SPITFIRE CAPITAL LLC

May 22, 2018

"Ultimately, then, the higher long-run return from investing in cheaper stocks is a righteous form of payback for the pain of sitting around for years watching all those growth stocks with piddling profits go straight up."

Jason Zweig, Patience is a Virtue for the Value Investor, *Wall Street Journal*, April 28-29, 2018

First Quarter 2018

	March 2018	1Q 2018	Since inception
The Spitfire Fund L.P.[1]	**+0.6%**	**-6.1%**	**+222.1%**
Russell 2000	**+1.3%**	**-0.1%**	**+112.4%**
S&P 500	**-2.5%**	**-0.8%**	**+121.1%**

In the first quarter, The Spitfire Fund L.P. (the "Fund") was down -6.1% (net), compared to the Russell 2000 and S&P 500 which were down -0.1% and -0.8%, respectively. Since inception, the Fund has achieved a cumulative net return of +222.1%, representing a compound annual net return of +11.5%. Over the same period, the Russell 2000 and S&P 500 have achieved cumulative total returns of +112.4% and +121.1%, respectively, and compound annual returns of +7.3% and +7.7%, respectively.

Blue Bird Corporation (NASDAQ: BLBD), GTT Communications, Inc. (NYSE: GTT) and Lear Corporation (NYSE: LEA) were the main positive contributors in the quarter, with price changes of +19%, +21% and +5%, respectively. Horizon Global Corporation (NYSE: HZN), AA plc (London: AA/ LN) and National Research Corporation (NASDAQ: NRCIA) were the laggards with price changes of -41%, -53% and -22%, respectively We ended the quarter with gross and net long exposure of 83% and cash of 17%.

During the first quarter we initiated two new long positions. One of these came public in 2017 through a reverse merger into a SPAC. Like Blue Bird Corporation following its reverse merger in early 2015, the Company remains majority owned by a leading private equity firm and fits our value creation framework. We believe that the combination of modest revenue growth, margin expansion, achieved partly through the realization of cost savings related to recent acquisitions and the deleveraging of the balance sheet through free cash flow will drive an attractive base case return to equity holders. Should the Company succeed in driving faster organic revenue growth through adoption of their integrated, cloud-based platform, returns should be commensurately attractive. We look forward to discussing our new positions in future letters.

[1] The Spitfire Fund L.P. commenced operations on July 1, 2007. Performance data is through March 31, 2018. The Fund's returns are shown net of all fees and expenses. Index performance is presented on a total return basis assuming reinvestment of dividends.

One Belvedere Place, Suite 200 · Mill Valley, CA 94941
t: 415.878.1908 · w: www.spitfirecap.com · e: info@spitfirecap.com

The most significant drag on our first quarter performance was our position in Horizon Global Corporation (NYSE: HZN), which declined 41%. We initiated our position in the Company in the first quarter of 2016. Horizon was spun out of parent company TriMas Corporation (NASDAQ: TRS) in June, 2015. The Company is the market share leading manufacturer of branded and private label towing and trailering products sold through the OEM, aftermarket and retail channels. Brands include *Draw-Tite*, *Reese*, *Tekonsha*, *Westfalia* and *Witter*. In late 2016, Horizon acquired Westfalia Group, the European market leader in towing and trailering products, from German private equity firm Deutsche Private Equity.

We believe that Horizon has generally followed the correct strategy since the spin out. Domestically, the Company consolidated its OEM, aftermarket and retail-focused organizations, eliminating duplicate administrative, sales, marketing and distribution functions. In Europe, the Company improved upon its sub-scale presence through the acquisition of Westfalia. The Company also pursued a low-cost manufacturing strategy through consolidating manufacturing for the Americas in Reynosa, Mexico, and shifting production of aftermarket products in Europe to Romania.

Unfortunately, the management team's execution against the strategy has been very poor, particularly since the closing of the Westfalia transaction. Domestically, the Company has struggled with the manufacturing and distribution realignment, leading to problems in fulfilling customer orders. Internationally, the transition to low cost country manufacturing has also been more challenging than expected and the Company remains burdened with sub-scale, unprofitable legacy operations in certain markets.

Given our concerns over governance and execution, we filed a Schedule 13D with the Securities and Exchange Commission ("SEC") in February, the first such filing since our Schedule 13D filing related to Blue Bird Corporation in August, 2016. Since that time, we have made a number of concrete suggestions, including the proposed addition of two new board members: Tim Leuliette, the former CEO of Visteon; and Tim Tevens, the former President and CEO of portfolio company Columbus McKinnon Corporation (NASDAQ: CMCO).

Following Horizon's poor first quarter earnings release in early May, the Board of Directors removed Mark Zeffiro and appointed Carl Bizon as interim President and CEO. While these are steps in the right direction, we will continue to push for improved governance, execution and accountability as we believe that the Company is significantly undervalued and worth more in the hands of a competent management team or third party acquirer. At a recent $6 per share, Horizon has a market value of only $150 million and is trading at around seven times pro forma 2018 EBITDA[2] and double digit free cash flow yield, reflecting deep investor skepticism. We believe that the stock could double from here as execution improves.

During the first quarter, volatility in the U.S. equity markets increased dramatically relative to the somnolence of the prior year. Through the end of March, the VIX index averaged 17.3, over 50% higher than the 2017 average level of 11.1. As we discussed in our fourth quarter 2017 letter, the increase in volatility was due in part to investor uncertainties regarding domestic inflationary

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[2] Pro forma for the pending acquisition of Brink Group.

pressures, the pace of Federal Reserve interest rate increases and concerns over the economic cycle, exacerbated by technical factors related to the trading and investing complex built around the VIX itself.

First quarter earnings were relatively strong, however. For the S&P 500, first quarter sales grew by 11% and pre-tax earnings by 13%[3], suggesting strong fundamentals even before accounting for the accretive impact of lower corporate tax rates. First quarter S&P 500 EPS were up over 23%, of which the lower corporate tax rate accounted for about 700bps[4]. At 2,640.87, the S&P 500 ended the quarter trading at about 16.5x the full year 2018 consensus EPS estimate of $160, down from a peak multiple of over 23x in late January.

Our portfolio company CEOs were similarly upbeat. By way of example, Carl Christensen, the normally conservative Chairman and CEO of Altra Industrial Motion Corp. (NASDAQ: AIMC), said in his company's earnings release, "*We are increasingly confident in the positive momentum occurring in the industrial economy. Our bookings are strong across the vast majority of our end markets, and we are encouraged by our prospects for a strong second quarter and full year. As a result, we are raising our guidance for the full year 2018*."

We believe that our relative underperformance in the first quarter was due to three factors. The first relates to company-specific underperformance such as Horizon, as discussed above. The second relates to investor concerns regarding the impact of increasing interest rates on the housing market and consequent underperformance of homebuilders and other housing related stocks. We have about 10% of the portfolio in Beacon Roofing Supply, Inc. (NASDAQ: BECN), a leading distributor of residential and commercial roofing products, and in Builders FirstSource, Inc. (NASDAQ: BLDR), a leading distributor of lumber, millwork and other value added products to homebuilders. While higher interest rates will impact affordability, we remain constructive regarding the longer term outlook for the U.S. housing market. In 2017, single family housing starts were around 850,000, still below 30-year average starts of over 1 million. We have recently purchased additional shares in Beacon at a discount to the $47.50 per share paid by investors in the September, 2017 equity offering related to the acquisition of Allied Building Products which closed in January, 2018.

The third driver of our relative underperformance relates to concerns over companies' ability to pass on increasing wage, raw material and freight costs in an inflationary environment. With unemployment of 3.9%, the wage survey leading indicator stands at +3.2% year over year. The transportation and warehousing component of the Producer Price Index has risen +5% year over year, reflecting higher logistics costs. Blue Bird Corporation, our largest position, was down after reporting lower than expected gross margins in a seasonally weak quarter due to the rising cost environment. Notwithstanding the first half margin performance, we believe that Blue Bird will deliver higher full year margins, starting in the second half, driven by the combination of improved mix (more propane, CNG and gasoline- powered buses and fewer diesel buses), higher prices and renegotiated supplier contracts.

[3] Source: Goldman Sachs research.
[4] Source: Factset Research Systems.

In recent days, the Russell 2000 has started to outperform the S&P 500 which is being weighed down by the stronger dollar and concerns over weakening international relative to domestic end markets. As usual, we are constantly re-underwriting the portfolio, including stress testing our assumptions and assessing the impact of a mild US recession in our base case underwriting scenarios. We are optimistic that we will exit this soft patch as the portfolio laggards improve their performance and as the rest of our investments demonstrate improving revenue growth, margin performance and cash flow generation.

We continue to grow and strengthen our research team. In March, Mike O'Neill joined Spitfire as a Research Analyst. Mike started his career at Credit Suisse and spent three years at Greenbriar Equity Group, a middle market private equity firm focused on the transportation, distribution and industrial equipment industries. Most recently, Mike spent five years at Mount Kellet Capital and Moore Capital Management in New York, where he tried to apply a value investing approach to distressed debt and public equity investing. Mike has relocated to the Bay Area and can be reached at mike@spitfirecap.com or at (415) 483-4236. Trent Ketterer has also extended his stay at Spitfire for another year, his fourth. We are looking to hire an entry-level analyst, with at least two years of consulting, investment banking or private equity experience. Please send any hard-working, eager candidates our way.

We are enjoying our new Mill Valley offices, and have been pleasantly surprised by the number of management teams and investors that visit Marin County while in the Bay Area. Please feel free to come by if you are in the neighborhood.

As ever, we are grateful for your interest and support.

Julian Allen
Julian@spitfirecap.com
(415) 878-1901

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