Investment Securities

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Dear Client,

Performance Overview

	Value Equity Composite[1], Net	Benchmark[2]
Quarter 3 2013	9.12%	6.43%
YTD 2013	10.89%	22.50%
COMPOUND ANNUAL GROWTH RATE (THROUGH YEAR END 2012)		
3 Year	11.56%	13.35%
5 Year	3.63%	4.16%
20 year Inception	13.04%	8.59%

Year to date, the Robotti Value Equity Composite has returned 10.89**%**, versus the benchmark return of 22.50**%.** As is evident, we have underperformed our benchmark for the first 9 months of the year. That being said, our investments have gained ground, as we outperformed the benchmark for the quarter by 269 basis points. In much the same way that we do not get overly exuberant with short term outperformance, we also do not overly concern ourselves with short-term underperformance. As I have said many times before, our desire is to continue to understand the specific long-term drivers that push our investments to success, and focus on them.

Understanding the underlying drivers of our investments is not as valuable if we do not also have the discipline to adhere to the investment framework we have developed over 30 years. While we find ourselves faced with continued “easy money” policies of the Federal Reserve, another debt ceiling debate and the shutdown of our Federal Government, we must remain focused on the intrinsic value of specific companies. The noise of the markets is nothing new. We are constantly bombarded with facts that tempt us toward one seemingly obvious conclusion, but when looked at with more scrutiny (or within a more rational framework) provide unintuitive results. This can be illustrated by the commonly held belief that

[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.

tall parents have tall children, while short parents have short children. While that fact may be mostly true, there is one small but decidedly important caveat: tall couples' children are more likely to be shorter than their parents, while the children of short parents tend to be taller. Reversion to the mean provides a simple, albeit unintuitive explanation for this observation. The statistical concept of mean reversion does not apply to only mathematics or science, but can sometimes be observed in business as well.

Reversion to the mean is one framework through which we view companies with short-term headwinds. In order to be effective as contrarian investors it is a necessity to have a long-term view and wait for this reversion to occur. Just as the average height of humans will revert to a mean, often supply and demand will as well. We try and focus on the important aspects of the business rather than the noise. To do that, we must be willing to wait a substantial amount of time for the rest of the market to realize the intrinsic value of our investments. Although we think we have developed the ability to estimate the intrinsic value of companies, one aspect of investing that we claim to have little expertise in is market timing. In fact, we think timing investments is something that is nearly impossible to produce consistent results with, and as such, we don't attempt to give it too much bandwidth. Although an expert can make a confident estimate of how tall a child may be, there is no way of knowing when that child will hit their growth spurt. In terms of investing, this means that we are often too early when entering an investment, knowing we will potentially lose money in the short-term, before we make it. I said it last quarter, and I believe it holds true still, that we would much rather have a lumpy 15% than a smooth 12%, and this is a year where we have seen lumps come our way, but we have a strong conviction that we can continue to outperform over the long-term.

Skechers USA Inc.

It is always a useful exercise to look back on our investments and perform internal case studies on what went right, and what went wrong. Generally we try and focus on how our thinking changed as more data points were provided to us throughout the course of our investment. As we were able to harvest a portion of our investment in Skechers (NYSE:SKX) this quarter, it seems like a good time to begin this review.

In late 2010 we began to purchase shares of Skechers, a fashion forward shoe company that designs and markets contemporary footwear for men, women and children. Admittedly, Skechers is not likely to be the first stock to come to mind when thinking about Robotti & Company. While the industry may seem unusual, the reasons for our investment will sound very familiar. Shares were down over 50% from their 52-week high of $45 as a result of an inventory backup caused by what we will refer to as the "toning shoe debacle." The stock price continued to fall as analysts increasingly called for management's scalp. The situation went from interesting to downright exciting when the stock fell below its ~$17.50 tangible book value. As the stock continued to fall below $15, on its way to a low of $11.70, the value proposition became far too great to ignore. After a great deal of blank stares, confused looks, and a steady chorus of how investing in retail, especially fashion oriented retail, was a loser's game, the stock closed the quarter at $31.11[3].

[3] Data from Bloomberg

The "toning shoe debacle" was the catalyst for such incredible value. The company was experiencing a period of huge growth from an extremely hot product – the toning shoe, which was introduced at the end of 2009. Exact figures were never broken out, but it is our belief that toning had grown to account for over $400 million of Skechers' revenue. As is often the case with the market, when something does well, the expectation is that it will continue to do so in perpetuity. With analysts expecting the toning category to grow to the moon, it was easy to see the difficulty of living up to such lofty expectations. As it became clear that the toning shoe was not going to be able to continue its meteoric rise, retailers began cancelling orders, inventory grew rapidly and the stock suffered enormously. Questions from analysts no longer pondered the takeover of a category, but whether the toning shoe category would disappear altogether. Our initial thought at this point was that while their popularity might wear off, toners wouldn't be an overnight phenomenon, and the category wouldn't disappear completely.

I suppose it should not have been a surprise that we failed to predict a fashion trend. Toning sales did dry up "overnight" and for all intents and purposes, the category "completely disappeared." We didn't plan this just to illustrate the importance of having a margin of safety, although it is one of the clearer examples of that. Our variant view simply rested upon the belief that the market had overacted to a short-term buildup of inventory and had already priced in the elimination of the toning shoe market. There were inventory management issues that had to be understood. However, we believed that investors were so focused on whether or not the toning shoe was a fad, that they were missing the bigger picture.

Skechers was a profitable and growing business well before the introduction of the toning shoe. Since 2000, revenue had grown at almost an 8% CAGR; gross margins dropped below 40% only once (to 38% in 2003); and operating margins had averaged over 6%. Returns on equity had averaged roughly 12% over 5 years and 13% over 10 years. In addition, the company has had net cash the entire time we've held it. It was clear that gross margins would temporarily decline and inventory levels would be unpredictable in the short-term. In the worst case, we felt the company would have been forced to write down inventory and would end up with a flat to down year, thus putting the situation behind them.

The crux of our thesis was that as expectations for the toning shoe market adjusted downwards and excess inventory was worked through, cash would build on the balance sheet and investors were likely to shift their attention to Skechers' core shoe business. Having appreciated over 55% year-to-date we have seen that shift in attention from investors. While we did sell off a portion of our investment in Skechers, we continue to hold a sizeable amount. One of our Analysts, David Kessler, was integral in helping form our investment thesis for Skechers, and was able to help me work through my first "blank stare" on the company.

Ainsworth Lumber Co. Ltd.

I have spoken ad nauseum about our commitment to being long-term investors and not market timers. With our investment in Ainsworth Lumber (TSX:ANS) we came to an interesting convergence of the two. Within three weeks of opening a position in Ainsworth, Louisiana-Pacific Corporation (NYSE:LPX) struck a deal to buy all of the outstanding common shares of Ainsworth Lumber, giving us a nearly 20% return on our investment.

Ainsworth Lumber is a leading, low-cost Canadian producer of oriented strand board ("OSB"). OSB is a substitute for plywood specifically in homebuilding and commands over 60% of the market. The OSB industry went through a period of significant pain during the recession, but like many industries, that difficulty was cathartic as the industry consolidated and survivors emerged as stronger companies. Brookfield Asset Management (NYSE:BAM) became a large shareholder of Ainsworth, bringing new management and reshaping the company in the process. Ainsworth emerged as a well-capitalized company in a newly consolidated market benefiting from significant tailwinds and renewed focus on niche products.

Idea generation is an important part of the investment process, and Ainsworth provides a good example of just one of the ways an idea might come to our attention. It was through our investment in Builders FirstSource (NASDAQ:BLDR) that we were exposed, and subsequently attracted, to its suppliers. We believed that lumber/engineered wood products would provide fertile ground for investment opportunities and our study of the industry led us to the small, overlooked, recently recapitalized company known formerly as Ainsworth Lumber. Given our focus on uncovering value that we think is being overlooked by the market, it is not surprising that we often find ourselves fishing in the same pond as private equity or other opportunistic investors. We still see a long runway for growth within Louisiana-Pacific and intend to receive and hold shares of LPX as compensation for our investment in Ainsworth.

Subsea 7

Subsea 7 (OB:SUBC), which continues to be the largest single position in the value equity composite, has experienced some significant market price swings this year. Last quarter we discussed our view that a write-down related to the Guara-Lula project in Brazil was project specific and not systemic. The market seems to have come around to our way of thinking and we have seen SUBC appreciate over 16.5% this quarter. As the market moves beyond this one-time event, we should begin to see more realization of the company's true potential. I would refer those interested to our previous letters where I expound on Subsea 7 in greater detail. We continue to believe the company maintains an advantageous position within an oligopolistic industry. Through this quarter I have had the opportunity to spend a fair amount of time with some of its executive management and a number of its competitors, and continue to be impressed with the direction both the company and the industry are headed.

Position Changes

We tend to have low turnover in our portfolio due to our predisposition for the long-term, and that continues to be the case. As discussed above, we sold a portion of our position in Skechers due to significant appreciation, and started a new position in Ainsworth Lumber. We continued to sell down our interest in PriceSmart (NASDAQ:PSMT) and Drew Industries (NYSE:DW). PriceSmart owns and operates 30 membership warehouse clubs in Central America and the Caribbean. It was founded in 1994 by Sol Price, a warehouse store pioneer. We entered into the company roughly ten years ago, believing that the company operated in a niche business with little competition. The last ten years proved us right, albeit with some rocky times along the way, and it has reached a valuation that we think dictates harvesting. As

such we have been selling off our substantial investment over the last year whenever the market gives us a good selling opportunity. PriceSmart is certainly an investment that proves right Warren Buffet's lumpy 15% versus smooth 12% return adage – though over the 10 years we have held it we have seen a lumpy 1,200% return.[4]

Thank You

It is often said that if you love what you do, then you never work a day in your life. I can say that that is the case for me and the team at Robotti. Finding value in companies is exciting and enjoyable, especially with investors such as yourself that provide patience and confidence in us and our process.

All the Best,

Robert E. Robotti

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[4] On September 30th, 2003 the price was $6.50/share, and on September 30th 2013 the price was $95.23/share for an aggregate return of 1,365%; over the same period the S&P 500 returned 68.84%, and the Russell 2000 returned 120.2%. All data taken from Bloomberg. While we have owned PSMT during this entire period, we have bought and sold both before and during this period, as such our return may not be the same as stated here.

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