December 8, 2015

Market participants can get so caught up in predicting other participants' behavior that they ignore value and fail to buy bargains out of fear that the assets in question will remain unpopular or become more so. This creates great opportunities for those investors whose willingness to think independently and endure the short term pain that comes with temporary unpopularity enables them to purchase attractive investments from the bargain counter.

Superior investors know – and buy – when the price of something is lower than it should be. And the price of an investment can be lower than it should be only when most people don't see its merit.

Howard Marks, *It's Not Easy*, September 9, 2015[1]

Longer term, a cash cushion provides investors with an element of resilience at a time of uncertainty. It is unclear whether the global economy will transition to broader-based growth, thereby validating elevated market prices, or tip into lower growth and financial instability as weaker fundamentals undermine central bank's effectiveness in suppressing volatility and bolstering asset prices.

Mohamed El-Erian, *Financial Times*, November 3, 2015

Third Quarter 2015

	3Q 2015	YTD 2015	Since inception[2]
The Spitfire Fund L.P.[3]	**-8.7%**	**+0.7%**	**+149.3%**
Russell 2000	**-11.9%**	**-7.7%**	**+47.7%**
S&P 500	**-6.4%**	**-5.3%**	**+52.7%**

In the third quarter, The Spitfire Fund L.P. (the "Fund") was down -8.7% (net), compared to the Russell 2000 and S&P 500 which were down -11.9% and -6.4%, respectively. Year to date, through September 30, 2015, the Fund was up +0.7% (net), compared to the Russell 2000 and S&P 500 which were down -7.7% and -5.3%, respectively. Since inception, the Fund has achieved a cumulative return of +149.3% (net) and has compounded capital at +11.7% (net) annually. Over the same period, the Russell 2000 and S&P 500 have achieved cumulative returns of +47.7% and +52.7%, respectively, and have compounded annually at +4.8% and +5.3%, respectively.

[1] Read this excellent memo: https://www.oaktreecapital.com/docs/default-source/memos/2015-09-09-its-not-easy.pdf?sfvrsn=2.
[2] The Spitfire Fund L.P. commenced operations on July 1, 2007. Performance data is through September 30, 2015.
[3] The Fund's returns are shown net of all fees and expenses. Index performance assumes reinvestment of dividends.

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Libbey, Inc. (NYSE: LBY), Blue Bird Corporation (NSDQ: BLBD) and US Physical Therapy, Inc. (NYSE: USPH) were the main detractors to the Fund's performance in the quarter, with price changes of -21%, -23% and -18%, respectively. Patrick Industries Inc. (NSDQ: PATK) and our modest short position in the iShares Russell 2000 ETF (NYSE: IWM), both of which we exited during the quarter, were the biggest winners. We ended the quarter with gross and net long exposure of 84% and held approximately 16% of the Fund in cash.

During the quarter, we increased the Fund's position in Blue Bird Corporation (NSDQ: BLBD). Blue Bird is one of three domestic manufacturers of school buses. The Company came to market in February, 2015 through a reverse merger with Hennessey Capital Acquisition Corporation (NSDQ: HCAC), a blank-check special purpose acquisition corporation. Cerberus Capital Management, the Company's private equity sponsor, remains the majority shareholder with 57% of shares outstanding. With its small market capitalization, limited float and single equity research analyst[4], Blue Bird is off the institutional radar screen.

The domestic school bus industry is a stable oligopoly comprised of three manufacturers. In addition to Blue Bird, these include IC Bus, a subsidiary of Navistar (NYSE: NAV), and Thomas Built Bus, a subsidiary of Freightliner/Daimler. Blue Bird entered the school bus industry in 1927; IC traces its heritage back to Ward Body Works which first produced a school bus in 1933; and Thomas, originally a streetcar manufacturer, launched its first school bus in 1936. Barriers to entry include scale, distribution[5] and the brand loyalty/service experience of school districts and fleet operators. Changes in market share are driven by price, service, quality and innovation, particularly related to the powertrain.

The industry is cyclical and is correlated with the domestic property market as school districts are generally funded through property tax and other state tax revenue. Over the last 20 years, school bus shipments have averaged 30,550 per year. In 2007, the most recent peak, the industry shipped 34,882 units. Shipments declined to 23,882 units in 2011. In 2015, shipments are estimated to increase 5% to about 30,000 units and will likely achieve the 10-year average in 2016. We would characterize the industry as in the mid-cycle of its recovery.

Since 2010, Blue Bird has increased its market share by seven percentage points from 23% to 30%. The Company has increased its market share in both diesel-powered and in alternative fuels, particularly propane, a category in which Blue Bird has dominant share. Since 2010, propane-powered buses have grown from 1% to over 7% of industry shipments. Propane-powered buses are simpler to maintain, produce lower emissions, have better cold-weather performance and are quieter than diesel-powered buses. School districts report significant savings from the lower cost of propane fuel and lower maintenance expense relative to diesel engines[6]. Blue Bird's Type C Vision propane bus is manufactured in exclusive partnership with Ford, provider of the 6.8L V10 engine and 6R140 transmission, and ROUSH CleanTech, provider of the propane fuel and engine calibration systems.

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[4] BMO Capital Markets initiated coverage on Blue Bird on September 16, 2015, with a target price of $14.
[5] The school bus manufacturers sell buses through exclusive distributors who also service the buses.
[6] See Case Study – Propane School Bus Fleets, U.S. Department of Energy, August 2014 (http://www.afdc.energy.gov/uploads/publication/case-study-propane-school-bus-fleets.pdf).

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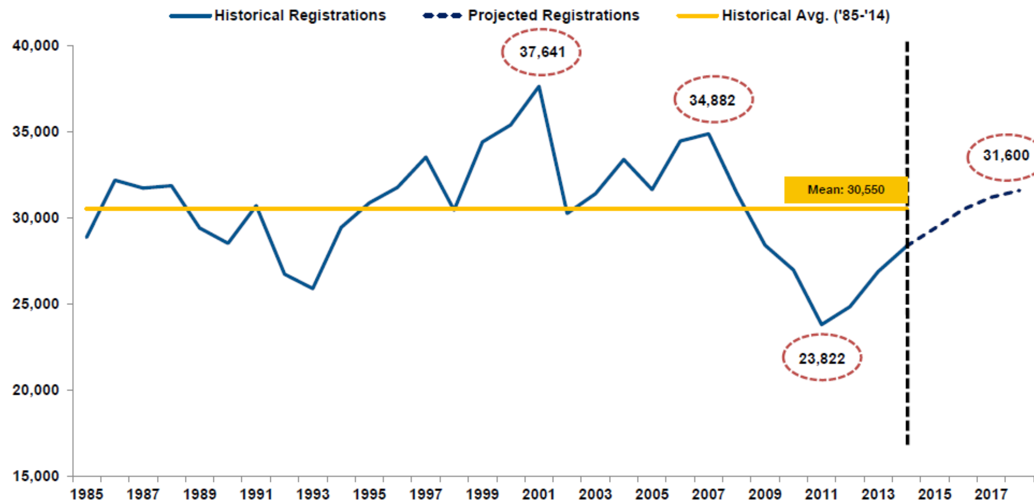
Historical U.S. school bus shipments[7]



Blue Bird continues to innovate, particularly with respect to new powertrain offerings. In July, the Company launched a new gasoline-powered Type C school bus, the only in the industry, and in November, a compressed natural gas (CNG) Type C school bus, both based on the same Ford engine/transmission platform as its propane bus. The Company also launched a new, low price diesel Type C school bus based on the Cummins ASV 5.0L V8 engine. These new powertrains provide dealers and school bus operators with differentiated, lower price alternatives. As a result, we anticipate that Blue Bird will at least maintain and potentially increase its market share.

The manufacturing process is labor rather than capital intensive as the manufacturers assemble buses from purchased components, the most significant of which is the powertrain. Capital expenditures average less than one percent of revenue. Working capital usage is also limited as buses are manufactured to order and are typically paid for by dealers upon delivery and before suppliers are paid. As a result, return on capital and free cash flow generation are significant.

At $10.50 per share, Blue Bird has a market value of $264 million and, with $188 million of net debt, an enterprise value of $452 million, representing 6.7x our estimate of fiscal year 2015 adjusted EBITDA of about $67 million and less than 10x estimated adjusted earnings per share of about $1.08 per share[8]. With estimated full year free cash flow of about $30 million, the Company offers a 10%+ free cash flow yield. We anticipate that free cash flow will be applied to debt pay down and estimate that net leverage will drop from 2.8x today to less than 1.0x over the next three fiscal years[9]. At 6.5x estimated 2018 EBITDA of about $76 million, Blue Bird could trade to an enterprise value of $494 million and, adjusting for estimated 2018 fiscal year end net

[7] Historical school bus shipments and market share data are derived from RL Polk vehicle registration data. Source: Blue Bird investor relations presentation, page 15, November 19, 2015, and RL Polk.
[8] Blue Bird's fiscal year end is September 30th. The Company is due to report fourth quarter and full year earnings on December 15, 2015. Our EPS estimate excludes $13.8 million special management compensation payment funded by the majority shareholder and $12.5 million of one time business combination expenses.
[9] On September 17, 2015, Blue Bird announced a $25 million pre-payment on its term loan, demonstrating management's commitment to free cash generation and debt pay down.

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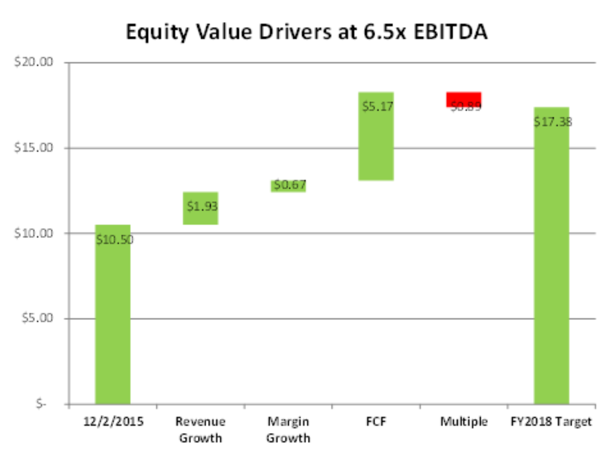
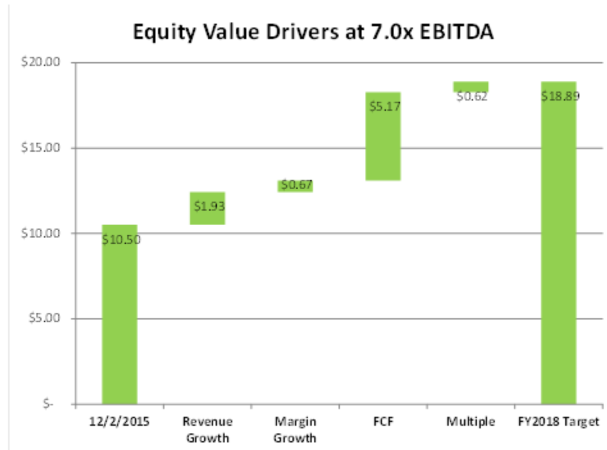
debt of about $58 million, a market value of $436 million, an increase of 65%. At 7.0x, the increase in market value will be about 80%, representing an annualized return of over 20%. Debt pay down of $130 million implies $5.17 in incremental equity value or over half of the expected return. We summarize the drivers of equity value below.





For years, investors have complained that high correlation between individual stocks has made stock picking challenging. This year, stock picking remained challenging. While correlations have diminished and dispersion has increased, market leadership has been extremely narrow. While the capitalization-weighted S&P 500 index is slightly up for the year, the equal-weighted version of the index is slightly down[10]. Returns in the index have been led by a small group of companies including Amazon (NSDQ: AMZN); Ebay (NSDQ: EBAY); Facebook (NSDQ: FB); Google (NSDQ: GOOG); Microsoft (NSDQ: MSFT); Netflix (NSDQ: NFLX); Priceline (NSDQ: PCLN); Salesforce.com (NYSE: CRM); and Starbucks (NSDQ: SBUX). An index comprised of these companies is up around 60% for the year[11], far ahead of the domestic equity benchmarks. The problem for value investors is that stocks in this group, with certain exceptions, have always looked expensive. Ned Davis Research has estimated that the group trades at a P/E ratio of 45x, over twice the market multiple. While dispersion is back, the winning strategy this year was to load up on stocks that looked overvalued and to hold on to them.

Indeed, as Howard Marks says, "it's not easy." While I am pleased that the Fund is up year to date and remains ahead of the benchmarks[12], we are continually re-assessing our investments and our research process with a view to driving continuous improvement and constant learning. I am convinced that this is the only way to improve our absolute and relative performance over time. I am more confident than ever that our strategy, when correctly applied, should continue to produce superior results.

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[10] As of November 30, 2015, the capitalization weighted index (SPX) is up 1.04% while the equal weighted index (SPW) is down -1.63%.
[11] Source: Financial Times research. *Financial Times*, November 28-29, 2015.
[12] As of November 30, 2015, the Fund is up an estimated +4% (net), ahead of the Russell 2000 (+0.6%) and S&P 500 (+3%).

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I will be in New York in mid-January on the 13th and 14th. Please let me know if you are available to meet. We are grateful for your interest and support and wish you and your families the very best for the holiday season and New Year.

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