ROBOTTI & COMPANY
ADVISORS, LLC

Investment Securities

6 East 43rd Street
New York, NY 10017
(212) 986-4800
Fax: (212) 986-0816

September 30, 2014

Dear Client,

To thrive as a value investor, you have to risk being called a dummy from time to time.
-Christopher Browne, Tweedy, Browne

Performance Overview

Value Equity Composite[1], Net		**Benchmark[2]**
Quarter 3, 2014	-13.43%	-6.40%
Year to Date	-9.30%	0.96%
RVE Annualized Performance as of 9/30/2014		
3 Year	13.08%	22.82%
5 Year	9.41%	15.29%
10 Year	9.16%	8.66%
20 Year	10.97%	9.26%

I recently found myself in front of a television that was tuned to a major business network. As I sat and watched, my stress level zoomed past a point I rarely experience, even living and working in the center of the busiest metropolitan city in the world. Many investors willingly expose themselves to a constant barrage of the airwaves, or so I am told by our traders, who have never been able to convince me of the need for a TV in the office. It doesn't stop; like a machine gun firing bullet points of news, one after another, with no time to sit and think. How can this be good for your wealth, not to mention your health?

More recently, I noticed an ad for an online broker in the September issue of *The Atlantic* magazine. The ad displays a picture of an investor using an iPad and the caption reads "*I watch for the perfect moment. The one that no one else sees.*" For commissions of just $7.99 per trade, this surfer is entitled to software that will allow him to find the most profitable trades - before everyone else? Investors sit glued to the news, believing that they can profitably capitalize on each new bit of information – *before everyone else*. How can this be? Clearly, if one hopes to outperform the market they must do something different than the market.

[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.

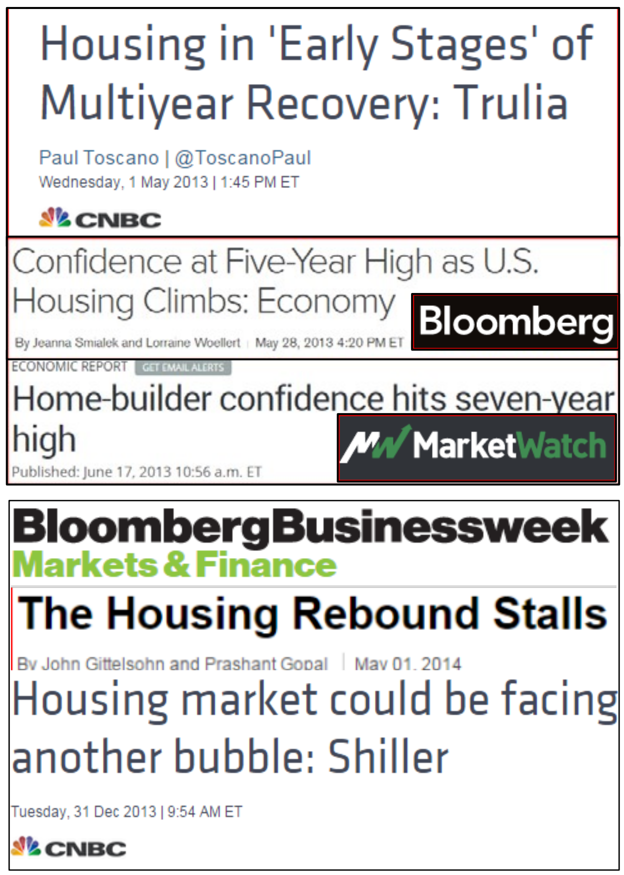
[2] Inception through August 2011, benchmark was the Russell 2000 Index. September 2011 to present, benchmark is the Russell 2500 Value Index.

But turn on the television or open up your browser and it doesn't seem so clear at all. Viewers are led to believe that all they need is a brokerage account and a dream. The media creates a sense of urgency that keeps investors tied to the news, in fear of missing out on the next big trade. Viewers are bombarded with screams of "buy-buy-buy" or "sell-sell-sell" and the market, in turn, rises and falls in reaction to each new piece of information.

Are You Mr. Market's Master (or vice-versa)?

The word "volatility" has taken on a negative connotation for investors. Conventional investment dogma states that more volatility means more risk, and we all know that risk is bad. In tune with our contrarian nature, we disagree with this assertion. The preoccupation with short-term news can sometimes have an outsized and disproportionate effect on stock prices, creating opportunities for investors who are able to tune-out the noise and focus on the long term.

When stock prices fall sharply, we often find opportunity - *so long as our conviction in our long-term view remains solid*. Opportunity is exactly what we see today in a number of our portfolio investments. For example, this holds particularly true for our housing-related investments, including Ainsworth Lumber, Norbord, Gibraltar Industries, Cavco Industries and UMH Properties. Builders FirstSource provides us with a timely example to illustrate what we mean.


Housing in 'Early Stages' of Multiyear Recovery: Trulia
Paul Toscano | @ToscanoPaul
Wednesday, 1 May 2013 | 1:45 PM ET
CNBC

Confidence at Five-Year High as U.S. Housing Climbs: Economy
By Jeanna Smialek and Lorraine Woellert | May 28, 2013 4:20 PM ET
Bloomberg

ECONOMIC REPORT GET EMAIL ALERTS
Home-builder confidence hits seven-year high
Published: June 17, 2013 10:56 a.m. ET
MarketWatch

BloombergBusinessweek
Markets & Finance
The Housing Rebound Stalls
By John Gittelsohn and Prashant Gopal | May 01, 2014

Housing market could be facing another bubble: Shiller
Tuesday, 31 Dec 2013 | 9:54 AM ET
CNBC

For the better part of 2013, investors were feeling confident about a recovery in the domestic housing markets. News headlines echoed this optimism and by November 2013, single-family housing starts reached an annualized pace of 710,000, the highest level since March 2008.

But the recovery did not continue on a straight path up. Economies rarely progress in a linear fashion – a fact that does not sit well with many academic theories and formulas. Single-family housing starts dropped 4.9% in December and another 13.6% in January, falling to an annualized level of 583,000 units and rattling investor confidence[3].

In early 2014, shares of Builders FirstSource hit a 52-week-high of $9.40. By the end of September, less than six months later, Builders FirstSource's stock dropped 45% marking a 52-week low of $5.10[4]. A prescient headline from CNBC.com on

[3] Federal Reserve Bank of St. Louis
[4] Capital IQ

September 22 read "Investors Leaving Housing High and Dry." Clearly, investors are running for the exits. The obvious question is: Should we be running along with everyone else?

Price is What You Pay, Value Is What You Get

Let's take a step back for a moment and reframe the question, putting aside the very important, but more difficult problem of determining Builders FirstSource's true economic worth.

On April 4, 2014, Builders FirstSource had 97.6 million diluted shares outstanding and $290 million of net-debt (long-term debt *minus* cash)[5]. In other words, if you happened to have an extra few billion dollars lying around, you could have bought the entire business for $1.2 billion (share price *multiplied by* shares outstanding *plus* net debt).

Just six months later, on September 29th, Builders FirstSource had 100.8 million diluted shares outstanding and $319 million of net-debt. Now, even if you didn't have a few extra billion handy, you could buy the same business for just $830 million[6]. Between April and September earnings had *improved* and the company made three acquisitions *adding $43 million of revenue*[7]. Yet the price one had to pay to buy the entire business fell by 31%!

Without knowing what the right price is – does it seem rational for the true economic worth of this entire business to have fluctuated >30% in less than six months? Of course, without knowing the true value of the business, this realization would be worthless. If the true value of Builders FirstSource is less than $830 million then the stock price just went from very expensive to just expensive.

Let's investigate further.

Where Are We?

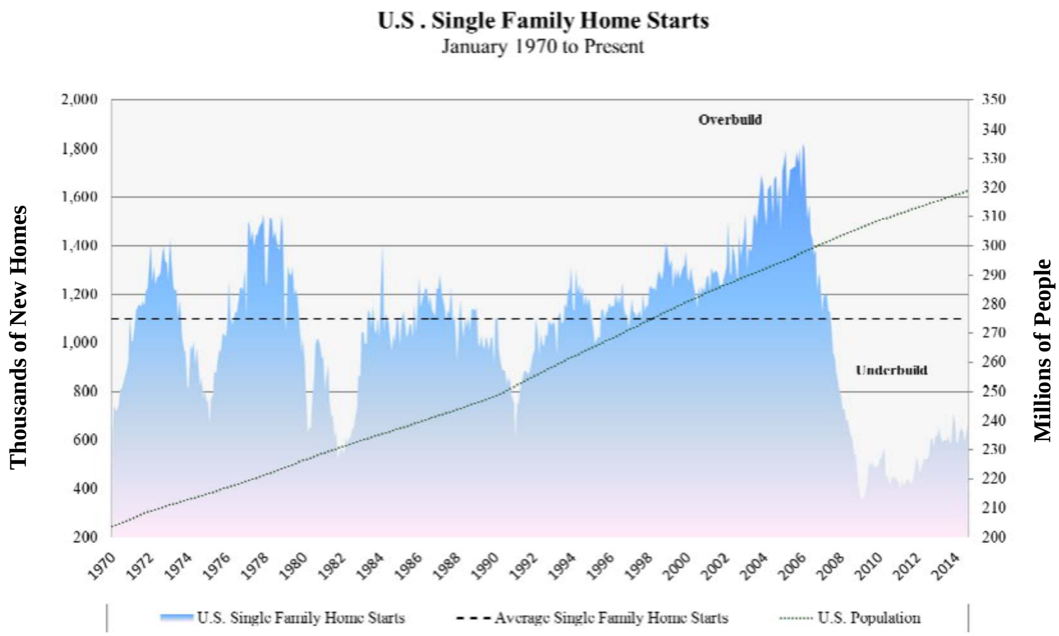
Over 30 years of investing, my team and I have observed that when forecasters agree on the same outcome, that outcome is often the least likely to occur! As the number of single-family housing starts slowly improved throughout 2012 and into 2013, the consensus view assumed that we had entered "rebound mode." But when new home starts began to struggle as we entered 2014, the consensus view reversed. We often find that consensus opinions end up as an "all or nothing" proposition.

Looking back, the total number of new home starts in the U.S. peaked at an annualized rate of 2.3 million in January 2006 before diving 80% to a low of 478,000 in April 2009. Single-family home starts, which peaked at 1.8 million in November 2005, cratered to 353,000 in March 2009[8]. This is a story that was a long time in the making. The normal economic cycle of the housing industry was amplified by the Federal Reserve's ultra-low interest rate policy, reckless subprime lending, complicated financial instruments such as mortgage backed securities, CDOs, CDO squared, and a host of other variables that led to the collapse of two major investment banks and turned into the worst recession in over 80 years.

[5] Builders FirstSource Q1 2014 Form 10-Q
[6] Builders FirstSource Q2 2014 Form 10-Q
[7] Builders FirstSource Q2 2014 Conference Call
[8] Federal Reserve Bank of St. Louis

Let's consider the longer-term trends as illustrated in the chart below. Since 1970, the annual number of single-family home starts in the United States has averaged 1.05 million units. Over that same period, the population has grown by 115 million people or 56%[9]. Between 1980 and October 2010 (the last official measure) the U.S. added 36.8 million households reaching 117.8 million, an increase of 46%[10].

How many single-family homes will be built this month? This year? These are questions we cannot answer. However, after analyzing the long-term trends, we are comfortable assuming that at present, we are closer to the lows of the normal housing cycle than we are from the highs. Furthermore, within the context of these long-term trends, we believe the normalized level of single-family home starts is more likely to be higher than the 30-year average of 1.05 million.



Source: Federal Reserve Bank of St. Louis, Robotti & Company Advisors Estimates

What's It Worth?

The U.S. housing market has just emerged from the most difficult period in its history. During that time the industry went through a cathartic process, one that often takes place during the trough of an economic cycle. Consolidation began, companies were recapitalized, capital structures were improved, unprofitable assets were shed, and costs were removed. Furthermore, the recovery is still in an early stage. In the pro dealer segment of the building distribution industry the top five competitors (ProBuild Holdings, 84 Lumber, Builders FirstSource, BMC, and Stock Building Supply) have emerged with a 25% share[11] of a

[9] Federal Reserve Bank of St. Louis
[10] United States Census Bureau
[11] Builders FirstSource Second Quarter 2014 Presentation

$169 billion single-family residential home construction market[12]. A long runway of consolidation should help boost revenue growth beyond the level expected from an inevitable industry rebound.

The primary driver of Builders FirstSource's revenue is single-family home starts. As of the August release, the annualized number of U.S. single-family home starts was 643,000[13]. Given our assumption that the normal level of single-family home starts is greater than 1.05 million, we believe that there is *at least 60% upside* from the current level. Just keeping pace translates into approximately 60% more revenue than Builders FirstSource currently generates.

In 2013, Builders FirstSource generated $2,399 of revenue per single-family home start. This number has increased every year since 2009 when it generated $1,534 per single-family home start. Given the likelihood of further consolidation, we believe this number will continue to increase over the long-term.

FYE 12/31	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	TTM
U.S SFH Starts	**1,505**	**1,604**	**1,719**	**1,474**	**1,036**	**616**	**442**	**471**	**434**	**537**	**621**	**656**
% growth	*10.4%*	*6.6%*	*7.2%*	*(14.3%)*	*(29.7%)*	*(40.5%)*	*(28.2%)*	*6.6%*	*(7.9%)*	*23.7%*	*15.6%*	*5.6%*
Revenue / SFH	**$1,113**	**$1,283**	**$1,360**	**$1,463**	**$1,417**	**$1,610**	**$1,534**	**$1,487**	**$1,795**	**$1,994**	**$2,399**	**$2,354**
% growth	*1.1%*	*15.3%*	*6.0%*	*7.6%*	*(3.1%)*	*13.6%*	*(4.8%)*	*(3.0%)*	*20.7%*	*11.1%*	*20.3%*	*(1.9%)*

Source: Builders FirstSource Annual Report, Federal Reserve Bank of St. Louis, Robotti & Company Advisors Estimates

Just assuming that the normal level of single-family home starts is 1.05 million (a conservative assumption in our opinion), Builders FirstSource should generate $2.5 billion of revenue. Adjusted EBITDA[14] margin was 4.1% in 2013 and 4.4% over the past twelve months. We think a very conservative estimate of a normal EBITDA margin is 6%. That comes out to a low-case, normalized, pre- tax earning power of approximately $1.05 per share or 4.7x the stock's closing price of $4.92 on October 10th, especially modest for a non-capital intensive distribution business.

Conclusion

Price fluctuations have only one significant meaning for the true investor. They provide him with an opportunity to buy wisely when prices fall sharply and to sell wisely when they advance a great deal. At other times he will do better if he forgets about the stock market and pays attention to... the operating results of his companies.

Benjamin Graham, The Intelligent Investor

So as you now see, a dramatic move in the price of a stock combined with our conviction as to where we are within the normal housing cycle provides us with a compelling investment opportunity; one we can take advantage of, as long as we are not influenced by the short-term manic moods of Mr. Market.

Of course, we have not revealed a precise estimate of the true economic worth of Builders FirstSource. By doing so, we hope to give you further insight into our way of thinking. The concept of *margin of safety* is fundamental to our investment philosophy and we only invest when the room for error is wide. When the difference between price and value is so wide, precision is not a prerequisite for investment. Lest you think otherwise, we have spent a great deal of time analyzing the value of Builders FirstSource and welcome your call if you would like to discuss further.

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[12] 2013 National Association of Homebuilders
[13] Federal Reserve Bank of St. Louis
[14] Earnings before interest, taxes, depreciation and amortization

There are many who believe that value investing makes so much common sense that it must also be easy. Times like these prove why this is not true. While others "wait on the sidelines" for the "future to become more certain," we ask – which future? If your definition of the future is 3 to 6 months, our response is that the future is never certain. If your definition of the future is 3 to 5 years, our response is that we are just as certain as we were 6 months ago. Time horizon arbitrage, the opportunity created by having a different time horizon than a majority of the market, has frequently been the source of a profitable competitive advantage. Cal-Maine Foods and Skechers, both of which were sold since the quarter end, represent just two of the recent examples where our focus on the long-term value of a business has paid off. (*For a detailed account of our investment in Skechers, please see Robotti & Company Advisors Third Quarter 2013 Letter.*) We continue to take advantage of Mr. Market's manic mood swings and refuse to let his moods drive our view of value.

In September we hired Sean Flynn as Managing Director to lead the marketing efforts for Robotti & Company Advisors, LLC. Sean was most recently the Head of Marketing at Loeb King Capital and has 14 years of experience in the asset management industry. We welcome Sean to the team and hope you will get to know him in the coming months. 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. As always, if you have any questions or concerns, feel free to contact us anytime.

Most Sincerely,

Bob Robotti
Chief Executive Officer &
Chief Investment Officer

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