January 23, 2015

**Separate Account Client Letter**
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**Fourth Quarter 2014**

For the year ended December 31, 2014, the Focus Equity Composite returned 10.66% net of fees[1] compared to 12.56% for the Russell 3000 Index. For the fourth quarter, the Composite returned 10.10% net of fees compared to 5.24% for the Russell 3000 Index. The returns for your individual account will differ somewhat from the Composite due to variations in account holdings and other client-specific circumstances. Your account's actual performance is presented in an attachment. We remind you that your portfolio's composition is significantly different from the broad market indices, so your performance will inevitably deviate from these indices, especially over shorter time periods. We manage your portfolio for long-term results, and we encourage you to evaluate its performance over a multi-year time frame. Long-term Composite returns are presented at the end of this letter.

High Quality = Competitive "Moat"

As long-term investors, our research process emphasizes appraising the factors that we believe matter most to a business's long-term success. These include the quality of the business, the growth opportunity, and the capability of the management team, among other considerations. Of these factors, identifying a high quality business is perhaps the most important.

A "high quality" business can mean different things to different investors. Frequently, businesses with high returns on capital are characterized as high quality. But many of the high return on capital businesses of today will not be high return on capital businesses in five or ten years as competition erodes their excess profits.

When we speak about a high quality business, we are referring to a company that not only earns a high return on capital today, but one that is also likely to sustain high returns long into the future due to its unique competitive position. Warren Buffet memorably refers to such businesses as possessing a competitive "moat": *"A truly great business must have an enduring 'moat' that protects excellent returns on invested capital. The dynamics of capitalism guarantee that competitors will repeatedly assault any business 'castle' that is earning high returns."* Buffett's metaphorical moat is formed when a business possesses one or more sustainable competitive advantages; low cost position, high customer switching costs, proprietary know-how, government license, and network effects are a few such competitive advantages. Assessing a business's moat is more of an art than a science, but we believe that it is critical to successful investing.

As taught in Finance 101, the value of any financial asset should equal the present value of all of its future cash flows. Accurately predicting the future cash flow of a business is difficult. Without a moat, it becomes even more difficult because competition can quickly disrupt the business's cash flow. On the other hand, predictability of cash flow increases if a business has a moat. Market share, pricing, margins,

[1] Net of highest applicable fee of 1.0% per annum, as described in our Form ADV, Part 2A

and economic returns are far more defensible for a business that, for example, has high customer switching costs or high barriers to entry.

To successfully value a business we have to make a reasonably accurate forecast of that business's future. So when we evaluate a business, we consider if it is a wide moat business, a no moat business, or somewhere in between. The wider and more enduring we perceive a business's moat to be, the higher conviction we can have in the business's future cash flow. While a business's quality is just one input into our security selection – along with the business's growth opportunity, management capability, valuation, etc. – it is a foundational consideration.

Notable Portfolio Changes

*Encore Capital Group (ECPG)* – During the quarter, we increased the Encore Capital Group allocation in separate accounts from about 4.4% of assets to about 6.5% of assets. For your reference, we last discussed Encore in our third quarter 2013 letter.

Encore is a business that has undergone dramatic transformation over the last decade, evolving from a no moat business into a medium moat business today. In the early-2000s, Encore's primary business of purchasing defaulted credit card receivables had few barriers to entry. When returns from buying receivables became attractive, new entrants would flood into the industry increasing competition and driving down returns. All that was required to participate was a checkbook and a contract with a third party call center. In the mid-2000s, the industry began to change as larger and more sophisticated debt collectors – most notably Encore and Portfolio Recovery Associates (PRAA) – started to realize important cost of capital and operational advantages relative to their competitors. For Encore, these operational advantages included:

- *Debtor database* – Encore's historical database of debtors and collections activity grows every year that it is active in the marketplace. According to the company, in 2008, when Encore acquired a portfolio, it had previous collections experience with about 17% of debtors in the new portfolio. Today, when Encore acquires a portfolio, it has had previous collections experience with more than 50% of debtors in the new portfolio. Knowing the willingness and capacity of debtors to pay their debts is very helpful in efficiently collecting on a portfolio of receivables. Having one of the largest databases provides Encore an informational advantage over most of its peers when evaluating new portfolio purchases.

- *Low cost call centers* – Encore has gained significant efficiencies through its wholly-owned call center operations in India, and more recently Costa Rica. Since its establishment in late 2005, Encore's Indian call center has grown to more than 50% of the company's total call center collections at approximately 1/3 the cost of the company's U.S. operations. Encore's competitors have failed to build effective offshore call centers, providing Encore an important cost advantage over its peers.

Economic returns in the industry are determined by what a company pays for a portfolio of receivables, how much it collects on that portfolio, and the cost to collect. Since 2007, Encore has levered its operational advantages to drive down its cost to collect to 39% from 51% of gross collections. This shift has enabled Encore to bid more aggressively for new portfolios and gain massive market share over the last five years; gross collections are up 26% and Adjusted EBITDA is up 31% per annum over the period. The next phase of operational improvement for Encore is the internalization of a large portion of its domestic legal collections efforts. By 2016, we expect about one-half of Encore's domestic legal



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collections to come through its in-house attorneys rather than a network of retained law firms. We think this can lower Encore's overall cost to collect by another 150-200 basis points while materially increasing collections.

In 2000, the top five companies in this industry had about 35% combined market share. Since 2008, eight relatively large companies, representing about a third of the industry, and numerous small companies, have chosen to exit the industry. Today, the top five companies have about 90% combined market share. We believe the trend has even further to go as some of Encore's remaining competitors are ill-equipped to meet the recently increased regulatory burden from the Consumer Financial Protection Bureau (CFPB) and the Office of the Comptroller of the Currency (OCC).

Debt collectors are not the only ones facing increased regulatory scrutiny. Major credit card issuers that sell receivables to debt buyers are also under the microscope. As a result, three major credit card issuers, representing about a third of the market, stepped back from selling their bad debts in 2013. This supply reduction has made the current environment more challenging for debt buyers. While we believe that Encore is still earning attractive returns on new U.S. debt purchases, and it is still growing its earnings per share at a mid-teens rate, the stock has fallen out of favor due primarily to the supply contraction. We view this supply reduction as temporary, and have used the disruption to add to the Encore position. One of the sidelined issuers returned to selling bad debts in late 2014; we expect another to return in late 2015, and the final major issuer to return in early 2016. As these remaining issuers return, we anticipate that supply will meaningfully increase. We added to the Encore position at about 8.5x our estimate of 2015 EPS. We view this as an attractive price for a medium moat business that we think should generate mid-teens annualized earnings per share growth over the next five years.

*Marlin Business Services (MRLN)* – During the quarter, we increased the Marlin Business Services allocation in separate accounts from about 2.0% of assets to about 4.0% of assets. Marlin is a nationwide provider of equipment lease financing, primarily to small- and medium-sized businesses. The company finances over 100 categories of commercial equipment, including copiers, security systems, computers, and telecommunications equipment. Marlin accesses its end customers primarily through a network of over 11,900 independent commercial equipment dealers and national account programs.

With an average lease size of approximately $13,000, Marlin is focused on the fragmented, small-ticket segment of the market. Highly efficient sales, service, and credit operations are required to cost-effectively process these low-balance transactions. Marlin differentiates itself in the marketplace by employing primarily a telephonic sales approach rather than a more traditional "feet on the street" model, offering its dealers a single point of contact for customer service, and processing applications quickly for faster approvals. Marlin benefits from operating in a niche market often ignored by commercial finance companies and regional banks that lack the systems and infrastructure necessary to cost effectively serve the small-ticket segment.

Historically, Marlin relied on the securitization market to fund its lease originations, but by 2007 it had embarked on a long-term strategy to migrate to a bank deposit-funding model. Before the migration had begun in earnest, the recession hit and the securitization market seized up. Marlin faced a funding crisis and was forced to dramatically curtail its new lease originations. In March 2011, when a regulatory restriction on Marlin's bank assets was lifted, the company was able to fund its new originations with low-cost bank deposits.

We first purchased shares of Marlin in the third quarter of 2011. At the time, the shares traded at a discount to tangible book value and the company was earning a low single-digit return on equity. Our view was that Marlin, with its new lower cost of funds, could earn an attractive mid-teens return on equity

as it ramped origination volume off of recessionary lows and put its excess capital to work. In addition, an upshot from the credit crisis was that Marlin's pure play leasing competitors were essentially locked out of securing their own bank charters because of a new, more stringent regulatory environment after the crisis. Its niche focus and bank funding model lead us to think of Marlin as a narrow moat business.

Fast-forward almost four years and Marlin's originations have ramped nicely, but the company remains significantly under-levered. The company's return on equity has increased to 11.5%, but would be in the mid-teens with a more efficient balance sheet. With its existing capital base, the company could increase the size of its lease portfolio by 50% and still exceed its minimum regulatory capital ratios. To our frustration, the payment of a special dividend in 2013, recurring quarterly dividends, and a new share repurchase program have made only a small dent in the company's excess capital position.

Importantly, in late December, the company's largest shareholder sold a significant block of stock to the second largest shareholder (both have representation on Marlin's Board). This transaction elevated the purchaser to a 23% ownership position from 10%, and reduced the seller to a 5% position from an 18% position. We know this 23% shareholder to be an active owner with strong financial acumen, so we believe that this transaction presages a transition at Marlin to an intensified growth effort and a more appropriate capital management policy. This transaction was a key consideration in our decision to increase the Marlin position size.

Regional banks, struggling to organically grow their lending portfolios, have been active acquirers of equipment leasing companies. We believe that Marlin is an attractive platform for a regional bank and think that it will ultimately be sold. Marlin trades at 11x our estimate of 2015 earnings per share and 1.3x book value; an attractive valuation and a comfortable discount to recent private market transactions.

*American Woodmark (AMWD)* – During the quarter, we increased the American Woodmark allocation in most separate accounts from about 1.8% of assets to about 2.5% of assets. Woodmark is one of the three largest kitchen cabinet manufacturers in the U.S. While there are thousands of cabinet manufacturers across the country, most are local or regional operators lacking the scale and geographic footprint to effectively service the large home centers (Lowe's and Home Depot) and the national homebuilders (Toll Brothers, D.R. Horton, Lennar, etc.). Woodmark, along with Masco Cabinetry (owned by Masco – MAS) and MasterBrand Cabinets (owned by Fortune Brands Home & Security – FBHS), are uniquely positioned to service these large customers, enabling a favorable competitive dynamic among the three.

American Woodmark entered the housing depression in 2007 with one of the best balance sheets in its industry. During the downturn, while its primary competitors were focused on aggressive cost cutting and manufacturing consolidation, Woodmark's financial stability enabled it to mostly maintain its customer facing sales force and manufacturing capability, enter a new distribution channel (kitchen & bath dealers, or "K&B dealers"), and embark on a six sigma/total quality remake of its organization. Product quality and service (timely, accurate, and damage free manufacturing / delivery / installation) improved to industry leading levels, enabling the company to gain significant market share with home centers and home builders. We believe that the competition's service levels still lag Woodmark's service levels by a wide margin, providing opportunity for continued market share gains. Also, over the last few years, as volume began to come back into the new home construction market, Woodmark pruned many of its less lucrative builder accounts to better align itself with more profitable and growth-minded accounts. As the homebuilding industry continues to gradually recover, we believe that this rationalized customer base should underpin attractive volume and margin growth for the company.

In addition, Woodmark's entry into the K&B dealer market presents significant opportunity and is beginning to gain traction. The K&B dealer channel composes approximately one-half the kitchen



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cabinet market. While there are many more competitors in this channel than the home center and builder channels, we believe profitability is slightly better because average sales prices are higher and dealer buying power / negotiating leverage is lower (the market is highly fragmented with an estimated 10,000+ K&B dealers). Woodmark had not meaningfully participated in this channel in the past because its bandwidth was consumed trying to service its rapidly growing home center and builder customers. In contrast, Masco Cabinets and MasterBrand Cabinetry receive about one-half their revenue from this channel. Woodmark is leveraging its unique service capabilities in the K&B channel to win market share from the incumbents. Over the last few years, Woodmark has opened about 1,000 K&B dealer locations establishing an important foothold. Today, they are focused on refining this K&B dealer mix and increasing their sell-through with these dealers. Our conversations with K&B dealers reveal a marketplace very receptive to Woodmark's value proposition. In time, K&B dealers have the potential to be Woodmark's largest sales channel providing a decade of solid growth opportunity for the company.

It is our view that Woodmark's advantaged service platform/share gains, active customer repositioning, and long-term K&B dealer channel potential are underappreciated by investors. We believe that Woodmark is perceived to be a low growth cyclical building products company with its potential limited to recapturing volume and margin from the housing recovery. While cyclical recovery is certainly an important driver, we believe that the long-term growth and margin potential provided by the items cited above should produce better earnings per share growth and future value than most expect.

We added to the American Woodmark position during the fourth quarter at about 15x our estimate of earnings per share, excluding the company's excess cash. We view this as an attractive valuation for this medium moat business given the significant recovery we expect in new single-family home construction over the next several years combined with the company's improved customer mix and market share opportunities.

Conclusion

We thank you for entrusting your capital to us. We take this responsibility seriously, and we will do our best to protect and grow your investment.

Please let us know if there is any change to your financial circumstances that might impact the manner in which we manage your account. In addition, please let us know if there are any updates that we should make to our records to keep your personal and account information current.

Sincerely,

Broad Run Investment Management, LLC

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**Broad Run Investment Management, LLC**
**Focus Equity Composite**
*September 1, 2009 through December 31, 2014*

| Year | Focus Equity Composite | | | Russell 3000* | | Number of Portfolios | Internal Disperson (%)[1] | Composite Assets ($ millions) | Firm Assets ($ millions) |
|---|---|---|---|---|---|---|---|---|---|
| | Gross Return (%) | Net Return (%) | 3-Yr St Dev (%) | Return (%) | 3-Yr St Dev (%) | | | | |
| 2014 | 11.76 | 10.66 | 9.44 | 12.56 | 9.30 | 41 | 0.10 | 1,618.5 | 1,619.5 |
| 2013 | 37.18 | 35.85 | 12.52 | 33.55 | 12.54 | 30 | n.m. | 1,454.0 | 1,459.8 |
| 2012 | 18.27 | 17.11 | 16.80 | 16.42 | 15.74 | 1 | n.m. | 781.2 | 781.2 |
| 2011 | 5.13 | 4.08 | -[3] | 1.03 | -[3] | 1 | n.m. | 672.2 | N/A |
| 2010 | 26.40 | 25.16 | -[3] | 16.93 | -[3] | 1 | n.m. | 772.8 | N/A |
| Sep - Dec 2009[2] | 8.64 | 8.29 | -[3] | 10.34 | -[3] | 1 | n.m. | 812.5 | N/A |

| Period Ending 12/31/14 | Focus Equity Composite | | | | | Russell 3000* | | |
|---|---|---|---|---|---|---|---|---|
| | Gross Cumulative Return (%) | Gross Annualized Return (%) | Net Cumulative Return (%) | Net Annualized Return (%) | St Dev (%)[4] | Cumulative Return (%) | Annualized Return (%) | St Dev (%)[4] |
| 1 Year | 11.76 | 11.76 | 10.66 | 10.66 | n.m. | 12.56 | 12.56 | n.m. |
| 3 Years | 81.32 | 21.94 | 76.04 | 20.75 | 9.44 | 75.00 | 20.51 | 9.30 |
| 5 Years | 140.93 | 19.23 | 129.33 | 18.06 | 14.46 | 106.72 | 15.63 | 13.44 |
| Since Inception | 161.74 | 19.76 | 148.33 | 18.58 | 14.35 | 128.09 | 16.71 | 13.33 |

*Past performance is not indicative of future results.*

* Supplemental information; this is not intended to be a benchmark for the composite, and is only shown for reference purposes.

**Broad Run Investment Management, LLC ("Broad Run") claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Broad Run has been independently verified for the periods October 27, 2012 through December 31, 2014. The verification report is available upon request. Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. Verification does not ensure the accuracy of any specific composite presentation.**

*Notes:*

A. Broad Run is an investment advisor registered with the U.S. Securities and Exchange Commission under the Investment Advisers Act of 1940, as amended. Broad Run is defined as an independent investment advisor that is not affiliated with any parent organization. Policies for valuing portfolios, calculating performance and preparing compliant presentations are available upon request. A list of composite descriptions is available upon request.

B. The Focus Equity Composite contains all fee-paying, discretionary accounts that are managed according to Broad Run's Focus Equity Strategy. The Focus Equity Strategy invests primarily in U.S equity securities—regardless of capitalization—and seeks long-term capital appreciation while incurring a low risk of permanent capital loss. The Strategy uses a concentrated and low turnover investment approach, and generally seeks to invest in what we believe are high quality growth-oriented companies trading at discounts to our assessment of their intrinsic value. Broad Run has determined that no appropriate benchmark for the Composite exists because the Focus Equity Strategy has minimal exposure to a number of sectors and is invested across the market capitalization spectrum.

C. Valuations are computed and performance is reported in U.S. dollars.

D. The Focus Equity Composite was created in October 2012; its inception date is September 1, 2009. For the time period September 1, 2009 to October 26, 2012, the Composite is composed solely of an equity mutual fund. Broad Run's Managing Members served as Portfolio Managers for this equity mutual fund while employed at the fund's Advisor. For the time period October 27, 2012 to February 28, 2013, the Composite is composed solely of the successor equity mutual fund to the aforementioned equity mutual fund. Broad Run is engaged as the sole Sub-advisor of the successor equity mutual fund (managing 100% of its assets) by its new Advisor, and the firm's Managing Members serve as Portfolio Managers for the successor equity mutual fund. Broad Run has met the GIPS portability requirements to link the returns of the equity mutual fund and the successor equity mutual fund. For the time period after February 28, 2013, the Composite is composed of the successor equity mutual fund and separate accounts. Currently, the assets in the mutual fund comprise a significant majority of the Composite's assets.

E. Gross of fees returns are calculated gross of management and custodial fees and net of transaction costs. Net of fees returns are calculated by deducting the monthly-equivalent amount of our highest applicable annual management fee of 1.00% ("Model Net Fee"), as described in our Form ADV, Part 2A (without the benefit of breakpoints) from the monthly composite gross return. All returns presented in the above tables (including the reference index) include the reinvestment of dividends, interest income, and capital gains.

F. The annual composite dispersion presented is a dollar-weighted standard deviation of the gross returns for all accounts in the composite for the entire year, using beginning of period values.

G. The three-year annualized standard deviation measures the variability of the gross returns of the composite and the reference index over the preceding 36-month period.

H. Broad Run's standard annual asset based management fee schedule is 1% of the account's total assets on the first $5,000,000 and 0.85% thereafter. Gross performance results do not reflect the deduction of Broad Run's investment advisory fee, which will affect a client's total return.

[1] n.m. - Not statistically meaningful for periods less than one year, or when five or less accounts in composite for the entire year.
[2] Annual Performance Results reflect partial period performance. The returns are calculated from September 1, 2009 to December 31, 2009 for the Focus Equity Strategy Composite.
[3] The 3-year annualized standard deviation is not shown due to having less than 36 months of composite returns.
[4] n.m. - This statistical analysis is based on monthly gross performance numbers and is not statistically meaningful for periods less than 3 years.



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*Other Disclosures*

**Additional Composite Details.** The Focus Equity Composite includes a mutual fund for which we charge a sub-advisory fee that is lower than the Model Net Fee. However, the mutual fund's total operating expenses, which are not applicable to you, are in excess of the Model Net Fee. Therefore, the actual performance of the mutual fund in the Composite on a net fee basis will be different, and will normally be lower, than the Model Net Fee performance. However, the Model Net Fee performance is intended to provide the most appropriate example of the impact management fees would have by applying management fees relevant to you to the gross performance of the Composite. Actual fees and expenses in client accounts may differ from those reflected in this Composite presentation and would cause actual performance to differ. The performance figures do not reflect the deduction of any taxes an investor might pay on distributions or redemptions.

**Index Disclosure.** The S&P 500 Index is an unmanaged index of 500 common stocks chosen for market size, liquidity, and industry group representation. The Russell 3000 Index measures the performance of the largest 3000 U.S. companies representing approximately 98% of the investable U.S. equity market. Both indexes are market-value weighted. Index figures reflect the reinvestment of dividends and capital gains. Index figures do not reflect deductions for any fees, expenses, or taxes. Investors cannot invest directly in an index. The indices' performance returns are included to illustrate the general trend of the U.S. equity market and are not intended as benchmarks for the Composite.

**Investing Involves Risk.** Investing involves risk, including the possible loss of principal. Past performance is no guarantee of future results and client accounts may not achieve the Focus Equity Strategy's investment objective. There may be market, economic, or other conditions that affect client account performance, or the performance of the referenced market index. The Strategy invests in small and medium size companies. Investments in these companies, especially smaller companies, carry greater risk than is customarily associated with larger companies for various reasons such as increased volatility of earnings and business prospects, narrower markets, limited financial resources and less liquid stock. A client account invested in the Focus Equity Strategy will hold fewer securities and have less diversification across industries and sectors than a diversified portfolio, such as a portfolio based on an index. Consequently a client account and/or the Composite performance may diverge significantly from the referenced market index, positively or negatively.

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