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Dear Client,

Performance Overview

	Value Equity Composite[1], Net	Benchmark[2]
Q2 2014	0.47%	4.20%
Year to Date	4.77%	7.87%
RVE Annualized Performance as of 6/30/2014		
3 Year	9.33%	15.85%
5 Year	15.88%	21.02%
10 Year	10.96%	9.07%
20 Year	12.23%	9.99%

Contrarian Investing

You have likely heard us say that we are contrarian investors. This used to be a good way to differentiate ourselves from other investors. Increasingly, it seems to me that it has become quite common for investors to describe themselves as contrarian. On TV, the internet and in print, the term contrarian has become a fashionable label. Does that mean we no longer differentiate from the mass of active investment managers?

Many self-proclaimed contrarians insist that they will only invest in companies with above average returns on capital, rock solid balance sheets, a history of consistent earnings growth and free cash flow generation that are run by management teams that are not only shareholder friendly, but also superior operators. I have a name for businesses like these - "The Holy Grail." In over 30 years as an investor, I have found it to be extremely rare for a company to embody each of these attributes and also be cheap. More importantly, there is no absolute definition of a cheap stock or of a high quality business. Instead there are many characteristics/traits that must be analyzed and weighed in relation to each other. The analysis must be considered with regards to historical context and current realities, not to mention the overall investment portfolio as a whole.

1 The Value Equity Composite has been defined and created to include all fee paying, discretionary accounts with an initial size of $100,000 or more that are managed with an objective of capital appreciation through the purchase and sale of primarily equity securities that, at the time of purchase, are small to mid-cap and that have been selling for significantly less than their intrinsic value or those that may grow their intrinsic value at above average rates. This composite was created in December 2001. The Investment results of the Value Equity Composite are only for illustration purposes and it cannot be assumed that future results will reflect this past performance. Performance of this composite has been calculated using U.S. Dollars. These results were calculated based on reinvestment of dividends and other earnings. Individual account performance may vary.

2 Inception through August 2011, benchmark was the Russell 2000 Index. September 2011 to present, benchmark is the Russell 2500 Value Index.

Contrarian investing most often means committing capital to companies that are unpopular and unloved. Often the only agreement among "experts" is that these are troubled companies or even bad businesses. The attributes of these companies are unlikely to meet all of the criteria of a purported "investor checklist." Long ago, Benjamin Graham pointed out that these potential investments often share common qualitative traits, but the most commonly shared trait is that the majority of other investors think it is a poor investment.

Skechers (NYSE:SKX) provides a great case study of this. To say that the investment community held a unanimously negative view of Skechers at the time of our investment would be a major understatement. Only now that the company has worked through its problems, a fact that has not been lost on the market, has the widespread view changed to one that is almost unanimously positive. Securities are cheap because "the market" thinks the business is unappealing and/or permanently impaired. Sometimes this viewpoint is due to the assumed time horizon. We have found that the market's definition of long-term has become increasingly shorter while our definition of at least 3 to 5 years remains unchanged. The goal of our analysis is to be able to view a company through a different lens than the rest of the market. Our experience is that great investment ideas arise from the times when our research and analysis lead us to a different conclusion than most others -- a variant view. Very often, we find the market ends up agreeing with us down the road and we are able to reap the benefit of that disparity. The ability to understand the long-term dynamics that are necessary for the stock to not be cheap is as critical as determining the probability that those dynamics will unfold. Investing is more of an art than a science. Just as with painting there are common tools and accepted methods that one must master to be a great painter, but there is no one set of rules for how to paint a masterpiece.

We continue to reduce our position in Skechers as it has attracted attention and momentum has taken hold, both of which have impacted its valuation and risk/reward. The company has bounced back from its inventory issues and, as we expected, investors have shifted their focus to the core shoe business which has been performing extremely well. The stock is up over 200% from its lowest point, resulting in a decline in our margin of safety.

Investing in companies when everyone else thinks we are crazy, no one believes our thesis and the recent fundamentals do not conform to widely held views of what a successful investment idea should look like is what makes us contrarian. This is why our definition of contrarian investing has never changed no matter how popular the label has become and why it still differentiates us from most investors.

Successful investing requires an accumulation of wisdom and there is no shortcut for the time this accumulation requires.

Second Quarter Review

For the year to date our worst three performers have been Stolt Nielsen (OB:SNI), Leucadia National (NYSE:LUK) and Ainsworth Lumber Co. Ltd. (TSX:ANS). Our worst performing investment for the quarter and the year was Ainsworth, a low cost Canadian producer of engineered wood products focused primarily on oriented strand board (OSB). We learned about the business through our ongoing research in the building materials and building distribution industry. Less than a month after our initial investment in Q3 2013, Ainsworth announced that it would be acquired by Louisiana Pacific (NYSE:LPX) at a price that was nearly 20% higher than what we paid. On May 14th, it was announced that due to regulatory issues the deal would be abandoned and the stock fell from trading at a level near the proposed deal price of $3.76 back to our initial purchase price.

Although there is now one less possible outcome for Ainsworth, our initial premise upon which we invested has not changed. Ainsworth emerged from the housing crisis as a well-capitalized company and is well positioned to benefit from the continued improvement of the U.S. housing market, where 75% of its sales are generated. A period of consolidation has the left OSB industry's top 5 players (Louisiana Pacific, Georgia Pacific, Norbord, Weyerhaeuser, and Ainsworth) responsible for 77% of North American production. Ainsworth will increase its capacity by 50% within the next 10 – 12 months and has the ability to increase that to >100% with limited capital investment. Furthermore, the company's renewed focus on niche value added specialty products, favorable geographic locations, and international sales provide advantages in what is primarily a commodity business. As a result, we took advantage of the failed deal with Louisiana Pacific to add to our position. As contrarians, we take advantage of the opportunity to buy more stock when it declines subsequent to our initial purchase, sometimes meaningfully. When our research allows us to maintain our conviction in an investment even if the perception of the market deteriorates, we can add to the upside for our clients, reap more of the benefit over the long-term and relish those opportunities in hindsight.

A significant contributor to second quarter performance was LSB Industries Inc. (NYSE:LXU). LSB is a leader in two niche businesses: (1) a chemical business and (2) a climate control business. The business is run by the founder Jack Golsen and his son Barry Golsen. Together the family owns nearly 14% of the outstanding shares. At the tail end of last year, an activist fund wrote a public letter to LSB's management and Board of Directors. When the letter was made public, our initial reaction was that it would be positive for the company, since it would serve to make the company more aware of the shareholder friendly options available to them. The Board took to heart many of the points raised in the letter. They have since reduced the size of their Board, while still adding 3 new members with experience in their businesses who were recommended by the activists. In addition, they also set up a special committee to review other aspects of the business. Over the quarter, LSB has appreciated over 11%.

We continue to see improvements from an area we view as a core competency - Energy. The top three contributors to our performance for the Composite are Enerflex Ltd. (TSX:EFX), Calfrac Well Services (TSX:CFW) and Helmerich & Payne, Inc. (NYSE:HP). All three of these companies have proven to be strong, disciplined capital allocators. We view their performance as a reinforcing data point in our outlook on natural gas and energy in North America.

Enerflex has been a staple in the Composite for almost a decade, and over that period we have been able to further develop our investment thesis. Having owned Enerflex through their acquisition by Toromont and subsequent spinoff, we have gotten a very good look as to how management acts over various economic environments and within different corporate structures. They have proven a commitment to shareholder value as evidenced by the investment in high return projects and intelligent capital allocation. This is most recently highlighted with their acquisition at the end of this quarter of a company focused on international contract compression and processing. With this new acquisition, Enerflex has smartly grown their compression fleet and exposed themselves to growing markets while focusing on recurring revenue and higher margin business.

Similarly, Calfrac puts an emphasis on disciplined capital management as evidenced by both opportunistic acquisitions at a discount to replacement value as well as its recent increase to its organic capital program. Calfrac is adding horsepower to its fleet in both the United States and Canada at a very opportune time. Reinvestment in their respective businesses at appropriate times has helped all three of these companies to position themselves well to a North American market that we believe will continue to increase in activity. Investors have begun to see past short-term headwinds and notice that Enerflex, Calfrac and Helmerich & Payne are companies with above average returns on capital, rock solid balance sheets, a history of earnings growth and free cash flow generation that are run by management teams that are not only shareholder friendly but also superior operators.

Thank You

I don't want repetition to make my comments seem anything less than genuine, but I am eternally grateful to have clients like you. The contrarian philosophy that I described at the beginning of this letter is the one that remains the foundation of our investment philosophy and can only be followed by managers who have clients with a shared commitment to patience, a similar time horizon, and a bond of trust. Over time, the majority of capital we have raised has been through referrals. If you know of someone who has a similar temperament and who might benefit from our guidance and partnership, we would be thankful for an introduction.

Have a wonderful and relaxing summer and, as always, feel free to contact us anytime.

All the Best,

Robert E. Robotti

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