds separate. In addition, combining the funds into one master fund offers numerous advantages including:

1. Greater asset diversification to investors in both funds.
2. Lower costs due to having to perform certain administrative activities, such as tax returns, for one fund instead of two.
3. Increased investment opportunities, as we will not have to ask fund manager permission to invest two smaller funds (and to take up two of the finite 99 spots in any given fund). In short, a fund investing $1 million has access to more opportunities than two funds each investing $500,000.

As the manager and one of the largest investors in both funds, it is my view that this combination improves the probability of permanently preserving capital and of compounding that capital at the highest rate over time in both funds. The combination would be effective the first of this year, 2012. As with our previous votes, an email to me indicating whether you vote for or against this recommendation is all that is needed. "I vote yes (or no) to the Navigator II and Navigator III combination." In an effort to make this process efficient, please vote by email to dananglin@princehenrygroup.com 5:00 P.M. EST on Friday, April 27th. If, for any reason, you need more time, please email me by the deadline, and we will accommodate you.

First Losses

For some investors the fact that my capital was absorbing the first losses was an important criterion for investing in Navigator II. This arrangement will remain the same whether or not we combine Navigator II and III. If we have a yes vote and combine the funds, then my capital will absorb the first losses, if any, on the combined Navigator II and III. The only difference is, in my view, the probability of having a permanent loss is lower if we combine the funds.

Thank You

"This time is different." is one of the most fatal philosophies in investing. Accordingly, Navigator's portfolio positioning reflects the belief that at some point, assets will begin to trade based on their own intrinsic merits, or lack thereof, and not on whether the Greeks and the Germans are singing Kumbaya with each other.

I am not minimizing the macroeconomic challenges facing the United States or the world. These challenges are enormous. I am betting, however, that at some point in the investment cycle, I do not know exactly when, great businesses will be worth more than lousy businesses. Navigator, via its diversified group of managers and assets is extremely well positioned to benefit as this evolution happens.

I remain optimistic about Navigator's continued success. Thank you for trusting me with your hard earned money. I reiterate my promise to do everything I can to prove worthy of that trust.

Please remember to email me with your vote on the combination of Navigator II and III.

If you have questions, I very much encourage you to call me at 917-509-2161 or email me at *dananglin@princehenrygroup.com*.

Sincerely,

Dan Anglin

Exhibit A: Seven Investments Total 75% of Navigator II and III's Combined Capital

	Investment	Percent of Combined Capital
1	TriPro	25%
2	T2	15%
3	Spencer	12%
4	Spitfire	8%
5	Semper Vic	5%
6	Cohesive	5%
7	Value Act	5%

***As a reminder, please click on the following link for a video reviewing these investments:**
http://www.princehenrygroup.com/BigRocksMed.html