SOUTHPAW CAPITAL

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April 10th, 2012

Dear Partners,

In the first quarter of 2012 the equity markets offered a welcome reprieve from motion sickness inducing ups and downs, as the S&P 500's total return was 12.6% with hardly an adverse movement. The Fund fared slightly better on a net basis (after management fee, performance fee accrual, commissions, administrative and start-up re-imbursement cost). Southpaw Value Fund, LP ("Southpaw," the "Fund") returned 17.57% net of fees and expenses in the first quarter of 2012, as compared to 3.14% for the HFRX Global Hedge Fund Index.

Southpaw Value Fund, LP

ESTIMATED NET MONTHLY PERFORMANCE | 2012

PERIOD	SVF	SVF (Gross)	HFRX	S&P 500
JANUARY	7.04%	8.88%	1.72%	4.48%
FEBRUARY	5.72%	7.11%	1.42%	4.32%
MARCH	3.90%	4.80%	-0.02%	3.29%
1st QUARTER	17.57%	22.23%	3.14%	12.59%
APRIL				
MAY				
JUNE				
2nd QUARTER	0.00%	0.00%	0.00%	0.00%
JULY				
AUGUST				
SEPTEMBER				
3rd QUARTER	0.00%	0.00%	0.00%	0.00%
OCTOBER				
NOVEMBER				
DECEMBER				
4th QUARTER	0.00%	0.00%	0.00%	0.00%
YEAR TO DATE	17.57%	22.23%	3.14%	12.59%

There exist a relatively unknown term that sailors and scuba divers use called slack water that describes when the tide is neither coming nor going...but is almost entirely calm. It usually occurs after low tide, while the water is rising. Scuba divers often plan a dive at the time of slack water, as the absence of powerful tidal flows means that less effort is required to swim, and there is less likelihood of meandering away from where they want to be. For any boat, a benign current will improve the vessel's velocity and challenging channels become easier to navigate. The duration of a slack tide is inversely related to the starting height of the tide. It is a seemingly surreal and sublime moment…almost as if suspended in time…the main downside being that is does not last longer.

The market's and Fund's recent risk adjusted performance are without the slightest doubt a "slack tide" moment—a moment with low volatility when a rising tide lifted most boats. This near perfect tranquility (at least in terms of returns—negative/mixed news continued unabated) likely won't be sustained for too long, but it was nice to enjoy in the moment. The fodder for this slack tide has been the combination of coming off of a depressed valuation base along with dour sentiment, and the length of calmness has also been inversely proportional to the low starting height of the tide-or market level reached after last summer's sell-off. The S&P 500 has been buoyed by modest multiple expansion since September, going from 12.0x earnings on a trailing basis, to 14.6x. Being overweight cyclical companies and thus positioned offensively has helped the Fund recently, although our short book has also been profitable even in the face of this historic rally. This is also unlikely to continue.

There are many misconceptions about hedge fund performance. It is quite simple to measure performance, but more difficult to assess the underlying risks. As a result it is easy to highlight performance comparisons between hedge funds and certain indices. To some, if the S&P 500 is up 20% and hedge funds are up only 15% then hedge funds have not earned their keep and investors have wasted money on high fees. In the past quarter Southpaw had on average less than 90% total gross exposure (never exceeding 100%, in other words used zero portfolio leverage), and 75% net exposure, had profitable long and short books with minimal-to-no active trading and below average concentration. At the security level, we also feel our holdings may be characterized as less risky than the overall market due to lower valuations, low net leverage or in many cases large net cash positions, as well as dividends and healthy buybacks in place, in some cases. It is also quite easy to make these claims when the market is playing along nicely and is going up a little bit each day; we restlessly await a rude reversal as a true test.

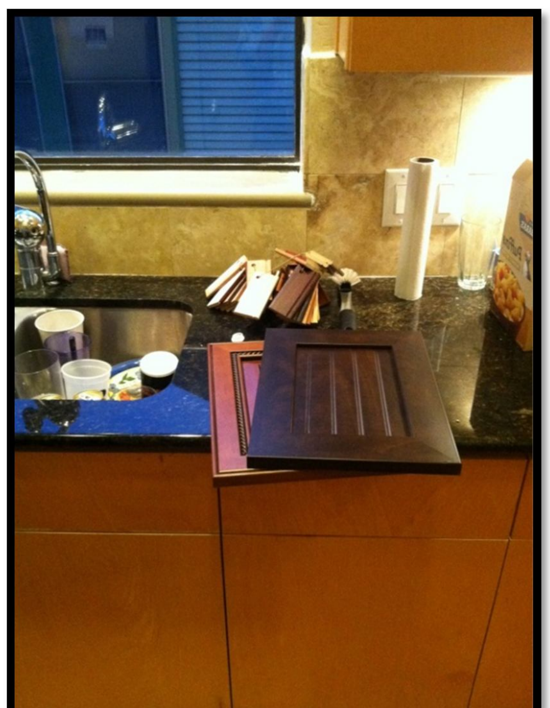
We fully expect and welcome the cross-currents and choppier waters to resume at any time. One may be thinking, "be careful what you wish for" as surely a tempest or squall could be on the horizon. That is highly likely to be true and that volatility would create more opportunities. Investment opportunities are important, but it will be consistently applied exertion and relentless fact finding on our part that will be indispensable in order to act with conviction as those opportunities arise.

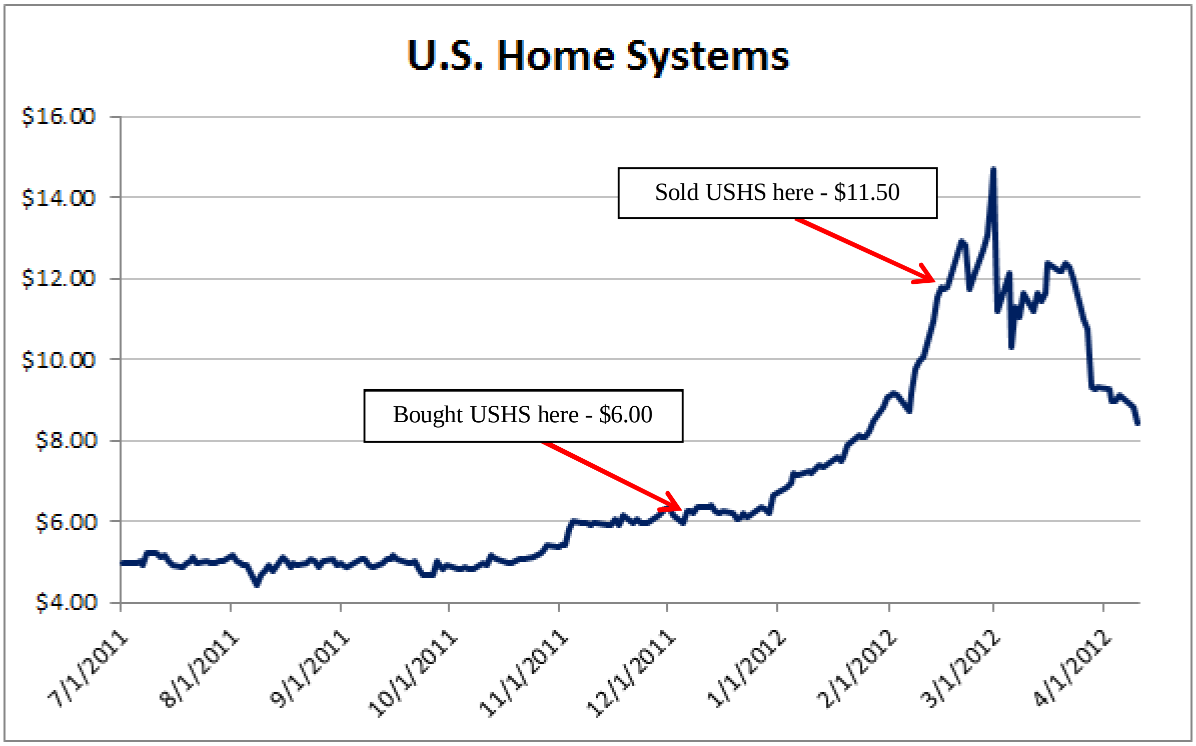
Given the intellectual rigor in the field of finance, it's tough to come up with ideas that are truly original. This is why we insist on fishing alone for out of favor, under-followed companies. Most other Wall Street fishermen cruise to the same locations to harvest the same schools of surface fish. Over time, not many of these fishermen do any better than the others—they just deplete their mutual resources. Meanwhile, since we are in the equivalent of a catboat the realm of possible fishing spots for us is much broader so we aim to sail into abandoned harbors and reel in the big ones in solitude. Fortunate enough to possess a sticky capital base, we are much more willing to take perceived liquidity risk, that is micro-cap stocks that have low average daily trading volume, if we think we are getting superior businesses at great prices.

As emphasized in the last quarterly update, an outsized proportion of the Fund's assets are in North American-centric auto parts suppliers and this remains the case. This has been an area of overall gains so far, yet a few positions are still around our cost basis and the positive fundamentals continue to build, so we remain steadfast in our auto exposures.

Seeing as how we like to emphasize scuttlebutt research now seems an opportune time to point out the phrase's nautical origins. Scuttlebutt originated as a slang word for rumor or gossip exchanged around the water cask of a ship. The term as it applies to investment research was popularized by guru Phillip Fisher, father of market guru and southpaw billionaire Ken Fisher. Although we do not make investment decisions on rumor or gossip, scuttlebutt can be a valuable way to add to our mosaic of information--including the use of products (where possible), touring of facilities, speaking with competitors and customers, interviewing employees and management, etc.

We have only exited three longs entirely so far in the Fund. One was a merger arbitrage trade in Q4 2011, one was an unforeseen buyout (~30% return in a month), and the last one was U.S. Home Systems (USHS). USHS has a strategic relationship with Home Depot to do cabinet re-facing. We came across this company at a conference in Dallas in early November. We were intrigued by the valuation and proceeded to read their public filings, listened to the conference calls, got a comfortable grasp of the financials, so we were well prepared for a meeting with the CFO. Before the meeting with management we had cruised to a few Home Depots to talk to the in-store sales reps and pick their brains. After the meeting, in order to gain more insight we engaged the company to do an in-house demo on cabinet re-facing in George's home (see pictures), where we grilled another veteran salesman for two hours. Like most big ticket purchase items, we felt home renovation still had a large pent-up demand carried over from the Great Recession, although USHS had experienced record revenues in the last two years. At our purchase price of $6.00, the shares were available for a ~10% earnings yield and a ~20% free cash flow yield, along with zero debt and 27% of the market cap in cash. We gained comfort with the company's value proposition to customers and felt the market underappreciated the numerous potential growth initiatives from increasing bathroom remodels, expanding the independent contractor network, new marketing campaign, new product offerings and categories. We felt USHS represented one of the cheapest housing related names available in the market at the time. It turns out that building materials were among the top five performing industries in Q1. We exited the position just 75 days later for a 91.67% gain (> 440% annualized return) as the shares priced in some of the increasing positives. Although we left some money on the table as the price went parabolic, it appears that with a recent earnings disappointment and market weakness, it is quite possible that we will get the chance to buy the shares back near our original purchase price again.





A recurring theme of our small but expanding short book is the current construction slowdown in China. One position we are shorting (where scuttlebutt was not necessary, nor feasible) to express a bearish view is the Aluminum Corp of China (ACH). ACH is a vertically integrated aluminum producer. For ACH we initiated the position for many reasons, including because we predict materially lower profits than consensus expectations on lower aluminum prices, higher electricity cost, falling production volumes, increased interest expense, and another wave of increasingly negative sentiment from the realities of the China slowdown. ACH also acts as a natural hedge to our auto exposure, as aluminum is a large input into auto production. It appeared to us that the equity was baking in materially higher aluminum prices for the foreseeable future, when we found the prospects for a sustained increase much less likely. The unavoidable structural shift in the Chinese economy will make for a continued rough patch for hard commodities producers.

The following characteristics also have made ACH an attractive short candidate:

- Total Debt/EBITDA of 5.8x; over-leveraged balance sheet and hyper-sensitivity to increasing cost of debt capital
- Net Debt/(EBITDA – maintenance CapEx) of 60x; indicative of high and increasing maintenance capex
- 40% of aluminum's end markets are construction related
- Price-to-earnings ratio of 35x
- EV/EBITDA at 12.5x at the time of trade initiation, very high for a cyclical and capital intensive business; high on relative and absolute scales

- Aluminum inventory in China at an all-time high; aluminum is more exposed to construction than copper
- Meaningful cost inflation in terms of labor and the Chinese government allowing electricity costs to rise, squeezing already razor thin margins
- Negative operating profit in each of the last three years
- Return on equity of less than 3%;which is indicative of destroying economic value for shareholders
- Management has proven to be poor stewards of capital; They acquired five fabricating plants in 2008 and invested in additional capacity in both 2009 and 2010. This aluminum product fabrication segment has not yet made a profit
- In China in 2011 total housing floor space completed was nearly twice the figure of sales; Starts must drop below sales in order to avoid adding to existing inventory gluts (see chart below)
- For construction starts to be flat in 2012 versus 2011, they would need to rise 75% from the December 2011 run-rate
- Many Tier-1 cities have in excess of 20 months of existing housing inventory (source: The China Times); A healthy or average amount of inventory in the U.S. is considered to be 6-7 months
- No clear strategy; ACH expanding outside of aluminum into other commodities we have a negative view of including iron ore, rare earth elements, and coal

The graph below depicts the total residential floor space under construction in China, versus sales, including and excluding the government's mandatory economic housing projects that began in 2009.

Source: Credit Suisse Hong Kong Ltd.

The Fund remains…how shall I say this…utterly unrestrained by our marketing prowess. This freedom, while allowing us to venture into the nooks and crannies of the marketplace with hardly a trace, has left us in a severely sub-optimal position due to our fixed costs being high as a percentage of assets. Hopefully this condition is ameliorated hastily through both organic growth and new capital contributions, so existing investors (and future ones) can amortize these fixed expenses over a larger asset base that could easily and immediately improve annualized returns by upwards of two percent. We do appreciate and will continue to very much appreciate introductions to potential partners.

It is not a challenge for me to personally associate and empathize with the monomaniacal Captain Ahab in Moby Dick, though instead of a vengeful hunt for a white whale, I am foredoomed with a purely cerebral preoccupation (and though perhaps as equally challenging, not nearly as physically risky) with finding only one thing: the elusive--but not mythical--creature known as Alpha. Diverting precious time away from this pursuit to take care of life's necessary but mundane tasks is often viewed as an unfortunate inconvenience.

We remain focused on superior security selection. Since I've already sailed way past overboard with the nautical metaphors, allow me to anchor with a few more: For now we aim to crank up the vigilance, try to stay the course, do our best to stay on an even keel and sail close to shore. Most importantly, over the next several quarters we want to adhere to Rule #1 (don't lose money) and avoid discussing rip-tides and capsizing.

Please contact us if we can be of assistance to you in any way. Thank you for the opportunity to invest a portion of your hard earned capital.

Sincerely,

Southpaw Capital, LLC

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The S&P 500 Index™ is an unmanaged index and a market-capitalization-weighted index of 500 stocks designed to be a broad measure of United States stock market.

The HFRX Global Hedge Fund Index is designed to be representative of the overall composition of the hedge fund universe.

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