VOSS

CAPITAL

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The Voss Value Fund, LP returned 6.56% net of all fees and expenses in Q1 2016, compared to the S&P 500's total return of 1.35% and the Russell 2000's total return of -1.51%. Our longs contributed 3.5% to gross returns, our shorts contributed 6.8% and cash & interest detracted 2.0%.

Voss Value Fund, LP

ESTIMATED NET MONTHLY PERFORMANCE | 2016			
PERIOD	VVF (Net)	VVF (Gross)	S&P 500 TR
JANUARY	-3.24%	-3.16%	-4.96%
FEBRUARY	6.48%	7.34%	-0.13%
MARCH	3.43%	4.33%	6.78%
1st QUARTER	6.56%	8.46%	1.35%
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	6.56%	8.46%	1.35%

Voss Value Fund Monthly Net Returns Since Inception													
	Jan.	Feb.	March	April	May	June	July	Aug.	Sep.	Oct.	Nov.	Dec.	Year
2011										1.51%	-4.09%	3.17%	**0.44%**
2012	7.04%	5.72%	3.90%	-3.44%	-1.13%	-0.21%	2.26%	3.04%	-0.07%	-1.49%	1.17%	2.68%	**20.87%**
2013	7.22%	-0.18%	2.18%	-0.63%	8.80%	0.29%	3.32%	0.02%	1.55%	0.70%	3.87%	4.64%	**36.21%**
2014	-1.24%	-0.16%	6.16%	6.70%	-0.20%	-2.20%	-4.47%	0.43%	-3.82%	0.94%	2.69%	6.69%	**11.25%**
2015	-1.21%	7.65%	-1.15%	-0.49%	-0.12%	-1.91%	-2.80%	6.66%	0.22%	7.72%	-5.97%	-1.87%	**5.69%**
2016	-3.24%	6.48%	3.43%										**6.56%**

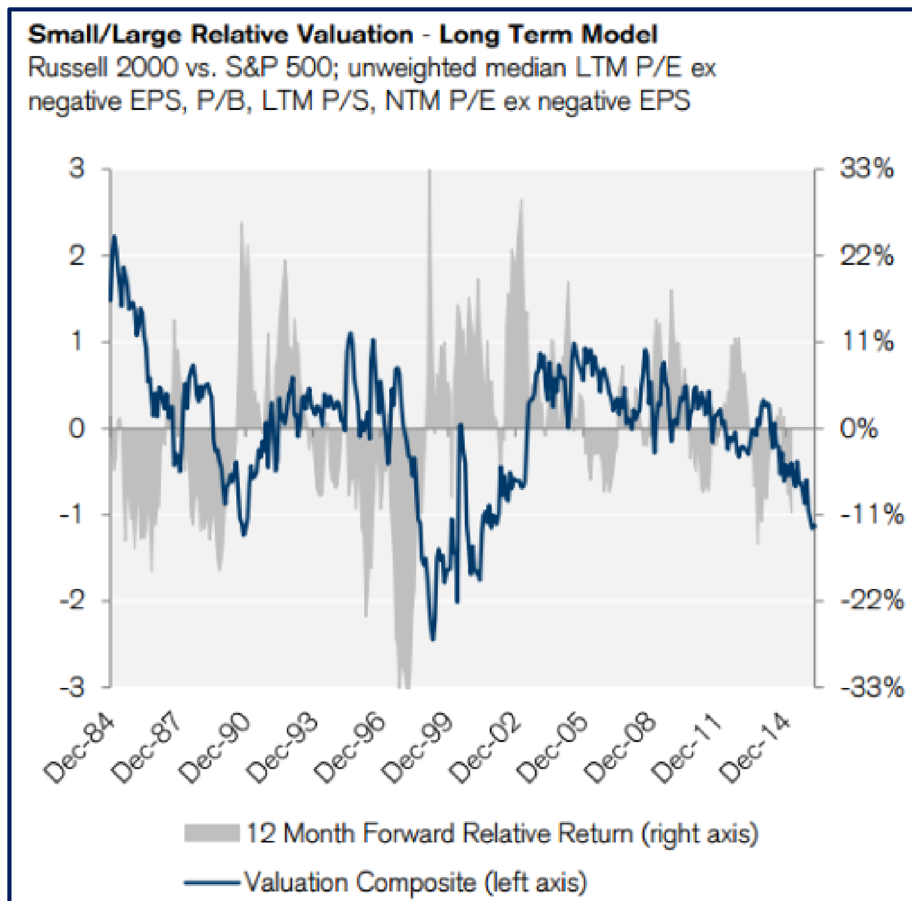
All YTD performance figures are unaudited, estimated, and may be subject to subsequent adjustment. A limited partner's actual returns may vary from published fund returns based on the timing of capital and fee arrangements. This statement represents information based on the policies of the fund's managers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

Given the long term nature of our investing style, it is not wise to read too much into a single quarter's P&L. Over the course of just three short months, random winning/losing investments can wreak havoc on one's psyche and performance. However, after enough time has lapsed and a large number of investments have been made, even a small edge should become apparent. We do not idolize those investors who continuously bet the farm, because as a group they suffer from extreme survivorship bias—the randomness of the market in the near term spells ruin if one is dependent on concentrated bets. We will continue to operate in a manner where no single mistake is fatal to our portfolio.

In Q1 we were helped by having avoided crowded, overvalued momentum stocks, by cashing in on some of our hedges near the market bottom, and by a burst of out-performance in Canada during the market rebound. Peak to trough the Russell 2000 experienced a -26% decline (with Microcaps faring much worse), versus a -14% for the S&P 500 index. This was about on par with the 2H 2011 declines of -29% for the Russell 2000 and -19% for the S&P 500. On February 8th, using Credit Suisse's multi-factor valuation composite, the Russell 2000 dipped below its 30-year average valuation ever so briefly.

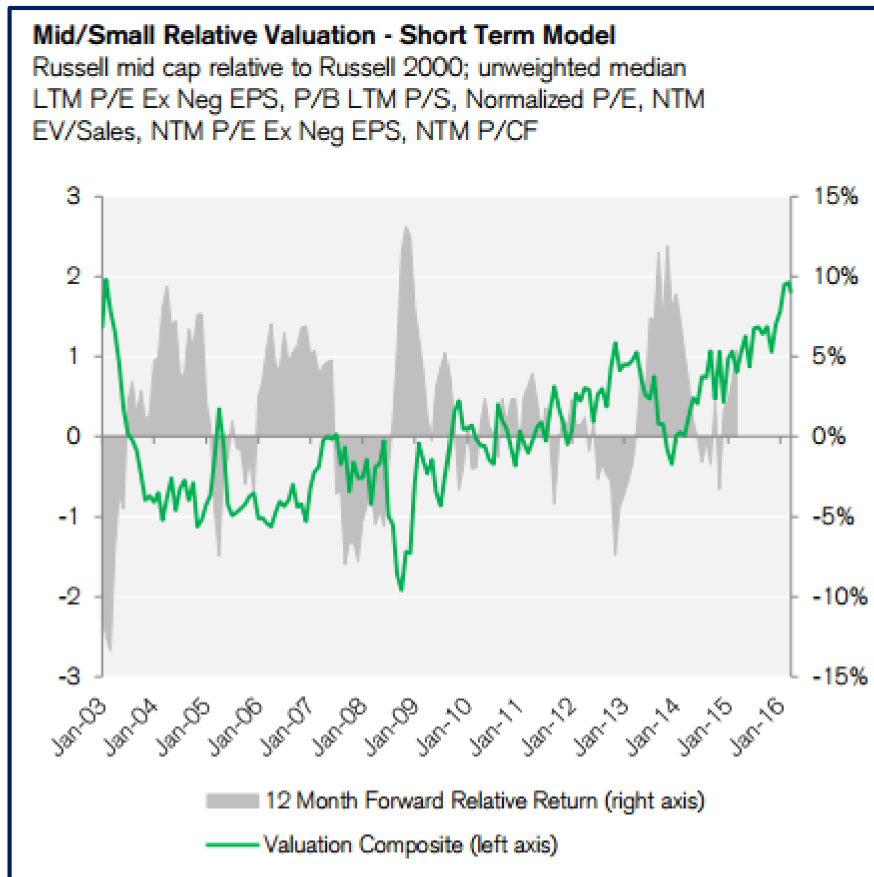
The market bifurcation into haves and have-nots continues as the bull market stretches into extra innings, prolonging compelling opportunities to put money to work on both the long and short side. Volume and valuations have collapsed across many smaller market cap companies that continue their march deep into "out of favor" territory. Tight liquidity is producing many pricing anomalies.

Within the market, a few mega caps continue to monopolize all the investor attention, media ink, and capital flows. In aggregate, money has continued to flow out of small stocks. Since February 2009 through the end of Q1 2016 there has been at least $80 billion of cumulative capital withdrawn from active small cap funds[1]. Partly due to these negative fund flows, and partly due to a high starting valuation and weak earnings growth, the Russell 2000 remains flat over the last two and one-half years. This is a potentially phenomenal time to add money to small cap value, as on a relative basis, this style on a forward valuation basis has not been cheaper relative to large cap growth since the final stages of the Tech Bubble in 2000 or the recession of 1990/1991.



Of course, judging from the 1998/1999 era in the chart above, the spread can get a lot worse before it gets better.

Following the peak in spread between large cap growth and small cap value performance in 2000, small caps trounced large cap returns by a 20%+ per annum margin for four years subsequently from 2001-2004. While a similar scenario with the same magnitude of spread is wishful thinking, smaller stocks do have considerably less valuation risk presently and could meaningfully outperform by 5%+ p.a. for several years. The recent cycle of growth outperforming value that we've been experiencing is the longest monthly duration on record (114 months), with Russell 3000 Growth Index outperforming the Russell 3000 Value Index by a cumulative 66% since July 2006.[4] An additional data point favoring small caps is that mid-cap stocks' valuation relative to small caps has hit an all-time high (since 2003 shown):



Should a relative market shift in favor of our size and style occur going forward, our portfolio stands to benefit. Even without such a tailwind we have still been maintaining a nice positive spread over the indexes in a risk-controlled fashion.

Three Thinkable Takeout Targets

We've been disappointed in our dry-spell in terms of position buyouts. We think this is about to change and wanted to highlight three newly established holdings that have near-term upside optionality as potential takeover targets.

First, Marlin Business Services (**MRLN**). MRLN is about as steady-Eddy of specialty finance company as we can find. Currently, given the high profile issues of many specialty lenders (e.g. Lending Club, OnDeck Capital, etc.), a flattening yield curve, persistently low rates, and ongoing pervasive investor fear of a 2008 style credit crash and global recession, most every kind of credit services or specialty finance company is deeply out of favor. We think MRLN is different than most and of a superior breed. MRLN operates as a branchless bank in the small-ticket equipment leasing market and makes money from interest and fees on leases and loans to small businesses for critical operating equipment. MRLN works in conjunction with over 12,000 equipment distributors and OEMS to directly originate these leases, which average about $14,000 in size.

The yield on MRLN's loans and leases averaged 9.02% for 2015 and its liabilities, which include certificates of deposit, money market funds, and debt, cost ~1.02%. MRLN's Net Interest Margin, the spread between these interest earning assets and liabilities, is around 8% which is vastly superior to traditional banks.

One promising new growth initiative that is just getting underway is a new working capital loan product for small businesses. Given MRLN has distribution capability and direct relationships with tens of thousands of small businesses, they have begun offering loans with average yields of 21%+, more than twice the yield on their leases. They have recently beefed up their sales staff, causing a spike in expenses, but we expect sequentially improving productivity out of the new employees over the next few quarters.

We like the extreme credit, customer, and industry diversification within MRLN, as no one equipment vertical, industry, or geographic concentration can endanger the business. Credit quality and net charge offs have been steady and benign over the last several years, ranging from 1.4-1.6%.

An acquisition of MRLN by a larger bank with an even cheaper cost of funds makes a lot of strategic sense. There are substantial synergies to be realized from duplicative SG&A eliminations as well as excess capital embedded on MRLN's balance sheet that could be released with a more relaxed banking charter. Discussions with management reveal an open minded attitude towards a company sale at the right valuation. The top two institutional shareholders combined own over 33% and judging from the trading liquidity of the shares, there is a high probability that they will push the board towards a liquidity event.

There are several direct transaction comps we have found for MRLN, with the best pure-play public comp being the sale of MicroFinancial (MFI) to Fortress Investment Group in December 2014. Similar to MRLN, MFI had flattish revenue growth preceding its buyout and a 9.9% 5-year average return on equity, in-line with MRLN's 9.6% for FY 2015. The $230mm MFI transaction was consummated at 15.2x trailing net income and 1.6x book value of equity. We think MRLN can fetch a similar P/B multiple, giving MRLN at least 33% upside from here. If a buyout is not imminent, we are comfortable waiting with a 3.9% dividend yield and a paying valuation at under 9x forward earnings.

We are no longer afraid to recycle old ideas, as our second idea is Build-A-Bear Workshops (BBW), a name we have written about publicly before. We have long thought that private equity buyers would be interested in owning BBW given the unique nature of the brand and concept, the large net cash position, and growth opportunities in licensing and international franchising. The Board had recently enhanced the management team's Change in Control compensation package, which is triggered by a sale, further aligning incentives and likely prepping the company for a transaction. We quickly reloaded BBW to a full size position now that the company has announced it is exploring strategic alternatives and is shopping itself. While we cannot point to a perfectly comparable transaction or precise value for BBW given its uniqueness as an experiential retailer, we are hard pressed to find any remotely comparable transaction in recent years (specialty retailers, toy companies, etc.) that went below 8x EBITDA. A similar takeout multiple would give BBW at least 35% upside from here. If a buyout is not consummated, our Linus blanket is the valuation we are paying of only 4.75x 2016 EBITDA estimates and 9.4x EV/2016 Pre-tax income, using the low end of guidance.

Lastly, we think Bravo Brio Restaurant Group (BBRG) is a likely takeout candidate. BBRG is the cheapest public restaurant stock we are aware of. BBRG operates two restaurant concepts: Bravo Cucina Italiana (51 locations) and Brio Tuscan Grille (65 locations). Both concepts are marketed as polished casual, with average check sizes of $21.80 and $26.17, respectively. A key to our thesis is that both concepts generate very healthy average revenue per restaurant, with Bravo at $3.2 million and Brio at $4.2 million. This high AUV leads to solid unit economics with healthy cash flow and restaurant level operating margins of 15%. Both BBRG brands have suffered from four consecutive years of traffic declines, which is what has created the opportunity. The guest count declines are mostly why the stock is so depressed as investors extrapolate the trend. Therein lies the opportunity as now the valuation is compelling enough that a strategic or financial buyer could step in and pay a premium for the company. Their likely goal would be to tweak the model to try to stem the traffic declines and milk the cash flow. Based on diligent scrutiny of relevant and recent transaction comps, we believe BBRG can fetch between 6-8x EBITDA, giving the stock between 55-125% upside from its current 4.2x multiple.

Since 2010 there have been 65 public restaurant transactions globally, done at an average 9.0x EBITDA, a median multiple of 7.9x, and a minimum of 5.5x[3].

Deal Stats (2010 - Present)	
Average EV/EBITDA:	**9.0x**
Median EV/EBITDA:	**7.9x**
Minimum EV/EBITDA:	**5.5x**
Maximum EV/EBITDA:	**22.1x**
Average Deal Size (mm):	**550.7**
Median Deal Size (mm):	**266.7**

Just at the minimum deal multiple of 5.5x BBRG would still have over 48% of upside. At a 6.0x multiple, the upside is greater than 65%. Drilling deeper into just a handful of what we think are the most relevant restaurant buyouts, chosen because they were similar sized concepts, had similar margins, similarly negative SSS comp trends, and similar restaurant level operating metrics and cash flow characteristics, we find that the deals got done between 5.8x (lowest being McCormick & Schmick's, not shown) and 9.8x (Benihana's).

Transaction Comps				LTM		
(USD $ mm)	Transaction Value	EV/LTM EBITDA	EV/LTM Sales	Revenue	EBITDA	EBITDA Margin
CPKI	461.1	7.9x	0.7x	641.5	58.4	9.1%
PF Chang's	1,039.0	8.4x	0.8x	1,240.0	123.0	9.9%
Benihana's	296.0	9.8x	0.8x	352.0	30.1	8.6%
Morton's	181.5	7.3x	0.6x	316.0	24.8	7.9%
Average	494.4	8.4x	0.7x	637.4	59.1	8.9%
Median	378.6	8.2x	0.7x	496.8	44.2	8.8%
BBRG	**147.0**	**4.4x**	**0.4x**	**424.0**	**35.8**	**8.5%**

None of the transactions with similar AUV's and EBITDA levels were completed at an EV/Restaurant Level EBITDA multiple *below 4.5x* (the lowest being California Pizza Kitchen). BBRG is under 2.3x restaurant level cash flow and at the transaction comp minimum of 4.5x has 136% upside. Even at a distressed multiple of 3.0x restaurant level EBITDA, the stock has 42% upside.

Restaurant-Level Operations	*(For FY before buyout)*		
($ thousands)	Restaurant EBITDA	Restaurant Margin	EV/Restaurant EBITDA
Cali Pizza Kitchen	102,321	16.2%	4.5x
PF Chang's Bistro	157,373	17.1%	-
Pei Wei	40,716	13.1%	-
Total	198,089	16.1%	5.2x
Benihana	23,396	10.8%	-
RA Sushi	9,231	12.1%	-
Haru	4,068	12.5%	-
Total	36,695	11.3%	8.1x
BBRG	**63,365**	**14.9%**	**2.3x**
Bravo	23,988	14.9%	-
Brio	39,114	14.9%	-

Management has done an admirable job of holding margins steady in the face of declining sales and continues to generate cash. However, under the existing Board and leadership team BBRG's total return has underperformed its listed peers by >125% over the last five years, and the FactSet Restaurant Index (50 publicly listed restaurant stocks) by >200% since its 2010 IPO. It has been a historically great interval for restaurant stocks and BBRG has sunk in a rising tide and destroyed substantial shareholder value. As with our previous restaurant purchases (all three over $100mm in market cap so far have been bought out: CEC, PFCB, FRS) we have a relentless focus on what a rational buyer would pay in the private markets, giving us a variant view to profit from.

BBRG is cheap on a current status quo basis at around 4x 2016 FCF, but we don't believe the current management team's turnaround initiatives are urgent enough to turn the ebbing traffic tide or investor sentiment and think the company should immediately hire an independent investment bank to search for a buyer to maximize value for long suffering shareholders.

There is an old joke in the psychology field: How many psychiatrists does it take to change a light bulb? One, but the light bulb has to want to change. As opportunistic investors, we want to embrace change, in both ourselves and in the market. Change in the marketplace must be approached as a stimulating challenge, not an onerous ego threat.

The weakness of any investment approach is its dogma. We are relentless in rooting out and challenging dogma--especially our own. Once we have defined ourselves as one kind of pure investor, we've sown the seeds of our own undoing. Instead of having a rigid and narrowly defined identity, we want to consistently make money on longs, on shorts, on small caps, on mega caps, on industrials, on restaurants, etc. By never completely subscribing to a single investment philosophy, but rather systematically accumulating a compendium of the best processes and maintaining a certain level of detachment to any single idea or style, we engender a more flexible mindset with no single identity to protect.

This is not to say we have no investment identity with constant style drift. On the contrary, we have internalized certain core investment principles that will always constitute the foundation of our philosophy. Focusing more intensely on the downside risk than potential return is one such core principle that is embodied in our everyday habits. Knowing that we can always be wrong and that nothing is certain is another core Voss principle. Not following authority blindly, thinking independently and checking first hand data are others. Also understanding that no single investment regime is permanent, and that no one style is forever superior to another are important principles as well. What drives price during one quarter is not what will move markets during other quarters. The present regime is always temporary.

Rarely is the present time golden to those who reside within it. Every cohort of investment managers likely bemoans the current period they are working in and longs for a better bygone era. Judging from hedge fund returns, a "challenging market environment" has been a near constant since our inception. If we resort to using this catch-all phrase as a rationalization for not generating alpha-no matter how backwards things in the market often seem-it would only sustain that sorry status quo. That is not good enough for us. We continue to embrace and relish the paradoxically frustrating notion that the market is not even close to a rational place, thus making it a consistently challenging domain. The human nature that underlies the stock market is viewed internally at Voss as a constant to be diligently deconstructed and forever exploited. The relationship people have with their stocks is highly emotional and as we all know, human emotions are both strong and volatile. If the herd mentality of market participants is not about to go away, then our behavioral edge is not about to, either.

To continued Alpha,

Travis

Sources:

1: Bank of America Merrill Lynch report: "What are your neighbors doing?" 03/22/2016 2: Steve Schwarzman, CEO of BX, Goldman Sachs US Financial Services Conference, 12/09/15 3: Source: CapIQ 4: Credit Suisse US Equity Strategy Report, "Fresh Eyes on US Equities" 04/18/16

Performance Metrics (October 2011 - April 2016)

	Russell 2000	Russell 2000 Value	iShares MicroCap	Credit Suisse HF L/S Index	Credit Suisse AllHedge Index	Voss
Annualized Alpha	-0.01	-0.01	-0.01	0.05	0.02	**0.13**
Beta	1.16	1.09	1.13	-0.12	-0.07	**0.44**
Beta +	1.19	1.10	1.14	-0.30	-0.19	**0.45**
Beta -	1.17	1.00	1.15	0.08	0.09	**-0.12**
R-squared	0.75	0.73	0.63	0.04	0.04	**0.16**
Correlation to S&P 500	0.86	0.85	0.79	-0.20	-0.20	**0.40**
Active Premium	0.00	0.00	0.00	-0.10	-0.12	**0.05**
Information Ratio	0.03	-0.06	0.03	-0.67	-0.95	**0.41**
Annualized Sharpe Ratio	0.72	0.71	0.68	0.19	-0.27	**1.27**

Disclosures and Notices

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