VOSS CAPITAL

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

April 26th, 2015

Dear Partners,

The Voss Value Fund returned 5.13% net of fees for the first quarter of 2015. This compared to a 0.95% total return for the S&P 500. Gross exposure ended the quarter at 128.7%, with net exposure at 57%. On the quarter net exposure averaged 23.1% on a Beta-adjusted basis. Our top 10 long positions make up 61.5% of the portfolio. Our top 10 short positions make up 28.7% of gross exposure. Shorting contributed 2.2% during the quarter. The Value Fund's annualized return to Partners net of fees since inception stands at 20.7%. Returns since inception are shown in the appendix.

Voss Value Fund, LP

ESTIMATED NET MONTHLY PERFORMANCE | 2015

PERIOD	VVF (Net)	VVF (Gross)	S&P 500 TR
JANUARY	-1.21%	-1.13%	-3.00%
FEBRUARY	7.65%	9.34%	5.75%
MARCH	-1.15%	-1.34%	-1.58%
1st QUARTER	5.13%	6.66%	0.95%
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	5.13%	6.66%	0.95%

All 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 Member of Voss Capital, LLC, with any inquiries.

The Russell 2000 total return in Q1 was +4.3% versus +1.0% for the S&P 500. This is a relative return scenario that is generally favorable for our style and small cap orientation, but embedded within that benchmark performance the

sector contributions hurt us, with healthcare leading the other sectors by a wide margin at +6.2%. Specifically within Healthcare, Biotech was up another 22% on the quarter.

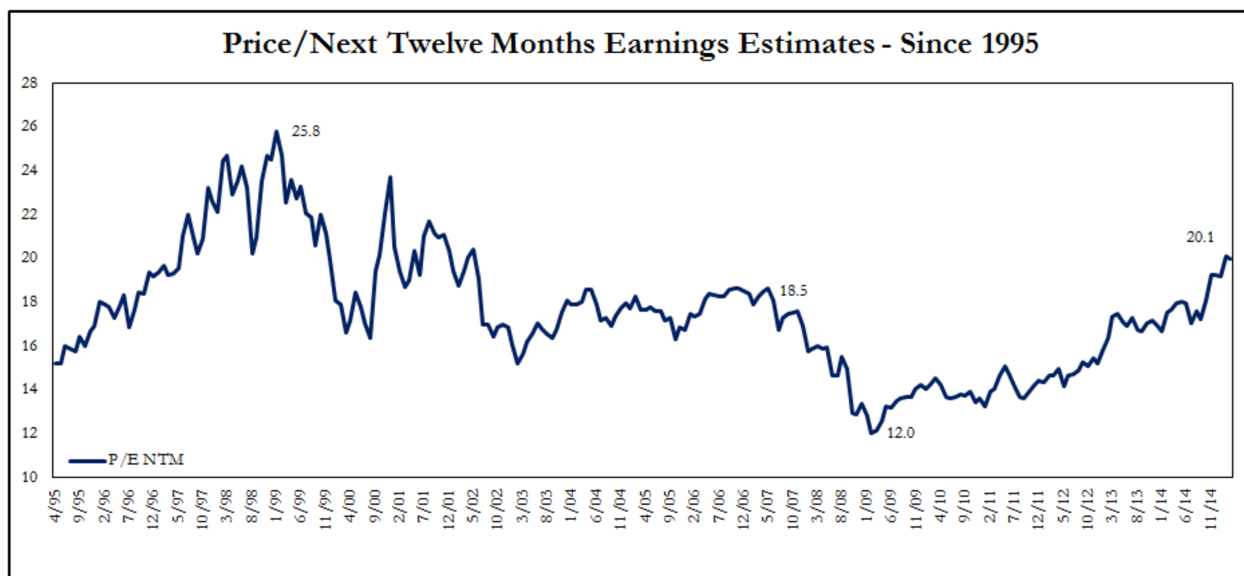
If you are a reader of previous Voss literature, you know that we believe there is much optimism embedded in biotechnology stock valuations. Biotech has moved from a 40% CAGR *better than* the S&P 500 over the last 3.5 years to a mid-80s annualized excess return rate year-to-date.

A Barbell of Froth

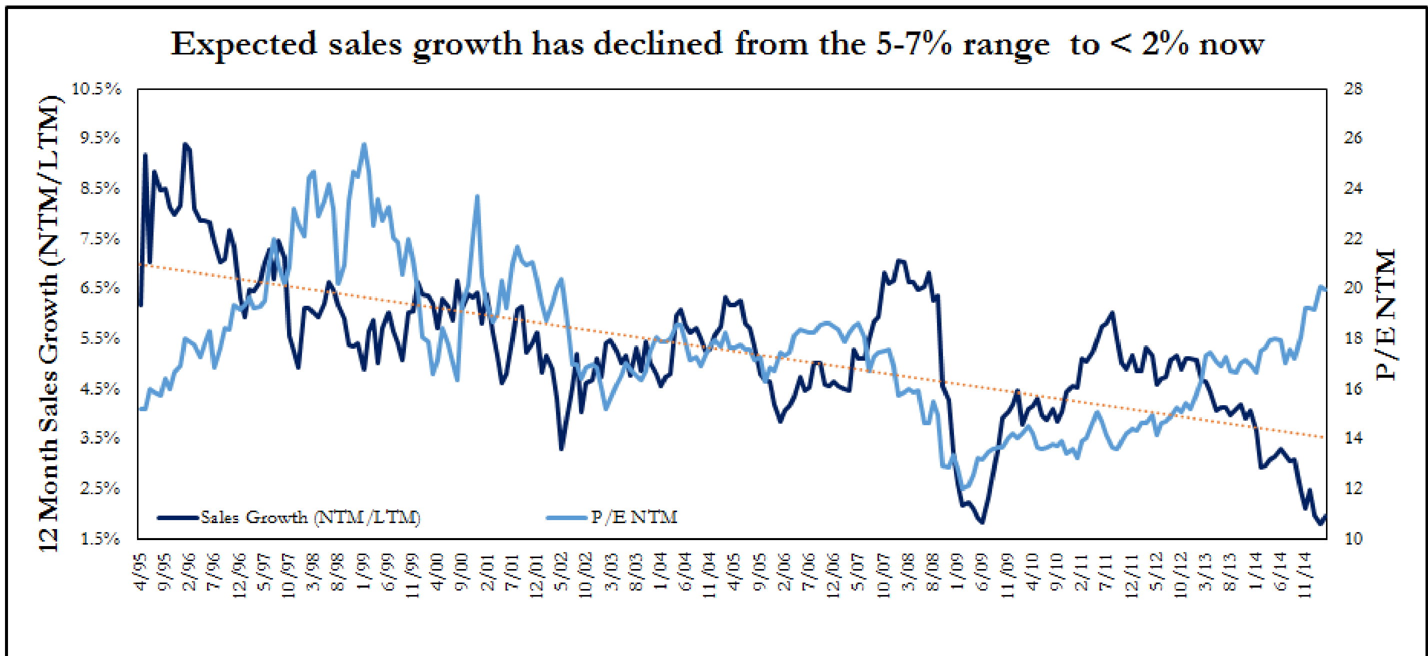
Another area in the market that forms a somewhat logical barbell to the frenzy of Biotech is the Consumer Staples sector. It's our view that managers are buying these stocks because they feel safe due to their relatively stable cash flows and their current dividend yields. Just as when Lee Iacocca said "auto buyers want economy and they'll pay any price to get it," investors want yield and they'll pay any price to get it, paradoxically driving asset prices up and yields down. At the end of Q1 US REITs were at 25.8x forward AFFO estimates versus their long term average of 16.4x (this is 57% above average). These sorts of stocks are the clear beneficiary of investors' habitat preference—if you are taken out of a long duration fixed income security you are likely to seek a similar replacement "habitat" and these stocks can be thought of as long duration yield vehicles. However, as we will demonstrate, many are underestimating the potential downside when these stocks correct to longer term growth adjusted valuations.

Thinking from a portfolio manager perspective, "barbelling" Biotech and Consumer Staples makes some sense. One may want to take advantage of the asset pumping Fed and buy the most speculative of stocks (pre-commercial Biotech), while at the same time desiring a hedge with "safer" stocks that are good relative values on the available yield spectrum. It is not a stretch to say this Consumer Staples froth is a direct extension of central bank policies. The rally in these names is worthy of skepticism and further investigation.

First, these stocks on a P/E basis are not the most expensive they have ever been and indeed were more expensive in the mid to late 1990s. If you look at the current constituents of the S&P 500 Consumer Staples, those that existed then (which is many of them) did indeed look more expensive:

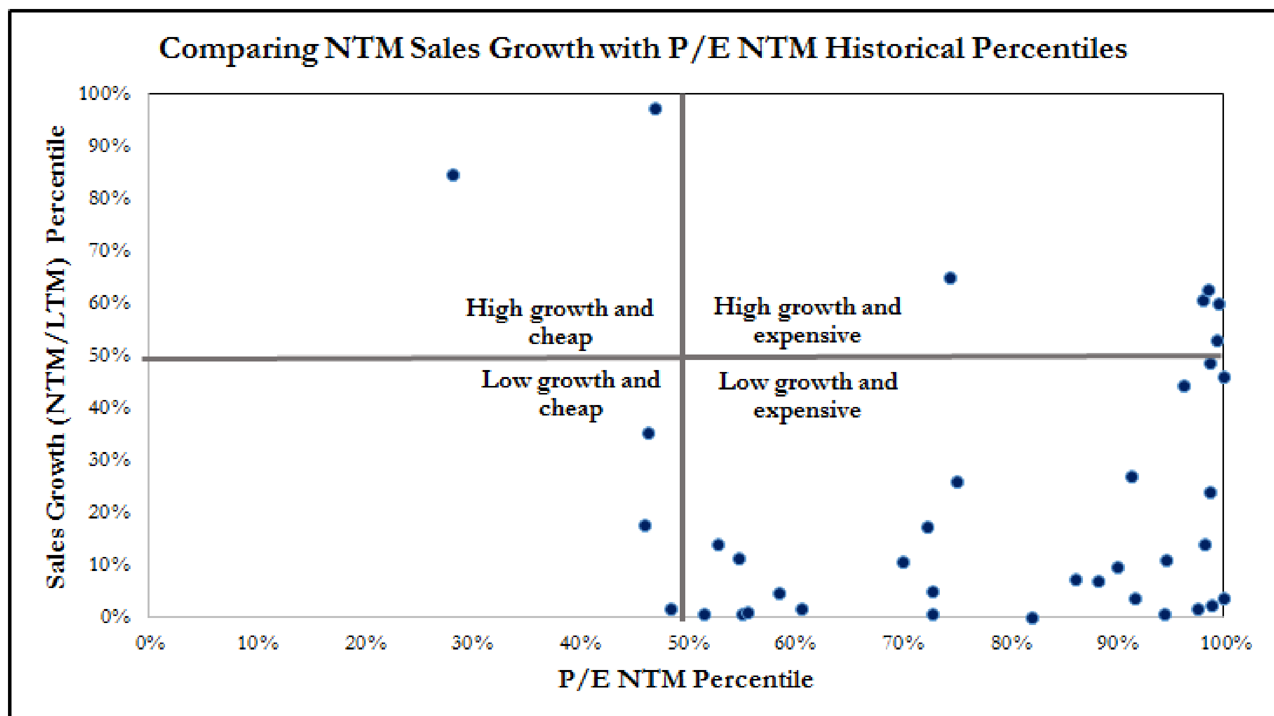


Back then, however, these companies were borderline growth companies. If you were to overlay the expected sales growth of these companies on their forward earnings multiple, you would see that perhaps they deserved a higher multiple as sales then were growing >3x faster:



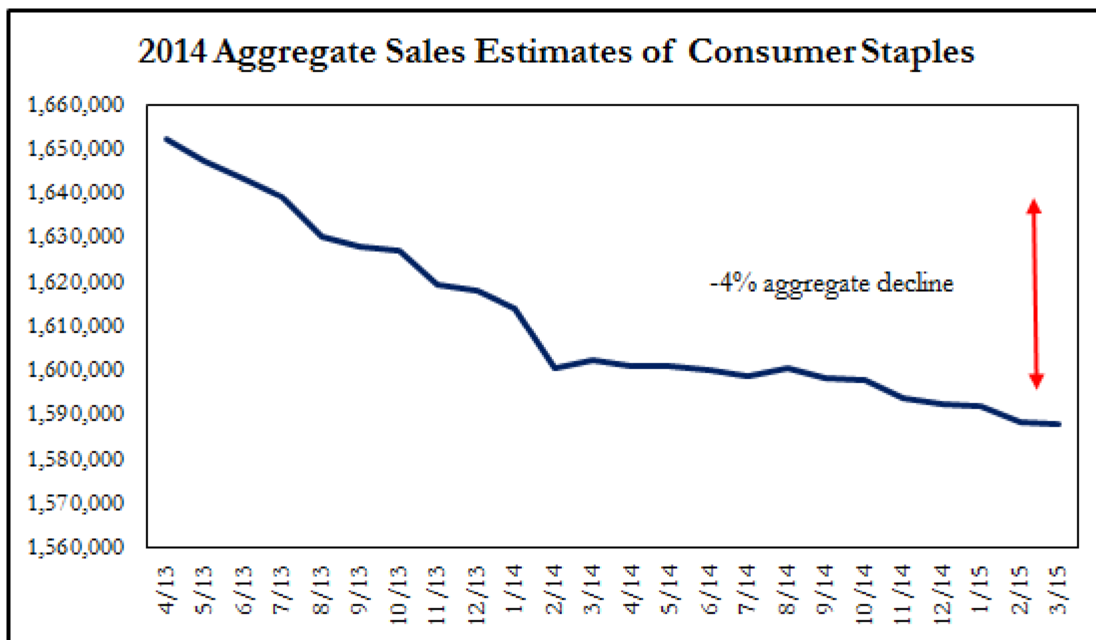
As of right now sales growth expectations are right where they were at the trough of The Great Recession, closing in on 0%, while P/E multiples are at a 15 year high. From the chart above, you can see the gap began developing in early 2013 when stocks really start taking off, with Consumer Staples subsequently experiencing 5 points of earnings multiple expansion while the estimated growth rate simultaneously collapsed from >6.5% to ~1.5%.

We looked at these data points from an additional angle by plotting each stock on a four-quadrant graph. Each dot below represents a company (see the full list of tickers in the sensitivity table below, but simply put they are the constituents of the S&P 500 Consumer Staples Index). The Y-axis (vertical) is, relative to its own history, what a company's sales growth percentile is using next twelve months estimated growth over last twelve months. If a company is currently expected to grow sales faster than it ever has, it would plot at the top at 100%. The X-axis (horizontal) uses the same logic but for P/E on a forward basis. A reading at 0% would mean the stock is currently cheaper than it has ever been.

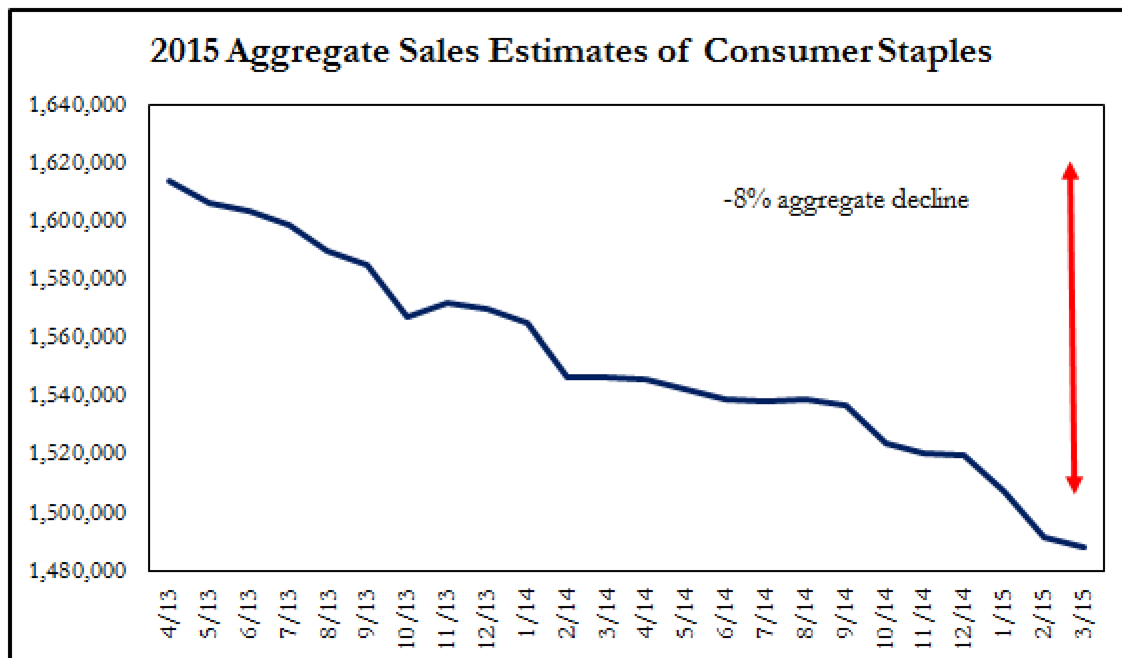


You would generally expect most of the stocks to be in either the lower left box or the upper right box. All things equal, if you're growing sales and earnings slower than you normally do, your historical P/E should be lower relative to its history. Things that would change this are higher margins and returns on capital than is normal historically. What you can see, however, is that a vast majority of the companies are in the "low growth and expensive" quadrant. The two major outliers, Walgreens and Tyson Foods, are both the beneficiaries of major acquisitions that make comparing forward sales and trailing sales an apples-to-oranges comparison. If you were to adjust for that acquired growth, Walgreens would move to the lower right box and Tyson would be in the lower left box.

A key takeaway is that there are a significant number of stocks that are at all-time high P/E valuations and all time low projected sales growth. Also, it is no great secret that historically Wall Street's sales estimates tend to be much too high. For instance, here are the companies in aggregate with their 2014 Sales Estimates trend over time:

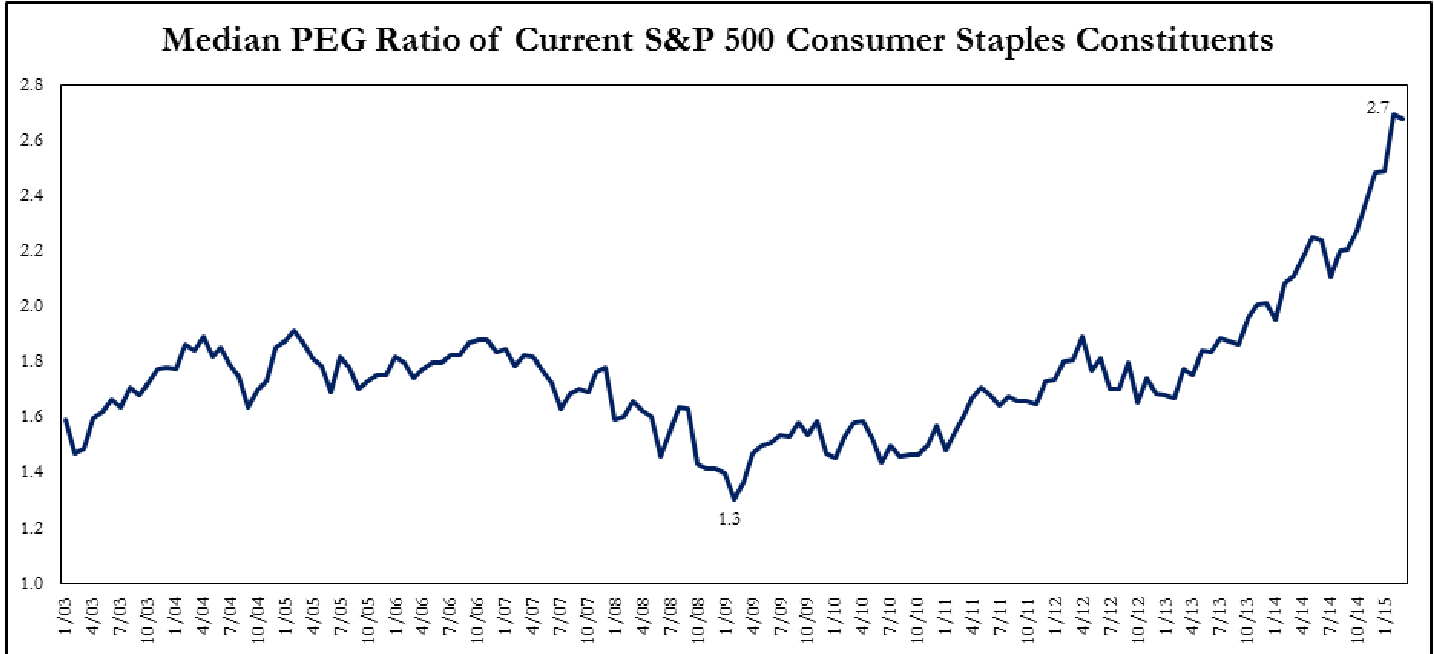


2015 sales estimates have seen a more substantial decline thus far, shown here starting from April 2013:

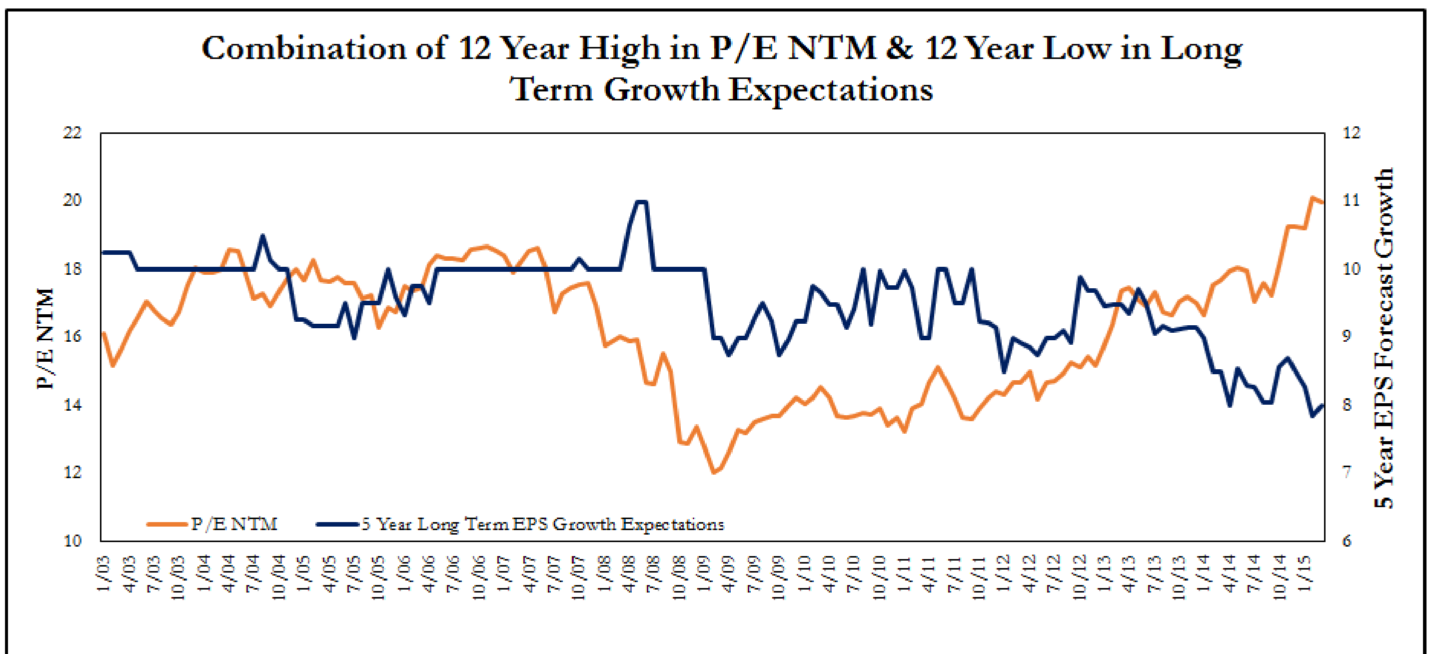


PEG and Longer Term Growth

Although we do not have data before 2003 on analysts' Long Term Growth expectations, we thought we would at least show you what the aggregate Price-to-Earnings-to-Growth (PEG) ratio looks like for these companies since 2003:



Digging in a little further, we can see this record high PEG is a combination of both Long Term Growth expectations coming down and the Price/Earnings multiple expanding from ~12x to ~20X since 2009.

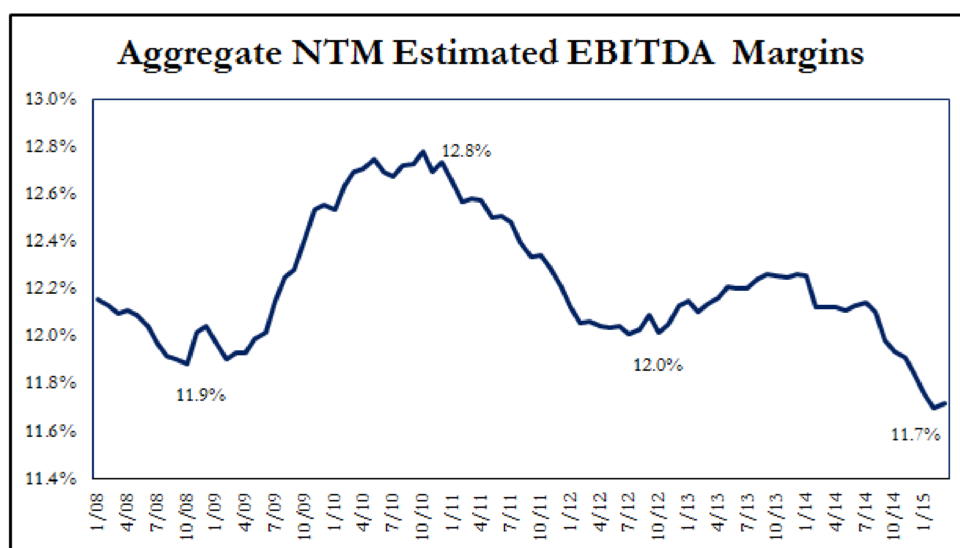


The Median Long Term Growth rate is currently projected at around 8%. We ponder two obvious things on this data point: Is it still too high? And is the quality of the EPS growth going to be low?

In 2014 the median EPS growth in the group was 4%. In 2013 it was 5.7%. Median EPS growth is both declining and is currently at only half of what the expected future compound annual growth rate is over the next 5 years (in other words, analyst expect an inflection to much higher growth from here despite our 7th year into a bull market/economic expansion). If you compare Consumer Staples' Net Income to EPS (to essentially parse out the "Buyback effect"), things look even worse. The Median Net Income Growth in 2014 was 0.8%. Assuming there is a recession in the next 1-3 years, what might this do to the projected growth rates? Shouldn't the Growth level be downgraded or lowered from a PEG standpoint if the quality if the earnings growth is lower?

Margins

Analyzing the sector's margins, we want to see if there may be significant operational improvements that are expected that could explain the rapid multiple expansion. Aggregate net income margins for the group as a whole have been remarkably flat since 2006 at around 6.0%. Looking back to the beginning of 2008 we see that there was material EBITDA margin expansion emerging after the Great Recession trough, but those stronger margins have actually begin to decline and are now, in aggregate, expected to be lower than before 2008 on a forward basis.



PEG Ratio Sensitivity Analysis

This is simply a theoretical exercise and we understand each stock has its own idiosyncratic situation, but below we have a table of each stock in the Consumer Staples Universe to show **what would happen to the stock price if each company were to revert to its long term historical average PEG ratio**, assuming current growth and earnings are held constant. Of course, alternatively, each company could drastically accelerate its projected growth for PEGs to normalize. The median and average decline needed to return PEG ratios to their 10-year average is 32% and 31%.

	Price	P/E NTM	LTG	Current PEG	10-Yr PEG	Upside/Downside at 10-Yr PEG
MO	$ 50.02	17.5x	7.6%	2.3x	1.7x	-25%
ADM	$ 47.40	13.8x	-1.5%	3.5x	1.1x	n/a
BF.B	$ 90.35	26.2x	7.7%	3.4x	1.9x	-44%
CPB	$ 46.55	19.2x	3.8%	5.9x	2.6x	-48%
CLX	$ 110.39	23.2x	5.9%	3.5x	1.9x	-52%
KO	$ 40.55	20.1x	4.8%	3.8x	2.0x	-51%
CCE	$ 44.20	16.4x	4.0%	3.6x	1.6x	-61%
CL	$ 69.34	22.7x	8.4%	2.9x	1.8x	-32%
CAG	$ 36.53	16.2x	8.5%	1.9x	1.7x	-11%
STZ	$ 116.21	23.8x	12.7%	2.7x	1.1x	-42%
COST	$ 151.50	27.5x	10.1%	2.7x	1.6x	-40%
CVS	$ 103.21	19.3x	14.0%	1.4x	1.0x	-28%
DPS	$ 78.48	19.9x	8.0%	2.6x	1.8x	-28%
EL	$ 83.16	26.3x	15.0%	1.8x	1.6x	-9%
GIS	$ 56.60	19.2x	5.9%	3.5x	2.0x	-40%
HSY	$ 100.91	22.6x	10.1%	2.3x	2.3x	3%
HRL	$ 56.85	21.3x	7.5%	2.9x	1.7x	-40%
SJM	$ 115.73	20.1x	5.5%	3.2x	1.9x	-48%
K	$ 65.95	17.9x	3.0%	5.3x	2.0x	-67%
GMCR	$ 111.73	25.5x	15.0%	1.6x	1.2x	-27%
KMB	$ 107.11	18.5x	5.9%	3.1x	1.9x	-40%
KRFT	$ 87.12	26.6x	5.9%	3.6x	2.5x	-44%
KR	$ 76.66	19.4x	12.0%	1.7x	1.4x	-13%
LO	$ 65.35	17.4x	9.0%	1.9x	1.4x	-27%
MKC	$ 77.11	21.6x	7.5%	3.0x	2.0x	-29%
MJN	$ 100.53	24.5x	8.6%	2.6x	2.2x	-23%
TAP	$ 74.45	18.8x	2.6%	7.6x	1.2x	-83%
MDLZ	$ 36.09	20.1x	9.8%	2.1x	2.0x	0%
MNST	$ 138.40	39.2x	22.3%	1.7x	1.3x	-23%
PEP	$ 95.62	20.1x	7.4%	2.9x	1.8x	-35%
PM	$ 75.33	17.4x	3.6%	3.9x	1.4x	-71%
PG	$ 81.94	19.5x	8.0%	2.4x	1.6x	-32%
RAI	$ 68.91	17.8x	9.0%	2.0x	2.0x	0%
SYY	$ 37.73	19.0x	10.0%	1.9x	1.5x	-23%
TSN	$ 38.30	10.8x	14.1%	0.8x	1.5x	95%
WMT	$ 82.25	16.6x	3.6%	3.6x	1.2x	-74%
WBA	$ 84.68	20.7x	14.0%	1.5x	1.1x	-24%
WFM	$ 52.08	28.3x	13.1%	2.2x	1.7x	-20%
Median						**-32%**
Average ex 2 Outliers						**-31%**

Data source for all numbers shown: FactSet

The outliers here are ADM, which currently has an assumed negative long term growth rate, and Tyson, where there is a lot of concern on the buy side that the chicken commodity cycle could be peaking (versus the sell side that maintains a heady 14% Long Term Growth Rate).

While we chose to show just Consumer Staples sector here as they are generally thought of as a sector with stable cash flows and is thus increasingly considered a "bond substitute," these same valuation extremes—especially growth adjusted—look similar to us across most pockets of the market. Retailers as a group, for example, are at 20x 2015 earnings estimates.

In aggregate companies in the S&P 500 in Q1 that have missed earnings estimates were still up as much (+0.9%) as the 5-year average of companies that beat earnings estimates (+1.0%). In other words, missing now is as good as beating over the last five years. The same thing can be said for lowering guidance. Lowering guidance now is better for one's stock price than raising guidance has been over the previous 5-years. Companies are not being punished for lowering earnings guidance, with their stocks rising an average of 1.7% on the announcement compared to a 5-year average decline of 1%.[2]

One of easier decisions from a portfolio allocation point of view is to limit Healthcare and Consumer Staples exposure from here as we believe these sectors may underperform by a wide degree for years to come when the tide turns. While one would think then that shorting is an equally easy decision, it is not. It has been tough as explosive moves to the upside on non-news or negative guidance are the daily norm. We will continue to ratchet up our short exposure on individual stocks in these sectors mostly through the prudent and moderate use of put options so that we may limit our potential losses and have the opportunity to make multiples of our money paid on premiums.

Conclusion

I recently watched a fascinating documentary, The Summit, about an incident on K2 (2nd highest mountain in the world on Pakistan/China border) when 11 of the world's best climbers died in a 48 hour span. Several died on the way up, and many more on the way down. It was the worst loss of life of any modern mountaineering accident. Approximately 20% of adventurers who attempt to scale the peak perish (335 have made the summit, while 82 have died trying--of course, some are willing to die trying).

It is well known that the higher you rise in terms of altitude, the less oxygen you are receiving. All your blood cells are deprived of oxygen when you're ascending and have stayed at such an extreme altitude, which in turn "numbs" your brain cells. The longer that you're up at a high altitude the more prone you become to problems inside your body. Your body starts to create mucus and excess fluids causing your brain and lungs to swell up due to metabolism change. This is a terrible condition known as High Altitude Cerebral Edema. As these problems develop it becomes much harder to think in a logical fashion and make rational decisions as sufferers enter an altered mental state.

For the climbers on that ill-fated expedition August 1st, 2008 there were lots of reasons to turn around, and not as many to continue higher:

> "People asked how could you keep going when someone died? When people see someone die in a car wreck or see a bad wreck on the side of the road, they drive on. You think it can't happen to me."[1]

The K2 trek is full of extremes and "the extremes can be addicting."[1] The longer the climbers stayed elevated, the more deprived of oxygen they got and the more fatigued they got. The guy who was leading the way down (at night) got hit by a big block of falling ice and took out the fixed-line ropes with him, so the rest of the other climbers had lost their life line. When they couldn't find the rope later, they got off the designated path and their problems compounded.

The market has its own set of problems forming from such a long time spent at high altitude. Rather than lack of oxygen causing brains to numb it has been the effect of 0% interest rates for seven straight years. People's logical decision making abilities seem to be breaking down and the risk of making major capital allocations mistakes may compound from here. From a corporate point of view this entails destruction of shareholder value via levered buybacks and levered acquisitions at all-time high valuations.

In an unashamed admission of ignorance, we struggle to make heads or tails of many moves lately. This is a dangerous environment--one where stocks can make irrational moves on non-news. What should be well known and telegraphed (like a pass from Jay Cutler) and hence not a catalyst, is sending shares sky-rocketing or plummeting. Prevailing market prices are once again upholding their reputation as pathological liars. A "professional investor" should neither take their cues from the daily quotes, nor point to them as justification of their fundamental view. The reality is this happens 90%+ of the time (think someone telling you "the stock keeps going up every week, so therefore you are wrong.").

Now is not a time to get complacent from the slow hypnotic melt-up in prices. We detest complacency and idleness—not idleness in portfolio activity, but idleness in critical thinking and any necessary objective fact gathering that is grounded in reality that will help us optimize the risk/reward of our portfolio. We will continue to relentlessly seek out an uncorrelated collection of undervalued stocks that we believe have limited downside. If we relax for even one second after a long period of time at such a high altitude, that's when we can slip up from not thinking clearly. It's possible we get left behind by The Great Humiliator as the grade of incline steepens near the top, but we will happily forego a trip to the very peak of the market if it means we can avoid disaster when widespread complacency morphs into fear on the way down.

Thank you for your continued trust in us. Please don't hesitate to reach out if we can help you in any way possible.

Cordially,

Voss

Appendix

Value Fund returns since inception:

	Voss Gross	Voss Net	S&P 500
Q4 2011	1.5%	0.4%	11.8%
2012	27.3%	20.9%	16.0%
2013	46.6%	36.2%	32.4%
2014	15.2%	11.3%	13.7%
Q1 2015	6.7%	5.1%	1.0%
Annualized	27.3%	20.7%	21.4%

1: Quote from The Summit documentary

2:. FactSet Earnings Insight for the S&P 500 – report dated April 17th, 2015.

More on 2015's Q1 Earnings: For Q1 we've just had the largest decline in EPS (-4.1%) since Q3 2009 (-15.5%) and the first decline since Q3 2012 (-1.0%). Energy is admittedly dragging the entire S&P EPS growth rate from +4% to -4%, but it is not only Energy with earnings declines, but actually five out of the ten S&P sectors.[2] Additionally, a lot of the weakness can be attributed to a stronger USD. After experiencing this quick Net Margin dip in Q1 2015, consensus estimates are for net margins to rise sequentially each quarter in 2015 with the rising trend continuing throughout 2016. Even with net margin compression, positive EPS surprises have by far concentrated in the Consumer Staples sector due to the aforementioned buybacks. Consumer Staples actual earnings growth is slated to be just +0.1% in Q1, while revenue growth is +2.7%. The group as a whole is expected to have negative earnings growth in Q2. Despite estimated +1.4% earnings growth in 2015, the group's collective earnings are expected to inflect sharply higher to +8.7% the next year….mañana, always mañana. Only one sector (Telecom) is expected to have declining earnings growth in 2016 (a slight -0.2% slowdown from +5.1% to +4.9%)—remember this is despite five sectors already proving negative in Q1. Mid way through the Q1 reporting season 71% of the companies that offer any revenue guidance have issued negative guidance. Looking ahead, once again every sector is expected to show accelerating revenue growth in 2016, which would be in the 7th year of economic expansion. Color us skeptical.

Disclosures and Notices

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. 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. Voss 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.