KASE CAPITAL

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January 28, 2013

Dear Partner:

I hope you had wonderful holidays and wish you a happy new year!

In each annual letter (this is my 9th for this fund and 14th overall) I seek to frankly assess the fund's performance, reiterate my core investment philosophy, and share my thoughts on various matters. In addition, I disclose all of the fund's long positions and in Appendix A explain my thinking behind each one so you can better understand why I've purchased these stocks, how I invest, and why I am very confident in our fund's future prospects.

Now that I'm managing money solo, I've adopted the name "Kase", so our fund is now doing business as the Kase Qualified Fund. The letters of "Kase" come from the four most important people in my life: my wife, Susan, and three daughters, Alison, Emily, and Katharine. May they bring all of us as much good fortune as they've brought me! Also, please note our new address and phone number on this page.

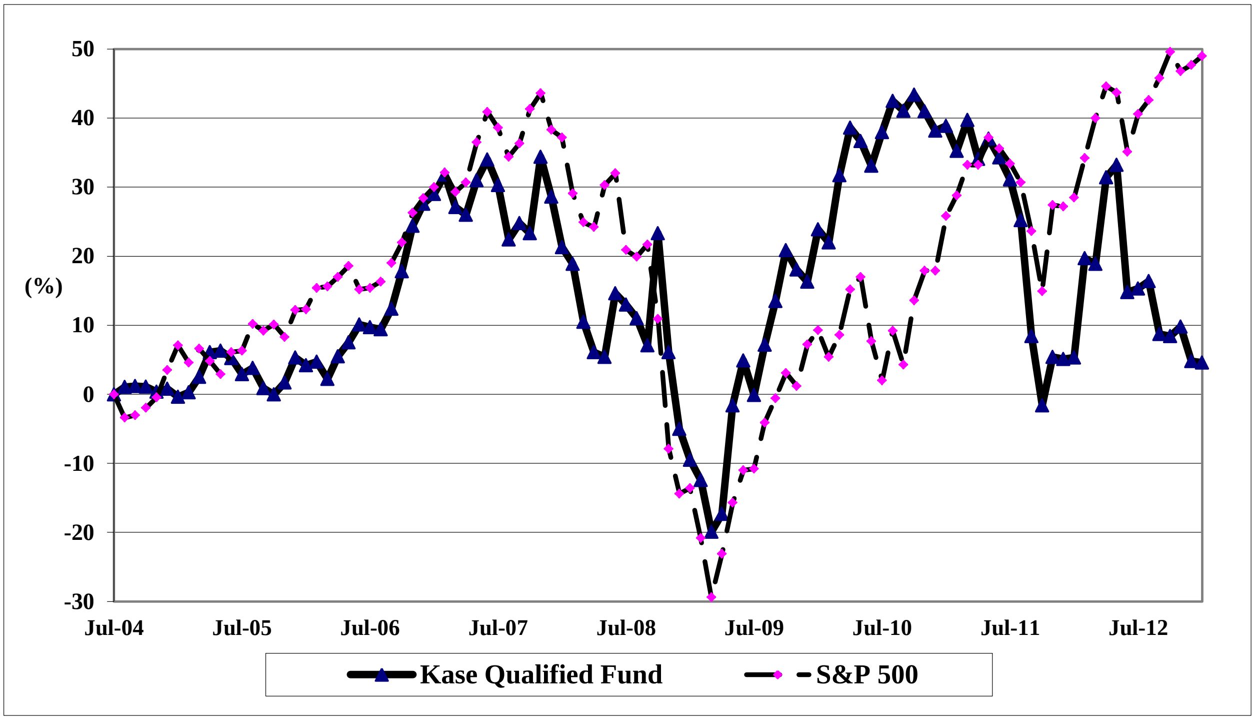
Performance

Our fund was down slightly in 2012, significantly lagging the major indices, as this table shows:

	December	4th Quarter	Full Year	Total Since Inception	Annualized Since Inception
Kase Qualified Fund (net)	**0.8%**	**-3.5%**	**-0.7%**	**4.6%**	**0.5%**
S&P 500	0.9%	-0.4%	16.0%	49.0%	4.8%
Dow	0.8%	-1.7%	10.2%	56.6%	5.4%

Past performance is not indicative of future results. Please refer to the disclosure section at the end of this letter. The T2 Qualified Fund (dba the Kase Qualified Fund) was launched on 7/1/04.

This chart shows our fund's net performance since inception:



Past performance is not indicative of future results.

And this table shows our fund's net performance by month since inception:

	2004		2005		2006		2007		2008		2009		2010		2011		2012	
	Kase QF	**S&P 500**	**Kase QF**	**S&P 500**	**Kase QF**	**S&P 500**	**Kase QF**	**S&P 500**	**Kase QF**	**S&P 500**	**Kase QF**	**S&P 500**	**Kase QF**	**S&P 500**	**Kase QF**	**S&P 500**	**Kase QF**	**S&P 500**
January			**0.7**	-2.4	**0.5**	2.7	**2.2**	1.7	**-2.0**	-5.9	**-3.2**	-8.4	**-1.5**	-3.6	**-2.6**	2.4	**13.6**	4.5
February			**2.2**	2.0	**-2.4**	0.2	**-3.6**	-2.1	**-7.1**	-3.3	**-8.6**	-10.8	**8.0**	3.1	**3.3**	3.4	**-0.6**	4.3
March			**3.5**	-1.7	**3.2**	1.3	**-0.9**	1.1	**-4.0**	-0.5	**3.2**	9.0	**5.2**	6.0	**-3.9**	0.0	**10.4**	3.3
April			**0.2**	-1.9	**1.9**	1.4	**4.0**	4.6	**-0.7**	4.9	**19.0**	9.6	**-1.4**	1.6	**2.1**	3.0	**1.4**	-0.6
May			**-1.0**	3.2	**2.4**	-2.9	**2.3**	3.3	**8.7**	1.2	**6.6**	5.5	**-2.6**	-8.0	**-2.0**	-1.1	**-13.8**	-6.0
June			**-2.2**	0.1	**-0.4**	0.2	**-2.8**	-1.5	**-1.4**	-8.4	**-4.8**	0.2	**3.7**	-5.2	**-2.4**	-1.7	**0.4**	4.1
July	**1.1**	-3.4	**0.9**	3.7	**-0.3**	0.7	**-6.1**	-3.0	**-1.8**	-0.9	**7.3**	7.6	**3.3**	7.0	**-4.5**	-2.0	**1.0**	1.4
August	**0.1**	0.4	**-2.8**	-1.0	**2.7**	2.3	**2.0**	1.5	**-3.5**	1.3	**5.9**	3.6	**-1.0**	-4.5	**-13.4**	-5.4	**-6.6**	2.3
September	**-0.1**	1.1	**-0.9**	0.8	**4.8**	2.6	**-1.2**	3.6	**15.1**	-9.1	**6.5**	3.7	**1.6**	8.9	**-9.2**	-7.0	**-0.3**	2.6
October	**-0.7**	1.5	**1.7**	-1.6	**5.6**	3.5	**9.0**	1.7	**-13.9**	-16.8	**-2.3**	-1.8	**-1.7**	3.8	**7.2**	10.9	**1.4**	-1.9
November	**0.4**	4.0	**3.5**	3.7	**2.6**	1.7	**-4.3**	-4.2	**-10.5**	-7.1	**-1.5**	6.0	**-2.0**	0.0	**-0.3**	-0.2	**-5.6**	0.6
December	**-1.2**	3.4	**-1.0**	0.0	**1.1**	1.4	**-5.7**	-0.7	**-4.7**	1.1	**6.5**	1.9	**0.5**	6.7	**0.2**	1.0	**0.8**	0.9
YTD TOTAL	**-0.4**	**7.1**	**4.6**	**4.9**	**23.7**	**15.8**	**-5.9**	**5.5**	**-25.4**	**-37.0**	**37.0**	**26.5**	**12.1**	**15.1**	**-24.1**	**2.1**	**-0.7**	**16.0**

Past performance is not indicative of future results.
Note: Returns in 2009 reflect the benefit of the high-water mark, assuming an investor at inception.

After 11½ strong years of successfully managing this fund and its sister fund, the Kase Fund, which launched in 1999, the fund has lagged badly over the last 2½ years. To turn things around, I've made many changes (discussed below), most importantly returning to my roots of managing money solo.

In June, Glenn and I decided to each run our own funds, and began doing so on July 1st. As part of this process, I took our fund to cash so that I could rebuild the portfolio from scratch. However, I wasn't able to exit a handful of illiquid positions, most notably the Iridium warrants, which impacted performance in the second half of the year, but today I'm pleased to say that the portfolio is where I want it, conservatively positioned in my very best ideas. My mind is clear and focused on the long term, and I'm looking forward with confidence and optimism.

These feelings were bolstered recently when Netflix, which is by far the most controversial and heavily shorted stock we own, reported blowout earnings and the stock rose 71% last week (it's more than tripled since its lows of last summer). Thanks in large part to Netflix, our fund is up nearly 4% so far this month, despite its very low gross and net exposure, so 2013 is off to a solid start (all data and prices in this letter are as of the market close on 1/25/13).

Longs

Since I took over as sole portfolio manager seven months ago, I have purchased/repurchased only eight stocks, seven of which have risen – and are currently the seven largest positions in the fund (we took a small loss on Apple, which I sold). If I can maintain an .875 batting average over time, we will do very well indeed.

I am pleased with the fund's concentrated yet well-diversified long portfolio, which I believe will substantially outperform the market over time. Here is a list of every long position the fund holds today, ranked in descending order of size (each is discussed in Appendix A):

1. Berkshire Hathaway
2. AIG
3. Howard Hughes
4. Citigroup
5. Goldman Sachs
6. Netflix
7. Canadian Pacific
8. Grupo Prisa
9. Spencer Holdings (private placement)
10. dELiA*s
11. Iridium
12. Japan side fund (private placement)
13. Spark Networks

Note that the illiquid legacy positions that hurt our performance in the second half of 2012 – most notably, dELiA*s, Iridium, and Grupo Prisa – were approximately 30% of capital on July 1st, but are now under 10%. With the benefit of hindsight, I of course wish that I'd sold more of them last summer, but today I think they are attractive "mispriced options" that will do well from current depressed levels.

The fund is currently 59% long, and my highest priority is to identify a small number of cheap, safe, new investments that will take the fund's long exposure to the 80-100% range. This won't be easy, unfortunately. In today's markets, complacency abounds – market volatility levels haven't been this low since before the financial crisis in early 2007 – so high-conviction long ideas are few and far between right now. I've been doing a lot of work on a range of companies and am finding many stocks that are trading at a 10-20% discount to intrinsic value, but that's not a big enough margin of safety, so I continue to look.

I can't tell you how long it will take me to build the fund's short and long exposure up to my target levels, but I can assure you that I will be patient – and my experience over more than 14 years of managing money professionally is that my patience has eventually been rewarded.

New Strategy

In late June, as I prepared to once again manage the fund by myself, I thought hard about how to maximize my chances for success going forward. I ultimately decided to go back to the much simpler, more focused, lower-risk approach that had worked for me so well early in my career. To that end, I have significantly reduced the fund's overall exposure, position sizes, use of options, and trading.

I truly believe that less is more. Going forward, the funds I manage will be concentrated in my very best, carefully researched investment ideas, with approximately 15 meaningful positions on the long side and a similar number of (much smaller) positions on the short side. My target portfolio exposure is 80-100% long and 15-30% short. In this increasingly short-term, trading-oriented environment, I aim to do as little trading as possible, and would be delighted if I am able to generate a handful of great investment ideas each year.

I also want to emphasize what I'm *not* doing. While I want with every bone in my body to get us out of the hole that we're in, I'm not going to do it the wrong way. I've seen too many fund managers try to quickly make back losses by swinging for the fences – trading rapidly, using leverage and options, and buying speculative stocks – and they invariably blow themselves (and their investors) up. I'm taking the opposite approach, which can by summarized by the first rule of holes: "When you're in one, stop digging!" (hat tip to Molly Ivins).

Shorts

Beginning in July, I reestablished my favorite short positions and added a number of new ones over the course of the fall, resulting in 20-25 positions and exposure in the 30-40% range. While this is far lower than the level of recent years, I concluded that it is still too many positions and too much exposure, so I have adjusted the portfolio accordingly. Today the fund currently holds only eight short positions (excluding a number of tiny ones that I haven't covered to avoid realizing substantial taxable gains) and total short exposure is 14%.

When I set the target last June of 25 short positions, I thought this was a manageable number – but I overestimated my bandwidth. Managing so many positions spread me too thinly, which had two effects: our fund suffered losses that should have been avoided and, less visibly but perhaps more importantly, the amount of time I spent on shorts impacted my ability to find great longs.

To rectify this, going forward I plan to only invest in my absolute highest conviction 10-15 short ideas, with the sole goal of making money. My focus is on flawed or broken businesses whose stocks I think are likely to suffer precipitous, permanent declines. Good examples are InterOil, Nokia, and K-12, three of the four largest short positions in the fund.

In contrast, I covered (slightly profitable) short positions in Chipotle and Caterpillar in December. Both companies face near-term headwinds that are, in my opinion, not reflected in their stock prices, which I why I shorted them. But both are also excellent businesses that I wouldn’t want to bet against long term, so I’m not going to bet against them short term either.

Reducing short exposure without materially changing long exposure of course results in a higher net long position, which means the fund should, in general, perform better in rising markets, but not as well during market declines. This is a trade-off I’m willing to make for three reasons:

a) Historically I’ve had more success on the long side vs. the short side, and I expect that this will continue to be the case, so it makes sense to tilt the portfolio more toward the long side (though I do think the fund’s more focused short book will contribute to returns going forward);
b) I think the U.S. stock market, after 13 years of near-zero returns, will likely compound at 4-6% (including reinvested dividends) over the next decade – yet another reason to tilt the portfolio more toward the long side; and
c) I hope to be clever in identifying major bubbles and busts, as I did with the Internet and housing markets, and increase short exposure at the right times.

Performance Objectives
In every year-end letter I repeat my performance objectives, which have been the same since the fund’s inception: My primary goal is to earn you a compound annual return of at least 15%, measured over a minimum of a 3-5 year horizon.

I arrived at that objective by assuming the overall stock market is likely to compound at 5-10% annually over the foreseeable future, and then adding 5-10 percentage points for the value I seek to add, which reflects my secondary objective of beating the S&P 500 by 5-10 percentage points annually over shorter time periods. While a 15% compounded annual return might not sound very exciting, it would quadruple your investment over the next 10 years, while 7-8% annually – about what we expect from the overall market – would only double your money.

Since inception 8½ years ago, I have not met my 15% objective, thanks in part to one of the worst periods ever for stocks, and the fund has underperformed the S&P 500 by 4.3 percentage points per year. I am not satisfied with this performance and am determined to improve it.

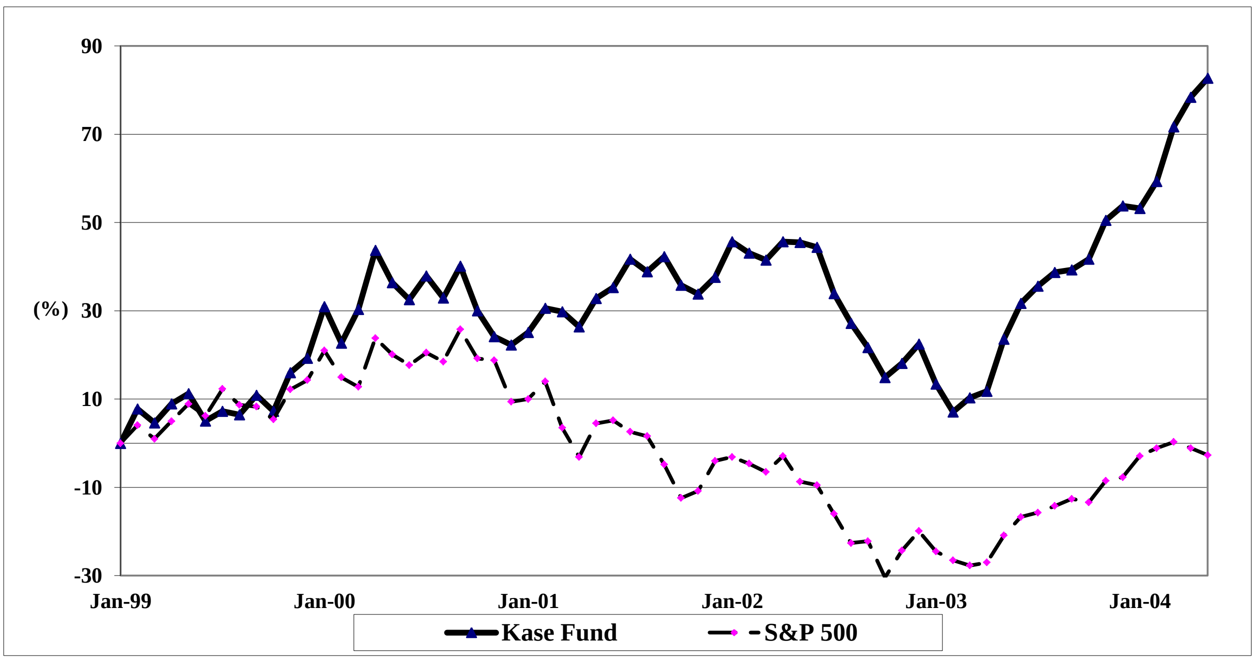
Continuing Your Investment
The fund’s returns have been dreadful for more than two years now, which I understand might make you question your investment with me. The best two arguments I can make in asking you

to give me more time to turn things around are: a) my 5+ year track record managing the Kase Fund (prior to the inception of this fund) in a style similar to today; and b) the fact that nearly every investor, even those with the best long-term records, goes through periods of significant underperformance.

Regarding the former, below is the track record of the Kase fund when I was running it by myself in the 5 1/3 years from January 1999 through April 2004. As you can see in the table and chart below, it substantially outperformed all of the indices, beating the S&P 500 by 12.5 percentage points per year on a compounded basis. Obviously the world has changed a great deal since then and I cannot promise similarly strong returns, but one thing I can say with certainty is that I have much more experience now than I did then – and the longer I'm in this business, the more I realize how important experience is.

	Total Return Since Inception	Annualized Since Inception
Kase Fund (net)	**82.7%**	**12.0%**
S&P 500	-2.7%	-0.5%
Dow	23.8%	4.1%
NASDAQ	-12.4%	-2.5%

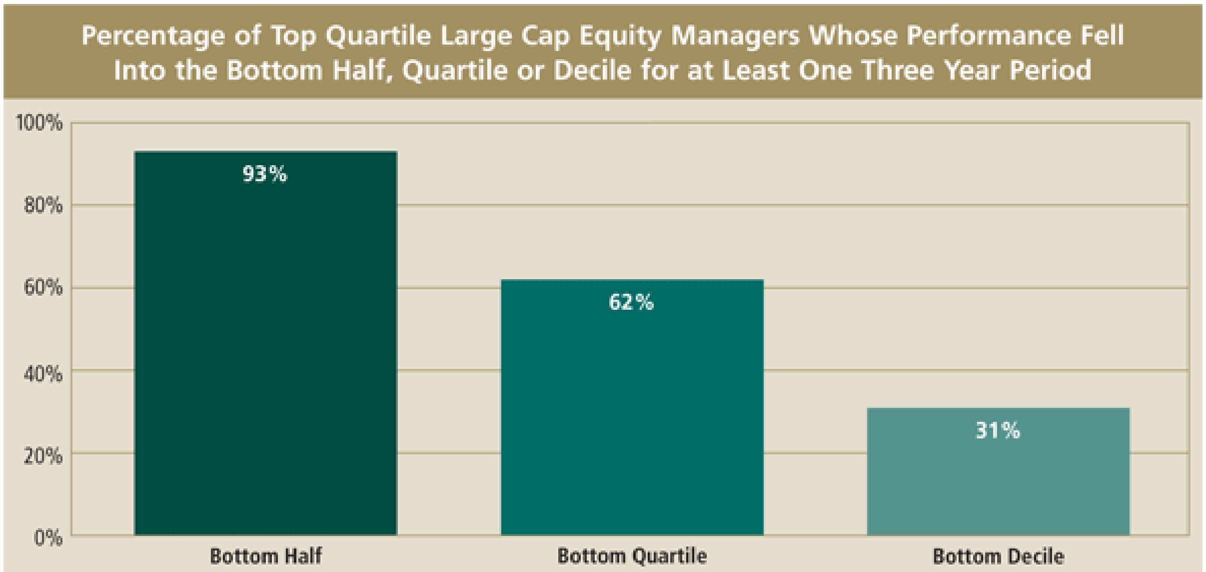
Past performance is not indicative of future results.
Notes: From January 1999-April 2004. Gross and net returns are after the 1% management fee and all other expenses of the fund.



Past performance is not indicative of future results. During this period, the Kase Fund was named the Tilson Growth Fund.

Regarding the latter, it's important for both investors (you) and investment managers (me) to understand that virtually all money managers will underperform at times, occasionally badly and for extended periods, yet the long-term results can still be excellent. Indeed, the well-respected Davis Funds did a study of the 192 large-cap funds with top-quartile performance during the decade ending 12/31/10 and found some surprising results:

- 93% of these top managers' rankings fell to the bottom half of their peers for at least one three-year period;
- 62% ranked among the bottom quartile of their peers for at least one three-year period; and
- 31% ranked in the bottom decile for at least one three-year period, as this chart shows:



Davis Funds concluded:

> When faced with short-term underperformance from an investment manager, investors may lose conviction and switch to another manager. Unfortunately, when evaluating managers, short-term performance is not a strong indicator of long-term success.
>
> Though each of the managers in the study delivered excellent long-term returns, almost all suffered through a difficult period. Investors who recognize and prepare for the fact that short-term underperformance is inevitable – even from the best managers – may be less likely to make unnecessary and often destructive changes to their investment plans.

The Davis study assumed that an investor simply bought at the beginning of the 10-year period and didn't add or withdraw any money. Obviously returns would have been lower for investors who added to their investment after a period of strong gains – chasing performance is very common and is one of the biggest mistakes investors make – while those with the courage to add to their investment during periods of underperformance would have significantly improved their results.

My goal is to be one of those managers who rebounds from an extended period of poor performance to once again post outstanding long-term returns.

Quarterly Letters
The next letter you receive from me will be in early April. Writing letters every month was time consuming, stress inducing, and led me (and, no doubt, many partners) at times to think short-term, which is detrimental to my long-term-oriented investment strategy. If you do not currently receive monthly statements from our bookkeeper, Cohen & Associates, and would like to, please email Kelli at KAlires@KaseCapital.com.

Quarterly Conference Call
I will be hosting my Q4 conference call from 4:00-5:00pm EST on Tuesday, February 5th. The call-in number is (209) 647-1600 and the access code is 627309#. As always, I will make a recording of the call available to you shortly afterward.

Conclusion
After a strong 12-year run, 2011 and 2012 were lost years. I feel very badly about this and apologize to you. But I know you don't want an apology – you want performance! To that end, I've reflected on the mistakes I've made, learned from them, and taken significant steps to maximize our chances of success going forward: I'm now the sole portfolio manager and have dramatically simplified, focused, and de-risked the fund. I'm confident that my strategy is sound, I will execute it well going forward, and we will all profit.

I'm heartened and humbled that the vast majority of the fund's partners have chosen to maintain their investment. I'm determined to reward your vote of confidence and want to thank you for your patience, confidence and support.

If you have any comments or questions, please call me anytime on my cell phone at (646) 258-0687.

Sincerely yours,

Whitney Tilson

Whitney Tilson

Appendix A: All 13 Long Positions

Note: The stocks are listed in descending order of size as of 1/25/13.

1) Berkshire Hathaway

Berkshire is firing on all cylinders and the earnings power of its wholly owned businesses continues to grow, so I have increased my estimate of its intrinsic value to approximately $180,000/A share, well above today's level of $147,290 – plus I think intrinsic value is likely to grow at roughly 10% annually. More than $1 billion per month from the operating businesses is pouring into Omaha every month for Warren Buffett to allocate, and he's doing a great job of this.

Berkshire recently raised the price limit at which it is willing to repurchase shares from 1.1x book to 1.2x, and made a $1.2 billion repurchase in one transaction. This puts a soft floor on the stock of $134,000 (based on 1.2x Q3 book value; it's surely somewhat higher now).

Our slide presentation on Berkshire is posted at: www.tilsonfunds.com/BRK.pdf.

2) AIG

AIG today is a radically different company from the widely reviled one that contributed to the collapse of the world financial system and had to be bailed out by taxpayers to the tune of $182 billion. AIG has paid back every penny to the government, which even earned a profit on the bailout! AIG has successfully exited all major non-core assets and today is comprised primarily of two large businesses, Chartis and SunAmerica.

At the end of Q3, AIG's book value was $68.87 which, with earnings and share repurchases, should grow to approximately $75 by the end of 2013 vs. the current stock price of $36.70. I think the stock is worth at least 1x book value, so I expect it will double in the next 2-3 years.

Two of our slide presentations on AIG are posted at: www.tilsonfunds.com/AIG-5-12.pdf and www.tilsonfunds.com/AIG-10-12.pdf.

3) The Howard Hughes Corp.

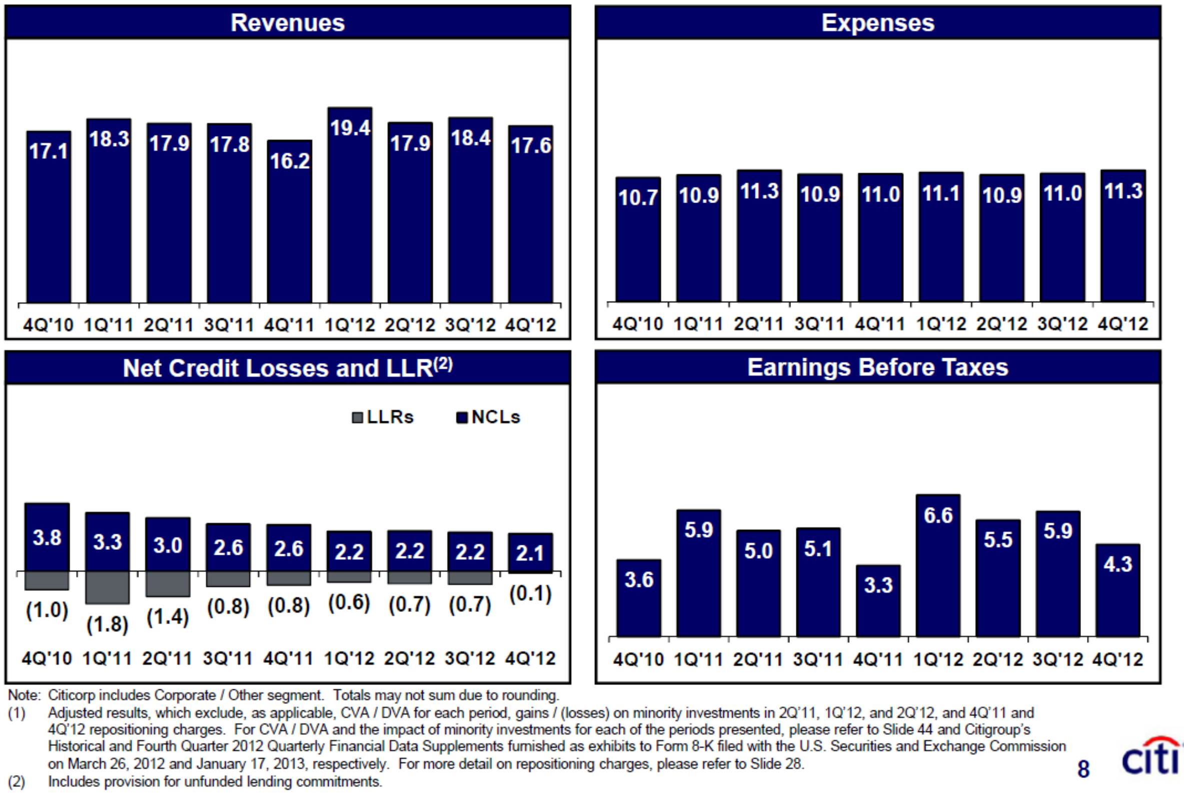
When General Growth Properties emerged from bankruptcy in early November, 2010, it did so as two companies: GGP, which had all of the best malls, and HHC, a collection of master planned communities, operating properties, and development opportunities in 18 states. Many of these properties are generating few if any cash flows and are thus very hard to value, but I think the company has undervalued, high-quality real estate assets in premier locations and that there are many value-creating opportunities can be tapped.

In July and August I visited four of Howard Hughes's properties that account for two-thirds of the company's book value: Summerlin (Las Vegas), The Woodlands (Houston), Ward Centers (Honolulu), and South Street Seaport (NYC). In all cases, I was extremely impressed with the properties, the managers running them, and the development plans underway.

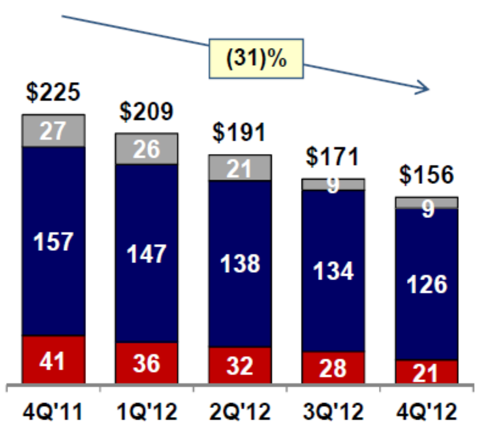
Our slide presentation of HHC, including an estimate of intrinsic value of as much as $125/share (vs. today's $72.78), is posted at: www.tilsonfunds.com/HHC-10-12.

4) Citigroup

Citigroup is two businesses: good bank (Citicorp) and bad bank (Citi Holdings). The former is a very strong worldwide franchise that generates robust (albeit somewhat erratic) profits, as shown by this page from the company's Q4 earnings presentation:



Ah, but what about bad bank? Citigroup is rapidly shrinking Citi Holdings, which peaked at $827 billion in assets in Q1 '08, via sales, charge-offs and runoff, as this chart shows:



% of Total Citigroup Assets				
12%	11%	10%	9%	8%
QoQ Decline (%)				
(9)%	(7)%	(9)%	(10)%	(9)%

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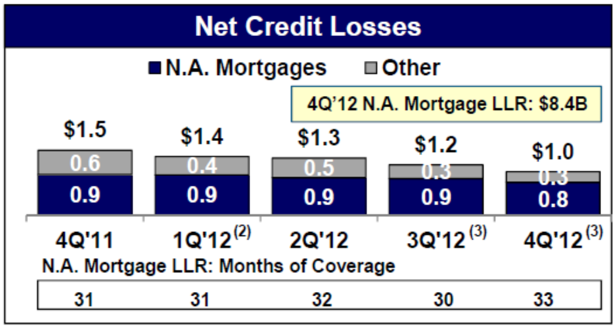
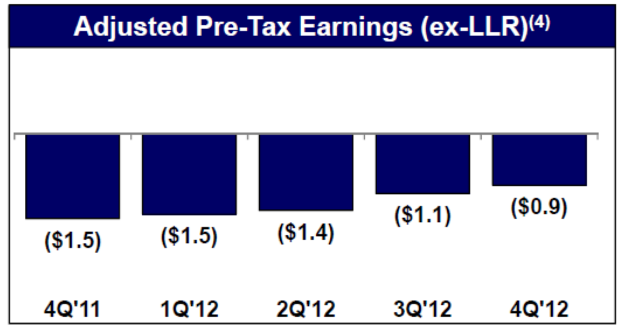
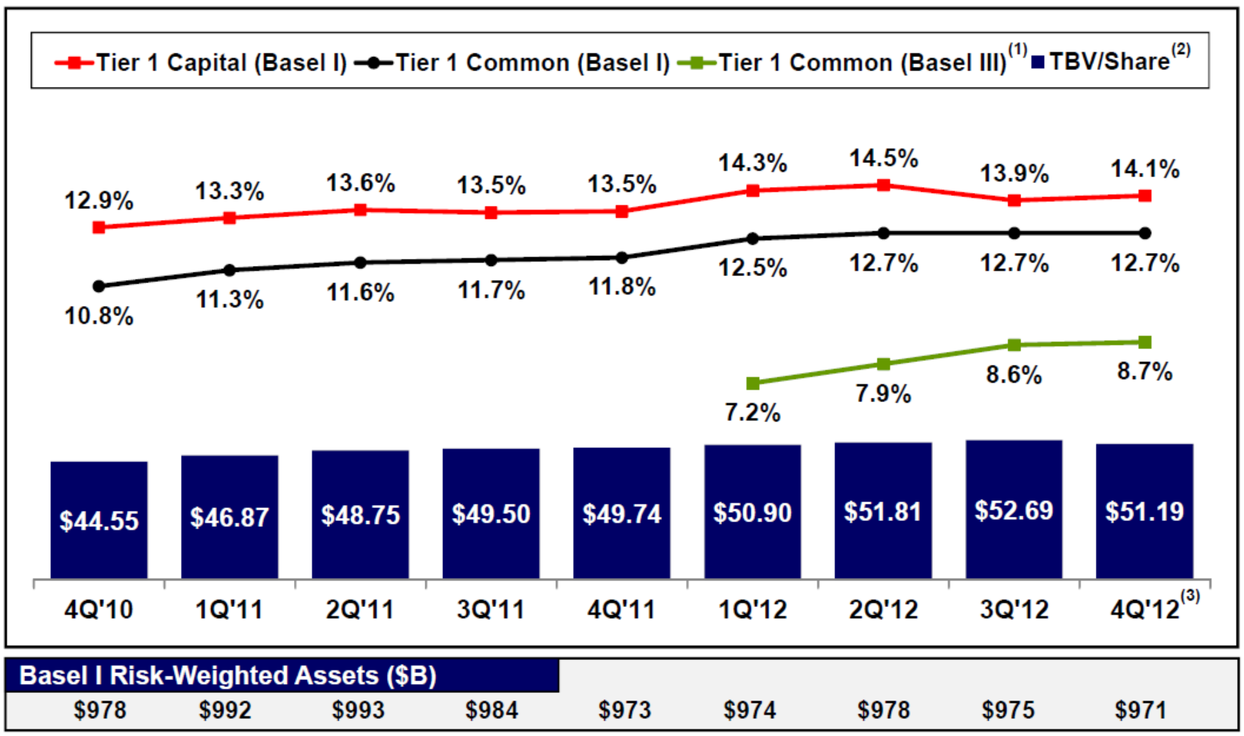
Meanwhile, losses at Citi Holdings continue to shrink:





And Citigroup's balance sheet continues to strengthen, increasing the chances of a dividend and/or share buyback program, as this chart shows:



In summary, Citigroup's good bank is doing well, bad bank is shrinking and reducing losses, and the balance sheet is in good shape. Reflecting this, the stock has risen nicely from the high-$20s last summer, but at $42.91 it's still well below tangible book value of $51.19, which is the low end of my range of intrinsic value.

5) Goldman Sachs

Like Citigroup and AIG, Goldman was been buffeted by a seemingly endless series of storms since the financial crisis, but is now emerging in good shape. The company recently reported blowout Q4 earnings, with revenues up 53% and earnings per share more than tripling. Return on equity, which had been mired in the single digits, leading the stock to trade at a discount to book value, was a healthy 16.5% in Q4.

Goldman, as the premier investment banking franchise in the world, should be able to consistently earn at least mid-teens ROE, in which case it's worth a substantial (30-50%) premium to tangible book value vs. today's 8% premium at $144.46 (and I think book is good, as Goldman is more aggressive in writing down assets and marking them to true market prices than any of its peers.)

6) Netflix

I highlighted Netflix as one of my favorite ideas at the Value Investing Congress on October 1st when the stock was around $54 (see my slides at: www.tilsonfunds.com/NFLX-10-12.pdf). I highlighted the remarkable similarities between Amazon in 2001 and Netflix in 2011: almost the same revenues, number of customers, market cap, and willingness to invest virtually all profit back into the business – and noted that Amazon's stock had risen by *twenty times* since then. Given that Netflix has higher margins, is profitable and free cash flow positive, and has a much stronger balance sheet than Amazon did then, I argued that it has similar exponential upside potential.

To be clear, I didn't say I thought it was *likely* that Netflix was going to be a 20-bagger in the next decade (though now that it's more than tripled in less than four months, the odds of this have improved!), but rather pointed if there was a 10% chance of a 10x return, the expected value of this one scenario justified the entire stock price at that time. I like investments in which I think there is uncapped upside and my downside is limited (in this case by Netflix's attractiveness as an acquisition candidate at its then-depressed valuation).

Fast forward to today, the company reported blowout earnings last week, triggering a 71% jump in the stock. Netflix added nearly four million global streaming members in the fourth quarter – far above guidance and analyst expectations – and nearly 10 million for the year, bringing total streaming members to more than 33 million. Netflix is now in 40 countries and is gaining traction around the world. Even the legacy DVD-by-mail business didn't decline as much as expected and produced healthy cash flows. In summary, my investment thesis so far is playing out better than I could have hoped.

Ah, but now I have a problem (albeit a high-class one): with the stock having skyrocketed to $169.56, up from below $100 a week ago and less than $53 last summer, should I take my profits and hope for a pullback in the stock? Or should I hold on, betting on the exponential upside scenario?

The answer to this question would be easy if I could peg the stock's intrinsic value in a narrow range, as I can do for most other companies in our portfolio. But Netflix can't be valued in traditional ways such as a multiple of current earnings, cash flows, and/or book value, so I value it based on a probability-weighted scenario analysis. At one extreme, what are the chances that, over the next 5-10 years, Netflix becomes a globally dominant, highly profitable entertainment/media company – in which case, the stock could be a 10-bagger from here? At the other extreme, what are the odds that subscriber growth slows, content costs rise, cash flows turn sharply negative, and Netflix has to either raise capital or sell itself on distressed terms – in which case, the stock would collapse? And what is the likelihood of various in-between scenarios? Last summer, the stock was priced as if the disaster scenario was a real possibility while now, only a few short months later, its priced as if the dominate-the-world one is much more likely.

Even after the big run-up in Netflix's stock, I think it remains undervalued and there's a good chance of continued upside surprises, but there's also now much more downside. With a market cap of nearly $10 billion today, it's much less likely to be acquired at a premium than when the company had a $3 billion market cap. Thus, I've been taking profits all the way up, which is why it's only our 6th largest position today (around 4%).

For more on Netflix, see:

a) Our initial report, *Why We're Short Netflix* (12/16/10, www.tilsonfunds.com/WhyWereShortNetflix.pdf)
b) Netflix CEO Reed Hastings's response: *Cover Your Short Position. Now.* (12/20/10; http://seekingalpha.com/article/242653-netflix-ceo-reed-hastings-responds-to-whitney-tilson-cover-your-short-position-now)
c) Our report on *Why We Covered Our Netflix Short* (2/9/11; www.tilsonfunds.com/WhyWeCoveredOurNetflixShort.pdf)
d) Our report on *Why We're Long Netflix and Short Green Mountain Coffee Roasters* (11/13/11, www.tilsonfunds.com/NFLXGMCR.pdf)

7) Canadian Pacific

CP is the only new long position in the portfolio since I took over as sole portfolio manager. It was a chronically underperforming railroad, plagued by an ineffective CEO and a complacent board. Well-known activist fund Pershing Square took a large stake in the company in late 2011 and, after unsuccessfully trying to persuade the board to remove the CEO, waged a successful proxy battle that resulted in a mostly new board and the hiring of Hunter Harrison as CEO. Harrison is a legend in the industry for the remarkable turnarounds he led at Illinois Central and Canadian National and, in owning this stock, I'm making what I think is a high probability bet that he'll be able to do it again.

I purchased the stock after attending the company's analyst/investor day in December and seeing the remarkable strides the company has already made in less than six months of Harrison's leadership. It killed me to buy the stock after it had doubled in just over a year, but it's already up roughly 10% to $111.94 and I think it's a good bet to hit $150 within 2-3 years and approach $200 within five years. For more information, see Pershing Square's excellent slide presentation at: www.visualwebcaster.com/Pershing/84724/materials0812.html.

This investment highlights two investment traps I do my best to avoid. The first is the "I missed it" syndrome whereby one looks at a stock that's moved up in price, says, "Rats, I missed it", and doesn't consider it further. How many people figured out that Warren Buffett was an investment genius long ago, but fell prey to the "I missed it" syndrome when Berkshire's stock was at $100, $1,000, $10,000, and $100,000/share? It's completely irrelevant where a stock has been; the *only* thing that matters is where it's priced today and whether that price reflects an attractive risk-reward equation. Easy to say, but hard to do…

The second trap is the “not invented here” syndrome. Value investors are tend to be contrarians, so they take particular pride in coming up with investments that they found themselves and in which no other investor they know holds a position. I too have a fondness for such investments. But it’s irrational to reject a great investment idea just because someone else had it first or “everyone else owns it”. My job is to find great investments, regardless of their provenance, so while I always do my own work, every quarter I scour the 13F filings of the most successful value investors, read publications like my own, Value Investor Insight and SuperInvestor Insight, track web sites like Value Investors Club and SumZero, etc. in search of new ideas to research. As Picasso once said, “Good artists copy but great artists steal.”

8) Grupo Prisa

Grupo Prisa is a media conglomerate based in Spain with 75% of its business in Spain and Portugal and the balance in Latin America. It’s a good business with valuable assets plagued by two things: the terrible depression in the Iberian peninsula and a bad balance sheet. Thus, it’s not surprising that the stock has fallen sharply (the A and B shares that trade in the U.S. are at $1.53 and $1.52, respectively).

To its credit, the company is doing a great job addressing both of its problems. Regarding the depression in its biggest markets, Grupo Prisa has cut costs and focused on its Latin American business, which grew 12.0% and accounted for 25.4% of revenues in the first three quarters of 2012, up from 22.2% year-over-year. For the entire company over that period, revenues were down 2.0% and adjusted EBITDA fell 3.4%, remarkably good performance considering the economy in Spain (unemployment hit 26% in the fourth quarter; for young people, it was 55%).

Grupo Prisa has also meaningfully strengthened its balance sheet. In the first three quarters of 2012 , it reduced its net debt by 11% from 3.53 to 3.13 billion euros and increased its shareholders equity by 32% from 2.22 to 2.94 billion euros, primarily by successfully doing two convertible bond issues.
Notably, Telefónica, the largest Spanish multinational by market cap and one of the largest telecommunications companies in the world, invested 100 million euros and, in addition, the world’s richest person, Mexican billionaire Carlos Slim, owns a 3.2% stake. Some very smart, strategic players see great value in Grupo Prisa. When this will be reflected in the stock price is anyone’s guess, but the stock is already up 30% this year. Again, stay tuned…

For background information, see this May 7th, 2011 article in Barron’s entitled *Read All About It: A Solid Spanish Media Play*: http://bit.ly/barronsprisa.

9) Spencer Holdings (private placement)

Spencer is a reinsurance company in the extended auto warranty business. Most new cars (and “pre-owned” ones sold by a dealer) come with some sort of warranty – say, three years/30,000 miles – and, for a price, the dealer will extend this warranty to, say, seven years/70,000 miles. Spencer works with the dealers to develop this product and reinsures the extra four years/40,000 miles in exchange for a portion of the premium.

This is an extremely high-quality business that was purchased at a great price from a distressed seller. The company has been infused with $20 million of new capital (including ours), which has positioned it for rapid growth in coming years. It is about to launch another round of capital raising at a valuation that is expected to be higher than the round at which we invested. If all goes well, Spencer could IPO within a year. We know management well and Glenn has a seat on the board.

*10) dELiA*s*

dELiA*s sells apparel, accessories and footwear to teenage girls and young women through 107 retail stores, direct mail catalogues, and its website. We bought approximately 10% of the company many years ago in the $2 range, when it had a market cap equal to the net cash on the balance sheet, so we figured we were getting the company for free. Unfortunately, the company has been free cash flow negative every year and has thus steadily burned through its cash such that it now has only roughly 60 cents/share of cash and the stock is at $1.02. It's been a classic value trap so far.

There is reason for hope, however. The company has had four consecutive quarters of positive same store sales in its retail division and its cash burn has been greatly reduced. Its market cap is less than $32 million and, net of expected fiscal-year-end cash of $19 million, an enterprise value of less than $13 million. This is absurd for a company that has more than $220 million in sales and is nearly break-even on an EBITDA basis.

The CEO has announced that he is leaving, which could lead to a sale of the company or the hiring of a replacement who could take the business to a new level. Stay tuned…

11) Iridium

Iridium operates a constellation of low-earth orbiting satellites that provide worldwide real-time data and voice capabilities over 100% of the earth. The company delivers secure mission-critical communications services to and from areas where landlines and terrestrial-based wireless services are either unavailable or unreliable. It is one of two major players in the Global Satellite Communications industry.

Iridium continues to execute well and the stock is about where it was a year ago, but there's been tremendous volatility over this period. The company reported two strong quarters to start 2012 and its stock rose to $9.73, but then it slightly missed estimates in the last two quarters, causing the stock to tumble to a low of $5.25, from which it has now rebounded to $7.12.

Unfortunately, the majority of our stake early last year was in highly illiquid warrants, so we weren't able to sell early last year and gave back all of our gains (and then some) later in the year. At the end of September, however, the company offered to convert its outstanding warrants to stock, which allowed me to convert our position to a safer and more liquid instrument (common stock rather than warrants which, in addition to being highly illiquid, expire in mid-February) and reduce our position size to the 2-3% range, which is just where I want it. The conversion is also great news for the company, as it simplifies the capital structure and reduces the dilution that would have taken place had the warrants been exercised.

Overall, I'm pleased with the company's performance. In the first three quarters of 2012, while revenue rose only 1%, operating profit rose 21%, net income rose 47%, and operational EBITDA rose 5%. At the end of Q3 '12, the company had 595,000 billable subscribers, up 17% year-over-year.

I believe this is an excellent company and the stock is significantly undervalued. Comparable businesses are trading at 9-10x EV/EBITDA, while Iridium, which is growing significantly faster than and taking share from its competitors, trades at around 6x EBITDA.

Our slide presentation on Iridium is posted at: www.tilsonfunds.com/IRDM-10-12.pdf.

12) Japan side fund (private placement)
This is a single-idea side fund managed by Kyle Bass of Hayman Capital that will profit if the yen weakens and/or interest rates rise in Japan. We believe that Japan is in dire financial straits and that it's inevitable that the yen will weaken significantly and, in addition, that at some point investors will demand higher interest rates on Japanese government debt (believe it or not, the 10-year rate today is 0.72%, less than half the 1.98% on U.S. 10-year Treasuries).

We invested in this fund in November 2011 and it is designed to decay over three years. If investors continue to view Japan as a rock-solid safe haven, this investment will steadily decline to zero over the remaining 1¾ years of the fund. If, on the other hand, investors open their eyes and do even the most superficial analysis of Japan's income statement and balance sheet, and act accordingly, this investment could pay off exponentially.

It may already be starting to do so. In its first year (November 2011 through October 2012), the marked-to-market value of the fund declined by 41%, but it rose 52% in the last two months of 2012 due to the yen weakening (in mid-2012 it was trading in the high 70s vs. the dollar and has now weakened to above 90). This is due primarily to new Prime Minister Shinzo Abe pushing for even greater deficit spending by the government and significant quantitative easing (money printing) by the central bank.

I think this investment is analogous to buying credit-default swaps on leveraged financial institutions exposed to subprime mortgages in 2007, when trouble was clearly on the horizon, yet one could still buy CDSs on their debt for a pittance. I think the situation in Japan is more precarious than ever (as one person put it, "Japan is a bug in search of a windshield"), so I like this investment a great deal.

13) Spark Networks
Spark Networks owns and operates online dating web sites, mostly notably JDate and ChristianMingle. Dating web sites are an incredible business: they have negative working capital, no inventory, customers pay up front so there's no bad debt, there's no customer concentration risk, and it's not economically sensitive.

Spark's two main web sites are similar businesses in very different stages of growth. JDate, which targets Jewish singles, is a fabulous, stable, mature, cash cow, generating 88% contribution margins and approximately 60% EBITDA margins on revenues of $26.1 million over the past year. It's not growing, however – in fact, revenues fell 5% in Q3 '12.

Spark is plowing all of its profits (and then some) from JDate into its growth vehicle, ChristianMingle (CM), which is addressing a market that is *30 times larger* than the Jewish market. This investment is paying off: in Q3, CM revenues grew 84%, its seventh consecutive quarter of 75%+ growth (at $8.5 million in Q3 revenues, it's already larger than JDate, which had revenues of $6.4 million), paying subscribers jumped 89%, and brand awareness among Christians has risen to 60% in the past 18 months. But funding such rapid growth isn't cheap: in Q3, Spark spent $10.9 million on direct marketing expenses for CM (vs. only $0.8 million for JDate), which is why Spark is currently reporting losses (net income in Q3 was -$1.7 million).

Dating sites have powerful network effects and tend to be winner-take-all businesses (think Match.com and JDate), so Spark's large investment in ChristianMingle to establish it as the dominant player in its niche makes sense – but it does make it hard to value Spark since it's currently losing money. The key variable is CM – how big can it get and what will its margins look like once it's mature? I think revenues will soon reach $50 million annually (not a stretch, given they're already at a $34 million run rate and high growth hasn't slowed) and could top out at $100 million or more, and there's no reason why it shouldn't have margins close to JDate's once it's mature.

Using these numbers, it's easy to see how Spark's total EBITDA gets to $20-$50 million and valuations in the sector range from 7-10x, so with a market cap today of only $144 million (at $7.00/share), there is multi-bagger upside potential here.

As an added bonus, Great Hill Partners, a well-respected private equity firm, owns 44% of Spark and, after nearly seven years of ownership, is likely looking for an exit, so it wouldn't surprise me to see the company sold at a nice premium. The most likely buyer is IAC, which owns Match.com and has acquired many smaller dating web sites. IAC's market cap is $3.6 billion, so Spark would be a bite-sized acquisition.

The T2 Qualified Fund, LP (dba the Kase Qualified Fund) (the "Fund") commenced operations on July 1, 2004. The Fund's investment objective is to achieve long-term after-tax capital appreciation commensurate with moderate risk, primarily by investing with a long-term perspective in a concentrated portfolio of U.S. stocks. In carrying out the Partnership's investment objective, the Investment Manager, T2 Partners Management, LP (dba Kase Capital Management), seeks to buy stocks at a steep discount to intrinsic value such that there is low risk of capital loss and significant upside potential. The primary focus of the Investment Manager is on the long-term fortunes of the companies in the Partnership's portfolio or which are otherwise followed by the Investment Manager, relative to the prices of their stocks.

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The fee schedule for the Investment Manager includes a 1.5% annual management fee and a 20% incentive fee allocation. In practice, the incentive fee is "earned" on an annual, not monthly, basis or upon a withdrawal from the Fund. Because some investors may have different fee arrangements and depending on the timing of a specific investment, net performance for an individual investor may vary from the net performance as stated herein.

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