SPITFIRE CAPITAL LLC

August 31, 2017

Second Quarter 2017

	Q2 2017	YTD 2017	Since inception
The Spitfire Fund L.P.[1]	**+4.2%**	**+0.9%**	**+207.7%**
Russell 2000	**+2.5%**	**+5.0%**	**+94.7%**
S&P 500	**+3.1%**	**+9.3%**	**+100.0%**

In the second quarter, The Spitfire Fund L.P. (the "Fund") was up +4.2% (net), compared to the Russell 2000 and S&P 500 which were up +2.5% and +3.1%, respectively. Through the first six months of the year, the Fund was up +0.9% (net), compared to the Russell 2000 and S&P 500 which were up +5.0% and +9.3%, respectively. In the ten years since inception, the Fund has achieved a cumulative net return of +207.7%, representing a compound annual net return of +11.9%. Over the same period, the Russell 2000 and S&P 500 have achieved cumulative total returns of +94.7% and +100.0%, respectively, and compound annual returns of +6.9% and +7.2%, respectively.

GTT Communications, Inc. (NYSE: GTT), National Research Corporation (NASDAQ: NRCIA) and Owens-Illinois, Inc. (NYSE: OI) were the main contributors to performance, with price changes of +30%, +37% and +17%, respectively. Libbey Inc. (NYSE: LBY), Steelcase Inc. (NYSE: SCS) and Natural Gas Services Group, Inc. (NYSE: NGS) were the laggards, with price changes of -45%, -16% and -5%, respectively. During the quarter we exited one and initiated one new position. We ended the quarter with gross and net long exposure of +86%.

During the quarter, Baker Hughes, Inc. (NYSE: BHI) merged with General Electric Corporation's (NYSE: GE) oil and gas operating subsidiaries to form a new public company, Baker Hughes, a GE Company (NASDAQ: BHGE). As part of the transaction, legacy BHI shareholders received a special cash dividend of $17.50 per share and a share in BHGE, which represents a 47% economic interest in the combined operating company. GE owns the majority 53% economic interest in the combined operating company. The fund retains a small (slightly less than 1%) position in BHGE.

The sale of BHI to GE represents the eighteenth sale of a Spitfire portfolio company to a strategic or financial investor. We originally invested in Baker Hughes in early 2015 as we (prematurely) looked for investments in the beaten down oilfield services industry. We wrote about our search for suitable investment candidates in the first quarter 2015 investor letter where we outlined our investment criteria:

[1] The Spitfire Fund L.P. commenced operations on July 1, 2007. Performance data is through June 30, 2017. 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.

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- Strong balance sheet, preferably with net cash;
- Ability to cut costs and capital expenditures to achieve positive free cash flow, even in a depressed environment;
- High customer ROI and leveraged to the production process rather than the exploration cycle;
- Exposure to higher quality exploration and production customers rather than highly levered, cash flow negative E&Ps; and
- Experienced management team with track record of successfully managing through the 2008-2009 market dislocation.

With a market value of over $28 billion at the time of our initial investment, Baker Hughes is the largest company by market value that we have invested in. This resulted from our desire to improve our margin of safety given the industry downturn by investing in a market leading franchise with significant financial flexibility. At the time, Baker Hughes enjoyed a strong balance sheet, with net debt to EBITDA of less than one times and positive free cash flow of over $2 billion, implying a ~7% free cash flow yield. At the time of our investment, Halliburton Company (NYSE: HAL) had agreed to purchase BHI. Following the collapse of the Halliburton transaction, BHI received a $3.5 billion break-up fee, which moved the Company's balance sheet into a net cash position.

While BHI met our screening criteria, it is unlikely that we will repeat a de novo investment in such a large capitalization company. We prefer smaller companies where we have an opportunity to perform in depth, differentiated market and company research and to develop better relationships with senior management.

Through the first half of 2017, larger capitalization stocks dramatically outperformed smaller capitalization stocks and "growth" stocks dramatically outperformed their "value" counterparts. Through June 30, the total return on the S&P 500 index was 9.3%, 430 basis points ahead of the Russell 2000 which returned 5.0%. Over the same period, the Russell 1000 growth index returned 14.0% while the Russell 1000 value index returned only 4.7%, a divergence of 930 basis points. In part, this reflects the disproportionate impact of the so-called "FAAMG" stocks, which include Facebook, Inc. (NASDAQ: FB), Amazon.com, Inc. (NASDAQ: AMZN), Apple Inc. (NASDAQ: AAPL), Microsoft Corporation (NASDAQ: MSFT) and Google parent Alphabet Inc. (NASDAQ: GOOG). In the six months through June 30, the five FAAMG stocks plus Netflix, Inc. (NASDAQ: NFLX) increased their aggregate market values by about 22% or $514 billion, accounting for over 34% of the year to date increase in the S&P 500 index.

During periods of modest economic growth, investors seek out stocks with greater than average secular growth prospects, such as the FAAMNG stocks. As these six stocks represent about 14% of the S&P 500 by value, they also benefit disproportionately from passive flows into ETFs tracking the major benchmarks, which buy in proportion to a company's market value and irrespective of valuation, thereby creating further positive price momentum.

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In the first half, large cap stocks outperformed small cap stocks: S&P 500 vs Russell 2000…

…while growth outperformed value: Russell 1000 Growth vs Value.

Over longer time periods, returns to equity investors are a function of profits, profit growth and multiples (or discount rates). Profits and profit growth are in turn a function of revenue growth and margins. Revenue growth for the average company is roughly equal to nominal GDP growth, or about 4% currently, assuming real GDP growth of about 2% and inflation of about 2%. Assuming margins are flattish, then returns to stock market investors will be roughly equal to nominal GDP growth plus the dividend yield of about 2%, or 6% in total, assuming no change in multiples. While a 6% total return is lower than the assumed equity return of most pension plan

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trustees, they are in line with the trailing ten-year return of about 7%, a period which included the great financial crisis and post-crisis rally[2].

As investors, we are concerned with a proper assessment of a company's value, based on conservative underwriting assumptions and focused on its ability to generate free cash flow. While our typical investments may grow revenue in line with nominal GDP, equity value compounds at a higher rate due to increasing margins as well as substantial free cash flow. For us, free cash flow is synonymous with "owner" cash flow, as we are concerned with cash available after a business funds required investments in working capital and capital expenditures, pays for restructuring and other expenses required to drive margin improvement and settles past obligations such as underfunded pension arrangements and earnouts. Such free cash flow is available for paying down debt, paying regular and special dividends, buying back stock and for funding acquisitions. Executed properly, proper capital allocation can drive increasing equity value over time.

We have been able to generate excess returns through careful stock selection focused on well-managed companies in industries with stable competitive dynamics demonstrating increasing intrinsic value over time and generating significant free cash flow. We believe that our opportunity set will continue to grow as increasing allocations to passive investment vehicles drives mispricing of specific securities and as fee pressure on active managers forces ever increasing fund sizes and corresponding increases in minimum market capitalization and liquidity thresholds for individual stocks.

We have now pursued this investment strategy for ten years. Since starting Spitfire in the summer of 2007, we have lived through the Great Financial Crisis, the Eurozone Debt Crisis, the loss of the United States AAA-rating, the Brexit vote and the 2016 U.S. Presidential Elections, among other surprises. We have also witnessed a full market cycle, encompassing the sickening declines of 2008 and early 2009 and the ensuing recovery. I am proud to claim a track record that has exceeded the market benchmarks, after all fees and expenses, and over a full market cycle.

I anticipate remaining the largest individual investor in the Funds and remain focused on compounding my capital over the longer term. I am grateful to all our partners, investors and employees who helped build Spitfire over the last ten years. Over the next ten years, we aspire to maintain our superior track record while growing selectively with longer term family office and endowment investors who understand our strategy and investment process. I am grateful for your interest and support.

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[2] Of course, margins are at historical highs and interest rates at historic lows, so the dual assumptions of flat margins and constant multiples are more likely to prove optimistic than realistic.

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An investment in the Fund is speculative and involves a high degree of risk, including loss of principal, and is suitable only for sophisticated and qualified investors. Please see the Offering Documents for full details regarding the investment strategy, risk factors, liquidity terms, fees, expenses, conflicts of interest and minimum investment amounts.

Performance since inception calculations are based on an investment made in the Fund at inception on July 1, 2007. Fund performance is shown net of all fees and expenses and is unaudited. Returns may vary by limited partner depending on date of investment, high water mark if applicable, participation in new issues and differing management and incentive fees. Past performance is no guarantee of future results and there can be no assurance that the Fund will achieve comparable results in the future.

The Russell 2000 and S&P 500 are not directly comparable to the Fund's performance. The presentation of their returns does not reflect a belief by Spitfire Capital LLC that the Fund is an investment alternative to either index or is comparable to them in any way. The data is included only to provide an indication of the general performance of US equity markets during the periods for which the Fund's performance is presented. Index returns assume reinvestment of dividends.

Any reference to "margin of safety" does not imply that investments made by the Fund are safe. "Margin of safety" is an investment term that refers to the difference between the intrinsic value of a security and its market price.

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