VOSS
CAPITAL

2365 Rice Blvd Suite #217 | Houston, TX | 77005 |713-328-1126 | t@vosscap.com

April 26th, 2014

Dear Partners,

The Voss Value Fund delivered 4.68% returns in Q1 2014 net of all fees and expenses. Correlation (r^2) to the S&P 500 during the quarter was 0.01. The annualized alpha during the quarter was 26.9%. Annualized alpha since inception is 18.8% through the end of Q1 2014. The Fund's Sharpe Ratio during the quarter was 2.5 and checks in at 2.1 since inception. The Fund's gross exposure averaged 153.1% and ended at 139.9%. The Fund's net long exposure averaged 52.8% and ended at 50.4%. The net exposure averaged 1.9% over the quarter when considered on a beta-adjusted basis. Our top ten long positions currently constitute only ~45% of the portfolio as our concentration remains limited.

Voss Value Fund, LP

ESTIMATED NET MONTHLY PERFORMANCE | 2014

PERIOD	VVF (Net)	VVF (Gross)	S&P 500 TR
JANUARY	-1.24%	-1.15%	-3.46%
FEBRUARY	-0.16%	-0.08%	4.57%
MARCH	6.16%	7.43%	0.84%
1st QUARTER	**4.68%**	**6.11%**	**1.81%**
APRIL			
MAY			
JUNE			
2nd QUARTER	0.00%	0.00%	0.00%
JULY			
AUGUST			
SEPTEMBER			
3rd QUARTER	0.00%	0.00%	0.00%
OCTOBER			
NOVEMBER			
DECEMBER			
4th QUARTER	0.00%	0.00%	0.00%
YEAR TO DATE	**4.68%**	**6.11%**	**1.81%**

All YTD performance figures are unaudited, estimated, and may be subject to subsequent adjustment. A limited partner's actual returns may vary from published fund returns based on the timing of capital and fee arrangements. This statement represents information based on the policies of the fund's managers and general partner. Please contact Travis Cocke, Managing Partner of Voss Capital, LLC, with any inquiries.

Q1 Review

In Q1 you certainly did not have to crane your neck nor squint your eyes to catch a sufficient glimpse of the thinly veiled schizophrenia that's woven deep into every fiber of the market's true being. The market's growing and increasingly optimistic Momentum entourage could not help but feel invincible earlier this year as their gang continued parading and merrily frolicking in an uninhibited fashion around financial districts worldwide. They were not the least bit discouraged by passing signs of trouble and the countless unacquainted new members that were swiftly swarming the streets. But alas, a blast of hot air was finally let out of these high-flying, unprofitable, perceived secular revenue growers, which brought about plenty of convulsions and contortions within the universally adored pre-commercial biotech sector. Usually biotech's intangible basis for valuation leaves much uncertainty in the minds of speculators and conviction lacking among the generalist shareholder base, leading to precisely the types of sharp sell-offs we just went through. Luckily for us, some within the entourage are not throwing in the towel just yet and there are still plenty of opportunities to bet against the herd.

In a generous biotech financing market, there were 43 public Biotech follow-on equity offerings completed in Q1, to go along with 23 IPOs, for a total of nearly $6 billion in fresh equity raised.[1] The net new supply of healthcare related equity in Q1 2014 was record-setting and overwhelming even for the mightiest of positive fund flows, of which there was $700mm in positive biotech ETF fund flows in Q1[2]. We know the lights will eventually go off for many of our remaining biotech shorts, but the process has been analogous to turning off a certain kind of twist-knob lamp that everyone has experienced at one point or another. You think you're about to switch it out and, click...it gets brighter ...one more click, brighter still...and then finally, lights out. Just as it is "darkest before the dawn," in investing it could be said it is brightest before the collapse. This precise idea was also evidenced in the past quarter by a few unwarranted (unwarranted most certainly in hindsight, and only slightly less so in distressing real time) 20% one-day gap up parabolic blow-offs in the high-fliers that defined the peak moment of pain for short-sellers, ourselves very much included.

Ironically, even in the late January sell off, it felt like a risk-on environment to us as the sell-off was used to shift even more exposure into momentum names. February was a continuation and was quite painful for us on a relative basis as it was undoubtedly a "Party on, Wayne/Party on, Garth" market. March was a mirror image of February, characterized by "out with the new and in with the old." To give you some sense of this, our shorts detracted 4.7% in February and then reversed course and added 7.8% in March, providing over 100% of the +7.4% gross returns for the month.

If you walk everyday on a cobblestone street or dirt path versus purely on smooth pavement your balance is better as you are used to adapting to uneven surfaces. No one goes to a spin class (cycling) expecting the instructor to say "okay, pick a pace and stay steady" or "we'll do a steady hill climb, with no variation in resistance." Such a program would be quite boring and leads to complacency and is certainly not ideal for building long term strength. It is best to have wild variation in a sprint/walk or flat/hilly combo. The same can be said for markets. The slow steady melt-up leads to complacency and is not as healthy. Overall we've entered a choppier environment that feels healthier and is highly conducive to capturing the much desired alpha for our Partners.

A Tale of Two Markets

In listening to some respected money managers, say the legendary WEB or Seth Klarman for example, you would think the two are living in alternate realities from one another. Buffett: "Humans will behave in crazy ways in the next 50 years…very unlikely they do it in the next few years."[3] Klarman: "…here we are again, mired in a euphoric environment in which some securities have risen in price beyond all reason, where leverage is returning to rainy markets and asset classes, and where caution seems radical."[4] The reason for such a large discrepancy between their views is likely what they're focused on and something we have discussed ad nauseum in these quarterly updates. If one just looks at the mega cap stocks and the broader S&P 500 P/E ratio, one gets zero sense of the true nature of the broader market valuations and rampant speculation that has been taking place. Just as now, if you simply look at the S&P 500 that at the time of this writing is within 1% of its all-time high, you get zero sense of the absolute carnage inflicted on certain pockets of the market. As a bull market ages and an economic cycle gets long in the tooth, larger and larger market capitalization companies should outperform their more diminutive counterparts as investors seek shelter within earnings stability and quality when their economic growth outlook becomes less clear. In the momentum led run-up, mega caps had under-performed drastically and have much lower earnings multiples (often for good reason). Since the middle of March, this leadership has violently reversed trend and given mega-cap stocks' disproportionate weighting within the broad market-cap weighted indices, they are skewing the indices higher now while the mix-shift of stock leadership has tilted heavily in their favor. From 1/1/2013 up until 3/4/2014, the Russell 2000 index had outperformed custom Mega Cap basket of US stocks (simply defined as market cap >$80 billion) by 14.3%. This is fairly dramatic outperformance over such a short time frame, and since March 4th, the Mega Cap basket has outperformed the Russell 2000 by 7.1%, so over half of the outperformance has been eliminated. This trend can continue a while longer as the relative forward multiples of each group continue to mean revert. Leading up to the finale of each last few bull markets, even outside of the Tech bubble (in which the 30 largest companies doubled the S&P's P/E Ratio), Mega Caps have generally experienced several points of forward multiple expansion and go from a relative discount to par or slight relative premium compared to the overall market as a bull market ages.

With no broader market pullback in quite a while, there are very few tremendous opportunities at any one time, but this does not mean they are not there. We view the current environment as very fruitful for those actually focused on value-oriented security selection and conducive to delivering consistent alpha.

<u>AVG Technologies (AVG) – Long Position</u>

One stock we are still particularly fond of is AVG Technologies (AVG). AVG hits on numerous criteria of stock characteristics that we openly covet:

- Superior high return on capital business model with recurring revenue and high free cash flow conversion
- Strong, consistent free cash flow generation with a high forward FCF yield (~14%)
- Unanimously disliked by both buy side and sell side (judging by short interest and ratings)
- Analyst blind spot, evidenced by a singular focus of commentary on one problem segment (Suffering from "Forest through the trees" syndrome)
- Some call options in place on the stock that could act as a catalyst and reverse the current sentiment
- Limited downside to valuation even under draconian model assumptions (asymmetry, skewed to the upside)

To be clear, while we're on the theme, we think of AVG as a Dickensian stock as it's a tale of two segments: "Good AVG" and "Bad AVG" (does combining them make AVG avg.?). The Bad AVG business is their revenue sharing arrangement with Google and Yahoo, whereby they provide searching users with a "safe search" toolbar (advanced security on a search so as not to go to malware-infested sites). Searches from that toolbar generate advertising dollars that are partially shared back to AVG. This business is problematic from a customer concentration perspective in that most revenue is derived and dependent upon Google, a dominant force not known for easy or compassionate negotiating. This concentration issue reared its ugly head in the fall of 2013 as Google forced companies like AVG to make the toolbar download an "opt in" vs. "opt out" proposal. Most users simply clicked through the screen and did not check "opt out" in the earlier version and hence their download rates are projected to be materially lower under an "opt in" scenario.

A second whammy for the search biz, which AVG calls their Platform segment, came when they announced the exit of the third party search distribution component. In this case they provide toolbars to 3rd party players, essentially adding another middle man to the process and taking a smaller cut. Google's "Opt In" changes apparently made the margins on this business untenable, with total Platform gross margins going down an astounding 2,200 basis points between March and September. Within six months, a business that was growing at 50% and was about 40% of total revenues at the end of 2012 was now forecast to decline by 40% in 2014, with very uncertain margins and a wide range of possible outcomes. Analysts were particularly laser focused on this issue, as evidenced from the following quotes pulled from their reports:

- "While valuation is now depressed, it's difficult to recommend buying the shares until we can gain confidence in Platform stabilization." –Cowen
- "We don't typically change our ratings on results because our fundamental thesis is still usually intact. However, in in this case we believe investors will logically assign very little value to the Platform business...investors looking for fallen angels might want to step in because we believe the existing subscription business is worth $15 alone."- JP Morgan

- "At 9x CY14 EPS, the stock is cheap, but investors likely remain wary given the increased uncertainty around the platform business."- Morgan Stanley

Thus the backdrop of negative sentiment, in which AVG has become one of the top ten most shorted software stocks (~15% short interest), with low and declining analyst ratings (4 holds, 1 buy currently), and one of the three cheapest based on EV/FCF (NTM) in the software universe, sandwiched on our screens between 3 Chinese ADRs and ManTech, a company with major revenue/EPS declines the last 3 years.

We decided to conservatively value Bad AVG at $0.00 (even though we think it's declining yet positive cash flow stream is worth something) and take a look at Good AVG. Good AVG is a top five anti-virus and PC maintenance software provider, competing with the likes of Symantec and McAfee. They are a bit innovative in the sense that they use a Freemium download model and do not partner up with PC OEMs or big box retailers like Best Buy. Sentiment on this segment is also understandably weak given the terrible growth rate in PC sales and their perceived secular decline. However, whereas PCs have been in negative growth the last few years and still are, AVG has achieved a 14% revenue CAGR from 2010-2013, including a major acceleration of growth in 2013 to 27%.

What is going on? Management has a hidden gem of an asset called PC TuneUp within their core anti-virus business, which we believe takes advantage of the elongated PC cycle by making PCs viable for longer. We believe this product has grown into a material piece of the overall subscription business, although management does not break out its performance separately. Additionally, management claims they have been doing a better job monetizing existing users, something we cannot confirm but the numbers do appear to bare out (rising ARPU and rising % of paying PC users), possibly by cross-selling between the anti-virus and PC TuneUp businesses.

So taking a step back: the Subscription business just showed accelerating revenue growth (27% Y/Y), management is guiding to ~20% growth in 2014 with ~90% gross margins and we believe between 40-50% FCF margin (this is the margins they achieved before entering the search business). Additionally, the revenue is subscription based, which makes it more predictable than a license/maintenance software model (as long as churn does not rise substantially) and generally results in a higher multiple.

There are many ways to skin the valuation cat on this one, but if you take management's low end of Subscription guidance for 2014 of $289 million and apply a 40% FCF margin to it ($119.5), and put on a 10x EV/FCF (which we believe is very low for this type of business), you get a target value of almost $1.2 billion, which would give the stock over 24% upside. That's 24% upside on the single business being conservative on all three levers.

We believe the Search business (Bad AVG) is admittedly hard to value now, but management did guide to a mid-point of $87 million in presumably higher quality revenue. One call option embedded in the stock is that the bearishness over this business subsides through "stabilization", or if AVG develops more relationships with Yahoo/Yandex (Russian search engine), and one could easily see this business being worth another $6-8 dollars per share, or an additional 32%+ upside.

The other call option, which is very early in monetization and more of a sentiment builder in our view, is their rapidly growing anti-virus mobile user base. In the 4th quarter, the company noted they had hit 68 million mobile users, which is a 164% growth rate Y/Y and 19% sequentially. We pondered what a business like this might IPO at if it went public today (based on analysts reverting back to the preposterous EV/User methodology to value deals like Facebook/WhatsApp) on its own. While the validity of that analysis is questionable, we like to have these types of growth driver catalysts on a tech company as they often (ironically) help realize the value of the others pieces of the company.

At their Analysts' day in March, the company announced AVG Zen, which is designed to let users link all of their devices to a common platform, e.g. go to AVG Zen to manage your PC and mobile security. While we ascribe zero value for the company for mobile now, it became clear that management is thinking carefully about how to mine such a large user base. They pointed out that they could cross-sell mobile users to buy PC security (for the ones who don't already have it). There is a large range of competitive industries whose goods and services prices are converging at their marginal cost of production/distribution at near zero. This is sure to create plenty of value traps, or evaporating profits within those market areas, and ironically this theme or idea has been concentrated in the high-flying unprofitable revenue growers, as they all attempt to dominate market share to be able to better control future pricing. In a worst case scenario, this is the route the mobile security goes for AVG and they are unable to monetize it.

In a more draconian bear valuation case, where the Search Business is worth $0, the call options are worth nada, and their core anti-virus business begins to link more to the PC cycle and go into structural decline, we still believe the company is worth $18, a mere 3% below the closing price on April 24th. On the other hand, we can very easily see the stock at $30 in a conservative base case, and if we see traction in one of the two call options, $35+ is within the realm of possibility. While we do not care for situations with ambiguous risks and downside, we are quite willing to take a position in which there is ambiguity of upside

Paranoia^2

We are constantly paranoid about how our brains may be undermining us and do our best to neutralize those self-imposed cognitive threats. We are also paranoid that we'll stop being paranoid. What do we think is true that is actually false? What can blind-side us now? We obviously can't be sure ahead of time, but believe that the portfolio is structured in such a way as to survive most environments and thrive in others, such as the sideways market of late. During this momentum stock sell-off, our highest conviction thematic concentration (short biotech) is playing out so now there are more gray areas for us within the market. Now is a time to be patient. As value investors we must wait and not only must we be good at it, but we must learn to love it. Waiting is not thought of as waiting in the literal sense, rather it is an integral part of a disciplined investment process. Although the pickings are currently slim by historical standards, we maintain an almost maniacal sense of urgency in ferreting out the drool-inducing bargains from the overpriced charlatans and meticulously blending these asymmetric return situations into a safe, absolute return oriented portfolio, while unapologetically suppressing and filtering the consumption of irrelevant information. It is still a good time to put fresh capital on and continue recycling into our top long and short ideas which remain near cost basis.

Thank you for your ongoing investment in the Fund. Please let us know if we can be of assistance to you in any way.

To continued alpha,

Voss Capital, LLC

1. Baird: Biotech Trend Watch report, dated April 4th, 2014
2: Source: Credit Suisse Research
3: Warren Buffett, quoted from CNBC Squawk on the Street appearance, March 14th.
4: Quote from Seth Klarman, Baupost Group Q1 2014 Letter to investors.

Disclosures and Notices

The information contained herein reflects the opinions and projections of Voss Capital, LLC ("Voss") as of the date of publication, which are subject to change without notice at any time subsequent to the date of issue. Southpaw does not represent that any opinion or projection will be realized. All information provided is for informational purposes only and should not be deemed as investment advice or a recommendation to purchase or sell any specific security. While the information presented herein is believed to be reliable, no representation or warranty is made concerning the accuracy of any data presented. This communication is confidential and may not be reproduced or distributed without prior written permission from Voss. This confidential report is only intended for the recipient and may not be redistributed without the prior written consent of Voss Capital, LLC. This report is provided for informational purposes only and does not constitute an offer or a solicitation to buy, hold, or sell an interest in any Voss Value Funds or any other security. An investment in any Voss Value Fund is speculative and involves substantial risks. Additional information regarding the Voss Value Funds listed herein, including fees, expenses and risks of investment, is contained in the offering memorandum and related documents, and should be carefully reviewed. An offer or solicitation of an investment in any Voss Value Funds will only be made pursuant to an offering memorandum. There can be no guarantee that any Voss Value Fund will achieve its investment objectives.
Past performance does not guarantee future results. There is a possibility for loss as well as the potential for profit when investing in the funds described herein. Performance of the Voss Value Fund is presented on both a net and gross basis. Performance information labeled (Net) is net of all fees and expenses and includes the reinvestment of dividends and other income. Performance information labeled as (Gross) does not reflect the deduction of fees. Gross numbers include the reinvestment of dividends and other income. Portfolio characteristics and other information are provided as of the dates set forth herein. Current or future characteristics and other information may vary significantly from those provided herein and the firm undertakes no obligation to notify the recipient of any such variances. Indexes are unmanaged and have no fees or expenses. An investment cannot be made directly in an index. The funds consist of securities which vary significantly from those in the benchmark indexes listed above and performance calculation methods may not be entirely comparable. Accordingly, comparing results shown to those of such indexes may be of limited use. 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. THIS SHALL NOT CONSTITUTE AND OFFER TO SELL OR THE SOLICITATION OF AN OFFER TO BUY ANY INTEREST IN ANY FUND MANAGED BY VOSS. SUCH AN OFFER TO SELL OR SOLICITATION OF AN OFFER TO BUY INTEREST MAY ONLY BE MADE PURSUANT TO DEFINITIVE SUBSCRIPTION DOCUMENTS BETWEEN A FUND AND AN INVESTOR.