

DORSEY ASSET MANAGEMENT

January 30, 2015

Dear Investor:

The Global Moat Composite rose about 4.8% during the fourth quarter, versus a 1% gain in the MSCI World Index.¹ For the nine months from our April 1 inception through year-end, the Composite returned 2.1% versus 3.6% for the index. The strength of the dollar continued to hurt, knocking almost 6% off our since-inception results. In an effort to share our pain, we thought you might be interested in the following table, which shows the currency impact on the returns of our portfolio holdings.

Company	Px Chg (Local)*	Currency	FX Chg vs USD	Px Chg (USD)
PSG Group	33.9%	ZAR	(10.6%)	23.4%
Diligent	23.3%	NZD	(9.1%)	14.2%
XPO Logistics	19.8%	USD	0.00%	19.8%
Christian Dior	16.1%	EUR	(12.5%)	3.5%
Brookfield	14.2%	USD	0.00%	14.2%
MTU Aero	12.9%	EUR	(11.4%)	1.5%
Aurelius	8.6%	EUR	(3.3%)	5.3%
Fuchs Petrolub	8.4%	EUR	(9.4%)	(1.0%)
Roper	8.1%	USD	0.00%	8.1%
G4S PLC	6.7%	GBP	(6.2%)	0.5%
Meggitt PLC	5.9%	GBP	(7.1%)	(1.2%)
Silverlake Axis	2.0%	SGD	(4.9%)	(2.9%)
Howden Africa	2.1%	ZAR	(5.3%)	(3.2%)
Ashmore	(18.3%)	GBP	(4.9%)	(23.2%)
ALS Global	(16.4%)	AUD	(7.7%)	(24.2%)

*Price and FX changes are based on weighted average purchase price in the Global Moat Composite. Individual account returns will differ.

As we wrote in our last letter, we view currency as simply an additional risk factor, and we try not to fish in ponds with currencies that appear overvalued on a PPP basis. We don't have much of an opinion on the Euro, Pound, or Rand other than that none appeared frighteningly expensive when we initiated the relevant portfolio positions. The recent Swiss Franc debacle shows a) the difficulty of predicting currency movements in the short run, and b) the material impact that currencies can have if they go against you. We treat currencies much like a rational resident of Chicago treats the local

¹ Individual account returns may differ due to the timing of the initial investment.

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weather – something to be prepared for, but not something to be predicted with any confidence. Just as Chicago occasionally gets a 50-degree day in February and a 30-degree day in April, currencies sometimes surprise you. Our goal with the portfolio is not to be caught wearing shorts on Michigan Avenue in April when it's 30 degrees. (Our goal with our quarterly letters is to stop talking about currencies.)

In the remainder of this letter, we'll update you on the portfolio and offer some thoughts on whether or not it's a good idea to discuss our holdings in investor letters. (Spoiler alert: We think it is, but there are some cogent arguments as to why we should not.) We'll close with some operational news.

Portfolio Update: Aurelius

We added one new position in the past quarter, a German firm called **Aurelius** (AR4_GR, €1.1b market cap). In form – though not in substance – Aurelius looks much like a traditional private equity firm: It purchases unwanted non-core businesses from corporate owners, and works to increase the value of those assets via restructuring and cost-cutting (not via leverage). We think three things set Aurelius apart from the scores of mid-market private equity firms jostling for European deals.

Aurelius' first advantage is structural: As a publicly listed firm with permanent, internally-generated capital, Aurelius enjoys more transparency and stability than a traditional private equity partnership that sources limited-life capital from outside investors. The public listing makes Aurelius more of a "peer" to the large corporates from which it often sources deals; coupled with its strong (€370m net cash) balance sheet, Aurelius is perceived as a safer, lower-risk choice for many large corporate sellers. Permanent capital is also a substantial advantage, as sellers can be wary that traditional private-equity buyers will go for short-term fixes that prepare a newly acquired asset for quick sale, rather than pursuing true root-and-branch operational improvement. (Permanent capital also gives Aurelius the valuable option of keeping an asset in the portfolio, if that approach is likely to deliver higher long-run returns than a sale.) Finally, Aurelius' ten-year track record of success – only four bankruptcies out of 42 purchases, and an almost 10x money multiple on invested cash – is beginning to build meaningful brand value amongst large corporates.

The second quality that attracted us to Aurelius is strategic. The company generally pursues deals that do not require large cash investments (in fact, Aurelius is often *paid* to take the assets it acquires), but which are complex and require significant investments of human capital. So, the deals are too small financially for larger buyers – who have pressure from limited partners to put substantial amounts of

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capital to work quickly – and too complex for small buyers who typically limit themselves to a single region or industry. Aurelius’ recent purchase of the Scholl footwear brand from Reckitt Benckiser is a good example – a listed U.K. company selling a business with most of its revenues coming from Southern Europe and Asia.² We have spoken with several contacts in the European private equity industry, and those conversations confirmed for us that there is substantially less competition for deals which have “hair” – cross-border issues, labor negotiations, etc – but which do not require large financial investments. The big guys need to put more money to work, and the small guys don’t have the necessary skill sets.

Finally, we think Aurelius’ managers are likely to be excellent business partners for some time to come. Founder and CEO Dirk Markus owns just over a quarter of the company, and other managers own an additional 10%, aligning their incentives with ours. About 50% of the cash from every portfolio exit is paid out as a dividend, which we think is sensible given that Aurelius’ deals are time-intensive rather than capital-intensive. We also think this payout policy is evidence of management’s discipline in sticking with its niche – after all, if Aurelius planned to go the empire-building route and pursue much larger deals with potentially lower returns, it would be hoarding cash. This is not a scenario that worries us, since all of the Aurelius managers we have met or spoken with (including Markus) seem to be in it for the “love of the game” and not solely for financial gain.

Valuing a company like Aurelius is tricky. We chose to think about it in two parts: The value of the existing portfolio, and the present value of cash deployed in the future. By triangulating the EBITDA being generated by the existing portfolio companies with comparable European companies, and cross-checking our assumptions with Aurelius’ internal budget, we estimated that the current portfolio companies are worth somewhere between €28 and €30 per share, which is about the level at which we purchased our position. We think cash deployed on future deals is worth somewhere between €12 and €20, depending on whether Aurelius’ average deal size remains at €8m, or moves up to €12m as the company moves into new geographies.

The foregoing is likely far more than you ever wanted to know about a somewhat-obscure German capital allocator, but Aurelius is optically a weird beast, so we thought it merited a bit more explanation. However, if we are correct in our assessment of CEO Dirk Markus and the opportunities available to Aurelius, you should be hearing a lot more about it in future letters.

² The North American rights to the Scholl brand are owned by Bayer.

Portfolio Update: Hermes & ALS

Last fall, LVMH boss Bernard Arnault signed a peace treaty with the family that owns a large chunk of uber-luxury firm Hermès, which Arnault had been attempting to take over for some years. A court-brokered deal required LVMH (which we own via **Christian Dior**) to distribute a large proportion of the Hermès shares it owned, so we now own Hermès shares separately from Dior/LVMH. Although Hermès is arguably one of the strongest luxury brands around, the shares currently reflect this value at almost 30 times earnings, so we sold our small position in late January.

You wouldn't know it from the share price – down about 10% in USD terms over the past quarter – but things are looking brighter for **ALS Global**. Cost control is taking hold in the problematic energy segment, improving margins from 11% in the September quarter to 15% in the December quarter; the Life Sciences division is doing a better job than we had expected in fending off a competitive challenge from Eurofins, with margins improving to over 20%; and the company's cyclical but highly profitable Minerals segment may have hit bottom – margins in this business improved six percentage points sequentially, and came in 2 percentage points higher than the prior year off a slightly smaller revenue base. Minerals has a high level of operating leverage and prints mid-thirties operating margins when business is good, so a cyclical improvement sooner than we had initially forecast could be quite positive for our current intrinsic value estimate.

We remain excited about ALS, despite CEO Greg Kilmister's penny-wise-but-pound-foolish insistence on handling all shareholder interactions himself. We have joked with a couple of other shareholders about jointly funding an investor relations position at ALS – after all, if Greg can achieve industry-crushing margins despite wasting his time talking to yahoos like us, what could ALS do if he didn't have to spend a couple hours now and then on IR? We figure that's good for another 200 bps of operating margin, at least.

Research Update

We took advantage of last October's selloff to purchase our Aurelius shares at what we think will prove to be an attractive price, but unfortunately we also engaged in unproductive thumb-sucking that caused us to *not* purchase a couple of companies that we knew well, but which we wanted just a little cheaper. In fairness, the window of opportunity was quite brief...but since Pat preaches constantly about how opportunity cost is just as important as margin of safety, you'd think we'd have been nimbler. Hindsight is always 20/20.

We traveled to London and Denver for industry conferences, and to Macao to research the casino industry. The latter trip was especially instructive – we came away with a much clearer perspective on the relationship between Beijing and Macao (more supportive than you might think from reading Western news media), but also with some doubts as to whether the companies in the industry clear our (admittedly high) quality bar.

While there's no question that having one of the six gaming concessions is a license to print money, each new casino built in Macao has delivered lower returns on capital than its predecessors. Moreover, we are not yet sure how operators will effectively deploy capital once they either run out of land (of which there is a very finite supply) or saturate demand (which is likely some ways off.) In short, we came away fairly confident that the stocks are cheap, the industry economics are attractive & sustainable, and that demand vastly exceeds supply. However, we're not confident (yet) that the casinos are true compounding machines at this point in the industry's life cycle. If we can alleviate our concerns about the potential dearth of future reinvestment opportunities, we'll likely buy one of the casino operators that we have been digging into. But if further research indicates that the company is not one of the very best businesses in the world in terms of moat, management, and compounding potential, we'll pass.

As an aside, though it may seem silly to waste space discussing an investment we may not make, we think that self-reflection about such decisions is healthy. It forces us to clarify our own thoughts – if you really want to know why you believe something, try writing it down – and it also helps us to help you understand our investment process.

The Double-Edged Sword of Disclosure

Speaking of understanding our process, we wanted to spend a moment on why we write (and talk) about our positions. Although we think that transparency about what we own and why we own it is simply the right thing to do – it's what we would want if we were in your shoes – such disclosure carries very real behavioral risks.

First, publicly discussing our thesis for a position intensifies the "commitment bias" that people naturally experience after making a decision. (Commitment bias refers to the human tendency to misprocess subsequent information in a way that supports the original decision.) Second, we might not change our minds when we should, out of fear that doing so would cause us to appear silly or inconsistent in front

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of people whose opinions we value. The line between confidence and stubbornness can be vanishingly thin in the investment world, and public discussion of positions raises the risk of crossing that line unwittingly.

In sum, writing about what we own and why we own it puts us at increased risk of making poor decisions based on our natural human biases. So why do we do it? Simply, because we think the benefits outweigh the risks.

First, summarizing our opinion about a company in writing forces us to think clearly about it. It's easy to chat casually about an investment thesis, and it's equally easy to cut and paste a mess of tables and charts into a giant Word document. What's *hard* is synthesizing data and judgment into a clear and concise argument – the process usually reveals things that you don't know which you thought you knew, and forces you to understand concepts well enough to summarize them. (There's usually an inverse relationship between how well someone understands something, and how long it takes to explain the idea to a layman.) When I ran Morningstar's equity research group, we stuck with the "less is more" format for our analyses for precisely this reason: Conciseness forces clarity.

Second, writing about our positions memorializes our opinion *at that specific point in time*, based on the information then available to us. Hindsight bias is rampant in the investment industry – people's current memories of past beliefs are often changed by intervening events, and prior decisions get rationalized by post-hoc information. This is a pernicious process that can lead to "thesis creep," in which an investment thesis morphs over time to accommodate new information that is often contrary to the original thesis. If we write down what we think, and (*gulp*) share it with others, we moderate the risk of thesis creep, because we can compare new information with the original opinion that was based on then-available information.

Third, we don't think we have a monopoly on brains. The world is full of smart people, and some of them have different perspectives about the companies we own. These differing views may stem from the same information processed through a different analytical framework, or they may be based on information we don't have. Either way, our understanding of the companies we own will be enhanced by engaging with people who disagree with our viewpoint – and we're more likely to run across those people if we're open and honest about our own opinions.

However, if all of this candor is going to produce better investment outcomes – and we think it will – then two things need to happen. One, we need to constantly watch the aforementioned line between

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stubbornness and confidence, and ensure that we don't irrationally cling to prior opinions just because we're worried about looking bad. Two, our clients need to realize that we will occasionally revise past opinions when they are contradicted by new information. Reversing course looks inconsistent and we'd prefer to do it as infrequently as possible – after all, “reversing course” is just a euphemism for “being wrong” – but we think it's better to admit a mistake and learn from it than it is to pursue consistency for irrational reasons.

Operational Update

We brought on two new analysts in early 2015, and I'm super excited to have both on board. More researchers means more time allocated to turning over rocks and sharpening our knowledge of current portfolio holdings, and I'm looking forward to a successful 2015 on both fronts. Also, we got our partnership off the ground, and we're transitioning our non-institutional separate accounts into the fund. Assets under management at the end of 2014 were \$78 million.

Finally, I traveled to Mountain View, California in December to give a talk about competitive advantage as part of the “Talks at Google” series. It was a great experience – I got a quick tour of the famed Googleplex, and got peppered with thoughtful questions from some very sharp Googlers. You can view the talk at <http://tinyurl.com/pmakqwf>.

Thank you for your confidence and support. Please feel free to contact us at any time with questions.

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