BROAD RUN
INVESTMENT MANAGEMENT, LLC

# Historical Client Letters

# Welcome!

Enclosed you will find a compilation of our historical letters and other relevant client communications.

These writings begin in 2009, following our investment team taking over portfolio management responsibility for a mutual fund on August 21, 2009. We have included the commentary written for the mutual fund annual and semi-annual reports from October 2009 through October 2012, as well as manager Q&A pieces used for shareholder outreach. Mutual fund commentary subsequent to 2012 has been excluded from this compilation because it largely overlaps with the content in Broad Run's quarterly separate account client letters.

All investment commentary is presented as originally written, but organizational updates related to personnel changes have been removed. We have reformatted the content to better fit this publication, and certain elements have been redacted for compliance purposes.

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## Annual Management Commentary - FBR Focus Fund - October 31, 2009

Source: http://www.sec.gov/Archives/edgar/data/1277946/000120928610000003/e72647.htm

**Over the last 12 months, how did the Fund perform and what factors contributed to this performance?**

For the one-year period ending October 31, 2009, the Investor Class of the FBR Focus Fund returned [redacted]. This compares to the [redacted] and the S&P 500 Index, which returned [redacted] and [redacted] for the same period, respectively.

The Fund's favorable absolute and relative returns were a result of improved business prospects for its key holdings, owing to a better overall economic outlook and company-specific developments. Leading contributors to the Fund's performance were AmeriCredit, Bally Technologies, CarMax, Penn National Gaming, and O'Reilly Automotive. Leading detractors from the Fund's performance were Markel, Alimentation Couche-Tard, and 99 Cents Only Stores.

**Portfolio managers comments on the Fund and the related investment outlook.**

We are just a few weeks away from closing the books on the first decade of the new millennium. It has been a wild ride for the stock market and economy and this seems like a good time to reflect upon the period. In many ways this has been a remarkable decade with the economy stricken by not one, but two massive asset bubbles: the internet-telecom bubble and the real estate-credit bubble. The net result of these experiences is that the decade will be the worst for stock market performance since the Depression-era 1930s.

$10,000 invested in the S&P 500 ten years ago is now worth $9,090, a negative 0.95% annualized return. Thankfully, the Focus Fund can look back at a more favorable result – $10,000 invested 10 years ago is now worth [redacted], a positive [redacted] annualized return. So the important questions are why did the Fund achieve this performance and does this provide any insight into future prospects?

One might assume that a better investment result is the product of a better work ethic or IQ, but this is not the case. Investing is a competitive field populated by thousands of smart and ambitious professionals and while these traits are helpful to getting into the field, they provide limited advantage once there. We think that the Fund's results are a product of playing in the same investment game as the competitors, but with a different, and what we believe to be a better, playbook.

While the economy and market indices have languished, some individual businesses have flourished. The Fund does not own the overall stock market; it owns about 25 carefully selected individual businesses. It has the flexibility to avoid unattractive companies or sectors and instead focus its assets in the most compelling prospects. We believe both of these factors – playing defense by avoiding troublesome areas, then offense by concentrating in winning stocks – were key in the Fund's favorable outcome for the decade.

**Defense first**

The accomplished 19th century mathematician, Carl Jacobi, solved many problems by applying the maxim, "invert, always invert". Jacobi believed that the solution to many difficult problems could be found by expressing them in inverse form. His maxim has application in mathematics, but can also be adapted to investing.

While the objective of the Fund is capital appreciation, or "making money", this goal is best advanced by first applying the Jacobi maxim and asking "how do you avoid losing money?"

In practice this means that emphasis is placed on first understanding an investment's downside risk, which is defined simply as the potential that a stock bought or owned today will be worth less in several years. This happens when a business suffers a sustained deterioration in fundamentals, such as a decline in demand or increase in competition, or if simply too high a price was paid for the stock. Only by understanding these risks can the risk-return profile be assessed and the most promising investment prospects identified.

If a business and its risks are not understood then the downside potential cannot be handicapped, and consequently the Fund will avoid that stock. Many prospects fall in this category, either because of company specific risks or concerns about the overall industry sector. While this decade's bubbles were not clearly evident at the time, this defense first approach revealed sufficient warning signs for the Fund to steer clear of significant involvement in the most devastated sectors (internet, telecom, real estate, and banks).

It seems ludicrous that new excesses could be brewing when the turmoil from the real estate-credit bubble remains unsettled. But one would have thought the same thing in 2003 in the aftermath of the internet-telecom bubble. In fact, you may recall a popular San Francisco Bay area bumper sticker from that era that said, "Please God, just one more bubble"...it seemed pretty funny at the time. The reality is that financial history is full of bubbles, frauds, misperceptions, and excesses. Businesses are never stable. Competition is fierce, technology is continuously evolving, and creative destruction can ruin even blue-chip companies. Prudence and risk control are timeless investment principles and central to long term value creation.

**Then offense**

Avoiding bad investments is just one-half of the Fund's investment equation. The other half is finding stocks that are attractively priced and can grow intrinsic value at a good rate over the long term. Companies that meet this profile tend to have the following characteristics:

- Strong competitive position – a favorable industry structure and sustainable competitive edge that enables the company to maintain pricing power and earn outsized profits.
- Superb management – leadership that runs the business for the long-term, makes prudent decisions investing the company's profits, and acts with integrity in all dealings.
- Large growth opportunity – a revenue growth, acquisition, or operating leverage opportunity that allows for a mid-teens per share average annual growth in intrinsic value over a decade.

This method of picking long-term winning stocks has been used since the Fund's inception with good success. One such example is Penn National Gaming ("Penn"). Penn owns or operates 19 regional gambling casinos across the country. Penn's business meets the three criteria outlined above and its stock has often traded at a price that allowed for purchase at a reasonable valuation. Many states restrict the number of regional casinos licenses limiting new entrants and direct competition. Penn's management has done a superb job of growing its business through new construction, expansions, and acquisitions. Penn began the decade with three locations and has 19 today. Revenue has grown from $171 million to $2.4 billion and EBITDA from $27 million to $577 million. The net result is that the stock rose from [redacted] over the last ten years and the Fund participated the entire time.

Penn is just one example of the individual success stories that have helped produce the Fund's results over the last decade. We think that the portfolio today is stocked with businesses – some long-term holdings, some relatively new – that meet the Fund's investment criteria and have very good potential to chart their own unique success stories over the next decade.

We hope that this review helps you to better understand the past results and investment process of the Focus Fund. We believe that it is important as an investor – in stocks or mutual funds – to focus not only on reported investment results, but the fundamental process producing those results. As the asset bubbles over the last decade have illustrated, gauging an investment by just looking at recent price performance can be hazardous to your wealth.

We invest with a long-term time horizon and encourage our shareholders to do the same. Despite the mandatory discussion of one-year results referenced above, we encourage our investors to evaluate our performance over three-, five-, and ten-year periods since shorter time frames can be influenced by many transitory issues unrelated to the intrinsic worth of the Fund's holdings.

Finally, we are pleased to be writing this letter to you in our expanded role as the Fund's co-Portfolio Managers. We assumed this position on August 22, 2009, after working a cumulative 23 years as the analysts responsible for [redacted] the Fund's investments. We take pride in our Fund's history, and we will continue to apply the same common sense investment process, emphasizing risk control and capital appreciation – defense first, then offense – that has worked so well in the past.

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

**Manager Q&A - FBR Focus Fund - October, 2009**

**Q1: Please describe the investment approach used at FBRVX?**

Our goal, first and foremost, is to preserve capital from investment loss and inflation. Then, and only then, do we seek to grow that capital over time. To this end, we focus our efforts on finding companies with excellent business franchises, large growth prospects, and skilled management. When we find these gems – or as we say, "compounding machines" – we are very disciplined about the price we pay.

When all these elements come together, they give us a portfolio of businesses with better than average competitive positions and growth rates, at below average valuations. So our expectation is that such a portfolio will do better than average over time.

**Q2: Explain what you mean by "excellent business franchises, large growth prospects, and skilled management"?**

Sure. We are long-term investors and believe that these three characteristics best predict a company's ability to create value over a five-to-ten-year time frame.

» We look for businesses that have a sustainable competitive edge that enables them to earn outsized profits and keep competitors at bay. Warren Buffett refers to this as a competitive "moat". Some examples include high customer switching costs, high barriers to new entrants, a low-cost position, proprietary know-how, patents, and licenses.
» We look for businesses that can grow to three or five times their current size over the next decade. We like to say "we hunt for elephants, not rabbits". The longer the growth runway, the longer we can compound our capital at high rates in a tax efficient manner.
» We look for management that runs the business for the long-term, makes prudent decisions investing the company's profits, and acts with inflexible integrity in all dealings.

**Q3: How do you find new investment ideas?**

There is no computer screen or formula that can identify companies that fit our mold, so we employ an eclectic search process. Some ideas are the result of continuous reading of annual reports and periodicals, some spring from our travel to meet with companies in the field, and others are a product of one investment being tangential to the next.

Because so few businesses meet our mold, we reject far more ideas than we accept. When we do find a promising idea, we dig in with detailed proprietary research. We visit production sites, talk with customers and competitors, and meet with field and senior management, all with a goal of understanding the durability of the company's moat, the size/visibility of the growth runway, and the quality of management.

In most cases, when we find a compounding machine, it is not available at an attractive price. So we monitor the business and wait – sometimes for years – for the market to present an attractive entry point.

**Q4: The Fund has faired better than the market in big downturns. How do you manage risk to provide downside protection?**

Charlie Ellis, in his 1985 classic investment book, Winning the Loser's Game, famously observed that investing was like amateur tennis, where the victor prevails because he makes fewer unforced errors than his rival does. Players are too eager to serve aces and instead double fault, or aim for the corner and miss, when all they have to do to win is consistently hit the ball back over the net.

In investing, the power of compound interest is the investor's best friend. With enough time the power of compounding can carry the investor to an easy "win". So our first consideration is always to try to avoid mistakes that could interrupt the power of compounding…to avoid unforced errors. This means that we are ever watchful for businesses with growing competitive threats, excess financial leverage, unsustainable levels of demand, fad or obsolescence risk, etc. We believe that this loss-avoidance filter is a key contributor to the Fund's overall success, and especially in down markets when such weaknesses often get exposed.

**Q5: Please describe the opportunity that you see in one of your largest holdings: American Tower?**

American Tower (symbol: AMT) is the largest owner/operator of cellular transmission towers with core operations in the U.S. and a growing presence in Mexico, Brazil, and India.

This is a wonderful business franchise because it is cheaper for cell carriers (AT&T, Verizon, Sprint-Nextel, T-Mobile, etc.) to add capacity by hanging a new transmitter on an existing cell tower rather than build a completely new tower. And yet it costs virtually nothing for the existing tower to add that new tenant so incremental profits on revenue and investment are very high. Zoning rules make it difficult to build new towers so incumbent operators have a moat and enjoy excellent economics.

In the U.S., the proliferation of data and internet enabled smart phones (Blackberry, iPhone, etc.), combined with the build out of new high speed 3G and 4G data networks, has created increasing demand for network capacity and AMT's towers. So the company has growing revenue, earnings, and cash flow to reinvest back into the business.

Outside of the U.S., AMT has operated in both Mexico and Brazil for over five years and has just closed on a substantial acquisition in India, the world's second largest wireless communications market. Management executed this deal brilliantly, waiting patiently for years to buy these Indian assets at a discount price during the recession. India, Brazil, and Mexico all have a rapidly growing middle class and unreliable landline infrastructure giving the company a long runway of growth and high return investment opportunity.

We track and value AMT on a free cash flow per share basis. GAAP earnings substantially understate the company's return on investment and growth in intrinsic value. The company has undertaken a stock buyback program over the last two years that coupled with their growing revenues will be an important part of the company's value creation. Despite all these favorable characteristics, the shares trade at a modest multiple of free cash flow and at a big discount to our estimate of intrinsic value.

## Semi-Annual Management Commentary - FBR Focus Fund - April 30, 2010

Source: http://www.sec.gov/Archives/edgar/data/1277946/000120928610000331/e74851.htm

**Over the last 6 months, how did the Fund perform and what factors contributed to this performance?**

For the six month period ended April 30, 2010, the Investor Class of the FBR Focus Fund returned [redacted]. This compares to the [redacted] and the S&P 500 Index which over the same time period returned [redacted] and [redacted], respectively.

The Fund's favorable absolute returns were a result of improved business prospects for its key holdings, owed to a better overall economic outlook and company specific developments. Leading contributors to the Fund's performance were 99 Cents Only Stores (NYSE Symbol: NDN), Lamar Advertising (Nasdaq Symbol: LAMR), O'Reilly Automotive (Nasdaq Symbol: ORLY), and Penn National Gaming (Nasdaq Symbol: PENN). Leading detractors from the Fund's performance were Dynamex (Nasdaq Symbol: DDMX) and Iron Mountain (NYSE Symbol: IRM).

We invest with a long-term time horizon and encourage shareholders to do the same. Despite the discussion of six-month results referenced above, we encourage investors to evaluate the Fund's performance over three-, five-, and ten-year periods since shorter time frames can be influenced by many transitory issues unrelated to the intrinsic worth of the Fund's holdings. Long term performance metrics for the Fund can be found in the table below.

**Portfolio managers' comments on the Fund and the related investment outlook.**

Over the past few months, the financial headlines have been focused on the potential for sovereign debt defaults in Greece, other European countries and elsewhere around the world. The central concern is that excessive government debt levels will necessitate austerity plans that will hinder or even stall the global economic recovery. The major U.S. market indices have reacted negatively to this news, declining from recent highs set in April.

All investors face the challenge of how to react to various macroeconomic concerns that emerge on a fairly regular basis. Most often these concerns prove irrelevant with the passage of time, but occasionally they manifest in damage to the real economy and corporate profits. Our general viewpoint is that it is extraordinarily difficult to make money by placing bets on macroeconomic events. The world is too complicated with too many moving parts to have this be a consistently profitable exercise. Experience has taught us that we are most effective when building the portfolio one security at a time.

As long-term investors, we fully expect that our portfolio will face turbulent economic times at various points during our investment horizon. So we prepare for this eventuality, not by selling all our stocks at the first signs of trouble, nor by rotating our portfolio into more conservative sectors, but rather by owning companies with a wide "margin of safety". By this we mean companies with the business model and balance sheet to survive and thrive in many economic environments, owned at attractive valuations so that we are well protected from both company specific and macroeconomic risks.

We think the Fund's portfolio is constructed with a good margin of safety. In fact, we think that many of the Fund's largest holdings are well positioned to grow cash earnings per share at a double digit clip over the next several years regardless of the rate of economic recovery. These companies have their own profit drivers that are largely independent of the overall economy, i.e. American Tower (12.0% of assets*) is driven by the adoption of data intensive smart phones such as iPhone, Droid, and Blackberry, O'Reilly (10.3% of assets*) is driven by its ability to further integrate the CSK acquisition, and 99 Cents Only Stores (9.4% of assets*) is driven by its continued success in an operational turnaround.

This recent market swoon is not without benefits. We used the market volatility to add two brand new companies to the portfolio at prices that we consider very attractive. These new positions replaced less attractive holdings and improved the overall portfolio profile. We look forward to sharing more detail about the new holdings in the near future once we have completed our purchases.

**As of April 30, 2010*

**Manager Q&A - FBR Focus Fund - April, 2010**

**Q1: The stock market is up substantially over the past year. Do you still think there is a good investment opportunity in stocks today?**

The economy experienced major trauma in 2008 and the first quarter of 2009. At that time, there was legitimate concern that the financial system was irreparably broken, and an economic depression was around the corner. Stock prices reflected that concern, and they have rallied strongly as the economy has pulled back from the precipice and appears on the mend.

We think it is futile to try to predict the market's direction over the short term (anything less than three years). But there are some measures of long term market value – market capitalization to GDP, price to trailing ten year earnings, corporate profits as a percentage of GDP – that we think have merit. When we look at these measures today, they show that the market is reasonably valued relative to long term history, so neither substantially overvalued nor undervalued.

It is obviously more difficult to identify compelling ideas now than twelve months ago, but as a "focus fund", we only need to find two dozen good ideas from among the nearly 10,000 available opportunities. We continue to like the outlook for the companies in the fund, and we are finding select opportunities to upgrade the portfolio. We believe today is a much more normal investment environment than that seen over the past three years.

For example, during the first quarter we added shares to our position in Dynamex at a price of only 11x our estimate of earnings. Dynamex is a transportation logistics company with a unique nationwide franchise in the same day delivery field. The company has a strong competitive position with seasoned management and the potential to be 3 to 5 times larger over the next decade. We are delighted to buy businesses like this at such a reasonable valuation, and we are seeing other select opportunities in existing holdings and new prospects.

**Q2: Please explain how you research potential investments?**

We typically hold an investment for many years, so we conduct our research with an eye toward understanding the opportunity for a business over the next decade. Most of our research is focused on evaluating those things that make a difference in the long term, i.e. the competitive structure of the industry, management quality, and the sustainability of pricing and margins.

To build this knowledge, we begin by conducting industry standard research like reading annual reports, SEC filings, financial statements, attending presentations, and meeting with senior management. But to really understand a business we find it is important to dig much deeper. So we often visit company facilities, meet with field level employees, talk to customers, interview former employees, attend industry trade shows, and speak with public and private competitors.

While this is hard and time consuming work, we believe it gives us an edge over the more shallow practices common in the investment industry. It gives us an understanding of a company and its industry that often leads to unique investment insights.

**Q3: Please describe the opportunity that you see in one of your largest holdings: O'Reilly Automotive?**

O'Reilly Automotive is the second largest distributor of aftermarket auto parts in the U.S. with 3,400 locations across 38 states. The Company sells products ranging from spark plugs, windshield wipers, and motor oil, to alternators, transmissions, and cylinder heads. O'Reilly's revenue is split about 50/50 between retail customers and professional repair shops, in contrast to its large competitors - AutoZone, Advance, NAPA, and Carquest - that are much more slanted toward one customer group or the other.

We believe O'Reilly is competitively advantaged because its distribution platform is configured to keep its inventory of auto parts closer to the end customer enabling better parts availability and faster delivery times. This is very important to commercial and heavy duty retail customers. Competitors have been unsuccessful replicating O'Reilly's distribution model, so the company enjoys a service advantage that wins customers and market share over time.

Further, as the second largest company in the industry, O'Reilly has substantial buying power compared to its many small competitors. So the company can secure parts inventory at a much better price than local and regional competitors enabling it to earn higher profit margins and good economic profits.

With just 4% market share in a huge industry, O'Reilly has a lot of room to grow the business. Revenue growth should come from buying and improving competing stores, building new stores in existing markets, and expanding geographically into the Mid Atlantic and Northeast. Profit growth should exceed revenue growth as O'Reilly harnesses its buying power and makes better use of its existing distribution and store assets.

O'Reilly is guided by honest and able management. Greg Henslee, CEO, and Ted Wise, COO, are best-in class operators with a combined 66 years experience at the company. And David O'Reilly, Chairman, is a skilled capital allocator who has successfully shepherded the company through five major acquisitions. Despite its strong track record and future prospects, the stock still trades at a very reasonable price of about 15x our forward year earnings estimate, so we think it should continue to perform well for fund shareholders.

**Over the previous 12 months, how did the Fund perform and what factors contributed to this performance?**

For the twelve-month period ended October 31, 2010, the Investor Class of the FBR Focus Fund returned [redacted] compared to [redacted] for the [redacted], [redacted] for the Morningstar Mid Cap Growth Category Average and [redacted] for the S&P 500 Index.

On average, the Fund's portfolio companies produced growing earnings and earnings power over the period, with some modest valuation expansion. While economic conditions remain difficult, there has been sufficient stability to allow the portfolio companies to increase their intrinsic value.

Major contributors to performance during the period included American Tower, CarMax, and O'Reilly Automotive.

- American Tower experienced growing rental income from its tower portfolio as wireless service providers (AT&T, Verizon, etc.) leased more space to meet the rapidly growing demand for data services.
- CarMax benefited from a continued rebound in demand for used autos and an increase in the availability of auto financing from recessionary lows. Internal efficiency improvements enabled CarMax to set record earnings despite sales still well below pre-recession levels.
- O'Reilly Automotive continued to make good progress integrating its acquisition of CSK Auto and extracting value from those formerly underperforming stores. We discuss O'Reilly in greater detail in the second section of this letter.

The only major detractor from performance was Bally Technologies. Bally's solid performance in casino information systems was overshadowed by disappointingly slow industry wide sales of slot machines. We expect capital budgets at casinos to improve over the next several years, freeing up cash to invest in new slot machines to Bally's benefit.

We also had two portfolio companies accept buyout offers during the year: AmeriCredit and Dynamex. With modest valuations and interest rates at multi-decade lows, it is not surprising to see corporate and private equity buyout activity picking up.

We recycled some of the proceeds from the AmeriCredit buyout, along with selective pruning elsewhere in the portfolio, to add two new positions in the portfolio (Aon and Diamond Hill Investment Group) and to quadruple the size of our investment in Charles Schwab. We believe each of these companies has a strong franchise with a good growth opportunity at a very modest valuation.

We invest with a long-term time horizon and encourage Fund shareholders to do the same. Despite the discussion of one year results referenced above, we encourage investors to evaluate the Fund's performance over three-, five-, and ten-year periods since shorter time frames can be influenced by many transitory issues unrelated to the intrinsic worth of the Fund's holdings.

**Portfolio managers' comments on the Fund and the related investment outlook.**

In the course of a generation, there has been a wholesale change in the nature of stock ownership in this country. Based on New York Stock Exchange data, from 1940 through the mid 1970s, the average holding period of a stock by U.S. investors fluctuated between four and ten years. Then, in 1975, the average holding period began a steady multi-decade march lower to its current level of about six months. The reasons for this change are numerous, but it is safe to say that the relationship between the typical U.S. investor and his investment in a public company has changed from "going-steady" to "speed dating".

While we believe this short-term focus is pure folly, we do not protest too loudly. For it is this emphasis on the short-term by others that occasionally creates an opening for us to invest in exceptional businesses at discount prices.

Since inception, the Fund has had an average portfolio company holding period of about six years. While others spend their time trying to forecast share price movement over the next six months, we focus on building a deep understanding of a business and its long term value. We seek to identify well run, competitively advantaged companies that are likely to grow their per share intrinsic value at a mid teens or better rate per year over the next five or ten years. Our goal is to buy these high quality businesses at modest prices so that our long term investment return will approximate or exceed the growth in per share intrinsic value. Such gems are hard to find, especially with our disciplined valuation parameters. But occasionally the market loses sight of, or fails to appreciate the quality of a business and its growth prospects, giving us an investment opportunity. This concept is best illustrated with an example: O'Reilly Automotive.

O'Reilly Automotive is the second largest distributor and retailer of aftermarket auto parts in the U.S. with 3,535 locations across 38 states. The Company sells products ranging from spark plugs, windshield wipers, and motor oil, to alternators, transmissions, and cylinder heads.

The Fund first established a position in O'Reilly in January 2005 at [redacted] per share, or about 15x analysts' expectations of 2005 earnings per share (a reasonable metric to track intrinsic value per share for this business). Additional large purchases were made opportunistically in early 2007 and early 2008 at lower valuations in comparison to earnings. Over the Fund's nearly six year holding period, cash earnings per share have grown 18% per annum, and the stock price has tracked closely behind, up [redacted] per annum. Today the shares at [redacted] still trade at about 15x analysts' expectations of 2011 earnings per share.

During the same six year period, the S&P 500 grew operating earnings per share at just 2% per annum, so it was not a robust operating environment for businesses overall. The point we want to make is that occasionally you can find a needle in the haystack. There are businesses that can grow earnings at a rapid clip, available at conservative valuations that provide both downside protection and appreciation potential at least in line with mid teens growth in intrinsic value. The challenge is in identifying such opportunities.

In the case of O'Reilly, the company had a very successful history and had grown earnings per share at an 18% annual growth rate from 1999 to 2004 by acquiring competitors and gradually expanding its business from 571 stores in nine states to 1,249 stores in 19 states. So at the time of the Fund's initial purchase in 2005, the obvious questions were why had the company been so successful in the past, and was this prosperity likely to continue in the future?

Since we typically hold an investment for many years, we conduct our research with an eye toward understanding the opportunity for a business over the course of the next decade. Most of our research is focused on evaluating those things that make a difference in the long term, i.e. the competitive structure of the industry, management quality, and the sustainability of pricing and margins.

To build this knowledge, we conduct industry standard research like reading annual reports, SEC filings, financial statements, attending presentations and meeting with senior management. But to really understand a business we find it is important to dig much deeper. So we often visit company facilities, meet with field level employees, talk to customers, interview former employees, attend industry trade shows, and speak with public and private competitors. While this is hard and time consuming work, we believe it gives us an edge over the more shallow practices common in the investment industry. It gives us an understanding of a company and its industry that often leads to unique investment insights.

As a product of our research, we learned that O'Reilly was advantaged versus its competition because its distribution model was configured to keep its inventory of auto parts closer to the end customer enabling better parts availability and faster delivery times. This was very important to commercial and heavy duty retail customers. Competitors had been unsuccessful replicating O'Reilly's distribution model, so the company enjoyed a service advantage that had won market share in the past, and was likely to continue yielding benefits in the future.

Further, as one of the largest distributors in the industry, O'Reilly had substantial buying power compared to its many small competitors. So the company could secure parts inventory at a much better price than local and regional competitors enabling it to earn higher profit margins and good economic profits.

O'Reilly had a proven management team and a clear ambition to extend the company's past regional success into a national franchise. Greg Henslee, CEO, and Ted Wise, COO, were best-in class operators with a combined 66 years experience at the company. And David O'Reilly, Chairman, was a skilled capital allocator who had successfully shepherded the company through a number of major acquisitions.

With a single digit market share in a huge industry and a number of sustainable competitive advantages, we believed O'Reilly had ample room to grow its business. Revenue growth would come from the same places in the future as it had in the past, namely buying and improving competing stores, building new stores in existing markets and expanding into new geographies. Profit growth would exceed revenue growth as O'Reilly harnessed its buying power and made better use of its existing distribution and store assets.

No single factor convinced us that O'Reilly had a high probability of future success. Rather, it was the combination of the favorable elements cited above, some obvious to anyone that studied the company's history and public filings, others only revealed through diligent reading of industry trade publications and conversations with customers and regional competitors.

Of course not every investment we initiate performs as well as O'Reilly, but on balance the approach outlined above has worked well across the overall portfolio. We think it follows logically from the O'Reilly example that if the Fund's portfolio companies are purchased at reasonable valuations, then our long-term investment outlook should be shaped by the prospects for growth in per share intrinsic value for each of the Fund's individual holdings. We have a positive view on the long-term outlook for the Fund not because we expect a booming economic recovery or major bull, but rather because we have a favorable view of the fundamental outlook for each of the Fund's individual portfolio companies.

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

**Manager Q&A - FBR Focus Fund - October, 2010**

**Q1: You recently published a research paper, *Unconventional Wisdom*, about the merits of mutual funds with concentrated portfolios. Can you tell us more about what is in the report, and why you published it?**

Conventional investment wisdom dictates that diversification is the holy grail of risk reduction, and the more diversified the better. However, academic research shows there is a diminishing effect to the benefits of portfolio diversification. Recent research indicates that a 10-stock portfolio may eliminate 80% of unsystematic or company specific risk, and a 20-stock portfolio eliminates about 90% of this risk.[1] Yet the typical mutual fund holds more than 100 stocks – way more than is necessary for adequate diversification.

We believe that investors who concentrate their assets in fewer stocks have an important advantage compared to the typical "highly-diversified" mutual fund. With fewer securities, an investor can dedicate more time and effort to researching each individual investment. This enables better understanding of the risks and opportunities associated with each investment prospect and the key drivers of long-term value creation, which should ultimately lead to better investment decision-making. So, we believe, diversification does have a cost, and that cost is steep. The cost is the dilution of the best investment ideas by marginal ideas, and a limited understanding of each of the securities in the portfolio.

We believe that good investors occasionally have to challenge conventional wisdom. We have always understood the trade-off between diversification and specialization, which is why we attempt to strike a balance with about a 20-stock portfolio representing a wide range of industries. With the current portfolio construction, we enjoy just about all the benefits of diversification, while still maintaining an important informational advantage in our investments.

What we know intuitively about focused investing – that it optimizes risk and return potential – is increasingly being recognized by academics that are studying the empirical track record of focused funds. Since most of this academic research is relatively new, we wanted to highlight it for our shareholders and explain how and why it ties into our investment thinking.

**Q2: Tax rates are scheduled to increase significantly in 2011. How should fund shareholders think about the impact of those potential changes on their investments?**

As you are probably aware, tax legislation enacted in 2001 and 2003 is scheduled to sunset at the end of this year. Unless Congress acts soon, the income, capital gains, and dividend tax rates will reset at much higher levels beginning in 2011. The highest personal tax bracket will jump to 39.6% from the current 35.0%, and the second highest tax bracket will increase to 36.0% from 33.0%. The current 15.0% capital gains tax rate will increase to 20.0%, and qualified dividends will be taxed at ordinary income rates (up to 39.6%) rather than the current 15.0%.

One advantage of the FBR Focus Fund is that it has provided shareholders with attractive after-tax returns. The Fund's tax efficient nature is a direct result of our investment strategy which entails owning high-quality growth companies for the long-term. We intend to hold our investments for many years (over five years on average), which allows for taxable gains to be recognized at the more favorable long-term tax rate rather than the much higher short-term rate. Further, since these companies are growing, they have a need to invest in their businesses. Their corporate profits are typically retained to fund these growth investments rather than paid out to shareholders as taxable dividends. Consequently, we would expect the Fund's tax efficiency to persist.

**Q3: Please describe the opportunity that you see in one of your newest holdings: Aon Corporation ("AON").**

Aon's main business is insurance brokerage. The company helps its corporate customers identify the risks in their businesses, remediate those risks where practical, and secure cost effective insurance coverage for the balance. Aon's secondary line of business is human resource consulting, including compensation, health, benefits, and retirement consulting / administration.

[1] Source: John Y. Campbell, Martin Lettau, Burtan G. Malkiel and Yexiao Xu, "Have Individual Stocks Become More Volatile?", The Journal of Finance, Vol 56. Issue 1. February 2001

While “insurance” and “human resources” sound hum-drum, Aon is very exciting to us because of its solid and improving profitability and attractive financial characteristics. Customers have a regular annual need for its services, and once onboard, customers tend to be loyal to Aon for many years. 15-20% of revenue is converted to pre-tax profit, and the business is “asset light” so it takes little cash investment to support revenue growth.

What makes Aon such a good business is that it is one of only a handful of companies capable of servicing large customers (Fortune 1000) on a national or global basis. Since the industry has consolidated over the last two decades, there is little opportunity for the emergence of a new global brokerage or consulting platform, so profits should be lucrative and sustainable over the long-term.

Aon is a cyclical business, and we are well into the most severe insurance pricing and economic cycle in the last 50 years. This has dampened Aon’s revenue and earnings, but they should expand nicely once the cycle rebounds. Usually the valuations of a cyclical stock at the bottom of the cycle remain relatively expensive on earnings because investors anticipate an earnings rebound. Through the current down cycle, Aon has actually become quite cheap — trading around 11x our estimate of cash earnings. The low valuation and solid growth prospects provide equity owners with a good current earnings yield and the opportunity for upside from the eventual cyclical rebound.

While we wait for the insurance pricing and economic cycles to turn, Aon has numerous internal cost cutting and efficiency initiatives that should help drive earnings higher. Aon’s CEO, Greg Case, has streamlined operations and repositioned the company during his 5-year tenure, so we expect that he will continue to deliver for shareholders. Even in the absence of an upturn in the cycle, fund shareholders own a very good business with growing earnings at a discount price.

**Over the previous six months, how did the Fund perform and what factors contributed to this performance?**

For the six-month period ended April 30, 2011, the Investor Class of the FBR Focus Fund returned [redacted] compared to [redacted] for the [redacted] and [redacted] for the S&P 500 Index.

The Fund's return during the period was the result of improved business prospects for its key holdings, owed to a better overall economic outlook and company specific developments. Leading contributors to the Fund's performance were 99 Cents Only Stores (NYSE Symbol: NDN), Markel Corp. (Nasdaq Symbol: MKL), Penn National Gaming, Inc. (Nasdaq Symbol: PENN), and CarMax, Inc. (NYSE Symbol: KMX). The leading detractor from the Fund's performance was Lamar Advertising Co. (Nasdaq Symbol: LAMR).

We invest with a long-term time horizon and encourage shareholders to do the same. Despite the discussion of six-month results referenced above, we encourage investors to evaluate the Fund's performance over three-, five-, and ten-year periods since shorter time frames can be influenced by many transitory issues unrelated to the intrinsic worth of the Fund's holdings.

**Portfolio managers' comments on the Fund and the related investment outlook.**

The Focus Fund has long employed a rather unconventional approach. Ostensibly, the Fund is distinguished by its concentrated portfolio, low turnover, and long-term performance. But under the surface, there are many important, but less obvious points of differentiation from the typical mutual fund. By way of a few recent investment decisions, we hope to illustrate for you some of these subtleties so that you can better appreciate our approach to managing the Fund.

During the last six months we have had two portfolio companies receive buyout offers from private equity firms (Dynamex, Inc. and 99 Cents Only Stores). We believed both of these offers substantially undervalued these companies shares so we made the necessary filings with the SEC to become an "activist" investor (13D filing status) in order to defend our shareholders' rights and lobby for a more appropriate takeout price. Being an activist can be time consuming and potentially expensive, so it is not a decision to take lightly. However, in both circumstances we believed that we had a winning argument and very good chance to help increase the buyout price and generate an attractive return on our effort.

On April 11, 2011, The Wall Street Journal Online published an article about our 99 Cents Only Stores activity and observed that few mutual funds stage activist campaigns. This notion was not evident to us prior to reading the article, but upon some reflection it makes sense. For the economics of activism to work there generally need to be three ingredients: 1) you need to have a firmly held view of the company's value, 2) you need to be a large shareholder of the company (5%-plus), and 3) it needs to be an important enough position in your fund to warrant the effort. These ingredients are often present in our portfolio since our strategy revolves around getting to know a business very well, then making it an important, long-term investment in our portfolio when we see its stock price trading well below its intrinsic value. Since we frequently focus on small and mid-cap companies, a large position size for us often translates into a large percentage ownership in the target company. In contrast, the typical mutual fund in our peer group holds more than 100 stocks and sells those stocks about once a year making it far less likely that the three ingredients for activism will be present.

It is unusual that we have had these two activist experiences over the past six months, but the current environment is conducive to private equity and corporate buyer activity. We have never entered an investment with the intention of becoming an activist, but it is a valuable tool to have available if circumstances develop in such a way to warrant its use. We were pleased with the outcome of the Dynamex, Inc. buyout since the original proposed price was $21.25 per share and the deal closed 17% higher at a more appropriate price of $25.00 per share. We do not yet know the outcome of the buyout process at 99 Cents Only Stores, but believe that the current offer of $19.09 per share substantially undervalues the business.

Another distinguishing characteristic of the Fund is a willingness to look across the market capitalization spectrum in search of undervalued securities. Over the course of the last year, the Fund has established positions in companies with market capitalizations (at the time of purchase) ranging from $150 million (Diamond Hill Investment Group, Inc.) to $170 billion (Google, Inc.). This contrasts with many mutual funds that are pigeon holed into investing exclusively in one segment of the market capitalization range. Some mutual funds are even forced to sell their best small-cap stocks because they have appreciated into the mid-cap classification.

Because we are generally looking for growth companies, we have historically found more opportunity in the small and mid-capitalization space. We anticipate that this will continue to be the case. However, we think it is a mistake to ignore the important segment of the investable universe represented by large-cap stocks.

Despite its mega-cap status and approximately $30 billion in revenues, we believe that Google, Inc. can compound intrinsic value per share at a 15%-plus clip over at least the next five years. With a global search market share of approximately 65%, Google, Inc. is a toll gate on the growth of the Internet and the world's information. While today less than 30% of the world's population is accessing the Internet, we expect billions more to get online in the next few years. Two-thirds of the world's population has a mobile phone and these users are quickly transitioning to web-enabled devices (smart phones). In the United States, where 77% of the population is already online, the number of searches conducted last year grew at more than 20%. With its wide economic moat and rapid earnings growth, Google, Inc. as of April 30, 2011, trades at a modest 12.5x our estimate of forward twelve month economic earnings per share.

The Fund is also differentiated by its unique portfolio construction. We focus on holding about two dozen of the best investments that we can find from the universe of about 8,000 public companies. This leads us to heavy investment exposure in some sectors and little or no exposure in other sectors. For example, today we have exposure to just six of Morningstar's twelve market sectors, and even then with very different weightings. This is a distinct contrast to most mutual funds that maintain generally balanced sector exposures and try to add value by selecting the best investment opportunities within all sectors. Most mutual funds take this approach because they are focused on relative, rather than absolute returns. We accept that our approach will inevitably lead to short-term periods of underperformance relative to our prospectus benchmark, but has allowed us to substantially outperform the market over longer periods of time.

Indeed, you may have noticed that the last six months has been a period of underperformance, albeit with a favorable [redacted]. For historical perspective, consider that since the Fund's inception 14 years ago, it has underperformed its benchmark in 7 of those 14 calendar years. But over the entire period the net result has been quite satisfactory at abou [redacted] of average annual outperformance.

Our view is that long-term performance is determined just as much by what we choose to avoid as by what we choose to own. For example, healthy skepticism and a disciplined valuation overlay enabled the Fund to largely avoid the destruction wrought upon the telecom-media-technology sector during the internet bubble collapse in 2000-2003, and also largely avoid direct exposure to the mortgage lending debacle that precipitated the Great Recession. We didn't choose to own the hottest internet retailers or mortgage lenders like many of our more conventional peers, instead we avoided those industries altogether. We will continue to remain selective and disciplined in our security and sector exposure in our pursuit of creating long-term sustainable value for Fund shareholders.

**Over the previous 12 months, how did the Fund perform and what factors contributed to this performance?**

For the twelve-month period ended October 31, 2011, the Investor Class of the FBR Focus Fund returned [redacted] compared to [redacted] for the [redacted], [redacted] for the S&P 500 Index, and [redacted] for the Morningstar Mid Cap Growth Category.

On average, the Fund's portfolio companies produced growing earnings and improving earnings power over the period, with stable valuations. While economic conditions remain difficult and the recovery gradual, there was sufficient stability to allow the portfolio companies to invest in their businesses and increase their intrinsic value.

There were two major contributors to performance during the year- O'Reilly Automotive and 99 Cents Only Stores:

- O'Reilly Automotive completed a three year integration of its CSK Auto acquisition while continuing to extract value by growing commercial parts programs at those acquired stores. The company also struck new financing arrangements enabling it to improve its working capital efficiency and implement an aggressive share repurchase program.
- 99 Cents Only Stores received a buyout offer organized by its founding family. We considered the $19.09 per share offer that was made on March 13, 2011 to be inadequate so we lobbied actively for a robust auction process and higher price (our letters to the board and special committee are a matter of public record available at www.sec.gov). Our demands were met, and on October 11, 2011 the company announced the acceptance of a more equitable buyout deal at $22.00 per share.

The only major detractor from performance was Lamar Advertising. Demand for billboard advertising from Lamar's core mid-market customers has lagged the broader advertising recovery seen over the last year. Lamar stock significantly underperformed during the year as this divergence in performance became apparent.

Capital gains tax distributions of $5.24 per share this year were somewhat high in relation to the Fund's Investor Class ending share NAV on October 31, 2011 of $49.80. In general, the Fund's investment approach has been, and should continue to be relatively tax efficient since capital gains tend to be realized at lower long-term tax rates rather than higher short-term rates (note that 100% of this year's capital gain was characterized as long-term). However, the Fund's investment approach can also lead to lumpiness in the timing of capital gains distributions – such as was the case this year – as gains are realized irregularly and often in large size when we exit a long term position.

We invest with a long-term time horizon and encourage Fund shareholders to do the same. Despite the discussion of one-year results referenced above, we encourage our shareholders to evaluate the Fund's performance over three-, five-, and ten-year periods since shorter time frames can be influenced by many transitory issues unrelated to the intrinsic worth of the Fund's holdings.

**Portfolio Manager comments on the Fund and the related investment outlook.**

Over the past year, and particularly in the past six months, the financial headlines have been dominated by stories about macroeconomic risks and uncertainty. The European sovereign debt crisis, slowing GDP growth, lingering housing market distress, political rancor, and the U.S. credit downgrade have made for a very unsettled stock market.

While today's problems do seem troubling, the reality is that the world is always an uncertain place. There are routinely macroeconomic or geopolitical concerns that flare up causing significant investor angst. Consider today's concerns compared to those following the collapse of Lehman Brothers in 2008, after the attacks on September 11, 2001, during the emerging markets crisis in 1997/98, the "Japanese invasion" in the 1980s, a 20% prime rate in 1980, stagflation in the 1970s, or the 1973 oil embargo.

As investors, we are faced with the challenge of how to react to these various macroeconomic concerns. Most often these concerns prove inconsequential with the passage of time, but occasionally they manifest in damage to the real economy and corporate profits. Our general viewpoint is that it is extraordinarily difficult to make money by placing bets on macroeconomic events. Just observe the terrible track record of the full-time Wall Street economists in forecasting important turning points in the economy. The world is too complicated with too many moving parts to have this be a consistently profitable exercise. Experience has taught us that we are most effective when building the portfolio one security at a time.

As long-term investors, we fully expect that our portfolio will face turbulent economic times at various points during our investment horizon. So we prepare for this eventuality, not by selling all our stocks at the first signs of trouble, nor by rotating our portfolio into more conservative sectors, but rather by owning durable companies with a wide "margin of safety". By this we mean companies with the business model and balance sheet to survive and thrive in many economic environments, owned at attractive prices so that our long-term investment is well protected against unfavorable company specific and macroeconomic developments.

Today, we think the Fund's portfolio is composed of durable companies with a good margin of safety. In fact, we think that many of the Fund's largest holdings are well positioned to grow cash earnings per share at a double digit clip over the next several years regardless of the rate of economic recovery. These companies have their own profit drivers that are largely independent of the overall economy, i.e. American Tower (9.3% of assets*) is driven by the adoption of data intensive smart phones, O'Reilly (11.0% of assets*) is driven by its ability to further improve acquired CSK stores, and Markel (8.0% of assets*) is driven by the insurance pricing cycle and success of insurance and non insurance acquisitions.

We attempt to use stock market swoons to our advantage by purchasing shares in companies that we admire at discount prices. Over the last twelve months, we added six new holdings to the portfolio and increased the size of several other positions. Most of these changes took place during the market turmoil over the summer and fall. This is a lot of activity for us considering that the Fund has 22 total positions and a history of low turnover. However, this is also consistent with our historical pattern of long periods of portfolio inactivity when we believe that bargains are few, interspersed by a flurry of portfolio activity during periods when we believe that bargains are plentiful. While we often find ourselves in extended periods of portfolio inactivity, it is during these periods that we build and refine our list of investment prospects so that we are prepared for market opportunity when it arrives.

Whenever we add a new position to the portfolio, we carefully weigh its merit against the positions that we already have in the portfolio. We only add a new position if we believe that it is as good as, or better than what we already own. This comparison methodology helps us maintain a high standard for new purchases, and avoid complacency with existing positions. We are encouraged by these recent portfolio additions since they took the place of less favorable investment allocations in the Fund. Further, several of these new investments are in industries that did not have representation in the portfolio (i.e. health care, energy, and transportation) adding an increased level of overall diversification. Through this process of gradually, and sometimes not so gradually, layering new investment ideas into the portfolio, we achieve a process of continuous portfolio improvement. While in the short term the Fund may rise and fall with the overall market, over a period of years we think that the Fund's carefully selected portfolio of companies should produce quite satisfactory overall investment results.

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

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** As of October 31, 2011.*

## Manager Q&A - FBR Focus Fund – November, 2011

**Q1: It appears that you have been particularly active adding new names to the portfolio during the second and third quarters. Why have you been so active recently?**

Over the last six months, we added five new holdings to the portfolio and increased the size of several other positions. This is a lot of activity for us considering the Fund has 22 total positions and a history of low turnover. Macroeconomic concerns about slowing GDP growth, the U.S. debt ceiling, the U.S. credit downgrade, and the European sovereign debt crisis made for significant market declines and price volatility. We used this environment to our advantage by purchasing shares at discount prices in companies that we have wanted to own for some time. This is consistent with our historical pattern of long periods of portfolio inactivity when bargains are few, interspersed by a flurry of portfolio activity during periods when bargains are plentiful. While we often find ourselves in extended periods of portfolio inactivity, it is during these periods that we build and refine our list of investment prospects so that we are prepared for market opportunity when it arrives.

**Q2: Please tell us more about the new holdings in the portfolio.**

The new holdings cover a range of industries including Energy (World Fuel Services – INT), Health Care (Henry Schein – HSIC), Media (News Corp – NWSA), Transportation (Roadrunner Transportation Systems – RRTS), and Specialty Finance (Marlin Business Services – MRLN). Each is uniquely positioned as a leader in its particular niche, with excellent potential to grow its value at a high rate over time.

One good example is World Fuel Services. World Fuel serves as an intermediary between fuel buyers and sellers in the aviation, marine, and land fuel markets. It adds value for fuel buyers by aggregating demand across thousands of accounts to secure volume discounts from vendors, providing trade credit, and providing fuel hedging solutions, among other services. It adds value for fuel sellers by aggregating fragmented demand into ratable demand that aids operational efficiency, while reducing the credit risk and administrative intensity of servicing thousands of individual clients. World Fuel makes a small spread on each fuel transaction taking virtually no commodity price risk, and employing virtually no fixed assets.

World Fuel is the clear market leader in its industry. It is more than five times larger than the next closest competitor (in a business where scale is important), yet it has less than 5% global market share providing virtually open ended growth potential. The management team is excellent, and we were able to add shares to the Fund at just 11 times our estimate of 2011 cash earnings.

**Q3: Please discuss how you manage risk in the portfolio.**

Investing involves expending cash today to buy an interest in a company's future profits. Since no one can know with certainty how the future will unfold, risk is ever present in investing. This reality is best handled with a good dose of humility. We recognize that even the most informed investor cannot know exactly how a company or industry will develop over time. So to manage this uncertainty, we build several layers of risk control into the Fund portfolio, two of which we will discuss here.

In the past, we have discussed the key advantage of a prudently managed concentrated portfolio over a "highly diversified" mutual fund. Namely, that with fewer securities, an investor can be highly selective and focus more time and effort researching each individual investment to understand its unique risks and opportunities. So a central tenet of our risk control is the very careful selection of each individual security for the right combination of high asset quality and discount price such that we have a margin of safety against unfavorable future developments.

Another important risk mitigation tool involves controlling industry concentration. No matter how enthusiastic we are about the opportunities in a particular industry, we will refrain from making an enormous portfolio bet on any individual space. Our objective is to make prudent, high probability investments across discrete, non-correlated companies so that if one investment develops poorly, our other investments, driven by different business factors, continue to grow the overall portfolio value.

## Semi-Annual Management Commentary - FBR Focus Fund - April 30, 2012

Source: http://www.sec.gov/Archives/edgar/data/1277946/000120928612000321/e86602.htm

**Over the previous six months, how did the Fund perform and what factors contributed to this performance?**

For the six-month period ended April 30, 2012, the Investor Class of the FBR Focus Fund returned [redacted] compared to [redacted] for the [redacted], [redacted] for the S&P 500 Index, and [redacted] for the Morningstar Mid Cap Growth Category.

The Fund's return during the period was the result of improved business prospects for its key holdings, owed to a better overall economic outlook and company specific developments. Leading contributors to the Fund's performance were O'Reilly Automotive, Inc. (Nasdaq Symbol: ORLY), Bally Technologies, Inc. (Nasdaq Symbol: BYI), American Tower Corp. (NYSE Symbol: AMT), Penn National Gaming, Inc. (Nasdaq Symbol: PENN), and CarMax, Inc. (NYSE Symbol: KMX). The leading detractor from the Fund's performance was Encore Capital Group, Inc. (Nasdaq Symbol: ECPG).

We invest with a long-term time horizon and encourage shareholders to do the same. Despite the discussion of six-month results referenced above, we encourage investors to evaluate the Fund's performance over three-, five-, and ten-year periods since shorter time frames can be influenced by many transitory issues unrelated to the intrinsic worth of the Fund's holdings.

**Portfolio managers' comments on the Fund and the related investment outlook.**

We are pleased to report that during the six month period ended April 30, 2012, the Fund exited its position in 99 Cents Only Stores at a substantial profit. This sale eliminated a large and long-term holding from the portfolio. The Fund held the position for approximately seven years, and at various points during that time the position exceeded 10% of Fund assets. Please see the section below titled "99 Cents Only Stores - Shareholder Activism" for some details on our recent efforts to maximize value in this investment.

As we reflect upon this investment, it is interesting to note the stock's price volatility during our holding period. The stock suffered eleven separate occasions of 20% or greater price declines, including gut wrenching declines of 41%, 62%, 51%, and 46%. And yet, despite these price declines, the company has gradually grown its intrinsic value, and the Fund has had a good overall investment experience! The Fund's compound annual returns in 99 Cents Only Stores approximated [redacted] over the holding period which compares favorably to the low single digit returns from the major market indices.

We think that a key factor in making this a successful investment was the ability to hold onto the stock during these big price swoons, even adding to the position on several such occasions. This is not so easily done. When an investment declines significantly in market price, it is human nature to have self doubts about your investment decision. A common response from some investors is to sell a stock that is down to avoid further price declines. Some firms even implement "stop loss" rules that mandate sale of a position that moves too far below initial purchase price. While this may provide some short-term psychological relief from an unpleasant situation, it is frequently the wrong long-term investment decision.

In our experience, the best way to manage the dramatic price swings in a stock is to take a long-term view, and to have a firm opinion of the stocks' intrinsic value. It is only by knowing what a stock is worth (through diligent research and analysis), that you can determine if the current market price accurately reflects the company's value. While intrinsic value cannot be calculated with precision, it is often possible to establish a reliable range. With this intrinsic value range in mind, an investor is equipped to make the proper response when confronted with significant stock price swings.

While the price moves in 99 Cents Only Stores stock might seem unusual, they are actually quite common for an individual security. Consider that Fund holding CarMax has had nine separate 20% or greater declines since initial purchase in 2002, including declines of 51%, 80%, and 38%. Fund holding Bally Technologies has had sixteen separate 20% or greater price declines since initial purchase in 2001, including declines of 74%, 43%, 44%, 67%, 52%, and 41%. Despite this stock price volatility, like 99 Cents Only Stores, these companies have gradually grown their intrinsic value driving their stock price higher and producing nice returns for the Fund.

Our experience with 99 Cents Only Stores and other portfolio companies has long convinced us that volatility is the friend of the value investor with staying power. It is our observation that stock prices are much more volatile than a company's intrinsic value, and therein lies opportunity for the prepared investor. While the market swoons of the last several years are not enjoyable, they do create the environment in which great investment bargains can exist. We attempt to use the market volatility to the Fund's advantage by purchasing shares in companies that we admire at discount prices.

During the six month period, we used the market's volatility to add two new holdings (UTi Worldwide, Inc. and Dick's Sporting Goods, Inc.) and increase the size of six existing positions at compelling purchase prices. While recent market conditions remain particularly volatile due to the continuing European sovereign debt crisis, European recession, and fear of slowing growth in Asia, we believe many of the Fund's largest holdings are well positioned to continue to grow cash earnings per share at a double digit clip over the next several years even in a slow growth environment. Along the way, we plan to remain steadfast through the ebb and flow of fear and greed, allowing market volatility to serve us, not instruct us.

*99 Cents Only Stores - Shareholder Activism*

In March 2011, 99 Cents Only Stores received a buyout proposal from its founding family ("Schiffer/Gold Family") and the private equity firm Leonard Green Partners. We thought that the $19.09 per share proposal significantly undervalued the company, and, because of the Schiffer/Gold Family's involvement, we had serious concerns about the rigor that the company's board would apply in evaluating their offer against other opportunities.

As a long time investor in the company, and one of the largest shareholders, we believed that we had the credibility to favorably influence the sales process, and thereby improve results for Fund shareholders. Soon after the announced receipt of the buyout proposal, we changed our regulatory filing status with the SEC to "13D", enabling significantly more latitude to engage with, and potentially challenge, the company and board leadership.

We hired specialized legal counsel, and undertook a campaign to impress upon the board and other shareholders why the company was worth significantly more than $19.09 per share, and the importance of conducting a robust sales process to secure the best offer available. This campaign included a public letter to the board in April 2011, a public letter to the board's special committee in May 2011 (both available on file at the SEC's web site), numerous private communications with the special committee and its financial advisors, press releases, press interviews, and conversations with other large 99 Cents Only shareholders.

On October 11, 2011, the company announced that it had signed a binding agreement to be purchased by Ares Management, Canada Pension Plan Investment Board, and the Schiffer/Gold Family for $22.00 per share, which was a 15.2% premium to the initial proposal of $19.09 per share. While the precise impact of our 13D involvement cannot be known with certainty, we believe that these efforts were a significant influence in the process.

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

**Annual Management Commentary - Focus Fund - October 31, 2012**

Source: http://www.sec.gov/Archives/edgar/data/891944/000089853113000025/hft_fbr-ncsra.htm

**Over the previous twelve months, how did the Fund perform and what factors contributed to this performance?**

For the twelve-month period ended October 31, 2012, the Investor Class of the [redacted] Fund returned [redacted] compared to [redacted] for the [redacted], [redacted] for the [redacted] and [redacted] for the Morningstar Mid Cap Growth Category.

The Fund's favorable absolute and relative returns were a result of improved business prospects for its largest holdings, owing to a better overall economic outlook and company-specific developments. Major contributors to performance during the period included American Tower Corp., Bally Technologies, Inc. and News Corp.

- American Tower completed its conversion to a REIT structure in early 2012, which improved its tax efficiency, and the business continued to benefit from growing U.S. and international demand for improved wireless voice and data service.
- Bally Technologies continued to outpace its competitors with its strong gaming systems business, popular new product innovations and expansion into previously underpenetrated market segments.
- News Corp. continued to benefit from strong pricing power in its cable and broadcast channels, international expansion in emerging television markets and an aggressive share repurchase program.

There were no negative contributors this year - each of the Fund's 23 portfolio companies contributed positively to performance.

We invest with a long-term time horizon and encourage Fund shareholders to do the same. Despite the discussion of one-year results referenced above, we encourage fellow shareholders to evaluate the Fund's performance over three-, five-, and ten-year periods.

**Portfolio managers' comments on the Fund and the related investment outlook.**

It is our belief that the three characteristics that best predict a company's ability to create value over a five- to ten-year time frame are a high quality business, a large growth opportunity and skilled management.

As we reflect on the Fund's performance over the last year, we see several instances where management action created additional value for shareholders. Some examples include American Tower's international expansion and REIT conversion, Aon PLC's change in domicile to a lower tax jurisdiction, and White River Capital, Inc.'s large special dividend. But even more noteworthy is an event that occurred subsequent to the end of the Fund's fiscal year end; Penn National Gaming, Inc.'s (PENN, 7.2% of total assets at 10/31/12) announcement of a corporate reorganization.

On November 15, 2012, PENN announced its intent to become the first gaming company to split its business into two separate publicly traded companies, a REIT focused on owning gaming properties, and a management company focused on operating and developing gaming properties. The stock rose more than 30% on this announcement. This novel transaction should provide significant tax savings and expanded appeal to income-oriented investors (with a corresponding higher valuation multiple). Other benefits include fewer regulatory license ownership restrictions and potential new avenues of growth for both of the entities. The transformation is expected to be completed in 12 to 18 months.

The Fund has been invested in PENN, alongside its remarkable CEO, Peter Carlino, for more than a decade. While the timing and details of this recent announcement were a surprise, it is no surprise to us that Peter has once again found a thoughtful and innovative way to create value for shareholders. Time after time, Peter has demonstrated this ability through savvy casino projects, share repurchases, acquisitions and corporate transactions. Peter's record is not perfect, and there have been some disappointments along the way, but on balance he has been excellent. Across the public gaming companies, shareholder returns have been poor over the last decade, but PENN's share price has compounded at more than an [redacted] per annum clip thanks to Peter's leadership.

Occasionally, a great management team creates value through a large, high profile transaction like the recent PENN announcement, and sometimes it comes through more modest developments such as American Tower's REIT conversion, Aon's change in domicile, or White River's special dividend. But most often the benefits of great management accrue incrementally and behind the scenes through better strategic positioning and more productive use of company cash flows. Over the course of one quarter or one year these small advantages have little discernible impact on stock price performance. However, over the course of five or ten years, the time horizon over which we invest, these small incremental advantages can accumulate into big differences in company and stock price performance. Since inception, the Fund has had an average portfolio company holding period of approximately six years.

We find that many investors, because they have such short investment time horizons, do not place much emphasis on management quality. Other investors find assessing management so subjective that they don't even try. This is welcome news to us because we believe this often allows us to invest with the best management team in an industry without having to pay a premium valuation to do so.

How do we identify the very best management teams? Well, the historical track record is one of the most obvious and best indicators of management capability. But we also look for three other indicators: 1) they have a strong economic incentive to create shareholder value because of a large share ownership and/or thoughtful compensation program; 2) they run the business to maximize long-term profits, even if this means sacrificing some short-term profitability; and 3) they are thoughtful and transparent about how they allocate the company's cash flow across new projects, acquisitions, share repurchases and dividends. Peter Carlino of PENN measures up very well on these metrics, as do the CEOs and management teams of most of our portfolio companies.

Today, we think that the Fund is well positioned because we believe it contains a collection of high quality businesses with large growth opportunities, run by skilled management teams. These companies are trading at valuations that in our opinion should allow for a favorable rate of capital appreciation over the long term.

April 19, 2013

**Separate Account Client Letter**
**First Quarter 2013**

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We are delighted to be writing this first client letter to you in our roles as Portfolio Managers and Managing Members of Broad Run Investment Management, LLC (Broad Run). Through these quarterly letters, we will share with you information that we would want to know if our roles as investment manager and client were reversed. We will be candid in our reporting to you, highlighting both good and bad news. In this inaugural letter, we begin by providing a short history of our firm. We will then discuss our investment philosophy, research process, and Focus Equity Composite performance.

While our firm was founded in 2012, our investment team has worked together since 2004. Our first stop together was at Akre Capital Management "ACM" where we were the analyst team from 2004 through our departure in August 2009 (David had joined ACM in 1998, Brian in 2003, and Ira in 2004). In August 2009, we were hired by FBR Fund Advisers to serve as the portfolio managers of the FBR Focus Fund, a mutual fund that had previously been sub-advised by ACM. In October 2012, FBR sold its mutual fund business, and we founded Broad Run to sub-advise the mutual fund for its new owner and to offer our investment strategy in a separate account format.

Understanding our firm's name, "Broad Run", requires a brief geography lesson. Broad Run is a bucolic stream, or "run", in the Virginia Piedmont about 40 miles west of our firm's office. It is an important tributary to the Potomac River that flows from the Virginia Piedmont to Arlington, VA and Washington, DC, and eventually to the Chesapeake Bay. We think that Broad Run represents our journey and growth as investors – both metaphorically and literally – from our shared professional beginning at ACM in the foothills of the Blue Ridge Mountains, to our professional growth as portfolio managers at FBR in Arlington, Virginia, to our present position today as portfolio mangers and founders of our own firm.

We are proud of the results produced for clients during our time at ACM and at FBR, and we hope to continue this record of success at Broad Run. Throughout our journey, we have practiced a consistent investment approach. At Broad Run, we will continue to apply that same investment approach: a common sense investing discipline emphasizing risk control and capital appreciation – defense first, then offense – that has worked so well in the past.

<u>Defense First</u>

Charlie Ellis, in his 1985 classic investment book, *Winning the Loser's Game*, famously observed that investing was like amateur tennis, where the victor prevails because he makes fewer unforced errors than his rival does. Players are too eager to serve aces and instead double fault, or aim for the corner and miss, when all they have to do to win is consistently hit the ball back over the net.

In investing, the power of compound interest is the investor's best friend. With enough time the power of compounding can carry the investor to an easy "win". So our first consideration in investing is always to try to avoid mistakes that could interrupt the power of compounding…to avoid unforced errors. This means that we are ever watchful for businesses with rising competitive threats, excess financial leverage, unsustainable levels of demand, fad or obsolescence risk, excessive valuation, etc. We avoid businesses where rapid change or complexity make it too difficult for us to have a confident opinion about what the company, and its profitability, will look like in ten years.

<u>Then Offense</u>

If we can narrow our investment universe to only those companies that have a reasonable level of predictability and trade at modest valuations, we think that we will finish well ahead of most of our investing peers. From there, we try to select the best long-term performers. We focus our efforts on finding companies with excellent business franchises, large growth prospects, and skilled management.

- We look for businesses that have a sustainable competitive advantage that enables them to earn outsized economic profits. Some examples include high customer switching costs, high barriers to entry, a low cost position, proprietary know-how, patents and licenses.
- We look for businesses that can grow to be three or five times their current size over the next decade. We like to say "we hunt for elephants, not rabbits." The longer the growth runway, the longer we can compound capital at high rates in a relatively tax efficient manner.
- We look for management that runs the business for the long-term, makes prudent decisions investing the company's profits, and acts with integrity.

When we find the rare business possessing each of these characteristics, we are disciplined about the price we pay to help protect our downside risk, as well as to help ensure that our investment experience in the stock meets or exceeds the growth in value of the underlying business.

Research Process

We typically hold an investment for many years, so we conduct our research with an eye toward understanding the opportunity for a business over the next decade. Most of our research is focused on evaluating those things that can make a difference in the long term, i.e. the competitive structure of the industry, management quality, and the sustainability of pricing and margins.

To build this knowledge, we begin by conducting industry standard research by reading annual reports, SEC filings, financial statements, attending presentations, and meeting with senior management. But to really understand a business we find it is important to dig much deeper. So we often visit company facilities, meet with field level employees, talk to customers, interview former employees, attend industry trade shows, and speak with public and private competitors.

While this is hard and time consuming work, we believe it gives us an edge over the more shallow practices common in the investment industry. It gives us an understanding of a company and its industry that often leads to important investment insights.

There is no computer screen or formula that can identify companies that fit our mold, so we employ an eclectic search process. Some ideas are the result of continuous reading of annual reports and periodicals, some spring from our travel to meet with companies in the field, and others are a product of one investment being tangential to the next.

In most cases, when we find a high quality growth company it is not available at an attractive price. So we monitor the business and wait – sometimes for years – for the market to present an attractive entry point.

Results

For the quarter, the Focus Equity Composite returned [redacted] net of fees compared to [redacted] for the S&P 500. The returns for your individual account will differ somewhat from the Composite due to variations in account holdings. Your account's actual performance is presented in an attachment. We remind you that we manage your portfolio for long-term results, and we encourage you to evaluate its performance over a multi-year time frame. Longer-term Composite returns are presented on the next page.

While performance results are important, we think that it is equally important for you to understand the process behind the results. In this letter we have tried to provide some background on our investment philosophy and research process. In future letters, we will discuss individual companies in your account to provide you a better understanding of what you own, and why we think those investments will create value for you over time.

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.

Finally, please let us know if there has been any change to your financial circumstances that might impact the manner in which we manage your account.

Sincerely,

Broad Run Investment Management, LLC

July 19, 2013

**Separate Account Client Letter**
**Second Quarter 2013**

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For the quarter, the Focus Equity Composite returned [redacted] net of fees compared to [redacted] for the S&P 500 Index. Year to date, the Composite returned [redacted] net of fees compared to [redacted] for the S&P 500 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 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.

Your portfolio is predominantly a collection of what we believe to be secular growth businesses trading at conservative valuations. Our expectation is to own these businesses for five or even ten year periods. Over this long time horizon, we expect that your investment returns will be determined primarily by the growth in earnings power of these businesses.

Accordingly, we believe it is important to use these quarterly letters to give you a better understanding of the businesses that you own, and why you own them, rather than sharing our latest musings about the economy, markets, or politics. Our hope is that over time, your knowledge and appreciation of these businesses will grow, and you will come to understand why we think they will create long-term wealth for you. As we discuss your portfolio companies, we encourage you to view them through the lens of our five key investment criteria:

- We look for high quality companies that have a sustainable competitive advantage that enables them to earn outsized economic profits.
- We look for secular growth businesses that can become three to five times larger over the next decade.
- We look for excellent management that runs the business for the long-term and makes prudent decisions investing the company's profits.
- We look for discount valuations that provide us a margin of safety.
- We look to avoid companies with catastrophic risks like excessive financial leverage or unsustainable demand.

Notable Portfolio Changes

*Lamar Advertising (LAMR)* - During the quarter, we sold Lamar Advertising, which was about a 3.5% position. We had a long ownership history with Lamar, and at times it was a relatively large position. Ultimately, we achieved an adequate investment return in Lamar, but the business and stock never quite performed up to our expectations.

Lamar is among the largest billboard owners in the U.S. with about 140,000 "facings". Tight zoning rules restrict the construction of new billboards, so owning a large collection of existing billboards can be an excellent business. For the past several decades this tight supply has allowed billboard operators to increase pricing about 5 or 6% per year, on a relatively fixed cost base, driving very good earnings growth and cash generation. In addition, the introduction of digital billboard technology in the mid 2000s provided opportunities to selectively upgrade billboards to large LED screens that generate much more revenue than traditional analog boards.

Like most advertising companies, Lamar's revenue suffered during the 2008-2009 recession. We expected a strong revenue rebound coming out of the recession, and a resumption of historical pricing power beyond the cyclical rebound. Unfortunately, the rebound was not nearly as robust as we expected, and now more than three years later, Lamar has yet to regain meaningful pricing power. In addition, the rapid evolution of smart phone technology over the last few years - particularly mapping/navigation functions, and voice search via Google and Apple's Siri – has made us increasingly concerned that Lamar's important franchise in directional advertising (i.e. McDonald's at Exit 42, 5 miles ahead!) could face formidable new competition.

In August of 2012, Lamar announced that it was exploring a change in its legal structure from a corporation to a real estate investment trust (REIT). This announcement was met with enthusiasm by the stock market because a REIT structure provides tax savings and typically a high dividend payout that is attractive to certain investors. By the second quarter of 2013, continued enthusiasm for a potential REIT conversion, combined with a generally rising market, pushed Lamar stock to a relatively high valuation level. We did not think that the price properly reflected the soft revenue environment and emerging mobile competitive threat, so we exited the position in all accounts where feasible, and redeployed the proceeds into two other businesses (Dick's Sporting Goods and Micros Systems) that we believe offer better investment opportunity.

*Dick's Sporting Goods (DKS)* – Dick's is the largest sporting goods retailer in the U.S. with 520 Dick's and 81 Golf Galaxy stores spread across more than 40 states. The company has a knack for blending the best attributes of a large format store with the service levels of a specialty store through its "store-within-a-store" format. Dick's is advantaged by this unique store concept, buying power, and access to exclusive branded merchandise.

With industry leadership and clear competitive advantages - but just 9% market share - we believe that Dick's can sustain excellent growth for many years to come. We think that Dick's can more than double its store count and drive sales gains in existing stores by rolling out its branded in-store vendor shops and by improving footwear service. Operating margins should continue to improve over time through increased buying scale, improved private label penetration, and more effective footwear and apparel merchandising. With intelligent use of free cash flow, we believe that Dick's earnings per share can grow at a high-teens annualized rate over the next five years.

While many other growth retailers were trading at peak valuation multiples during the second quarter, Dick's was available at a discount to its historical valuation multiple and at an attractive absolute level of about 15x earnings. We believe that concern about a temporary sales slowdown due to unfavorable weather created this opportunity. We increased the Dick's allocation from about 1% of assets to about 2.5% of assets.

Instead of focusing on ephemeral issues like weather patterns or a single quarter's results, we concentrate our research efforts on building an understanding of a company's long-term value drivers: the company's business model, its competitive position, its growth prospects and capital reinvestment opportunities, and the quality of its management team. In the case of Dick's, we spent considerable time and effort investigating the two risks that we initially thought had the greatest potential to disrupt the company's future prospects: vendors selling direct to consumers through the Internet and through their own retail stores, and competition from Amazon.com and other Internet retailers. After conducting a pricing survey and speaking with Internet retailers, we concluded that Dick's is well insulated from the Internet threat because of minimum advertised price vendor policies, exclusive access to products, and product fit / trial. We also concluded that the direct to consumer efforts by Dick's vendors are for brand showcasing rather than the beginning of a new competitive channel. The rapid growth of Dick's premium vendor shops, offered in partnership with Nike, Under Armour, and The North Face, provide confirming evidence that key vendors remain committed to the wholesale channel.

*Micros Systems (MCRS)* – Micros is a provider of proprietary software and technology solutions to restaurants, hotels, and retailers. Their solutions are sold and serviced in over 180 countries, and they have leading market share in most of their addressable markets. Leading share enables Micros to invest more than its competitors in product R&D and its service network, while still maintaining lucrative profit margins. Micros solutions are mission critical to customers, and once installed, they are very difficult to displace. We believe the company has an excellent opportunity to grow as they innovate new products and solutions, and follow their anchor clients into emerging markets.

We have admired Micros for many years, but did not find an attractive entry point until recently. We established a small position (about 1% of assets) in the fourth quarter of 2012, and meaningfully increased the position in the second quarter of 2013 (now about 3% of assets). Micros stock has been under pressure the last year as sales growth has slowed due to a weak European hotel market and slow U.S. restaurant capital spending. In addition, the company has a new CEO, adding to the uncertainty. We believe that sales weakness will abate as the European economy stabilizes and enthusiasm builds for new versions of Micros products. We also believe that the new CEO's impressive track record and strong technology and sales background will ultimately benefit Micros. We purchased shares at about 14x our estimate of forward cash earnings, and we believe that - after this transition period - the business should be able to compound cash earnings per share at a mid-teens rate for many years to come.

Company Update

While we do not typically comment on short-term stock price volatility, given the origin of the recent price movement in American Tower (AMT), we thought it might be instructive to explain our thinking.

American Tower operates more than 56,000 cell towers in the U.S. and abroad, and leases space on its towers to wireless carriers such as AT&T and Verizon. Like the billboard industry, zoning restrictions make existing cell towers very good assets to own. Growth prospects are excellent as rising smartphone adoption increases demand for the company's towers in the U.S. and around the world. The company is superbly managed, and tends to trade at a reasonable valuation considering its compelling profile.

The stock opened the quarter at [redacted], ran to a high of [redacted] in May, and closed June at about [redacted], down about [redacted] from the high. American Tower is a REIT, and REIT prices tend to fluctuate with changes in U.S. Treasury yields. During this May-June period, Treasury yields rose fairly dramatically from 1.6% to 2.5%, driving American Tower stock lower.

With our long-term oriented investment strategy, and historically low interest rates, we had anticipated that rising rates would impact the stock during our holding period. We had factored rate increases into our long-term model, and still expected an excellent five-year rate of return in the shares. While rate increases may create occasional setbacks in the stock, we are willing to accept such short-term price setbacks in order to participate in the long-term wealth creation potential of the business. We have a high level of confidence that cash earnings per share growth will average more than 15% per year over the next five years, and we will likely own the shares for many years to come.

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. Finally, please let us know if there is any change to your financial circumstances that might impact the manner in which we manage your account.

Sincerely,

Broad Run Investment Management, LLC

October 18, 2013

**Separate Account Client Letter**
**Third Quarter 2013**

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For the quarter, the Focus Equity Composite returned [redacted] net of fees compared to [redacted] for the S&P 500 Index. Year to date, the Composite returned [redacted] net of fees compared to [redacted] for the S&P 500 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 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 for reference.

We did not make any material changes to your account during the quarter. Recall that our low turnover investment strategy has historically averaged a handful of new buys and a handful of sells each year, so it is not unusual to have periods of no portfolio activity. We are pleased with the collection of businesses that you own and believe that they are growing their earnings power and intrinsic value at attractive rates. We continue to scour the market looking for better alternatives to what you own today, and we will pounce when such opportunities become available.

<u>Company Updates</u>

Encore Capital Group (ECPG) is a leading "debt collector" of unpaid U.S. consumer credit cards, and increasingly telecom, bankruptcy, property tax/tax liens, and U.K. credit card debt. The company purchases unpaid receivables at a discount to face value then undertakes collection efforts on these receivables to produce revenue and drive a return on its investment. Encore has had a particularly eventful year with two large acquisitions adding to their scale and broadening their addressable market.

While an inglorious profession, debt collectors provide an essential service in the modern financial world. In fact, Encore has advantaged itself by bringing professionalism to the debt collection industry with sophisticated systems and analytics, clean collection practices, and a consumer bill of rights.

There is a general perception that Encore is a mediocre business that faces poor earnings prospects due to a recent rise in the price of charged off credit card receivables. Reflecting this view, the stock trades at a modest valuation of 10x 2014 earnings (and was at an even lower 8x at the beginning of the third quarter).

We think that this view fails to appreciate the important favorable structural changes that have occurred since the depths of the recession. Encore has dramatically improved its efficiency and lowered its costs. They have gained market share and scale, which has further perpetuated their low cost position. While credit card receivable prices have risen quite dramatically, Encore's cost structure continues to decline which should still allow it to earn improving profits. The two most recent acquisitions should aid this process.

We believe that Encore's future remains bright with mid-teens annualized earnings per share growth likely over the next five years. Should the company perform as we expect, the stock should eventually reflect the improved quality of the business and the growth opportunity at hand.

Bally Technologies (BYI) is the leading global provider of specialized information technology systems to help casinos run their casino floor. Bally is also one of the world's leading slot machine providers with a growing 15% U.S. market share in an oligopolistic industry.

Gaming devices and software systems are heavily regulated, so much so that all new titles and systems upgrades must be independently tested and authenticated by each state before they are approved for sale or lease. The infrastructure required to maintain and garner such regulatory approvals is substantial and helps keep new competitors from entering Bally's markets. Bally's fifty years of title-development experience, software-systems leadership, and worldwide reach further strengthen its competitive position. Growth opportunities are attractive as Bally introduces innovative new systems solutions and regulated gaming expands globally.

On July 16, Bally announced that it had agreed to acquire SHFL Entertainment, Inc. for total consideration of approximately $1.3 billion. This is a significant transaction in relation to Bally's own $2.9 billion value at that time. We believe that this transaction has great strategic and financial merit. Already a leading provider of slot machines and systems, the SHFL acquisition will broaden Bally's product offering to include proprietary table games, electronic table systems, and automatic shufflers. Bally will be able to offer casinos worldwide a nearly complete solution to their equipment and gaming systems needs. We believe that once integrated, the acquisition could be more than 20% accretive to earnings per share.

## 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. Finally, please let us know if there is any change to your financial circumstances that might impact the manner in which we manage your account.

Sincerely,

Broad Run Investment Management, LLC

January 22, 2014

**Separate Account Client Letter**
**Fourth Quarter 2013**

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For the year ended December 31, 2013, the Focus Equity Composite returned [redacted] net of fees compared to [redacted] for the S&P 500 Index and [redacted] for the [redacted]. For the fourth quarter, the Composite returned [redacted] net of fees compared to [redacted] for the S&P 500 Index and [redacted] for the [redacted]. 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 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.

Broad Run's Focus Equity Strategy is benchmark agnostic - meaning we do not attempt to position portfolios vis-à-vis an index. Rather than using a market index as a starting point in portfolio construction, your portfolio is constructed using bottom-up stock selection. While we are mindful of having appropriate economic diversification across the holdings in your portfolio, we do not let index sector weightings drive investment decisions.

Because the Focus Equity Strategy has minimal exposure to a number of sectors, invests across the market capitalization spectrum, and is absolute return oriented, we do not feel there is an appropriate benchmark for the Composite. Historically, we have presented the performance of the S&P 500 Index in an effort to illustrate the general trend in the equity markets. Going forward, we will replace the S&P 500 Index with the [redacted], as the latter provides a broader representation of the U.S. equity market.

<u>Notable Portfolio Changes</u>

*Mistras Group (MG)* – During the fourth quarter, we established a position in Mistras Group at about 2% of separate account client assets. Mistras is a leading provider of technology enabled "asset protection solutions"; it monitors and inspects large-scale energy, industrial and public infrastructure assets (refineries, pipelines, nuclear plants, airframes, bridges, tunnels) for performance and structural integrity. The company's clients use its services in order to comply with governmental safety and environmental regulations, extend the useful life of their assets, increase productivity, minimize repair costs, and avoid catastrophic disasters. Mistras uses a variety of technologies (e.g., acoustic emission, digital radiography, and eddy current) to inspect and monitor assets located around the world. Founded in 1978, the company is still led by its founder, Chairman, CEO, and 40% shareholder Dr. Sotirios Vahaviolos.

When we first met Dr. Vahaviolos in 2011 at an investment conference in New York City, we were immediately struck by his passion for the business, his long-term orientation, and the company's remarkable growth under his leadership (in the last ten years the company's sales have grown at a CAGR of 34%). At the time, the company appeared to fit the mold of one of our portfolio companies with the exception of its valuation (for your reference, we discussed our five key investment criteria in our second quarter 2013 letter). As is often times the case, we decided to wait for a more compelling price while continuing to follow the company from a distance.

Though the stock price languished over the last several years, cash earnings grew nicely and our interest was piqued again when we noticed Mistras among the holdings of an investor we hold in high esteem. Additional research revealed a fragmented industry evolving to the benefit of the large-scale players. Asset-intensive businesses are increasingly looking to outsource their inspection and monitoring activities to a one-stop shop with a global footprint. Importantly, the shale gas boom is anticipated to drive capital expenditures on U.S. oil and gas transportation and storage infrastructure, which should provide a strong tailwind for the company's largest end market.

We were pleasantly surprised to learn in November that Jon Wolk, the former CFO of American Woodmark (a long-standing portfolio holding), was joining Mistras as its new CFO. At American Woodmark, Jon was instrumental in the implementation of customer rationalization and capacity reductions that allowed the company to thrive the last few years. We believe that Jon's focus on expense control and intelligent capital allocation will help Mistras as it works to improve the profitability of its international segment and continues to consolidate its industry.

We believe that the continuation of the company's impressive organic growth combined with highly accretive bolt-on acquisitions and margin improvement should drive cash earning per share growth at a high-teens annualized rate over the next five years.

*Penn National Gaming (PENN) and Gaming & Leisure Properties (GPLI)* – For background, on November 15, 2012, PENN announced its intent to become the first gaming company to split its business into two separate publicly traded companies, a REIT focused on owning gaming real estate, and a management company focused on operating gaming properties. Almost one year later, on November 1, 2013, PENN completed the spin-off to its shareholders of Gaming and Leisure Properties. As a result, GLPI is now a separate company, which owns the real estate associated with 21 casino facilities, and leases the vast majority of these facilities to PENN.

We believe that as the first gaming-focused REIT, GLPI has a unique opportunity to create value by consolidating the gaming industry. GLPI's REIT status provides it a lower cost of capital compared to the rest of the industry, giving GLPI an advantage when competing to buy gaming properties. The industry is fragmented and highly leveraged, providing a potentially rich environment for transactions. As primarily a property owner, rather than an operator, GLPI is largely insulated from the stagnant overall gaming environment and competitive threats that have plagued the operators. This is because the vast majority of GLPI's revenue is from fixed, rather than variable lease payments from PENN. GLPI's primary means of creating value will be completing accretive property acquisitions rather than trying to grow same property revenue in a mature market. We view GLPI's Chairman and CEO, Peter Carlino, as one of the most savvy capital allocators / acquirers we know, and are looking forward to watching what he can accomplish over time with this unique vehicle.

Please note that we did not own GLPI at the end of the fourth quarter in taxable separate accounts. This related to a tactical decision we made around the receipt of GLPI's REIT conversion "purging" dividend. As of the date of this letter, all separate account clients once again own GLPI.

<u>Conclusion</u>

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. Finally, please let us know if there is any change to your financial circumstances that might impact the manner in which we manage your account.

Sincerely,

Broad Run Investment Management, LLC

April 28, 2014

**Separate Account Client Letter**
**First Quarter 2014**

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For the quarter, the Focus Equity Composite returned [redacted] net of fees compared to [redacted] for the [redacted]. 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 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.

<u>Notable Portfolio Changes</u>

*Brookfield Asset Management (BAM)* – During the first quarter, we established a position in Brookfield Asset Management ("BAM") at about 1% of separate account assets. BAM is one of the largest global managers of "real assets" (office and retail property, ports, transmission lines, toll roads, railroads, hydroelectric plants, wind farms, timberland) with over $174 billion under management. Real assets tend to be long-lived and provide stable and growing cash flow. Yet in the past real assets have been mostly inaccessible to passive investors. As firms like BAM buy these assets from traditional holders (utilities, corporations, governments) and make them more widely available via convenient investment products, the addressable market for their asset management services grows. To put this opportunity into context, the total value of real assets around the world exceeds $100 trillion, providing enormous potential for BAM.

BAM takes a value-oriented investment approach to this marketplace, and is among the best in the world at opportunistically buying assets and optimizing their cash flow once owned. BAM has generated excellent returns on their real asset purchases in the past, which has translated into excellent returns for BAM shareholders – the stock has returned about [redacted] annualized over both the last ten and twenty years. While these returns benefitted, to some extent, from the secular decline in interest rates, we think structural changes to BAM's business model give it the potential to continue producing similarly excellent returns in the future.

Historically, BAM used much of its own capital to buy assets, but over the last decade it has gradually transitioned to buying assets on behalf of third parties (via private equity and public investment vehicles). In April of 2013, BAM took another major step in its transition by spinning off its owned office and retail properties into a new publicly traded vehicle (Brookfield Property Partners). While BAM still owns sizeable stakes in these investment vehicles, its economics are increasingly driven by management fees and performance incentives rather than outright ownership of the assets. This approach is much less capital intensive, providing higher potential returns to BAM shareholders.

An important element of our investment case for Brookfield relates to its superb CEO, Bruce Flatt. Bruce took over leadership of BAM in 2002 at the age of 37 after rising rapidly through the ranks at BAM due to his uniquely savvy investment and deal making ability. When long time former CEO, Jack Cockwell was ready to retire, Bruce beat out candidates two decades his senior to take the reigns. During his tenure, Bruce has sold off the company's cyclical natural resources businesses (with uncanny timing) and repositioned the firm as an asset manager focused on real assets. He has already created significant value for BAM shareholders, and we think he has another two or three decades ahead of him. As is the case with many of our portfolio companies, Bruce and the rest of the leadership team are significant shareholders, owning approximately 20% of the shares outstanding ($5 billion worth!).

We purchased shares at about 105% of our estimate of net asset value. For a business that we believe can grow net asset value at a mid or high teens rate, this is an attractive price. Over time, we can foresee adding to the position opportunistically, making BAM a much larger position in your portfolio.

*News Corporation (NWSA)* - During the quarter, we sold News Corporation, which was about a 0.8% position. In June 2013, News Corporation separated its publishing business from its global portfolio of cable, broadcast, film, pay TV and satellite assets via a spin-off to shareholders. The publishing business kept the historic company moniker and the global media business was renamed Twenty-First Century Fox. We continue to own shares of Twenty-First Century Fox in client accounts.

When we first purchased shares of News Corporation in 2011, we were attracted by the cable network programming business, which generated the majority of the company's cash flow. Our view was that the cable channels would produce low double-digit revenue growth and low-teens cash flow growth over the next five years. Our appreciation for the strength of this business outweighed concern about an acceleration in the secular decline of the relatively small newspaper business. At the time, the company's shares were available at a bargain price of about 10x adjusted earnings partly on fears that a phone hacking scandal involving one of the company's British tabloids would taint other News Corp businesses.

When the separation of the publishing businesses was completed in June 2013, the market price of the new company revealed that we were not the only shareholders with a dim view for these assets. Selling pressure from uninterested shareholders caused the shares to trade at about a 40% discount to our estimate of net asset value. When this discount materially closed in the first quarter of 2014, we took the opportunity to exit the position.

*Penn National Gaming (PENN)* - During the quarter we sold Penn National Gaming out of separate accounts that held shares. PENN was about a 1.6% position in these accounts. For background, on November 15, 2012, PENN announced its intent to become the first gaming company to split its business into two separate publicly traded companies, a REIT focused on owning gaming real estate, and a management company focused on operating gaming properties. Almost one year later, on November 1, 2013, PENN completed the spin-off to its shareholders of Gaming and Leisure Properties (GLPI). As a result, GLPI is now a separate company, which owns the real estate associated with 21 casino facilities, and leases the vast majority of these facilities to PENN. We continue to own shares of GLPI in client accounts.

For many years, we have recognized that Penn National is a "treadmill business" where the company needs to keep running hard just to stay in the same place. While the company successfully developed new gaming properties in Ohio and Kansas, its existing gaming properties in Illinois, West Virginia, Maryland, Louisiana, and Indiana faced an onslaught of new competition. While we ordinarily invest in businesses whose existing operations we expect to appreciate with the passage of time, in this case we believed the company's management team possessed the skill and drive to overcome the strong headwinds facing the business.

In retrospect, the return in our PENN investment over the last 4½ year period has been disappointing. While absolute returns were reasonable (low double-digit rates), it lagged the overall portfolio performance by a wide margin. In the end, management did make an important difference, but it was not enough. Were it not for management's heroic efforts to help pass the Ohio Casino Amendment in November 2009, and the valuation expansion that accompanied management's REIT conversion, our return would have been lower.

*UTi Worldwide (UTIW)* - During the quarter, we sold UTi Worldwide, which was about a 0.7% position. UTi is a global freight forwarder, helping companies coordinate the movement of freight around the world and navigate the complex import/export rules of various nations. Freight forwarding can be a very good business with high margins, low capital needs, and attractive growth.

UTi is a company that we have followed since the mid 2000s. At that time it was performing well, but we were kept away by its high valuation and history of aggressive acquisitions. By 2008, the company was having difficulty as it became apparent that its' decade long acquisition binge had created an inefficient company with too little integration across geographies. In 2009, a new CEO, Eric Kirchner, was brought in to streamline and reposition the company. He had implemented two successful turnarounds at similar transportation logistics companies in the past, so he brought a great deal of credibility to the effort.

We first purchased shares in UTi during 2012 with the thought that the company was trading at an attractive valuation – about 15x current year earnings – and that it was three years into a five-year turnaround plan that would provide attractive margin and earnings improvement upon completion. Soon after our purchase, the entire freight forwarding industry became much more difficult with slower growth and increased pricing competition among forwarders. This was a big change for an industry that had seen twenty years of relatively uninterrupted growth and prosperity. We downgraded our earnings estimates for UTi several times, but maintained our UTi position with the belief that the company specific improvement opportunity would drive an attractive investment return.

In February of 2014, UTi revealed that its new freight forwarding IT system, which had been successfully implemented in dozens of countries in the prior twelve months, had hit a major snafu during the U.S. implementation. This stumble caused a delay in billing, which resulted in a cash shortfall and a significantly dilutive capital raise. We, and apparently most other observers, were surprised by the need to raise capital and the expensive price at which it was raised. After speaking with management, we think they raised far more capital than they needed (exacerbating the dilution). The dilution from the transaction significantly impacted our expected future value for the stock, and combined with our reduced confidence in company leadership, led us to exit the position in early March.

Our conviction in a company's business model, its leadership, and its future growth, combined with an attractive valuation, determine how we size positions in your portfolio. We maintained a small allocation to UTi because we could not develop the conviction that we needed to justify a larger allocation. This is an important element of our risk management approach. While our investment in UTi produced a loss, at just 1% of portfolio assets (at purchase price), the absolute impact on overall results was modest.

## 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

July 25, 2014

**Separate Account Client Letter**
**Second Quarter 2014**

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For the quarter, the Focus Equity Composite returned [redacted] net of fees compared to [redacted] for the [redacted]. Year to date, the Composite returned [redacted] net of fees compared to [redacted] for the [redacted]. 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.

We remain generally pleased with the performance of the companies underlying the stocks in your portfolio. As a group, they continue to grow their earnings at an attractive rate, and remain undervalued relative to our estimate of their true worth. The market's significant rise in 2013, and continued rise in 2014 have made it more difficult to identify deeply undervalued companies. But we continue to like the prospects for your holdings and are finding select opportunities to upgrade your portfolio, as discussed below.

Notable Portfolio Changes

*Simpson Manufacturing (SSD)* – During the quarter we sold Simpson Manufacturing from separate accounts, where it was about a 2.4% position. We have a long history with Simpson and admire its strong business franchise in structural "connectors". Connectors are engineered steel plates that provide structural support for wood frame buildings, especially in U.S. and Canadian earthquake and hurricane exposed regions. Simpson has come to dominate this market over the last 15 years, and today enjoys about 70% market share.

During the 2000's, gradual market share gains and increasing product content per new home drove attractive rates of growth for Simpson, but this secular growth has slowed in recent years as the company faced reinvigorated competition and natural limits to its own market share. Recognizing the maturation of its core connector business, Simpson used its prodigious cash flow to move organically and through acquisition into adjacent markets: it has expanded geographically into Europe and Asia, and broadened its product offerings to include fastener systems, shearwalls, and structural masonry repair products. While a reasonable strategy, the effort has taken significant investment and produced disappointing returns on capital.

Most recently, Simpson moved aggressively into roof truss plate manufacturing. This maneuver is a competitive response to the recent acquisition of its largest connector competitor (USP) by the largest truss plate manufacturer (Mitek, owned by Berkshire Hathaway). There is significant customer and distributor overlap between connectors and truss plates, so Mitek-USP has focused its sights on gaining market share in connectors while Simpson is now focused on truss plates. Our view is that it is going to be a long and expensive endeavor for Simpson to gain any meaningful market share in truss plates. To sell truss plates, a manufacturer needs its own roof truss design software to be used by the truss plate buyer. Truss plates buyers only want to learn and use one truss plate software system, so the incumbent truss plate provider has an entrenched position. While Simpson may be a good truss plate manufacturer, developing competitive software and displacing the incumbent is a challenging task.

Simpson, despite repeated attempts, has not demonstrated an ability to grow profitably outside its maturing core franchise. Cash flow from the connector business is being invested into these new markets at low rates of return, producing subpar growth in intrinsic value. With the recent move into truss plates, we expect this pattern to continue, with the added challenge of a reinvigorated competitor (USP) in connectors. By our calculation, we sold Simpson at a valuation that incorporated a fairly robust continued rebound in new home construction, and some reasonable success with truss plates and other new markets.

*Micros Systems (MCRS)* – In late June, Micros announced that it had entered into a definitive agreement to be acquired by Oracle at a price of $68.00 per share. We believe that Oracle's offer represents a full price to Micros shareholders and decided to exit the position in separate accounts (except in those accounts where it was prudent to wait for long-term capital gains tax treatment). Micros was about a 4.0% position in separate accounts at the time of sale.

We established the Micros position in the fourth quarter of 2012 while the shares were under pressure from slowing sales growth due to a weak European hotel market and restrained U.S. restaurant capital spending. Along with this slowing growth, investors began to worry about competition from low cost tablet based solutions. A CEO transition announced in December 2012 added to the uncertainty.

Our judgment at the time was that sales weakness would abate as the European economy stabilized and enthusiasm built for new versions of Micros' products. We also believed that the new CEO's impressive track record and strong technology and sales background would ultimately benefit Micros. We purchased shares at about 14x our estimate of adjusted earnings, and believed that - after a transition period - the business would return to its historical earnings growth rate in the mid teens.

Recently, Micros had begun to show signs of fundamental improvement, including a reacceleration of growth. In its latest reported quarterly results, sales grew 11% year-over-year with even stronger growth in earnings. While we believe that Micros would have continued to demonstrate steady progress, in our judgment the all cash offer proposed by Oracle provides full value for the shares, so we felt clients were justly compensated.

We used the proceeds from the sale of Micros and Simpson to increase the allocation to Diamond Hill and to make less significant increases to a handful of other portfolio holdings.

*Diamond Hill Investment Group (DHIL)* – During the quarter, we increased the Diamond Hill allocation in separate accounts from about 1.4% of assets to about 3.0% of assets. Diamond Hill is an investment management firm based in Columbus, Ohio, that provides services to institutions and individuals through mutual funds, separate accounts, and limited partnerships. While a relatively small firm based on its assets under management ("AUM"), we believe Diamond Hill has the ingredients (culture/people, philosophy, and process) to grow to be many times its current size.

Diamond Hill's strategies are rooted in the teachings of Graham and Buffett, emphasizing fundamental research, margin of safety, and a long-term investment horizon. The company's long-term view is reinforced by compensation, which is largely based on rolling five-year performance results. The company has an investment culture, rather than marketing culture, and the interest of clients, shareholders, and employees are well aligned. Employees may only invest for equity exposure in Diamond Hill's mutual funds or stock, and employee turnover has been very low.

Long-term investment performance has been good. Seven of the company's nine strategies have outperformed their benchmarks since inception, while the management team, led by CEO Ric Dillon, has taken AUM from $50 million in 2000 to $14.2 billion today. An improvement in investment performance after several years of average results has enabled annualized net flows to increase at a high-teens rate through the first half of this year.

We first purchased shares of Diamond Hill for the strategy in 2010 when the company had about $6.5 billion in AUM and operating margins in the low 30s. We paid about 12x our adjusted EPS estimates (excluding cash and investments) at that time. Since then, AUM has increased to $14.2 billion, operating margins have expanded to the high 30s, and the company has paid out significant special dividends. Yet for this recent Diamond Hill purchase, we only paid about 13x our current EPS estimate (excluding cash and investments). We think the business is stronger today than in 2010, and it is beginning to get traction with Tier 1 investment consultants that can help drive significant AUM growth over the next several years.

## 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

October 24, 2014

**Separate Account Client Letter**
**Third Quarter 2014**

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For the quarter, the Focus Equity Composite returned [redacted] net of fees compared to [redacted] for the [redacted]. Year to date, the Composite returned [redacted] net of fees compared to [redacted] for the [redacted]. 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.

Volatility has returned to the market after a long hiatus. The S&P 500 declined about 10% from its all-time high in September, only to recover nearly all of its lost ground more recently. One moment the market appeared concerned about plummeting German exports, falling commodity prices, and a tumbling ten-year Treasury yield. The next moment the focus had shifted to the potential for an expansion of quantitative easing in Europe, a delay to the Fed's first interest rate hike, and strong corporate earnings.

All investors face the challenge of how to react to various macroeconomic concerns that emerge on a fairly regular basis. Most often these concerns prove irrelevant with the passage of time, but occasionally they manifest in damage to the real economy and corporate profits. Our general viewpoint is that it is extraordinarily difficult to make money by placing bets on macroeconomic events. The world is too complex with too many moving parts to have this be a consistently profitable exercise. Experience has taught us that we are most effective when building your portfolio one security at a time.

As long-term investors, we fully expect that your portfolio will face turbulent economic times at various points during our investment horizon. So we prepare for this eventuality, not by selling all your stocks at the first signs of trouble, nor by rotating your portfolio into more conservative sectors, but rather by owning companies with a wide "margin of safety." By this we mean companies with the business model and balance sheet to survive and thrive in many economic environments, owned at attractive valuations so that we are well protected from both company specific and macroeconomic risks.

We think your portfolio is constructed with a good margin of safety. In fact, we think that many of your holdings are well positioned to grow cash earning per share at a mid-teens rate or better over the next several years regardless of the overall U.S. economic growth rate. These companies have their own profit drivers that are largely independent of the overall economy, i.e. American Tower is driven by the adoption of data intensive smartphones and O'Reilly Automotive is driven by a unique distribution model that should allow for continued share gains in the largely non-discretionary market for aftermarket auto parts.

<u>Notable Portfolio Changes</u>

*Bally Technologies (BYI)* – On August 1st, Bally Technologies announced that it entered into an agreement to be acquired by Scientific Games Corporation for $83.30 per share in cash, about a 38% premium over its prior day closing price and a modest premium to the stock's all-time high set in January.

The gaming equipment supply industry (Bally, IGT, GTECH, Multimedia Games and others) has been undergoing a wave of consolidation over the last year, and rumors involving Bally circulated in June and July, but we were nonetheless a bit surprised that this particular transaction came to fruition. The rationale for the deal makes sense to us – there are significant synergies to be realized by merging the second and third largest gaming equipment manufacturers – but the combined entity will have significant financial leverage and integration risk. Post deal, Scientific Games will be leveraged about 7x Debt/EBITDA. In addition, Scientific Games just acquired WMS in October of 2013, and Bally just acquired Shuffle Master in November of 2013. Now, effectively, all four of these formerly independent public companies are going to be consolidated into one entity. We have a great deal of respect for Scientific Games CEO, Gavin Issacs (a Bally alum), but he has a challenging task ahead of him.

At the time of the deal announcement, Bally was on average a 5.7% position in separate accounts. We chose to sell your Bally shares in the weeks following the announcement rather than waiting for the projected deal closing date in the first quarter of 2015 (since amended to late fourth quarter of 2014). While we viewed the transaction as likely to close – Scientific Games has contractual commitments from banks to finance the deal – we concluded that it was a still a high risk deal with reasonable potential of the buyer or banks getting cold feet and scuttling the deal or forcing a lower price. While our decision to sell meant that we had to forgo the last few dollars of potential return in Bally, given the circumstances, we thought exiting the position was the right course of action.

This acquisition appears to bring to a close our long history with Bally (we held shares in the Focus Equity strategy since 2009, and have closely followed the company since the early 2000s). Our hats are off to CEO Dick Haddrill, and his team, for a job well done. Over the last decade, Dick transformed Bally into a leading gaming equipment manufacturer and dominant casino systems provider. More recently, he made thoughtful use of the company's free cash flow and balance sheet to shrink the share count by over 30%. Adjusted EPS increased about fivefold over the decade.

*T. Rowe Price (TROW)* – During the quarter, we sold T. Rowe Price from separate accounts where it was on average a 2.5% position. We held the company's shares since 2009 and have long admired the company's unique culture and strong investment track record. Over our holding period, robust equity market returns, good relative investment performance, and positive net asset inflows combined to increase the company's assets under management ("AUM") from about $300 billion to more than $700 billion.

Historically, T. Rowe and many other U.S. equity-oriented asset managers, had a powerful business model that enabled them to produce above average rates of growth in intrinsic value. Their revenue growth was driven by healthy net asset inflows from client contributions and the appreciation of existing AUM. Modest operating leverage enabled earnings growth to exceed revenue growth. Since it takes very little working capital or fixed assets to support an asset manager, most of the earnings translated into free cash flow that could be used to repurchase stock or pay dividends to further enhance shareholder returns.

However, we have increasingly come to believe that a key element of the company's business model – namely, healthy asset inflows from client contributions – has changed for the worse, giving T. Rowe and other very large U.S. equity managers a lower growth profile going forward. The primary reason for this is the accelerating shift from active to passive investment strategies. Since 2009, passive products (ETFs and open-end index mutual funds) have seen their share of the U.S. equity fund market expand to 37% from 27%. Recent data suggests that this trend is accelerating with passive products seeing $131 billion of net inflows over the last year compared to $63 billion of net outflows for active products[2]. For T. Rowe, despite strong short and long-term performance, its annualized net flows have decelerated from high-single digit growth five years ago to near zero in the most recent quarter.

In addition, T. Rowe has a long history of making opportunistic, value-creating share repurchases. Yet the company has been fairly inactive with repurchases since the third quarter of 2013 indicating to us that management has not seen adequate value in its own shares. This observation, along with our concerns about net flows and a share price still relatively near its all-time high, combined to provide the rationale for the sale.

We used the proceeds from the sale of T. Rowe to increase your allocation to Brookfield Asset Management.

*Brookfield Asset Management (BAM)* – During the quarter, we increased the Brookfield Asset Management allocation in separate accounts from about 2.1% of assets to about 5.0% of assets. For your reference, our investment thesis for Brookfield is outlined in our first quarter 2014 letter.

Over the last six months, additional research and conversations with Brookfield senior management have provided us with the conviction to increase the position's weighting in your portfolio. We now have more confidence in the power

[2] Source: Morningstar

of the company's business model, asset raising momentum in its private fund business, and management's investment acumen.

While Brookfield and T. Rowe are both asset managers, contrasting their businesses was helpful to our decision to swap capital between the two positions. For example, Brookfield appears to be in the early or middle stages of a secular shift of institutional assets toward the real asset category, while the U.S. equity mutual fund business enjoyed its heyday in the 1980s and 1990s, and now appears secularly challenged by the shift toward passive public equity strategies. Brookfield is one of only a handful of firms that have the operational expertise, worldwide presence, and capital base to compete for large real asset transactions, while T. Rowe faces competition from nearly 800 fund sponsors with 9,000 mutual funds. Additionally, much of Brookfield's AUM is permanent or long-lived while T. Rowe's clients have daily liquidity.

## 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

January 23, 2015

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

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For the year ended December 31, 2014, the Focus Equity Composite returned [redacted] net of fees compared to [redacted] for the [redacted]. For the fourth quarter, the Composite returned [redacted] net of fees compared to [redacted] for the [redacted]. 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, 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 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 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

April 17, 2015

**Separate Account Client Letter**
**First Quarter 2015**

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For the quarter, the Focus Equity Composite returned [redacted] net of fees compared to [redacted] for the [redacted]. 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 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.

During the quarter, we established new positions in Hexcel Corporation and Ashtead Group plc, each at about 1% of separate account assets. Hexcel is a leading producer of carbon fiber and other advanced materials for the aerospace industry. Ashtead is the owner of Sunbelt Rentals, the second largest equipment rental business in the U.S. We believe that both companies are undervalued, high quality, secular growth businesses – "compounders" – that we can likely hold for the long-term. Over time, should our continuing research reinforce our investment theses, we will look to add to the positions opportunistically.

As these new positions were initially given small weightings, we thought it made sense to use this letter to explain our approach to portfolio construction and position sizing. As you know, we manage concentrated, conviction-weighted portfolios. Typically we hold 20 to 30 total positions with 60% to 80% of assets in the top ten positions. While this is an unconventional approach – most investment managers are much more diversified – we believe it allows us to provide magnified exposure to our best ideas while still maintaining economic diversification across the holdings.

When sizing individual positions, we take into consideration: 1) our confidence in the business's long-term financial prospects (a function of its fit with our investment criteria, the nature of the business, and our depth of knowledge) and 2) its valuation / expected long-term return profile. Portfolio holdings fall into three general categories:

- <u>Large weightings</u> (6-9% of assets) are reserved for businesses in which we have a *very high level of confidence* in their long-term prospects, with the stock price at a valuation that allows for very good or excellent expected investment returns. Large weightings typically compose more than half of portfolio assets.
- <u>Medium weightings</u> (3-6% of assets) are typically businesses in which we have a *high level of confidence* about their long-term prospects, with the stock price at a valuation that allows for very good or excellent expected investment returns. In some cases expected returns may even exceed those of a larger weighted position, but we limit the position sizing to reflect our lower level of confidence about the medium-weighted business's prospects.
- <u>Small weightings</u> (1-3% of assets) are typically new positions under active review, positions migrating in or out of the portfolio, or small companies that cannot accommodate a larger Focus Equity allocation.

The deeper our knowledge of a business, the better positioned we are to assess its fit with our investment criteria (high quality business, large growth opportunity, excellent management, low tail risk [explained in more detail in our Q2'13 client letter]) and to judge its long-term prospects. Because knowledge increases with additional research and the passage of time, it is difficult to have the same level of confidence about a business followed for a month as a business followed for a year. Frequently, a new position will begin with a small or medium weighting only to graduate to a larger weighting if our conviction builds over time. Less frequently, but worthy of mention, a new position is sold after further research uncovers evidence that contradicts our initial thesis.

By way of example, the position in Brookfield Asset Management was initiated at about 1% of separate account assets in Q1'14 and was increased to about a 5.0% position by Q3'14. While we had monitored Brookfield's progress from afar for almost a decade, a six-month period of more in-depth research, including multiple conversations with Brookfield senior management, provided us with the conviction to increase the position's weighting (see our Q1'14 and Q3'14 letters for more detail). In contrast, UTi Worldwide, a position first established in Q1'12, never graduated from about a 1% position. We maintained a small allocation to UTi, until it was sold in Q1'14, because we could not develop the conviction that we needed to justify a larger position. This is an important element of our risk management approach. While our investment in UTi produced a loss, at just 1% of portfolio assets (at purchase price), the absolute impact on overall results was modest. In the words of George Soros, "It's not whether you're right or wrong that's important, but how much money you make when you're right and how much you lose when you're wrong."

At the portfolio level, we contemplate how individual businesses interact as part of the whole. We attempt to limit overall exposure to any one industry or business factor risk. Our attempt is to build a portfolio in which we have high confidence in the component businesses, while also having high long-term expected returns. We seek enough diversification so that when one or several of these businesses encounter a setback, the balance of holdings can carry the overall portfolio forward.

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

July 16, 2015

**Separate Account Client Letter**
**Second Quarter 2015**

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For the quarter, the Focus Equity Composite returned [redacted] net of fees compared to [redacted] for the [redacted]. Year to date, the Composite returned [redacted] net of fees compared to [redacted] for the [redacted]. 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.

In the first quarter, we established new positions in Ashtead Group and Hexcel Corporation, each at about 1% of separate account assets. In the second quarter, additional research increased our conviction in the long-term prospects for both of these businesses, so we added to the positions on stock price weakness. Ashtead is now about 3% of separate account assets, and Hexcel is about 2%. We sold Roadrunner Transportation, which was about a 2% position, to facilitate these purchases. We discuss Ashtead, Hexcel, and Roadrunner in more detail below.

<u>Notable Portfolio Changes</u>

*Ashtead Group (AHT-LN)* – Ashtead is the owner of Sunbelt Rentals, the second largest equipment rental business in the U.S. Sunbelt rents a full range of equipment – forklifts, backhoes, aerial work platforms, scaffolding, generators, etc. – to construction contractors, industrial facilities, and other customers.

For most users, renting equipment is a better economic proposition than outright ownership because it eliminates a large capital expense, converts a fixed cost into a variable cost, and removes the need for burdensome regulatory record keeping. The rental industry is in a period of secular growth as these benefits become better known, and rental adoption increases. Today, equipment rental makes up about 53% of the overall U.S. market, up from about 42% in 2005 and 15% in 1996. In many other developed countries, equipment rental rates are 75% or more, suggesting significant remaining opportunity for growth in the U.S.

In addition, the U.S. equipment rental industry remains quite fragmented. United Rentals is the largest operator with 12% market share, Sunbelt is second with 6% share, Hertz is third with 4% share, and Home Depot and Blueline Rentals round out the top five with 1-2% share each. Beyond the top five, none have more than 1% share, and nearly half of the industry remains in the hands of thousands of small operators, each with less than $10 million of equipment inventory. Yet there are important benefits to scale and this has enabled the largest operators – in particular Sunbelt and United Rentals – to gain share. Rental customers value equipment availability, quality, and timeliness of delivery because if equipment arrives late to a job site, or breaks down, construction stops. The more sites and inventory a rental company has in a local area, the more likely it is to have the particular piece of equipment needed by the customer. The larger the rental company is overall, the better it can service regional and national customers and the more buying power it has over equipment manufacturers.

Leveraging these advantages, Sunbelt has grown from just 2% market share in 2002 to 6% share today. It has accomplished this largely through organic growth supplemented by small acquisitions. In contrast, United Rentals has been more active with large acquisitions, including almost doubling its size with the purchase of RSC in 2012. Sunbelt's approach has translated into industry leading returns on capital and uniform systems, processes, and culture. In recent years its cohesive store network and conservative balance sheet have enabled Sunbelt to service customers well and ramp up capacity while many others have been hamstrung by balance sheet constraints, tough acquisition integration, or self inflicted operating issues.

Sunbelt's goal is to achieve 12% U.S. market share in the medium-term, and 20% share long-term. We have come to believe that these objectives are quite achievable. In fact, Sunbelt already has more than 15% share in many of its more established markets. There are meaningful infill opportunities in Sunbelt's existing markets, and large pockets of the country where it does not yet have a presence. If Sunbelt is successful achieving its goals, the company could compound earnings per share at a mid-teens or higher rate per annum over the next decade. We paid about 13x our estimate of forward earnings per share, a reasonable price in our judgment, for a company with this growth potential. However, the company is quite cyclical, which factors into our 3% position weighting. While we believe that we are only in the fourth inning of an extended commercial construction cycle, and we have confidence in Ashtead's long-term prospects, we are more guarded when sizing positions in cyclical businesses.

*Hexcel Corporation (HXL)* – Hexcel is a leading producer of carbon fiber and other advanced materials designed for high-performance aerospace and industrial applications.

We believe that Hexcel has excellent growth prospects as Boeing and Airbus compete to make lighter, more durable, and more fuel-efficient airplanes. These aerospace customers are increasingly using carbon fiber (a man-made engineered material with a superb strength-to-weight ratio) and other advanced materials instead of aluminum, which is growing Hexcel's addressable content per plane. The latest generation wide body aircraft (Boeing's 787 and Airbus' A350) are over 50% composite content by weight compared to 10-15% on previous generation aircraft. On the A350, Hexcel's content per plane is about $5 million compared to about $1 million on previous generation aircraft.

We think of Hexcel as a "tollbooth" business; once Hexcel product gets designed into a new aircraft model it is almost certain to retain that supplier position for a multi-decade period. Airbus and Boeing have record order backlogs today driven in large part by demand for these next generation aircraft. As production of these new models ramp up, Hexcel's figurative tollbooth should see a significant increase in traffic, driving double-digit sales growth for at least the next five years.

Hexcel operates in a global oligopoly providing carbon fiber to the aerospace industry. Scale requirements, intellectual property, aerospace qualifications, and very high customer switching costs create barriers to entry, and limit aggressive pricing behavior by incumbents. This translates into attractive returns on capital for Hexcel and improving economics as the business scales.

We believe that Hexcel's double-digit sales growth should translate into mid-teens annualized earnings per share growth over the next five years. With its strong growth and revenue visibility, high return on invested capital, and the potential for its technology to be applied to additional end markets (carbon fiber is increasingly being used in high-end automotive applications), Hexcel should trade at a substantial premium to other aerospace suppliers and the overall market. Yet, at less than 18x our 2016 EPS estimate, Hexcel trades at a reasonable valuation and just a modest premium to its peers and the market.

*Roadrunner Transportation Systems (RRTS)* – Roadrunner provides a broad range of trucking and other transportation services to small and medium sized businesses. Roadrunner was formed through the rollup of regional less-than-truckload ("LTL") carriers in the mid-2000s. When we first became involved with the business in 2010, we were attracted to its position as the only national, asset-light LTL operator. It was our belief that this unique LTL model would allow the company to continue gaining market share from traditional high cost LTL providers, while using its free cash flow to make thoughtful acquisitions that would add further value.

Since 2010, the company has purchased truckload, refrigerated, drayage, brokerage and a host of related services businesses on the theory that a broad service menu would allow it to be a one-stop shop to its small and medium sized customers. While the service menu has broadened, it is not clear to us that there has been any meaningful cross-selling success. The LTL business has been diluted by these acquisitions and we have become increasingly skeptical that the acquisitions are providing adequate returns on capital. Add to this some recent operating missteps and senior management turnover, and Roadrunner became a source of capital for the purchase of additional Ashtead and Hexcel shares.

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 account information current.

Sincerely,

Broad Run Investment Management, LLC

October 27, 2015

**Separate Account Client Letter**
**Third Quarter 2015**

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For the quarter, the Focus Equity Composite returned [redacted] net of fees compared to [redacted] for the [redacted]. Year to date, the Composite returned [redacted] net of fees compared to [redacted] for the [redacted]. 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.

We did not make any material changes to your portfolio holdings during the quarter. Recall that our low turnover investment strategy has historically averaged a handful of new buys and sells each year, so it is not unusual to have periods of no portfolio activity. We are pleased with the collection of businesses that you own and believe that they are growing their earnings power and intrinsic value at attractive rates. We continue to search the market looking for better alternatives to what you own today, and will act when such opportunities arise.

The passage of time provides important perspective on the long-term orientation of the Focus Equity Strategy. Of the 20 positions currently held in the typical separate account, seven have been holdings in the Composite since its inception more than six years ago. Of the top 10 positions held at inception, four remain in today's top 10. This low level of turnover is consistent with our long-held belief that the best way to build wealth in the stock market is to own a carefully selected portfolio of undervalued, high quality, secular growth businesses, and to hold these businesses long-term as they compound their earnings over time.

While our long-term approach makes great sense to us, it is by no means conventional. We believe that the majority of our investment peers operate with a one or two year investment horizon, as compared to our five to ten year horizon. If your investment horizon is short-term, your research effort is likely to focus on predicting a company's short-term fundamental performance relative to consensus expectations. You likely look to develop an "edge" that gives you better insight into short-term sales trends, margins, and/or stock catalysts. Instead, with our long-term investment horizon, we conduct our research with an eye toward understanding the opportunity for a business over the next decade. We focus on evaluating those factors that we believe have the most impact on a company's investment results over the long-term: the quality of the business, its growth potential, management quality, exposure to catastrophic "tail risks", and valuation.

<u>Management Quality</u>

Of these factors, we believe that management quality – and especially management's capital allocation skill – are underanalyzed and underappreciated by most investors. We postulate that this is a direct result of the short-term investment horizons of most market participants. In the short term, capital allocation decisions typically have little impact on a stock price or business fundamentals, but like compound interest, these decisions accumulate to significant importance over time. Consider a new CEO hired to run a 100-year-old business. If that business earns a 12% return on equity today, and that ROE can be sustained, then in six years time the firm's equity base will have doubled. In just six years, the CEO will be responsible for investing 50% of all equity capital ever invested in a century old business. Over time, there is significant power to create – or destroy – shareholder value based upon what is done with a firm's profits and balance sheet.

Recognizing this, we look to invest in companies with management teams skilled at both operations and capital allocation, motivated with proper economic incentives, and possessing a long-term mindset. Assessing management quality is part art and part science. As a starting point, we review the historical financial record compiled by the management team, including trends in margins, returns on equity, and returns on capital, and how these metrics compare to other companies within their industry. As we dig deeper, we analyze the important capital allocation decisions the team has made in the past. For example, have they made large acquisitions or share repurchases, and how did those decisions turn out? As we read about the business, we stay attuned to how management discusses acquisitions, share repurchases, capital expenditures, dividends, and use of the balance sheet. When we meet with management, we query them about their capital allocation framework and how they think about creating long-term value. And of course, we evaluate their economic incentives, looking for a strong alignment of interest with the long-term equity holder.

In our experience, the most effective management teams have an unclouded view that their responsibility is to maximize long-term value per share. They understand the full set of capital allocation options in front of them, and are willing to move quickly and in size when they see an unusual opportunity. They recognize that there is a cost to acting today rather than waiting to see what opportunities are presented tomorrow, and have the internal political capital to forego short-term profits in favor of pursuing much larger, but longer-term opportunities. Unsurprisingly, we often find these characteristics in companies still run by the founder or founding family and in businesses with high insider ownership.

While capital allocation is one of the most important responsibilities of senior executives, most do not know how to allocate capital effectively. Commonly, they have advanced their careers because they exceled at sales or operations, not because of their past experience allocating capital. It is typically only after they arrive in the C-suite that their responsibilities include capital allocation. With no prior capital allocation experience, and their careers on the line, they often engage consultants and ask their institutional shareholders for their opinions. Usually, when done sorting through all the well intentioned, but conflicting advice, they remain handicapped by clouded thinking and indecision. It is the rare management team that can combine strong operating skill with excellent capital allocation ability.

While we cannot know with certainty how a management team will perform in the future, and even the best management teams can stumble, we think emphasizing management quality in our process is one factor that helps to stack the odds in our favor.

## 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 account information current.

Sincerely,

Broad Run Investment Management, LLC

January 31, 2016

**Separate Account Client Letter**
**Fourth Quarter 2015**

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For the year ended December 31, 2015, the Focus Equity Composite returned [redacted] net of fees compared to [redacted] for the [redacted]. For the fourth quarter, the Composite returned [redacted] net of fees compared to [redacted] for the [redacted]. 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.

Our Defensive Playbook

We are long-term investors in publicly traded businesses. We expect to own many of these businesses five, and even ten years from now. We believe that given a reasonable starting valuation our investment returns in these businesses will track their long-term growth in earnings per share. But, as recent market volatility reminds us, stocks, and for that matter businesses, face bumps in the road even if on a pathway to long-term value creation.

Our approach to navigating volatile markets is unchanged, which means we don't tweak and reposition the portfolio in an attempt to side-step short-term stock price volatility. Trying to time the market is largely ineffective and a distraction from what we consider the most important risk to the long-term investor: the potential for a "permanent capital loss."

A permanent capital loss is a sustained setback in investment value for long-term fundamental reasons. For us, a reasonable measure of permanent capital loss would be if an investment were worth less five years from now than it is worth today. We believe (1) negative business developments – new competition, adverse technological change, liquidity shortages, bad capital allocation, etc. – and (2) excessive valuation are the key sources of permanent capital loss, so our research process and portfolio construction methodologies are designed to help us to identify and mitigate these threats.

At the company level, our five investment criteria, in-depth business-focused research, and collaborative team-based approach provide a first line of defense. Typically, when we talk about the five criteria (high-quality business, large growth opportunity, excellent management, low "tail risk," and discount valuation) it is in the context of trying to identify long-term compounders, but the criteria also serve a loss avoidance purpose. Consider, for example:

- High-quality business - We seek to invest in businesses that have sustainable competitive advantages. Possessing such advantages should translate into higher-than-average-returns on equity, allowing for higher sustainable growth rates. In addition, we believe that those higher returns should be less subject to disruption by competition; market share, pricing, margins, and cash flow all tend to be more defensible for a business with high customer switching costs or barriers to entry.

- Large growth opportunity - We seek to invest in businesses that have large growth potential due to competitive market share gains or industry-wide secular growth trends. These businesses tend to have more control over their own destiny so that value creation can continue – albeit at a reduced pace – during challenging economic times.

- Excellent management - We seek to invest in businesses run by management teams that have a track record of value creation and personal economic incentives aligned with shareholders. Not only do we believe these executives are more likely to achieve continued success, but we also believe they are less likely to make short-sighted decisions that destroy value and jeopardize the sustainability of the business franchise.

- Low tail risk - We try to be ever watchful for businesses with rising competitive threats, excess financial leverage, unsustainable levels of demand, fad or obsolescence risk, etc. Additionally, we try to avoid businesses where rapid change or complexity make it too difficult for us to have a confident opinion about what the company, and its profitability, will look like in ten years. If we can be confident our portfolio companies are relatively well insulated from catastrophic events, we are more likely to view short-term volatility as an opportunity.

- Discount valuation - We seek to invest in businesses trading at a discount to intrinsic value, and at modest multiples of earnings and cash flow. We believe this approach provides additional upside potential if we are right about the long-term business performance, and helps reduce the downside if we are wrong in our assessment.

In evaluating an investment prospect against our criteria, we conduct in-depth fundamental research seeking a thorough knowledge of the business, its competition, and its industry. Our investment team conducts all research activities and makes all portfolio decisions. This team-based approach provides a combination of different experiences and perspectives we believe can lead to unique insights and more robust vetting of ideas. In our experience, an individual analyst – no matter how diligent – can miss an important business risk that will often be identified by the broader team.

Our second line of defense is at the portfolio level. Despite our best efforts, we have had and will continue to have individual investments go wrong. So we spread positions across a variety of industries and try to limit aggregate exposure to any single business factor so that a setback is contained and can be absorbed by progress in the rest of the portfolio. A new position to the Focus Equity Strategy will typically be sized between 1% and 4% of assets. Allocations to that position will change over time as our experience with the business grows and the strength of our conviction in the investment opportunity evolves. Large positions are reserved for businesses in which we have a very high level of confidence. Regardless of our enthusiasm for an investment, we typically limit the weight of our top position to about 10% of assets.

Notable Portfolio Changes

*Purchases*

During the quarter, we added to several separate account positions on stock price weakness. We increased Ashtead Group from about 2.5% to about 3.0% of assets, Hexcel Corporation from about 1.8% to about 4.0% of assets, and CarMax from about 5.5% to about 6.4% of assets. We discuss CarMax in detail below. For your reference, we discussed why we believe Ashtead and Hexcel have the opportunity to be long-term compounders in the second quarter 2015 letter.

*CarMax (KMX)* – CarMax is the largest used-car retailer in the U.S. It has grown into its leadership position by offering a consumer friendly car buying experience, in contrast to the adversarial experience at traditional auto dealers. CarMax stores offer a wide selection of late-model used cars (5 to 10x the typical dealer inventory) meeting high quality standards, with no-haggle pricing, and a generous return policy. The company provides a transparent vehicle financing process, attractive extended warranty options, and will buy your car from you even if they do not sell you a car.

Today, with 155 stores across the country, CarMax has about 3% share of the late-model used car market. We believe CarMax will eventually have at least 275 stores as it opens in new geographies and infills existing markets. We think an expanded store base would allow the company to more than double its market share, which seems attainable considering its has demonstrated the ability to take more than 10% share in its oldest, most penetrated markets. In addition, as consumers conduct more and more of their vehicle research online, we think CarMax is positioned to leverage its store footprint, strong brand, and technology capabilities to become the leading “omni-channel” auto retailer, which would enable further growth without the need for significant additional capital investment.

Over time, some traditional dealers have gradually adopted an element or two of the CarMax consumer value proposition, but these incremental changes have been insufficient to overcome the overall negative experience they deliver. We have also witnessed repeated attempts by startups (many sponsored by industry incumbents) to wholesale replicate the CarMax business model. None of these attempts, so far, has delivered meaningful success. We believe this is because it is deceptively difficult to manage a nationwide inventory of used vehicles that depreciate in value every day they are on the lot. CarMax has had decades to refine its information technology systems and pricing models to manage this challenge. In addition, the CarMax value proposition only gets stronger with scale. More than 30% of CarMax sales involve a vehicle transfers from one store to another. So the more stores and overall inventory in the CarMax network, the more likely CarMax is to match the shopper with his desired vehicle. The company has a multi-decade head start building this scale/network advantage. We remain watchful of some Silicon Valley startup concepts that offer peer-to-peer, and real estate light used-car sales models, but remain skeptical in their ability to deliver in the real world.

CarMax stock declined in the third and fourth quarters of 2015 on concerns about industry-wide sales and margin trends. During this period, new-car dealers found themselves with too much inventory. In response, they increased new-car promotions, which made them more attractive to consumers relative to late-model used cars. This pressured sales and margins in the used-car market.

We have seen situations like this several times in our 13 years following the industry. It will take a few quarters, but we believe wholesale used-car pricing will decline to the point that the value proposition of buying used versus new is reestablished. Once this equilibrium is reached, we think CarMax will regain its same-store sales momentum.

We view this as a short-term, transitional blip that is part of the ordinary fluctuations in this industry. We were pleased to add to our CarMax position at a low-teens multiple of estimated 2016 earnings per share (EPS). We view this as an attractive price for a company we think can compound EPS at a mid-teens rate for much of the next decade through a combination of double digit new store openings, mid-single digit same-store sales, and share repurchases.

*Sales*

During the quarter, we reduced allocations to several separate account positions, and sold out of one position entirely. As highlighted earlier in this letter, we typically limit the largest position size to about 10% of assets. In keeping with this guideline, we trimmed O'Reilly Automotive from about 10.9% of assets to about 9.8%. We reduced Diamond Hill from about 4.1% of assets to about 2.0% of assets as its rising valuation reduced our long-term expected returns relative to other portfolio companies. Additionally, we reduced Twenty-First Century Fox from about 5.0% of assets to about 4.0% of assets. We continue to like Fox's business and its prospects, but acknowledge that the pace of industry change has accelerated adding incremental uncertainty to our long-term view. Lastly, we exited Dick's Sporting Goods, roughly a 3.0% position, after concluding that the original assumptions underpinning our investment thesis were flawed. We discuss Dick's in detail below.

*Dick's Sporting Goods (DKS)* – We first established a position in Dick's in the Focus Equity Strategy in the second quarter of 2012. We were attracted to the company because of its leading position as a sporting goods retailer with attractive store economics, buying power, plenty of room for geographic expansion, and a proven owner-operator at the helm.

As we described in our second quarter 2013 letter, we expended considerable effort investigating two risks we thought had the greatest potential to disrupt the business: 1) key vendors selling direct to consumers (DTC) through the Internet and their own retail stores, and 2) competition from Amazon and other Internet retailers. We originally concluded that Dick's was well insulated from the threat of rising ecommerce sales because of minimum advertised price (MAP) – vendor policies that reduced price-based competition – the need for consumers to physically inspect certain products for fit and function, and its exclusive access to select products. We also concluded that domestic DTC initiatives of key vendors were for "showcasing" their brands rather than cannibalizing traditional wholesale distribution.

In the summer of 2014, we became concerned that third-party sellers on Amazon were increasingly breaking with MAP. When we spoke with Dick's management about this issue, they appeared unaware and dismissive of the threat. Unsatisfied with the initial response, we wrote a letter to CEO Ed Stack outlining our concerns and suggesting actions to remedy the problem. Dick's management assured us that our concerns would be raised with their vendors, but the MAP violations persisted.

At the Dick's 2015 Analyst Meeting held in April, CEO Ed Stack announced a slowing in the pace of new store openings and shared a view that 20% or slightly greater than 20% of sporting goods would eventually be sold through the Internet. He explained, "it's time to be a bit prudent about where we're putting stores and how much we're going to cannibalize, because this really is an evolving marketplace from an e-commerce standpoint." The company's forecast for total sporting goods industry online sales penetration exceeded our expectation and suggested the business might not be as well insulated from the threat of ecommerce as we thought.

Perhaps most notable, at its 2015 Investors Meeting in mid-October, Nike revealed that it plans to meaningfully accelerate the growth of its DTC business, with online sales projected to reach $7 billion in five years, up from about $1 billion today, and total DTC sales projected to reach $16 billion, up from about $7 billion today. This implies a meaningful change to Nike's domestic distribution strategy, deemphasizing growth through traditional wholesale partners such as Dick's in favor of its DTC channels. Nike is Dick's largest vendor at about 20% of merchandise purchases – up from 12% of merchandise purchases a decade ago – and an even greater percentage of profits. This announcement crystalized for us that Dick's, and all sporting goods retailers, are of diminished importance in the industry value chain. There is a strong economic incentive for Nike, Under Armour and others vendors with substantial brand equity to disintermediate their wholesale customers on the ecommerce portion of their business.

Recognizing these negative developments to two lynchpin assumptions in our investment thesis, we sold Dick's from separate accounts in late October and early November before the company's third quarter 2015 earnings release.

## Conclusion

We thank you for entrusting your capital to us. We take our 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 we should make to our records to keep your account information current.

Sincerely,

Broad Run Investment Management, LLC

April 21, 2016

**Separate Account Client Letter**
**First Quarter 2016**

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For the quarter, the Focus Equity Composite returned [redacted] net of fees compared to [redacted] for the [redacted]. The results for your account will differ somewhat from the Composite due to variations in account holdings and other client-specific circumstances. Your account's actual results are presented in an attachment. We remind you that we manage your account for long-term results, so we encourage you to evaluate its performance over a multi-year time frame. Long-term Composite performance is presented at the end of this letter.

The "Watch List"

As you know, in your portfolio we seek to own a small collection of exceptional businesses at attractive valuations, and to hold these businesses long-term allowing their growth in earnings to drive most of your investment results. It is challenging to identify businesses that meet our high hurdle for earnings growth, and rare to find them at appealing valuations. Fortunately, our concentrated and long-term oriented investment approach does not require frequent activity; on average we only need to add a few new investments each year.

A key tool in our search for these new investments is our "watch list." This is our shopping list of exceptional businesses that we would like to own if valuation and/or other circumstances allowed. This list reflects our collective knowledge after more than a decade of scouring the markets and conducting research to identify businesses that meet our five criteria (high-quality business, large growth opportunity, excellent management, low "tail risk," and discount valuation).

Some businesses have been on the watch list for just a few months, while others have been there for many years. We are continually looking to add to and refine this list, while advancing our understanding of these businesses and the industries in which they operate. Over the course of time, some development will typically occur at a watch list business spurring a fresh look and intensified consideration for its inclusion in the portfolio; perhaps the stock overacts to negative short-term news, there is a favorable industry development, or our own synthesis of information leads to a breakthrough insight. If we had not previously studied these businesses and been monitoring them, we would not be well positioned to notice the particular catalyst, nor able to intensify our research and reach an investment conclusion in as timely a manner.

During the first quarter, we established a new position in AMETEK, Inc. at a 1% initial weighting. AMETEK makes a wide variety of specialized electrical and mechanical instruments for industrial applications. AMETEK compounded earnings per share at close to 16% per annum over the last 10 years by acquiring leading niche instruments businesses and dramatically improving them using a variety of management tools (low cost sourcing, value engineering, lean manufacturing, etc.). The same people that executed this business plan in the past remain largely in place today, and we believe there is sufficient runway to continue executing this acquisition model for at least the next decade.

AMETEK is an idea from our watch list. We first studied AMETEK in early 2015 while making a systematic review of acquisition-oriented industrial conglomerates. AMETEK stood out from its peers for a variety of reasons so we advanced our work and added it to our watch list in the second quarter of 2015. At the time we liked the business but were concerned that falling oil prices, weakening emerging markets, and the strengthening U.S. dollar were not sufficiently reflected in consensus earnings expectations. By the first quarter of 2016, after revenue and earnings guidance were reset lower several times, we thought expectations more accurately reflected the macroeconomic challenges. Our continued research had advanced our understanding and appreciation of the business, so we initiated a small position. Over time, should our ongoing research reinforce our investment thesis, we will look to add to the position opportunistically.

Conclusion

We thank you for entrusting your capital to us. We will continue to do our best to protect and grow your investment over time.

Please let us know if there is any change to your financial circumstances that might impact how we manage your account. Additionally, please share any updates that may be necessary to keep our records current.

Sincerely,

Broad Run Investment Management, LLC

August 5, 2016

**Separate Account Client Letter**
**Second Quarter 2016**

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For the quarter, the Focus Equity Composite returned [redacted] net of fees compared to [redacted] for the [redacted]. Year to date, the Composite returned [redacted] net of fees compared to [redacted] for the [redacted]. The results for your account will differ somewhat from the Composite due to variations in account holdings and other client-specific circumstances. Your account's actual results are presented in an attachment. We remind you that we manage your account for long-term results, so we encourage you to evaluate its performance over a multi-year time frame. Long-term Composite performance is presented at the end of this letter.

We did not take any notable portfolio actions during the second quarter, so we will use this letter to highlight a few concepts we employ in managing your portfolio, and to introduce a table at the end of this letter that we plan to update for you at least once per year going forward.

<u>Deconstructing long-term equity returns</u>

Investment returns for the stock market, for a portfolio, or for individual equities, can be broken down in to three factors: earnings per share (EPS) growth, change in valuation, and dividend yield.

The table below deconstructs investment returns for the S&P 500 over the last 50 years using these three factors. Over this period, annualized price performance of 6.4% closely tracked annualized EPS growth of 6.2%. Change in valuation—from a starting P/E of 17.7x to an ending P/E of 19.3x—had almost no discernable impact on returns. Dividend distributions averaged 3.0% per annum, and if reinvested back into the Index would have resulted in a 9.6% annualized total return.

**S&P 500 Index: 50 Year Returns (1966 to 2015)**

| | EPS Growth* | Valuation Change | Market Performance | Dividend Yield | Total Return |
|---|---|---|---|---|---|
| Annualized^ | 6.2% | 0.1% | 6.4% | 3.0% | 9.6% |
| Cumulative | 21x | na | 22x | na | 98x |

** Excludes non operating charges in 2015*
*Data source: Robert J. Schiller, Factset*
*^ May not sum to total due to rounding and the effects of compounding*

<u>Targeting mid-teens value creation</u>

At Broad Run, we seek to produce long-term investment results that are well above those of the major market indices. We do this by constructing a portfolio of businesses that we believe will produce mid-teens, or higher, EPS growth over an extended period of time. We attempt to purchase / own these businesses at around a market multiple so that it is primarily earnings growth that drives our returns rather than change in valuation. Dividends are typically a small contributor to our total returns because most business we own tend to retain their earnings to reinvest back into growth initiatives.

Our simple logic is that if we can buy / own businesses that grow value (EPS growth + dividend yield) at nearly twice the rate of the overall market, at valuations similar to the market, then this higher growth should translate into higher absolute and relative investment returns over time. While some businesses we own will certainly fall short of our expectations, we believe enough of the others we own will meet or exceed our expectations to produce an attractive portfolio level result.

<u>"Owner Earnings"</u>

With our long-term investment horizon, we focus on what we believe to be the true underlying economics of a business rather than GAAP accounting numbers that may or may not provide a good measure of economic reality. Our preferred metric is "owner earnings," a term coined by Warren Buffett in his 1986 Berkshire Hathaway annual shareholder letter.

Owner earnings is the amount an owner of a business could take out of the business each year without diminishing the competitive position or future earnings power of that business. In some cases owner earnings are the same as GAAP net income, but in other cases adjustments are required to get to the real economics of the business. For example, in certain situations, we believe book value per share growth at a financial institution, AFFO at a real estate intensive business, or amortization-adjusted earnings at an acquisitive software company are better measures of economic profits and progress than GAAP accounting earnings.

Tracking portfolio progress

We monitor owner earnings per share, and growth in owner earnings per share at each business we own and at the portfolio level. We believe that these metrics provide a good measure of intrinsic value growth for the strategy. Of course, market price is the ultimate arbiter of value and investment results, but price and value can diverge for long periods of time so having a yardstick based upon business fundamentals is helpful.

In the table below, in column "A" we present our calculation of growth in owner earnings per share plus dividend yield for the Focus Equity Composite. In columns "B" and "C" we present total return for the Composite, both gross and net of a 1% fee. For perspective, in column "D" we present EPS growth plus dividend yield for the [redacted]. As illustrated in the discussion of 50-year S&P 500 results, we believe that EPS growth plus dividend yield is a good measure of value creation for an index. In column "E" we present total return for the [redacted]. Cumulative and annualized numbers are presented in the boxes at the bottom of the table, both including 2010, and excluding 2010 to remove the effect of the large earnings rebound from the Great Recession.

| | **Focus Equity Composite** | | | [redacted] | |
|---|---|---|---|---|---|
| | A | B | C | D | E |
| Year | Owner Earnings Per Share Growth + Dividend Yield** | Total Return Gross of Fees | Total Return Net of 1% Fee | EPS Growth + Dividend Yield | Total Return |
| 2010 | 29% | [redacted] | [redacted] | [redacted] | [redacted] |
| 2011 | 19% | [redacted] | [redacted] | [redacted] | [redacted] |
| 2012 | 17% | [redacted] | [redacted] | [redacted] | [redacted] |
| 2013 | 18% | [redacted] | [redacted] | [redacted] | [redacted] |
| 2014 | 19% | [redacted] | [redacted] | [redacted] | [redacted] |
| 2015 | 12% | [redacted] | [redacted] | [redacted] | [redacted] |
| Cumulative: | 181% | [redacted] | [redacted] | [redacted] | [redacted] |
| Annualized: | 18.8% | [redacted] | [redacted] | [redacted] | [redacted] |
| Cumulative (ex 2010): | 118% | [redacted] | [redacted] | [redacted] | [redacted] |
| Annualized (ex 2010): | 16.9% | [redacted] | [redacted] | [redacted] | [redacted] |

*[redacted] *EPS growth and dividend yield estimated using Factset data for* [redacted].

*** Based upon Broad Run s calculations; weighted by position size.*

From this table we share several observations:

- In any given year, fundamental business performance (column A / column D) and investment performance (columns B & C / column E) have differed significantly. However, when measured over several years, these differences narrow (see cumulative returns).
- Our calculation of intrinsic value growth for the Focus Equity Composite (column A) has comfortably exceeded Russell 3000 Index EPS growth plus dividends (column D).
- Total return for the Focus Equity Composite (columns B & C) has exceeded total return for the Russell 3000 Index (column E), but by less than we would expect based upon the business fundamentals in columns A and D.

We would also note that the strategy, since its inception almost seven years ago, has achieved our objective of mid-teens compounding of owner earnings per share / intrinsic value. We plan to update this chart for you at least annually, and suspect that it will become more instructive with the passage of time.

Owner earnings-based valuation

It is important to view owner earnings and intrinsic value growth in the context of valuation. Presented below is our internal estimate of owner earnings per share growth for the portfolio, and the forward price-to-owner earnings ratio for the portfolio at the beginning of each of the last seven years. As the table illustrates, despite significant market appreciation since the Great Recession, our estimates for portfolio growth and valuation remain largely inline with historical levels, leaving us with a favorable long-term outlook for the portfolio.

| | **Focus Equity Composite** | |
|---|---|---|
| Year | Price-to-NTM OE Estimate* | Growth Rate in OE/shr Estimate* |
| 2010 | 14.9x | 20% |
| 2011 | 15.4x | 16% |
| 2012 | 14.1x | 16% |
| 2013 | 15.5x | 17% |
| 2014 | 17.9x | 17% |
| 2015 | 17.4x | 17% |
| 2016 | 16.6x | 17% |

** Based upon Broad Run's estimates (may differ materially from consensus estimates); weighted by position size.*

A brief firm update

We are pleased to share that Broad Run has recently relocated. Our new office is in the same building as our old office, but on a different floor. We are enjoying a modest upgrade in finishes, with some additional square footage to accommodate growth. Our lease was struck with local office vacancy rates at 30-year highs, so rest assured that our keen sense for value remains firmly in place. Our new mailing address is:

Broad Run Investment Management, LLC
1530 Wilson Blvd., Suite 530
Arlington, VA 22209

In closing

We thank you for entrusting your capital to us. We will continue to do our best to protect and grow your investment over time.

Please let us know if there is any change to your financial circumstances that might impact how we manage your account. Additionally, please share any updates that may be necessary to keep our records current.

Sincerely,

Broad Run Investment Management, LLC

October 31, 2016

**Separate Account Client Letter**
**Third Quarter 2016**

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For the quarter, the Focus Equity Composite returned [redacted] net of fees compared to [redacted] for the [redacted]. Year to date, the Composite returned [redacted] net of fees compared to [redacted] for the [redacted]. The results for your account will differ somewhat from the Composite due to variations in account holdings and other client-specific circumstances. Your account's actual results are presented in an attachment. We remind you that we manage your account for long-term results, so we encourage you to evaluate its performance over a multi-year time frame. Long-term Composite performance is presented at the end of this letter.

There were no notable portfolio transactions during the quarter. This is not unusual for us, as our concentrated, long-term investment approach typically leads us to just three or four new positions per year, with some years higher, and others lower. At the end of the quarter, your portfolio was essentially fully invested in what we believe to be reasonably priced, high quality businesses that will compound their earnings at attractive rates for a long time to come. We continually search for opportunities to upgrade your portfolio, and will take action when circumstances warrant.

To further your understanding of what you own, and why, we will use this letter to describe our thinking behind American Tower (AMT), the largest holding (about 10% of assets) in your portfolio at the end of the quarter. We have a long history with AMT and believe it measures very well against our five investment criteria (high quality business, large growth opportunity, excellent management, low tail risk, and discount valuation) as explained below.

<u>American Tower</u>

AMT is the largest owner and operator of cellular towers in the U.S., with a growing presence in select emerging markets including Mexico, Brazil, India, Nigeria, and South Africa. These towers provide critical infrastructure to the wireless industry. Wireless carriers, such as AT&T, Verizon, T-Mobile, and Sprint, rent space on towers to install communications equipment that transmits and receives wireless signals from mobile phones and other devices.

A cell tower has wonderful economic characteristics. A typical tower has capacity for four tenants. The first tenant covers the cost of tower construction by providing a mid- to high-single digit return on capital. Each subsequent tenant requires virtually no incremental capital or operating cost by the tower owner, so more than 90% of rental revenue flows through to EBITDA. A tower with three or four tenants can have a 25%-plus return on invested capital and an 80%-plus EBITDA margin with de minimis maintenance capital expenditure needs.

So with these economics, what keeps everyone from building a cell tower in their back yard? For one, these are tall unsightly metal structures. So neighbors, preservationists, and zoning boards make it very difficult to get a new cell tower permitted. But equally important, there are only a handful of large wireless carriers in most markets. Tower lease agreements typically include five to 10 year initial terms with multiple five-year renewal options. If an incumbent tower has two or three carriers under contract, a new tower in the same trade area has limited opportunity to win clients. Over the last four years, the number of cell towers in the U.S. has grown at less than 2% per annum.

While owning a cell tower is a good business, owning a nationwide portfolio of towers is an even better business. With over 40,000 towers across the U.S. (about 25% of all cell towers in the country), AMT gets scale efficiencies in purchasing, construction, and management, while also streamlining the administrative cost and time to market for national wireless carriers.

Against this backdrop of attractive tower economics and supply constraints, there is dramatic growth in wireless data demand that is pushing carriers to lease more space on more tower locations to maintain the quality of their signal. Over the last two years, U.S. wireless data demand has doubled as data intensive 4G phones replace less data intensive 3G phones. Continued 4G phone adoption, supplemented by growth in tablets and other devices, is forecast to drive 40-50%

annual wireless data growth over the next five years (according to Cisco Systems). Further, we expect the U.S. 5G rollout to begin around 2020, driving another big uplift in data demand and cell tower utilization.

The wireless trends we see in the U.S. are playing out overseas on a lagged basis. We believe the U.S. is in the fifth or sixth inning of 4G adoption, while many emerging markets are still deploying 2G or 3G networks putting them about five or 10 years behind on the wireless technology adoption curve. Most emerging markets lack legacy fixed-line infrastructure for Wi-Fi offload, so the capture rate of data growth on wireless networks and cell towers is significantly higher than it is in the U.S. Today, AMT generates about 40% of its revenue from these faster growing overseas markets. We give credit to AMT management for investing in emerging market cell towers way ahead of competitors, establishing leadership positions that are paying off nicely today.

Unfortunately, a 40-50% annual increase in wireless data demand does not translate into a 40-50% increase in cell tower occupancy. Increased equipment occupancy is one of several solutions carriers have to meet this wireless demand, along with buying / deploying additional wireless spectrum, upgrading transmission equipment, and using non-tower transmission sites (rooftops, water towers, small-cells, DAS). Over the next five years, we expect AMT to grow revenue organically at 6-8% per annum in the U.S. and 10-14% overseas for a 9-10% blended organic revenue growth rate. With operating leverage, this organic revenue growth should translate into 10-12% organic EBITDA growth. In addition, AMT's 4-5% free cash flow yield, deployed into dividends and select acquisitions, should push total returns to the mid-teens. Today AMT trades at about 18x adjusted funds from operations (AFFO) [a reasonable approximation of owner earnings], a slight premium to the broader market earnings multiple, but with twice the expected growth of the market.

The risks we think are most pertinent to our AMT investment are technological threats / substitutes and financial leverage. Over the years, we have seen many perceived technological threats emerge, only to be proven uneconomic or technically flawed in practice. Today, traditional cell towers (150+ feet tall) are the most cost effective means to provide a strong wireless signal to a wide area. There are supplemental solutions, such as "small-cell" towers (under 30 feet tall), that can make economic sense for dense urban infill (mostly supplementing rooftop antennas, not cell towers), however, with an all-in-cost that is approximately 10x that of a macro tower site, small-cell towers have limited applicability elsewhere. Historically, satellite phones have been viewed as a possible alternative to terrestrial wireless, but billions of dollars of losses, accompanied by four major bankruptcies, have demonstrated satellite phones are only practical in niche situations (ships at sea, deep in jungles). Finally, Wi-Fi hot spots are a long rumored competitor to traditional cellular networks. Wi-Fi works well at a coffee shop or in your home, but it suffers from poor signal quality due to interference, a small service range, and a lack of mobility. We continue to watch technological developments in the industry by attending trade shows, reviewing industry publications, and speaking with consultants. This research informs our view that traditional cell towers will persist as the low cost, base-load solution for wireless communications.

Relative to most businesses we own, AMT uses significant financial leverage (~5x debt to EBITDA). We believe this leverage is appropriate given the predictable nature of the business (the debt is rated investment grade), however, it subjects the company to higher interest expense if rates rise. Simplistically, a 100 basis point (bps) rise in the cost of debt for AMT would increase interest expense by about 25%, decreasing AFFO by about 7.5% (the actual interest expense would change gradually over time since AMT has an average five year remaining term on its debt). Since we expect a mid-teens underlying growth rate in AMT's AFFO, it would take about two quarters of expected growth to recoup the AFFO lost to a 100 bps rise in financing rates, or about four quarters to recoup a 200 bps rise in rates. We would not be surprised to see a 100 or 200 bps rise in rates over our investment horizon, and consider this an acceptable risk / headwind in exchange for the significant underlying compounding of AFFO we expect from AMT. A rise in long-term rates might also impact the valuation multiple the market is willing to assign to AMT – as well as all other equities – but we believe we are reasonably well insulated with the current valuation of 18x AFFO.

Finally, we have followed the wireless and cell tower industry since the late 1990s. Over this time, we have observed that many investors understand near term industry growth, but consistently underestimate the long-term potential. We believe this is because they fail to appreciate the virtuous cycle that is at work across the industry; increasingly powerful handheld devices enable more robust applications, which require increased wireless bandwidth and throughput. Each turn of the cycle feeds the next, propelling the industry in unexpectedly favorable ways. We do not know of anyone that foresaw voice-centric Nokia phones from the late 1990s would be replaced by multifunctional BlackBerrys in the early 2000s, then full-featured Apple iPhones in the late 2000s. Without the now ubiquitous smartphone, demand for YouTube, Pandora, Google Maps, and Facebook would not be clogging up the airwaves creating the need for more broadband wireless today. With the arrival of 4G, and eventually 5G, the connected home, the connected car, and wireless delivery of cable TV become huge potential bandwidth hogs just over the horizon. While precisely modeling what impact these, and unknowable future applications will have on AMT is an exercise in futility, we believe the virtuous cycle is alive and well, and will lead to strong secular demand for wireless tower infrastructure far into the future.

In closing

We thank you for entrusting your capital to us. We will continue to do our best to protect and grow your investment over time.

Please let us know if there is any change to your financial circumstances that might impact how we manage your account. Additionally, please share any updates that may be necessary to keep our records current.

Sincerely,

Broad Run Investment Management, LLC

January 23, 2017

**Separate Account Client Letter**
**Fourth Quarter 2016**

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For the year ended December 31, 2016, the Focus Equity Composite returned [redacted] net of fees compared to [redacted] for the [redacted]. For the fourth quarter, the Composite returned [redacted] net of fees compared to [redacted] for the [redacted]. The results for your account will differ somewhat from the Composite due to variations in account holdings and other client-specific circumstances. We remind you that we manage your account for long-term results, so we encourage you to evaluate its performance over a multi-year time frame. Long-term Composite performance is presented at the end of this letter.

As we have mentioned before, we monitor the earnings growth at each of the businesses we own, and in aggregate at the portfolio level. For our investment approach (low turnover, modest valuations), we believe earnings growth (plus dividend yield) provides a good approximation of intrinsic value created[1]. Of course the market is forward looking, but past earnings levels are typically a good baseline for future earnings prospects. Market price is the ultimate arbiter of value, but price and value can diverge for extended periods of time so earnings growth is the key fundamental measure we use to evaluate long-term progress.

In our second quarter letter, we presented portfolio earnings growth and value metrics, and committed to updating them on at least an annual basis. Provided below is that updated information, with some related commentary. We plan to include this as a regular part of our fourth quarter review going forward.

Please note, when we refer to "earnings" in this letter, we are referring to earnings on a per-share basis, adjusted for certain items[2]. When we refer to earnings of the portfolio, we are referring to the aggregated earnings of the individual businesses based upon their weightings in the Focus Equity Composite (measured at the end of each calendar quarter).

<u>2016 Business Performance</u>

Our businesses made steady fundamental progress in 2016. Earnings for the portfolio grew 11% driving an estimated 12% increase in intrinsic value (inclusive of a 1% dividend yield). While this is somewhat below our "mid-teens" objective, we are content with the results considering the difficult overall environment for U.S. corporate profit growth. In comparison, the businesses in the [redacted] grew earnings [redacted] driving an estimated [redacted] increase in intrinsic value (inclusive of a [redacted] dividend yield).

| | 2016 Earnings Growth | | 2016 Dividend Yield | | Implied D in Intrinsic Value |
|---|---|---|---|---|---|
| Focus Equity Composite | 11% | + | 1% | = | 12% |
| [redacted] | [redacted] | + | [redacted] | = | [redacted] |

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[1] For further discussion, please see our Second Quarter 2016 Separate Account letter.
[2] Earnings for the Focus Equity Strategy and its underlying holdings are based upon Broad Run's calculations/estimates, with adjustments for certain amortization expenses (net of tax), non-recurring charges, and excess depreciation expenses, among other items. Broad Run's earnings calculations/estimates for the Focus Equity Strategy and its underlying holdings may differ materially from consensus. [redacted] earnings and estimates are FactSet "recurrent earnings". Contact Broad Run for additional details.

## 2016 Business Performance vs. Initial Expectations

At the beginning of 2016, our expectation was for about 17% earnings growth from the portfolio, compared to the 11% that was reported. For the [redacted], the consensus estimate was for [redacted] earnings growth, compared to the [redacted] that was reported[3].

| | 2016 Earnings Growth | | |
|---|---|---|---|
| | Initial Forecast | Actual Results | Variance |
| Focus Equity Composite | 17% | 11% | (6%) |
| [redacted] | [redacted] | [redacted] | [redacted] |

We believe there were two macroeconomic culprits to these earnings shortfalls: a disappointing 2% GDP growth rate (including continued recessionary conditions in energy and industrial markets), and strengthening of the U.S. dollar which reduced the value of overseas profits for U.S. corporations. All but two of the business we owned this year had earnings growth, and those two laggards had significant energy and industrial market exposure. In addition, we held four businesses that generated more than 40% of their revenue outside the U.S. Three of those four businesses underperformed our earnings expectations for the year, due largely to foreign currency headwinds. To the extent these macro variables stabilize or even reverse, earnings prospects for our portfolio and the overall market would improve.

## Long-Term Historical Business & Investment Performance

Our analysis of earnings growth is meant to provide an approximation, rather than a precise measure, of intrinsic value growth. As shown in the table below, there is a weak relationship between earnings growth (plus dividend yield) and price performance in any given year, but over longer time horizons there is a fairly strong relationship. We have updated the table for 2016 results.

| | Focus Equity Composite | | | [redacted] | |
|---|---|---|---|---|---|
| Year | Earnings Growth + Dividend Yield | Total Return Gross of Fees | Total Return Net of 1% Fee | Earnings Growth + Dividend Yield* | Total Return* |
| 2010 | 29% | [redacted] | [redacted] | [redacted] | [redacted] |
| 2011 | 19% | [redacted] | [redacted] | [redacted] | [redacted] |
| 2012 | 17% | [redacted] | [redacted] | [redacted] | [redacted] |
| 2013 | 18% | [redacted] | [redacted] | [redacted] | [redacted] |
| 2014 | 19% | [redacted] | [redacted] | [redacted] | [redacted] |
| 2015 | 12% | [redacted] | [redacted] | [redacted] | [redacted] |
| 2016 | 12% | [redacted] | [redacted] | [redacted] | [redacted] |
| Cumulative: | 187% | [redacted] | [redacted] | [redacted] | [redacted] |
| Annualized: | 16.3% | [redacted] | [redacted] | [redacted] | [redacted] |

** Source: FactSet*

## Business & Investment Outlook

With few exceptions, we believe the businesses in the portfolio are performing well and compounding capital for us at attractive rates. The portfolio is trading 16.4x our estimate of 2017 earnings, with earnings expected to rise 14% over 2016. This expected earnings growth rate, while attractive, is somewhat lower than prior years, a reflection of the continued difficult macroeconomic profit environment. However, valuation (based on price-to-earnings) of the portfolio is better than prior years, as shown in the next table. For comparison, the [redacted] is trading [redacted] earnings, with an expected [redacted] growth rate[4].

**[3] Source: Broad Run internal estimates for Focus Equity Composite, FactSet for Index estimates; Valuation based upon 12/31 prices.**

| | Focus Equity Composite | |
|---|---|---|
| Year | Price-to-NTM Earnings Estimate* | Estimated Earnings Growth* |
| 2010 | 14.9x | 20% |
| 2011 | 15.4x | 16% |
| 2012 | 14.1x | 16% |
| 2013 | 15.5x | 17% |
| 2014 | 17.9x | 17% |
| 2015 | 17.4x | 17% |
| 2016 | 16.6x | 17% |
| 2017 | 16.4x | 14% |

** Based upon Broad Run's internal estimates (may differ materially from consensus estimates); weighted by position size.*

Despite significant market appreciation since the Great Recession, our estimates for the portfolio's growth and valuation still remain largely in line with historical levels (with higher expected growth and lower valuation than the [redacted]), leaving us with a favorable long-term outlook.

Notable Portfolio Changes in the Fourth Quarter

Diamond Hill Investment Group (*DHIL)* - During quarter, we sold Diamond Hill from separate accounts where it was on average a 1.6% position. We held the company's shares since 2010 and have long admired the company's management, investment culture, and solid investment track record. Over our holding period, robust equity market returns and strong net asset inflows combined to increase the company's assets under management ("AUM") from about $6.5 billion to more than $19 billion. As AUM nearly tripled, the company's operating margin expanded from the low 30s to 45%. As an asset light business, most of the earnings translated into free-cash flow that was used to pay special dividends and seed new strategies.

You may recall that we substantially reduced our Diamond Hill position in the fourth quarter of 2015 and exited our position in another U.S equity-oriented asset manager, T. Rowe Price, in the third quarter of 2014. In both cases, we were concerned that the accelerating shift from active to passive investment strategies substantially reduced the forward growth profile and our margin of safety. We were willing to maintain a reduced position in Diamond Hill as the company had a number of relatively concentrated strategies with strong long-term track records, limited capacity, and substantial net-inflow momentum that we thought could more than offset industry headwinds for some time to come.

Due to Diamond Hill's success, capacity issues arrived faster than we anticipated. Over just the last two years, three strategies representing nearly half of Diamond Hill's AUM were closed to new investors (Long-Short, Small-Mid Cap, and Small Cap). Today the firm's Large Cap strategy represents more than 85% of the AUM invested in strategies open to new investors and about 45% of firm wide AUM. While the Large Cap strategy has generated benchmark-beating returns since inception, the strategy's 3-, 5-, and 10-year numbers are less impressive. Furthermore, the CEO and CFO that led the company over much of our holding period have transitioned management responsibilities to the next generation and substantially reduced their personal holdings. Recognizing that Diamond Hill now has to fight the shift from active to passive with one hand tied behind its back, we exited the position in separate accounts.

In closing

We thank you for entrusting your capital to us. We will continue to do our best to protect and grow your investment over time.

Please let us know if there has been any change to your contact information, any change to your financial circumstances or investment objectives that might impact how we manage your account, or if you would like to add or modify any reasonable restrictions to our investment advisory services.

Sincerely,

Broad Run Investment Management, LLC

April 19, 2017

**Separate Account Client Letter**
**First Quarter 2017**

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For the quarter, the Focus Equity Composite returned [redacted] net of fees compared to [redacted] for the [redacted]. The results for your account will differ somewhat from the Composite due to variations in account holdings and other client-specific circumstances. We remind you that we manage your account for long-term results, so we encourage you to evaluate its performance over a multi-year time frame. Long-term Composite performance is presented at the end of this letter.

As you know, we view the Focus Equity Strategy as a collection of our best investment ideas, regardless of market cap. Great investment ideas are hard to find, so we think maintaining a large opportunity set increases our chances of uncovering the investment gems we seek. While most of our new ideas have tended to fall in the upper small cap and mid cap areas, we do traverse the full cap spectrum from time to time. For example, we first purchased a position in mega cap Google/Alphabet at a $170 billion market cap and micro cap Diamond Hill Investment Group (since exited) at a $150 million market cap. During the first quarter, we again found opportunity in the small/micro cap space with the purchase of shares in relatively undiscovered, $280 million market cap, Drive Shack, Inc.

<u>New Position: Drive Shack, Inc. (DS)</u>

During the quarter we established a new position in Drive Shack, Inc. ("DS") at a 2% initial weighting in most accounts. DS is pivoting its business model from a yield-focused REIT to a growth-focused entertainment company. DS has recently curtailed its dividend, liquidated many of its income producing assets, and now sits with substantial cash and securities that will be redeployed into its new "Drive Shack" concept. This transition has induced selling by yield-focused shareholders providing an investment opportunity for us.

Drive Shack is a premium golf driving range with high quality food and beverage service. This is no ordinary golf driving range; it is a three story, 65,000 square foot "golf-entertainment center" with a technology enhanced driving range, bars / restaurant(s), music, and event / party space. It appeals to golfers and non-golfers alike, and offers an entertainment alternative to movie theaters, bowling alleys, billiards halls, and stand-alone bars and restaurants.

Industry pioneer, Topgolf, has already demonstrated that this is a successful concept that produces superb economics. Today it has 29 locations in the U.S., many with lines out the door during peak hours. Topgolf raised capital in early 2016 at a $1.4 billion valuation – a price of $60 million per location, versus a cost to build of $20 million per location. We estimate Topgolf generates $5-6 million of EBITDA per location, 20-25% ROIC, and 30-50% ROE.

Through conversations with industry participants, we have come to believe that a thoughtful, well-capitalized competitor can replicate Topgolf's success. Patented features at Topgolf were once a barrier to entry, but alternative technologies have arisen creating pathways to compete and differentiate. DS plans to compete with Topgolf, learning from the best of what Topgolf has developed and adding some innovations of its own. We believe there is room for 100 to 150 of these facilities in the U.S., providing plenty of room for two large competitors to coexist. DS plans to open its first Drive Shack location around the end of 2017 / beginning of 2018 (in Orlando, FL), with several more locations to follow soon thereafter.

Through a long and winding history, DS is externally managed by Fortress Investment Group, LLC, a large private equity firm. Fortress has substantial experience in the entertainment space, and a history of creating new businesses. Wes Edens, the Chairman of both Fortress and DS, has purchased more than $15 million of DS shares over the last four months. He has allocated one of his rising stars to the business, and we believe he is dedicating much of his own time to it as well.

We do not typically participate in early stage businesses because they often have unproven business models and rich valuations, and therefore unfavorable risk-return profiles. However, we believe this situation is different. We see a margin of safety in just how profitable Topgolf is: if Drive Shack can be even 50% as profitable per location as

Topgolf, we believe we will generate a decent investment outcome. Further, we paid a comfortable discount to our estimate of the value of the net cash, securities, and other assets DS owns today. If the first several Drive Shacks are not successful, DS can curtail the rollout, preserving much of the balance sheet value. Capital deployed into Drive Shack locations will go mostly into real estate, which should be an attractive acquisition target for Topgolf or another competitor if undermanaged by Drive Shack. So we believe our downside is fairly limited, with potential to earn many multiples of our cost basis in a blue sky scenario.

## In closing

We thank you for entrusting your capital to us. We will continue to do our best to protect and grow your investment over time.

Please let us know if there has been any change to your contact information, any change to your financial circumstances or investment objectives that might impact how we manage your account, or if you would like to add or modify any reasonable restrictions to our investment advisory services.

Sincerely,

Broad Run Investment Management, LLC

July 20, 2017

**Separate Account Client Letter**
**Second Quarter 2017**

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For the quarter, the Focus Equity Composite returned [redacted] net of fees compared to [redacted] for the [redacted]. Year to date, the Composite returned [redacted] net of fees compared to [redacted] for the [redacted]. The results for your account will differ somewhat from the Composite due to variations in account holdings and other client-specific circumstances. We remind you that we manage your account for long-term results, so we encourage you to evaluate its performance over a multi-year time frame. Long-term Composite performance is presented at the end of this letter.

We added one new position during the quarter, NVR, Inc., and saw a material price decline in another holding, O'Reilly Automotive. We share our thinking on both companies in this letter. Also, we usually limit the largest position size to about 10% of assets. In keeping with this guideline, we trimmed American Tower from about 10.8% of assets to about 9.9%.

<u>New Position: NVR, Inc. (NVR)</u>

During the quarter we established a position in NVR at a 2% initial weighting. NVR is a top ten homebuilder doing business under the NV Homes, Ryan Homes, and Heartland Homes brands. The company operates in fourteen East Coast states with a concentration in the Baltimore-Washington region (43% of 2016 revenue).

In general, homebuilding is not a business that we find appealing; it is cyclical and capital intensive, with limited competitive differentiation. However, NVR is an exception; it employs a unique business model that enables a much higher ROIC / ROE and more stable earnings / cash flow. This model should allow the company to gain share in a fragmented market for a long time to come.

We think NVR's unique business model and superior economics are built on three pillars.

- First, and most obvious, NVR outsources the ownership, entitlement, and development of land to third parties, making the company asset-light and flexible. To accomplish this, the company signs contracts with land developers giving NVR the exclusive option to acquire finished lots within certain communities. Land and lot development is a capital intensive, multi-year process, so this approach relieves NVR of these capital requirements while also enabling the renegotiation or abandonment of land commitments during difficult times. In exchange for this flexibility, NVR pays developers a premium price for finished lots. Further, for developers, the upfront cash deposit NVR pays covers a meaningful portion of project startup costs, and the contract (with NVR's size and reputation) helps facilitate attractive development financing from lenders.

- Second, with the operational and capital burden of land development outsourced, NVR has had the bandwidth to focus on becoming very efficient at constructing homes. It applies lean manufacturing to home construction, stripping out waste and expense from the process. For example, it offers fewer home designs than traditional builders (to reduce complexity) and assembles many components in offsite facilities (to improve throughput and quality). This efficiency is illustrated by its best in class "cycle time"; it takes NVR about three months to deliver a completed home to a customer versus an industry average of about four months.

- Third, NVR has built leading market share in its oldest markets, and seeks to be the dominant builder in each market in which it competes. Scale and market share enable NVR to leverage its management and marketing expense, secure attractive terms with vendors, and get good access to quality land deal flow.

Compared to a traditional homebuilder, NVR has a lower gross margin, offset by lower SG&A expense, netting to a similar overall operating margin. However, with land development outsourced, and good cycle times on home construction, NVR has much less capital invested allowing it to earn about a 15-20% ROIC and 20-30% ROE versus about 8-10% and 12-14%, respectively, at the other well run public builders. Further, NVR was the only public homebuilder to maintain positive earnings (more than $100 million in its worst year) during the housing bust.

Despite this success, NVR does not have anyone of note emulating its business model. We believe this is because competitors would have to effectively employ all three pillars cited above. Small- and mid-sized builders do not have the scale, construction efficiencies, or know-how to achieve attractive economics with this model. And large builders already have huge land development teams and billions of dollars invested in land ownership. After the housing bust, several large builders spoke about taking a more asset-light approach, but with the passage of time, those builders have maintained their old ways of doing business. Structurally, and culturally, the vast majority of homebuilders hold land ownership and development in high regard, as illustrated by the industry saying, "we build homes to sell land".

NVR actually began as a traditional homebuilder, and met with great success through the 1980s. However, the early 1990s recession pushed the company into bankruptcy, causing founder, Dwight Schar, to rethink the business model. Bankruptcy was the catalyst for change, but we believe it was NVR's existing scale and local market share that enabled it to successfully pivot.

Since the early 1990s, NVR has fostered a cadre of developers receptive to its business model. The company has gradually grown from its core Washington, D.C. base into adjacent markets where it could leverage its existing infrastructure and relationships. Today, it has about 20% market share in Washington, D.C., and 30% share in both Baltimore and Richmond. Newer markets, such as Pittsburgh and Charlotte, have 5-10% share, but are gaining as NVR gradually wins over incumbent land developers with its ability and willingness to pay higher prices than others. With just 2% share of the U.S. single-family home construction market, we expect NVR to sustain market share gains for a very long time.

Of course, homebuilding is a cyclical industry, but we believe that the U.S. is only partway through the recovery from the housing bust, so there is more upside for the market. Based upon long-term demographic data and homeownership rates, we believe that the country needs about 1.5-1.6 million new housing units per year to accommodate population growth. About 0.4 million of these units typically come in the form of multi-family housing, leaving a need for about 1.1-1.2 million single-family units. Today the U.S. is producing single-family units at only a 0.8 million rate, requiring 35-50% unit growth just to get back to a normalized level. Further, if we look at the number of housing units overproduced during the housing boom, and net that against underproduction since the housing bust, the market appears to be about 5 million housing units short of where it should be. As millennials increasingly join the ranks of homeownership, there is the potential that unit production rates will exceed normalized levels for many years until the U.S. gets back into housing stock equilibrium.

We also like NVR's management. Founder, Dwight Schar, is still Chairman of the Board, and CEO, Paul Saville, has been with the company since the 1980s. Each of these executives still owns more than $150 million of NVR stock. We give management credit for pivoting to an asset-light business model and fostering a culture and processes supportive of that strategy. They have been aggressive repurchasing their own stock, and opportunistic during the housing bust by renegotiating lot option contracts and moving into new geographies. They take a fairly conservative and long-term view in running the business, and spend little time on investor relations. Our primary criticism is that the equity compensation program is particularly generous to executives.

Finally, over a full housing cycle, we expect NVR to expand revenue about 7-12% per annum, composed of 5-10% organic unit growth and about 2% pricing growth. With a 20%-plus ROE, NVR should have significant free cash flow to direct toward share repurchases, pushing total earnings-per-share growth to about 13-16% per annum. We think that we have purchased shares with a good cyclical tailwind (though clearly not at the bottom!) as housing production returns to normalized levels, and that pricing in the D.C. market is poised to accelerate, providing potential upside to our numbers. We paid about 15 times our forward earnings estimate for NVR, a premium multiple to other homebuilders, but more than fully justified in our view, given the much better economics of the business model.

<u>Update: O'Reilly Automotive (ORLY)</u>

Shares of O'Reilly Automotive (about a 5.7% current weighting in most client portfolios) and its brick and mortar competitors have declined materially this year as disappointing same-store sales (up about 1.3% in the first half of the year for ORLY versus initial expectations of up 3-5%) stoked fears of market share loss to Amazon. We believe that Amazon's growth had a de minimus impact on same-store sales and that the sales weakness was instead a product of two consecutive warm winters and the lapping of significant increases in vehicle miles driven in 2015 and 2016. As weather normalizes and we anniversary these sales trends beginning in Q1'18, we expect the company to return to 3-5% same-store sales growth and mid-teens or better earnings-per-share growth.

We continue to believe the aftermarket auto parts distribution business is among the distribution/retail businesses most shielded from competition from Amazon. The commercial side (do-it-for-me, "DIFM") of the business (42% of O'Reilly's sales) requires "hot shot" delivery (mechanics generally expect to receive parts in 30-45 minutes) of more than a hundred thousand different SKUs. This is challenging without a significant store level, hub store level, and distribution center level inventory investment. It is difficult for Amazon to stock that much slow turning inventory close to the customer without a substantial brick and mortar investment and without a large base of commercial business. Much of the retail do-it-yourself ("DIY") side of O'Reilly's business (58% of sales) is immediate/same day need in nature, requires significant customer service (help with finding the right part, diagnosing the problem), has a large portion of customers that pay in cash, and involves frequent product returns.

Importantly, the availability of highly discounted auto parts online or from a catalog is not a new phenomenon. Rockauto has been around since 1999. Amazon entered the auto parts business in 2006. Before the existence of online competition, catalogs offered price discounts relative to brick and mortar stores. We acknowledge that the online/catalog channel presents a better value proposition for a small portion of DIYers that do not require assistance and do not need the part immediately. Amazon will continue to grow, expand its availability of next day and same day delivery, and compete aggressively for that sub segment of the market. Brick and mortar auto parts retailers will continue to face attrition of that customer segment going forward, as they have in the past.

Our calls/visits with regional auto part chain owners, store managers, vendors, and consultants over the last few weeks continue to confirm our view that recent same-store sales weakness was not a function of market share loss to Amazon or other internet retailers. We also note that Monro Muffler and NAPA have had weak comps even though they are DIFM focused, indicating the weakness is broad based and not connected to Amazon. The latest information we have (from May 2017) is that Amazon has $4-5B (90% DIY and 10% DIFM) of automotive parts sales growing at about a 20-25% rate, with $1.2-1.5B of sales of core aftermarket product that competes directly with O'Reilly. Relative to O'Reilly's $154 billion addressable market, Amazon's applicable $1.2-1.5 billion auto parts business is simply too small to explain the recent comp store sales slowdown.

The developments at O'Reilly over the last couple quarters have had only a modest negative impact on our earnings-per-share estimates five and seven years out (assuming we are correct and same-store sales do return to the 3-5% range in the not too distant future). We had modeled some multiple compression over our investment horizon, but expected it to layer in over a period of years, not months, and our scenarios did not include the stock trading as low as its current 14x forward multiple. While we believe that the Amazon fears are overblown, we acknowledge that once Amazon enters the daily conversation about a traditional retailer/distributor, the market values that company at a step function lower multiple. We suspect it will be difficult for O'Reilly ever fully shake this concern, so we have lowered future valuation multiple assumptions accordingly. That said, we believe the shares offer an attractive expected return profile.

In closing

We thank you for entrusting your capital to us. We will continue to do our best to protect and grow your investment over time.

Please let us know if there has been any change to your contact information, any change to your financial circumstances or investment objectives that might impact how we manage your account, or if you would like to add or modify any reasonable restrictions to our investment advisory services.

Sincerely,

Broad Run Investment Management, LLC

October 20, 2017

**Separate Account Client Letter**
**Third Quarter 2017**

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For the quarter, the Focus Equity Composite returned [redacted] net of fees compared to [redacted] for the [redacted]. Year to date, the Composite returned [redacted] net of fees compared to [redacted] for the [redacted]. The results for your account will differ somewhat from the Composite due to variations in account holdings and other client-specific circumstances. We remind you that we manage your account for long-term results, so we encourage you to evaluate its performance over a multi-year time frame. Long-term Composite performance is presented at the end of this letter.

During the quarter, we sold our World Fuel Services (INT) position in separate accounts, where it was about 2.1% of assets, after concluding that it was unlikely to compound value for us at a sufficient rate. We discuss this sale below. Also, we use this letter to discuss our roughly 9.2% position in Markel (MKL), a large holding that we have a long history with, but have not previously written about at length.

<u>World Fuel Services</u>

We first purchased World Fuel Services for the Focus Equity Strategy in the third quarter of 2011. At that time, we were attracted to the company by its leadership in marine and aviation fuel distribution, its high ROIC business model, and its long-tenured and successful management team. World Fuel was also benefiting from fuel producers outsourcing fuel marketing to third-party distributors/brokers, so we believed that it was well positioned for profitable growth through continuation of this trend.

World Fuel is the largest, and among the most credit worthy of the independent fuel distributors. During the Great Recession, and for several years afterward, its superior access to credit enabled World Fuel to finance favorable payment terms for customers (at a very healthy margin) when competitors could not. As credit has become more widely available, and oil prices have declined (from about $100 per barrel in 2011 to about $50 today), World Fuel's advantage diminished, and margin compression followed. In addition, at lower oil prices, the company's very profitable add-on services, such as fuel price hedging, are less utilized by clients, further pressuring margin.

World Fuel has responded by undertaking a major acquisition push in the aviation and land fuel distribution markets. These acquisitions have offset the margin compression on its legacy business enabling the company to hold overall profits relatively flat. However, acquisitions are not a historical competency of the company, and the results from this recent effort are not good; more than $1.3 billion has been deployed in these deals at what we estimate is a mid-single digit ROIC.

We have, time and again, been negatively surprised by the profitability of the legacy business at World Fuel, and the evidence suggests the company is not creating value through its acquisition program. We exited the position at a low-teens multiple of estimated 2018 cash earnings, a fair price in our opinion, for a business that does not have a recent record of financial success, nor a credible plan to create economic value going forward.

<u>Markel</u>

We have followed Markel closely since the late 1990s, and owned it as a large position in the Focus Equity Strategy since inception in 2009. Markel is a property and casualty insurance company managed with a very purposeful strategy to compound long-term value per share on an after-tax basis. In recent years, some in the financial press have begun referring to Markel as a "baby-Berkshire Hathaway" – a complimentary and reasonably appropriate comparison in our view – because of the companies' similar management philosophies and business mix.

Insurance companies can be thought of as having two lines of business: insurance underwriting, and investing. Insurance underwriting, the core function of an insurer, involves making contractual commitments to customers to pay insurance claims of uncertain magnitude in the future, in exchange for fixed premium payments today. Since there is a lag between when premium payments are collected, and when loss payments are made, capital or "float" accumulates and is available for the insurance company to invest for its own benefit.

In general, insurance is a lousy business; regulated and capital intensive with low customer switching costs and few barriers to entry. As a result, over the last 30 years the industry as a whole has produced a ROE of only about 8%. The allure of investable float, combined with the estimation required to set insurance pricing is a tough mixture that leads to aggressive competition and dismal economic returns. However, Markel, like our other businesses that operate in competitive, capital intensive industries (e.g. NVR and Ashtead), takes a very different approach from most in its industry which has enabled it to generate attractive growth and returns.

*Insurance Underwriting*

In insurance underwriting, Markel mostly focuses on niche and specialty segments of the insurance market, rather than the much larger but more commoditized standard commercial and personal lines categories. Markel provides coverage for more than 100 unique risk categories including: equine, antique cars, bars and taverns, and summer camps, among others. It requires specialized knowledge to price these policies accurately, and often unique distribution to reach the customer resulting in reduced competition and more opportunity for profitable business.

In addition, Markel has worked diligently to establish and maintain a culture of underwriting discipline. Insurance markets are cyclical, so employees on the front lines making decisions need to write business when pricing is sufficient, and curtail writing business when it is not. Much like the stock market, most of the time it is not obvious if pricing is good or bad, it takes experience and judgment to make the right decisions. To incent the right behavior, Markel compensates its underwriters based upon the actual performance of their book of business over time (usually 3 to 6 years depending upon the line of insurance), rather than on short-term production volumes like many other insurers do. This compensation system, along with other cultural values, helps attract team-oriented people, repel short-term thinkers, and perpetuate the solid underwriting culture.

The combination of Markel's selective market focus and disciplined underwriting culture have made the company a top-tier insurance underwriter. The "combined ratio" is a financial metric measuring success in underwriting insurance. A combined ratio below 100 is a profitable insurance operation, while a ratio above 100 is an unprofitable operation. The table below illustrates just how successful Markel has been at underwriting insurance over the last three decades, on an absolute basis, and relative to the overall industry.

| | **1986-1995** | **1996-2005** | **2006-2015** |
|---|---|---|---|
| Markel Combined Ratio | 90.2 | 99.7^ | 94.6 |
| P&C Industry Combined Ratio | 108.4 | 105.5 | 100.2 |

^Broad Run estimate of combined ratio adjusted for reserve strengthening in 2000 and 2001 related to Terra Nova acquisition.

*Investing*

In investing, relative to other insurers, Markel makes a substantially higher allocation to equities, and lower allocation to fixed income. Markel's target equity allocation (as a percentage of shareholders' equity) is 50-80%, many times higher than its peers. Markel is willing to accept higher volatility in equities, in exchange for higher expected long-term returns. This approach has been quite successful, with equities outperforming fixed income over time, and Markel's public equity portfolio outperforming the overall equity market by about 2.5% annualized over the last 27 years (11.8% vs. 9.3% for the S&P 500).

Since 2005, the company has broadened its equities activity to include buying private businesses. There are advantages to Markel in owning private businesses rather than public equities, including elimination of double taxation of dividends, and control/oversight of the investee's capital allocation. For business sellers, Markel has a unique value proposition compared to traditional strategic or financial buyers (preserve operational autonomy, job security for employees, and a long-term stable home). Markel's private equity investment results have been good, and as an asset class now compose about 1/5th of its overall equity portfolio. We like that buying private businesses provides an additional capital allocation option to management, and suspect that its importance will continue to grow over time.

*Growth & Valuation*

Given the nature of Markel's business, we believe that the annual change in book value per share is a good proxy for its annual change in intrinsic value. Over the last 20 years, Markel's book value per share compounded at 13% annualized.

We believe that the same forces that drove Markel's growth in the past are present today. If Markel can continue to generate superior underwriting results, produce solid investment returns, and make opportunistic acquisitions, we believe book value per share can compound at a low-teens rate over the next decade. If it achieves these results, we believe that it can at least hold today's valuation (1.6x book value), and appreciate in line with its growth in book value per share. Viewed another way, if Markel can increase book value per share 13% per year on average, at its current 1.6x book value multiple, it is the equivalent to trading at a 12-13x multiple of owner earnings. For these reasons, we believe Markel remains an underappreciated compounder.

In closing

We thank you for entrusting your capital to us. Please let us know if there has been any change to your contact information, any change to your financial circumstances or investment objectives that might impact how we manage your account, or if you would like to add or modify any reasonable restrictions to our investment advisory services.

Sincerely,
Broad Run Investment Management, LLC

January 22, 2018

**Separate Account Client Letter**
**Fourth Quarter 2017**

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For the year ended December 31, 2017, the Focus Equity Composite returned [redacted] net of fees compared to [redacted] for the [redacted]. For the fourth quarter, the Composite returned [redacted] net of fees compared to [redacted] for the [redacted] The results for your account will differ somewhat from the Composite due to variations in holdings and other client-specific circumstances. We remind you that we manage your account for long-term results, so we encourage you to evaluate its performance over a multi-year time frame. Long-term Composite performance is presented at the end of this letter.

As we have discussed before, investment returns for equities can be broken down into three factors: growth in earnings, dividends, and change in valuation. In the short-term, change in valuation can have a meaningful impact on investment results, but longer-term, change in valuation becomes much less important as growth in earnings and dividends accumulate to drive the majority of results[1].

For this reason, as long-term investors, our analytical focus is on trying to understanding a business's future earnings and dividends. We track how these metrics develop at each business we own, in aggregate across all the businesses we own, and at the portfolio level taking into account the impact of cash. This analysis helps us understand how these businesses are performing by providing a measure of progress independent of the vicissitudes of the stock market[2]. Each year-end we report a summary of this information to give you additional perspective on your investment with us.

Please note, in this letter when we refer to "earnings" or "EPS" for our businesses, we mean earnings on a per-share basis, adjusted for certain items. We make these adjustments to get to, what we believe to be, a better measure of the true economic earnings of the businesses. Please see footnote four for additional information about our methodology[3].

*2017 Business Results*

In 2017 our businesses made good fundamental progress. In aggregate, we calculate they grew EPS 11% and paid a 1% dividend. This compares to [redacted] EPS growth and a [redacted] dividend for the [redacted].

| | 2017 EPS Growth | | 2017 Dividend Yield | | EPS Growth + Dividend Yield |
|---|---|---|---|---|---|
| Our Businesses | 11% | + | 1% | = | 12% |
| [redacted] | [redacted] | + | [redacted] | = | [redacted] |

EPS growth was broad-based across our holdings, with only Mistras Group, a small position, reporting a notable decline for the year. In addition, Aon plc, a large position, sold its highly profitable but noncore Benefits Outsourcing division costing us about 1% EPS growth for the year. We like the rationale for this transaction, and believe the 1% foregone portfolio growth in 2017 will translate into about 1% accelerated growth in 2018 as sale proceeds are redeployed by Aon back into its business. Further, we think the remaining Aon business is a leaner and more focused enterprise, with potential for sustained higher organic growth rates beyond 2018.

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[1] For more detailed discussion, please see our Second Quarter 2016 Separate Account letter.
[2] While this is not particularly useful to measuring progress at many types of investment strategies - for example, a high valuation-high growth strategy, a slow/no growth-deep value strategy, or a high turnover strategy - we do believe it is instructive for our long-term, business-focused strategy where we typically pay market-level valuations for businesses we believe have above-average growth.
[3] Earnings and EPS for the Focus Equity Strategy and its underlying holdings are based upon Broad Run's calculations/estimates, with adjustments for certain amortization expenses, excess depreciation expenses, and non-recurring charges, among other items. For balance sheet-centric companies, change in book value per share, or change in Net Asset Value per share may be used to measure fundamental progress rather than EPS. EPS for the holdings/portfolio refers to aggregated EPS of individual businesses based upon their quarter-end weightings in the Focus Equity Composite. The source for [redacted] EPS is FactSet "recurrent earnings" which include consensus adjustments to reported accounting earnings. Broad Run's calculations/estimates may differ materially from consensus. Results for the most recent year are preliminary, subject to adjustment as annual reporting is finalized. Contact us for additional detail.

*Longer-Term Business Results & Investment Performance*

In the table below, we add these 2017 results to the historical EPS growth and dividend yields for the businesses owned by the portfolio (column A). In addition, we include the impact of any cash held in the portfolio (B) to bridge the gap between business level and portfolio level fundamental results (C). We include portfolio market performance (D & E), and corresponding fundamental and market performance for the Russell 3000 (F & G).

| | **Focus Equity Composite** | | | | | [redacted] | |
|---|---|---|---|---|---|---|---|
| | A | B | C | D | E | F | G |
| Year | Business Level EPS Growth + Dividend Yield* | Impact of Cash Balance | Portfolio Level EPS Growth + Dividend Yield* | Total Return Gross of Fees | Total Return Net of 1% Fee | EPS Growth + Dividend Yield | Total Return |
| 2010 | 30% | -1% | 29% | [redacted] | [redacted] | [redacted] | [redacted] |
| 2011 | 20% | -1% | 18% | [redacted] | [redacted] | [redacted] | [redacted] |
| 2012 | 17% | -2% | 15% | [redacted] | [redacted] | [redacted] | [redacted] |
| 2013 | 17% | -1% | 16% | [redacted] | [redacted] | [redacted] | [redacted] |
| 2014 | 19% | -2% | 17% | [redacted] | [redacted] | [redacted] | [redacted] |
| 2015 | 12% | -1% | 10% | [redacted] | [redacted] | [redacted] | [redacted] |
| 2016 | 7% | -1% | 6% | [redacted] | [redacted] | [redacted] | [redacted] |
| 2017 | 12% | -1% | 11% | [redacted] | [redacted] | [redacted] | [redacted] |
| Cumulative: | 241% | | 211% | [redacted] | [redacted] | [redacted] | [redacted] |
| Annualized: | 16.6% | | 15.3% | [redacted] | [redacted] | [redacted] | [redacted] |

[redacted] *For the Focus Equity Composite, EPS growth is a Broad Run estimate based upon reported results for the first three quarters of the most recent year and projections for the final quarter of the most recent year. For prior years, EPS growth has been updated to reflect actual reported results for the year, any changes in company level methodology, and other updates, as appropriate. May not sum due to rounding.*

We believe these results continue to show that there is a fairly weak relationship between fundamental business performance and market performance in any one year, but that the relationship strengthens as the time horizon is extended. We are pleased with the absolute and relative performance of the businesses that we have owned in the portfolio over the last eight years, and believe that our long-term investment performance is largely a reflection of these long-term business results.

*Business & Investment Outlook*

With few exceptions, we believe the businesses in the portfolio are performing well and are compounding capital for us at attractive rates. At year-end 2017, these businesses are trading 16.6x our estimate of 2018 EPS, which assumes about 25% EPS growth, 17% due to fundamental business performance, and 8% due to the Tax Cuts and Jobs Act of 2017 (subject to some uncertainty about the full impact of the tax cuts).

As shown in the table below, despite significant market appreciation since the Great Recession, our estimate of the valuation and growth for these businesses remains largely in line with historical levels (and, we believe, with higher expected growth and similar/lower valuation than the [redacted]), giving us a favorable long-term investment outlook.

| | Focus Equity Composite | | |
|---|---|---|---|
| Beginning of Year | Business Level Price to 1yr EPS Est.* | Business Level 1yr Est. EPS Growth Rate* | Business Level 5yr Est. EPS Growth Rate* |
| 2010 | 14.9x | 20% | mid-teens |
| 2011 | 15.4x | 16% | mid-teens |
| 2012 | 14.1x | 16% | mid-teens |
| 2013 | 15.5x | 17% | mid-teens |
| 2014 | 17.9x | 17% | mid-teens |
| 2015 | 17.4x | 17% | mid-teens |
| 2016 | 16.6x | 17% | mid-teens |
| 2017 | 16.4x | 14% | mid-teens |
| 2018 | 16.6x | 25%** | mid-teens |

** Based upon Broad Run internal estimates (may differ materially from consensus estimates), weighted by position size, excluding the impact of any portfolio level cash.*

*** 17% excluding expected direct profit impact of Tax Cuts and Jobs Act of 2017.*

*^ Valuation based upon prior year closing price.*

## Notable Updates from the Fourth Quarter

We did not make any notable changes to the portfolio during the quarter, however, two important holdings announced transformational transactions that are worth discussing.

*American Woodmark Corp. (AMWD)*, composing about 4.7% of separate account assets, is a leading manufacturer of kitchen and bath cabinetry for remodeling and new home construction (discussed in our Fourth Quarter 2014 Separate Account letter).

During the fourth quarter, the company announced the acquisition of RSI Home Products, Inc. ("RSI") for approximately $1.1 billion, nearly doubling Woodmark's EBITDA. RSI is highly profitable, and enjoys a leading position serving the entry-level cabinet market. Woodmark's strength is serving the mid-level of the market, so RSI's products are highly complementary. In addition, Woodmark has a unique distribution and installation program that is very popular with homebuilders and other customers. Woodmark plans to extend this capability to RSI, opening up significant opportunity to cross-sell RSI products to existing customers to gain wallet share.

We believe the transaction, which closed at the end of December, will add nearly 40% to Woodmark's cash earnings per share in 2018, and enhance the value creation opportunity beyond. We believe this transaction, combined with the already attractive company specific initiatives at Woodmark, and the continued cyclical rebound in the homebuilding and remodeling markets, positions the company to compound at a very attractive rate for many years to come.

*21st Century Fox (FOX / FOXA)*, composing about 3.5% of separate account assets, is a media conglomerate with leading positions in cable networks (Fox News, FX, National Geographic, Fox Sports, RSNs), broadcast television (Fox), movie and television studios, Hulu, and international media platforms (SKY, STAR India, etc.).

During the fourth quarter, Fox struck a deal to sell the majority of its assets to Disney in a nearly $70 billion transaction. We believe this is a financially and strategically attractive transaction for Fox, with the company getting full price for the assets it is selling to Disney, and retaining assets that are among the most differentiated and fastest growing in the traditional media space (Fox News, Fox Sports, Fox Broadcast). As Fox shareholders, we are due to receive Disney shares in about 12 to 18 months when the deal is forecast to close. We do not yet know if we will remain involved in Fox and/or Disney at that point, but do view Disney as well run with strong franchises and a much-enhanced ability to sell video content direct-to-consumer post acquisition.

This transaction will involve significant regulatory scrutiny, and it is far from certain the deal will be allowed to close in its proposed form. That said, we believe the antitrust concerns are manageable and the transaction will eventually clear. We view Fox as undervalued based upon the market price of Disney shares to be received, the value of the Fox assets that will remain, and the probability of the deal closing, so we continue to hold the shares.

In closing

We thank you for entrusting your capital to us. We will continue to do our best to protect and grow your investment over time.

Please let us know if there has been any change to your contact information, any change to your financial circumstances or investment objectives that might impact how we manage your account, or if you would like to add or modify any reasonable restrictions to our investment advisory services.

Sincerely,

Broad Run Investment Management, LLC

April 20, 2018

**Separate Account Client Letter**
**First Quarter 2018**

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For the quarter, the Focus Equity Composite returned [redacted] net of fees compared to [redacted] for the [redacted]. The results for your account will differ somewhat from the Composite due to variations in holdings and other client-specific circumstances. We remind you that we manage your account for long-term results, so we encourage you to evaluate its performance over a multi-year time frame. Long-term Composite performance is presented at the end of this letter.

During the quarter our businesses continued to perform well amid a supportive economic backdrop. Stock price volatility returned to the market after a long hiatus, as the prospect of rising interest rates and increasing geopolitical tensions challenged Goldilocks economic forecasts. This environment provided the opportunity to add to two existing positions that we believe have compelling long-term prospects: American Woodmark, and Carmax.

*American Woodmark (AMWD)* – We wrote about American Woodmark last quarter to discuss the completion of its transformational acquisition of RSI Home Products, a leading cabinet manufacturer serving the value price point. Recall our view is that the RSI acquisition has great financial and strategic value to Woodmark. The deal provides significant near-term accretion as Woodmark deployed its excess cash and liquidity into a very good business at an attractive valuation. EBITDA should nearly double in 2018 and cash earnings per share should increase about 60% (40% excluding tax law changes). Longer term there is a big opportunity to gain market share by cross selling RSI product into Woodmark's customer base, particularly the large homebuilders.

Woodmark shares came under significant pressure during the first quarter, trading down from a high of [redacted] per share in January to [redacted] at the end of March. Normally, such an extreme price move has obvious origins, but in this case, it is hard to pinpoint a root cause of the stock's selloff. Woodmark reported lackluster quarterly results in February with organic sales growth of only 2% (roughly in-line with the consensus sell-side estimate) versus high single digit growth just a few quarters earlier. However, because of the nature of the business, the company has always had volatile quarter to quarter results, and there are a number of reasons to believe that organic growth will reaccelerate from here. Further, RSI has about one-half of its employee base in Mexico, so recent noise around renegotiation of NAFTA may have had an impact. Thankfully, this is not a high-profile industry with a large disaffected U.S. employment base, like auto parts, providing it some political cover from brash posturing in trade negotiations. Our belief is that any material change to NAFTA, while unlikely, would be largely offset by rebalancing of the dollar-peso exchange rate over time. Finally, we note that many other building products and large ticket consumer discretionary companies also faced selling pressure during the quarter, probably due to expectations of rising interest rates combined with recent slack consumer spending data. While Woodmark may face some incremental headwind from these macroeconomic factors, we think company specific growth drivers overwhelm their impact over our investment horizon.

We believe Woodmark is likely to produce about $13 in cash earnings per share in fiscal 2021, up from $4.50 in 2017 and $7 to $8 in 2018. We believe this growth is readily achievable based upon our assumptions of a continued cyclical recovery of the housing market, continued gradual share gains for Woodmark's legacy business, modest operating leverage, aggressive debt paydown, and achieving the mid-point of deal synergy guidance. At a 14-15 multiple of 2021 cash earnings, this implies the company could be worth about $200 per share in three years, providing a compelling 25%-plus expected IRR.

*CarMax (KMX)* – CarMax is the largest used-car retailer in the U.S. It has grown into its leadership position by offering a consumer-friendly car buying experience, in contrast to the adversarial experience at traditional auto dealers. CarMax stores offer a wide selection of high-quality, late-model used cars (5 to 10x the used vehicle inventory at a CarMax lot compared to the typical dealer lot) with no-haggle pricing and a generous return policy. The company provides a transparent vehicle financing process, attractive extended warranty options, and will buy your car from you even if they do not sell you a car.

Today, with 187 stores across the country, CarMax has about 3-4% share of the late-model used car market. We believe

CarMax will eventually have at least 275 stores as it opens in new geographies and infills existing markets. We think an expanded store base will allow the company to nearly double its market share, which seems attainable considering it has demonstrated the ability to take more than 10% share in its oldest, most penetrated markets.

In addition, CarMax has embarked upon a new technology initiative to further transform the car buying experience. While CarMax has improved the traditional car buying experience, the overall process is still tedious, time consuming, and paper intensive. Over the last 24 months, the company has been upgrading its internal technology and client facing web capabilities. Various tech functions have already been rolled out, making the customer experience better, but the real breakthrough should come in about a year when all the pieces of the solution are in place. At that point, you will be able to complete as much, or as little of the car buying experience online as you would like. You will be able to select a vehicle, finance that vehicle, and arrange a trade in of your existing vehicle, all from the comfort of your living room sofa. You can pick up your new purchase at a Carmax store, or have it delivered to you at your convenience.

This innovation should not only enhance the customer experience, but also increase CarMax's operational efficiency as customers increasingly select a self-service purchasing pathway. CarMax, with a nationwide footprint, reputable brand, no-haggle pricing policy, proprietary vehicle transfer/logistics network, and over 50,000 vehicles in inventory, is uniquely positioned to deliver this "omnichannel" experience to car buyers. We believe this online capability is likely to further distinguish CarMax from its competition, enabling it to accelerate sales and market share gains, while increasing the asset turnover and capital efficiency of the business.

During the quarter, CarMax's stock declined as a result of weak same-store sales. Since last fall, the historical price difference between new cars and late-model used cars has compressed, making it relatively more attractive to buy new, and denting demand for used. There are a variety of reasons for this spread compression, most notably market disruption from the fall hurricanes and an excess of new car inventory.

We have seen situations like this several times in our 15 years following the industry (including as recently as fall 2015, which we wrote about in our fourth quarter 2015 client letter). It will take a few quarters, but we believe wholesale used-car pricing will decline to the point that the historical value proposition of buying used versus new is reestablished. Once this equilibrium is reached, we think CarMax will regain its same-store sales momentum.

We view this as a short-term, transitional blip that is part of the ordinary fluctuations in this industry. We believe CarMax is on the cusp of a big strategic advancement, so we were pleased to add to our position at a low-teens multiple of estimated 2018 earnings per share (EPS). We view this as an attractive price for a company we think can compound EPS at a mid-teens rate for much of the next decade through a combination of high single digit new store openings, mid-single digit same-store sales, and share repurchases.

In closing

We thank you for entrusting your capital to us. We will continue to do our best to protect and grow your investment over time.

Please let us know if there has been any change to your contact information, any change to your financial circumstances or investment objectives that might impact how we manage your account, or if you would like to add or modify any reasonable restrictions to our investment advisory services.

Sincerely,

Broad Run Investment Management, LLC

July 20, 2018

**Separate Account Client Letter**
**Second Quarter 2018**

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For the quarter, Broad Run's Focus Equity Separate Accounts returned [redacted] net of fees compared to [redacted] for the [redacted]. Year to date, the Focus Equity Separate Accounts returned [redacted] net of fees compared to [redacted] for the [redacted]. The performance for your account will differ somewhat from these reported results due to variations in holdings and other client-specific circumstances. We remind you that we manage your account for long-term results, so we encourage you to evaluate its performance over a multi-year time frame. Long-term performance is presented at the end of this letter.

During the quarter, we established new positions in Metro Bank plc and Facebook, Inc., each at about 2% of separate account assets. We believe both companies are undervalued, high quality, secular growth businesses – "compounders" – that we can likely hold for the long-term. Over time, should our continuing research reinforce our investment theses, we will look to add to the positions opportunistically. The new investments were funded with proceeds from the sale of Gaming and Leisure Properties, Inc., Mistras Group, Inc., and Henry Schein, Inc., the portfolio holdings we believed offered the least attractive risk-adjusted returns.

New Position: Metro Bank plc (MTRO-LN)

Metro Bank is a new entrant in the U.K. banking market, providing a customer value proposition very different from the incumbent banks. Metro opened its first branch in 2010, and today it has 56 branches in greater London.

Metro Bank was founded by Vernon Hill, one of the most successful U.S. bankers of the last 40 years. Hill was the founder, CEO, and Chairman of Commerce Bank, which he grew from one location with $1.5 million in shareholders' equity in 1973, to over 450 locations and an $8.5 billion market value at the time of its sale to TD Bank in 2007. Key to Commerce's success was a business model based upon fanatical customer service, making for happy customers and robust low-cost deposit growth. Metro is essentially the Commerce business model exported to the U.K.

Importantly, the U.K. is hungry for a better banking experience. The U.K. has one of the most concentrated and ossified banking industries in the western world. The top five banks have about 80% deposit share with only about 300 banks and building societies nationwide, while the top five banks in the U.S. have about 40% deposit share with about 11,000 banks and credit unions nationwide. This U.K. concentration has stilted competition and fostered abusive business practices; customer service ratings for banks are among the worst of any industry in the U.K. Amazingly, when Metro received its bank charter in 2010, it was the first new high street bank in more than 100 years!

Metro's points of differentiation are numerous, but to illustrate just a few: Metro has first rate facilities in prime locations, often with two-story glass windows and an open floor plan (most other bank branches are dark, old, and poorly maintained), branches are open 76 hours a week, including Saturdays and Sundays (most other bank branches are open just 35 hours a week), opening a new account takes less than an hour (most other banks take about a week), and call centers are based in London (not offshore) with calls answered by a live person (not an automated phone tree).

The reception from the British public and business community has been spectacular. Deposit growth is averaging £75 million per branch per year. Even branches over three-years old continue to grow at this rate (a 30%-plus comp!). These deposit growth numbers are unprecedented and are more than three times the pace Commerce delivered in the U.S. Metro has attracted deposits using virtually no advertising and paying below market interest rates; favorable press and word of mouth are driving these results.

Of course, incumbent banks can mimic some of Metro's points of differentiation, but it will be difficult for them to match its deeply ingrained customer service culture and modern technology platform. We have not seen any "fast followers" replicating Metro's business model yet, and our tours of London bank branches have confirmed just how much difference there remains between Metro and the incumbents - even eight years after its arrival.

Metro appeals to customers who are more interested in getting great service than a great interest rate on their deposits. By attracting deposits at a below market rate, Metro can take a conservative approach to lending (and still achieve its financial objectives). For example, Metro targets a modest 85-90% loan-to-deposit ratio, and its loan-to-value ratio on secured loans is just 59%. As a result, credit losses have been minimal so far, and we expect them to stay low relative to other banks over time.

Metro is growing quickly. Over the next five years we expect it to double or triple its branch count and quadruple its U.K. deposit share from ½% to about 2%. Metro is still scaling and just turned profitable last year, so profitability should expand rapidly as branches mature and overhead expenses are leveraged (just how rapidly remains unclear). Further, Metro's regulatory capital requirements are likely to be reduced in 2019 (just how significantly remains unclear). Making certain assumptions about these factors, and other variables, we conclude that Metro will achieve an ROE between 14% and 18% in 2023, and EPS of between £4.00 and £5.00. At that point, Metro should have significant growth opportunity remaining so we think shares can trade 13x to 16x earnings (a premium to other U.K. banks), or £52 to £80. At the midpoint, we would get about a doubling in the stock from our recent purchase price.

Viewed another way, we paid about 19% of estimated year end 2018 deposits for Metro. Commerce Bank's equity traded for many years at 15-20% of deposits (the company was sold to TD Bank for about 17% of deposits), and recent transactions of some specialty banks in the U.K. have been valued around 15% of deposits. Further, we paid about 2.5x year end 2018 book value, a healthy multiple for a bank, but a bargain if what we believe will transpire comes to pass. Finally, we purchased Metro at the lowest multiple of book value, deposits, and forward earnings (~25x) that it has traded at since it went public in 2016.

So why traverse the ocean for this investment? As we hope we communicated above, this is a unique combination of a proven U.S. business model being exported abroad by an outstanding U.S. banker into a large market with bureaucratic competition. Results to date have been excellent, with solid operational execution and enormous organic deposit growth. We think it will be difficult to replicate what Metro has built (and no one yet appears to be trying), and not particularly effective for competitors to simply mimic a few of its business practices. While Metro has not reached scale, there are good reasons to believe that a high teens ROE is attainable. With just ½% deposit share, Metro could plausibly be 10, 15, or even 20 times larger over the next two decades, providing a very long runway for potential compounding from what appears to us to be a sensible entry valuation.

<u>New Position: Facebook, Inc. (FB)</u>

Facebook is the largest social network in the world with 2.20 billion monthly active users (MAUs) and 1.45 billion daily active users. On average, Facebook's daily active users spend more than 40 minutes per day in app. In addition to the core Facebook platform, Facebook owns social network Instagram (>1.0 billion MAUs), messenger services WhatsApp (>1.5 billion MAUs) and Facebook Messenger (>1.3 billion MAUs), and virtual reality platform Oculus.

From time to time, negative news flow creates an opening for us to invest in an exceptional business at a discount price. Shares of Facebook came under pressure in late March when the press reported that Cambridge Analytica had harvested private information from the profiles of more than 50 million users. The negative headlines kept coming as the #deletefacebook campaign went viral and the Federal Trade Commission confirmed that it was investigating Facebook's privacy practices. The unwanted attention reached its crescendo in April with CEO Mark Zuckerberg's testimony before Congress.

The market feared a loss of users, advertiser boycotts, and diminished ad targeting resulting from increased regulation. As the dust settled, investors observed that the behavior of Facebook's users and advertisers was virtually unaffected by the negative news flow. In fact, comScore data suggests that Facebook's U.S. user growth and time spent in app actually increased in the wake of the scandal. Numerous surveys of advertisers and ad pricing data from the platform show continued strong growth in spending. This is no surprise, as we believe that on average Facebook advertising still continues to provide a return on ad spend of about 2x the next best alternative. For now, Congress does not seem to have any appetite for new regulations. Future regulation, should it look similar to the European Union's General Data

Protection Regulation, would likely advantage Facebook, relative to smaller publishers and ad tech vendors since securing consent to target advertising is much easier for Facebook than those who do not have a direct relationship with users. In short, Facebook appears to have emerged stronger from the privacy scandal.

Looking forward, Facebook should grow faster than the global digital ad market as it is well positioned to benefit from the growth in mobile, programmatic, and video advertising. Continuous improvements in ad formats (e.g. Stories) and targeting combined with the already high return on ad spend should provide a strong tailwind to ad pricing. Improved monetization of Instagram, WhatsApp and Facebook Messenger should supercharge already robust revenue growth from the Facebook app.

We believe Facebook should generate about 20% annualized revenue and earnings per share growth over the next five years. Importantly, Facebook has a number of assets that are extremely valuable but are not major contributors to earnings yet. WhatsApp and Facebook Messenger are the world's two largest messaging services but produce minimal revenue today. Facebook acquired WhatsApp for $19 billion in 2014 (and we believe it is worth comfortably more today). Additionally, the company holds $44 billion of cash and investments. When we adjust Facebook for this cash and the purchase price of WhatsApp, we believe we paid just 17x 2019 earnings for the core Facebook/Instagram business. In our view, the world's quintessential network effect business deserves to trade for much more than this slight premium to the market multiple.

<u>In closing</u>

We thank you for entrusting your capital to us. We will continue to do our best to protect and grow your investment over time.

Please let us know if there have been any changes to your financial circumstances or investment objectives that might impact how we manage your account, any change to your contact information, or if you would like to add or modify any reasonable restrictions to our investment advisory services.

Sincerely,

Broad Run Investment Management, LLC

October 23, 2018

**Separate Account Client Letter**
**Third Quarter 2018**

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For the quarter, Broad Run's Focus Equity Separate Accounts returned [redacted] net of fees compared to [redacted] for the [redacted]. Year to date, the Focus Equity Separate Accounts returned [redacted] net of fees compared to [redacted] for the [redacted]. The performance for your account will differ somewhat from these reported results due to variations in holdings and other client-specific circumstances. We remind you that we manage your account for long-term results, so we encourage you to evaluate its performance over a multi-year time frame. Long-term performance is presented at the end of this letter.

We did not add any new positions or make any notable changes to the portfolio during the third quarter. Several holdings have come under price pressure recently as concerns about rising interest rates have negatively impacted stocks in certain sectors. We have checked and rechecked our theses on these businesses, and like our investment positions in them. Importantly, we are pleased with how the businesses in the portfolio are performing (with almost all growing owner earnings per share, excluding the benefit of the tax cut, at a sustained mid-teen clip) and expect their stock prices to follow fundamentals over time. Portfolio valuation, on a next twelve month price-to-owner earnings basis, remains at a discount to the [redacted]. We take comfort in having a portfolio grounded in attractive near-term earnings multiples, in a market that appears long on enthusiasm and short on skepticism.

To further your understanding of what you own, and why, we will use this letter to describe our thinking behind Charles Schwab & Co. Inc. ("Schwab"), a top ten holding (about 6% of assets) in the portfolio at the end of the quarter. We have a long history with Schwab and believe it measures very well against our five investment criteria (high-quality business, large growth opportunity, excellent management, low tail risk, and discount valuation) as explained below.

<u>Charles Schwab & Co.</u>

To understand Schwab today, it is important to have some perspective on its history. Mr. Charles Schwab and two partners launched an investment newsletter for retail investors in 1963. By 1973, Mr. Schwab had bought out his two partners, renamed the company Charles Schwab & Co., and began offering traditional broker-dealer services to his newsletter subscribers. On May 1, 1975—known in the brokerage industry as "May Day"—the SEC deregulated brokerage commissions making them fully negotiable. Schwab, recognizing the challenge and opportunity in this deregulation, repositioned as a discount broker providing low priced trading to do-it-yourself retail investors.

Schwab, and other discount brokers, unencumbered by legacy cost structures, were able to undercut traditional full-service brokers on price providing tremendous savings to customers. Through the years, Schwab continually reinvested in technology to maintain its low-cost position, passing along savings to attract more customers, building its scale, and enabling further reinvestment in a virtuous cycle. For example, it was an early adopter of mainframe computing for electronic record keeping in 1979, it pioneered automated telephone trading in 1989, and it introduced web trading in 1996.

By the 1980s, Schwab had evolved beyond just trading services to offer a mutual fund marketplace (1984), custody and other services to independent investment advisors (1987), equity index funds (1991), 401(k) and company stock record keeping (1995), banking services (2003), an ETF marketplace (2013), a robo-advisor (2015), and target-date ETFs (2016), among many other offerings. In each instance, Schwab saw an opportunity to provide its customer base a broader product offering and strong value proposition versus the alternatives in the marketplace. Each offering made Schwab a more complete financial partner to customers and leveraged the company's relatively fixed costs across more products and services.

Today, Schwab has approximately $3.6 trillion in client assets under custody (compared to $1.1 trillion in 2008, $0.5 trillion in 1998, and less than $0.1 trillion in 1988), with about half from direct retail clients and about half from independent registered investment advisors (“RIAs”) that use Schwab for custody and other services. As of mid-2018, Schwab’s operating expenses are 16 basis points of assets, about one-half the level of other discount brokers and less than one-third the level of traditional brokers. Even four decades after its founding, Schwab remains a systematic market share gainer using essentially the same low-cost, low-price business model it began with. Adding to the appeal of the business model, client assets, particularly RIA assets, are very sticky and make Schwab a powerful asset gathering machine.

Schwab’s net new assets (inflows, less outflows) are averaging about 6% per annum, with market share coming from traditional brokers, discount brokers, and banks, among other places. Schwab’s RIA custody business is growing more quickly than its retail business as “breakaway brokers” leave traditional brokerage firms to become independent, often choosing to custody client assets with Schwab, the clear industry leader in providing this service. In addition, Schwab benefits from appreciation of existing client assets. Given clients’ asset mix, we expect about 4% long-term annual appreciation to combine with 6% net new assets for about 10% annual asset growth.

With just $3.6 trillion of a $45 trillion opportunity (inclusive of retail bank deposits), we believe this growth can continue for decades. This level of asset growth should translate to about 9% revenue growth (lower than asset growth because Schwab passes along cost savings to customers), and a similar level of operating income and net income growth. A free cash flow yield of about 4% (after funding growth) should deliver about 13% long-term EPS compounding. In addition, a one-time shift in where Schwab sweeps excess client cash balances (from money market funds to bank deposits), plus a normalization of the yield curve (aiding spread income) should, we believe, boost EPS compounding to the high teens over the next several years. Today the shares are trading at 16x next twelve month EPS, essentially in line with the market, for a world-class business with excellent growth ahead.

Over the last several years, and continuing into 2019, Schwab has been gradually changing the default sweep for cash held in client brokerage accounts. Before this transition, cash was swept into a Schwab money market fund, which paid clients a market rate of interest, less a generous fund management fee to Schwab (~40-55 bps). Under the new system, cash balances are swept into Schwab bank where they are paid rates competitive with bank checking or demand deposit accounts, which tend to be quite low. As a bank, Schwab has to hold capital to support these funds (they target 6.75% to 7.00% capital reserves), but it also earns much higher economics (~2.25% bps net interest margin [“NIM”] today) which provides a strong incremental return on equity at the bank (20%-plus). Importantly, Schwab’s bank invests the vast majority of client deposits in liquid, low credit risk mortgage securities with relatively short durations (typically 2-2.5 years).

This cash sweep transition has been, and should continue to be, a big earnings driver for Schwab. Some have criticized the company for this transition because it extracts more economics from client cash than it had previously (at just the point when short-term rates are rising and clients are expecting some increased return on their cash). Schwab’s defense against this criticism is that yield sensitive clients can still purchase higher yielding Schwab money market funds, CDs, short term bonds, etc., rather than sticking with the default cash sweep. Further, the company argues many clients like the FDIC coverage that comes with bank deposits. Of course, we also observe that most clients are focused on trading commission and fees, but are less informed about the way in which Schwab monetizes their cash balances.

Schwab views client cash in two buckets: investment cash held as part of a long-term asset allocation strategy, and transactional cash waiting to be deployed into other opportunities. Based upon experience and client surveys, the company believes about 50-65% of client cash is transactional, which is likely to remain in the bank sweep, and the remainder is investment cash that will be used to purchase higher yielding Schwab products (purchased money market funds, CDs, short term bonds).

Some of the debate around Schwab stock today is how much of the swept cash will stay at the bank, earning ~2.25% NIM versus how much will leave the bank for higher yielding alternatives where Schwab collects fees of perhaps ~35 bps (if a purchased money market fund). We think consensus estimates use a ~50% bank retention rate, at the low end of Schwab’s 50-65% expectation. If, however, this estimate is wrong and bank retention is only 35% (a substantial miss), we estimate it would reduce Schwab’s 2019 expected earnings by about 8%, pushing its next twelve-month earnings multiple to 17.5x from 16x; not a difference maker to the long-term investment opportunity.

Finally, Mr. Schwab still owns 10% of the company and is the Charmain of the board. He shepherds the company with a long-term mindset and deep belief in perpetuating its low-cost, low-price business model. Beyond Mr. Schwab, we are impressed with the executives at the company. In any brokerage company or large financial firm, there are many opportunities to expose the business to undue risk in pursuit of short-term profits. As outsiders, we cannot know everything that is going on inside the company. However, time after time, when we have had a chance to get a view into Schwab's inner workings and risk management, we have come away pleased that they are making prudent decisions to position the firm for success over the next 40 years.

## In closing

We thank you for entrusting your capital to us. We will continue to do our best to protect and grow your investment over time.

Please let us know if there have been any changes to your financial circumstances or investment objectives that might impact how we manage your account, any change to your contact information, or if you would like to add or modify any reasonable restrictions to our investment advisory services.

Sincerely,

Broad Run Investment Management, LLC

January 25, 2019

**Separate Account Client Letter**
**Fourth Quarter 2018**

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For the year ended December 31, 2018, Broad Run's Focus Equity Separate Accounts returned [redacted] net of fees compared to [redacted] for the [redacted]. For the fourth quarter, the Focus Equity Separate Accounts returned [redacted] net of fees compared to [redacted] for the [redacted]. The performance for your account will differ somewhat from these reported results due to variations in holdings and other client-specific circumstances. We remind you that we manage your account for long-term results, so we encourage you to evaluate its performance over a multi-year time frame. Long-term performance is presented at the end of this letter.

As we have discussed before, investment returns for equities can be broken down into three factors: growth in earnings, dividends, and change in valuation. In the short term, change in valuation can have a meaningful impact on investment results, but longer term, change in valuation becomes much less important as growth in earnings and dividends accumulate to drive the majority of results[1].

For this reason, as long-term investors, our analytical focus is on trying to understanding a business's future earnings and dividends. We track how these metrics develop at each business we own, in aggregate across all the businesses we own, and at the portfolio level taking into account the impact of cash. This analysis helps us understand how these businesses are performing by providing a measure of progress independent of the vicissitudes of the stock market[2]. Each year end we report a summary of this information to give you additional perspective on your investment with us.

Please note, in this letter when we refer to "earnings" or "EPS" for our businesses, we mean earnings on a per-share basis, adjusted for certain items. We make these adjustments to get to, what we believe to be, a better measure of the true economic earnings of the businesses. Please see footnote five for additional information about our methodology[3].

*2018 Business Results*

In 2018 our businesses made good fundamental progress. In aggregate, we calculate they grew EPS 25% and paid a 1% dividend. This compares to [redacted] EPS growth and a [redacted] dividend for the [redacted]. 2018 was a particularly strong EPS growth year partially due to the change in the corporate tax rate. We estimate that 7% of the EPS growth in our portfolio was attributable to the tax change, and 18% was due to non-tax related improvement.

| | 2018 EPS Growth | | 2018 Dividend Yield | | EPS Growth + Dividend Yield |
|---|---|---|---|---|---|
| Our Businesses | 25% | + | 1% | = | 26% |
| [redacted] | [redacted] | + | [redacted] | = | [redacted] |

Every business we own had EPS growth for the year. Four of our businesses grew at a single digit rate, four grew at 10 to 20%, and thirteen grew in excess of 20%.

*Longer-Term Business Results & Investment Performance*

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[1] For more detailed discussion, please see our Second Quarter 2016 Separate Account letter.
[2] While this is not particularly useful to measuring progress at many types of investment strategies - for example, a high valuation-high growth strategy, a slow/no growth-deep value strategy, or a high turnover strategy - we do believe it is instructive for our long-term, business-focused strategy where we typically pay market-level valuations for businesses we believe have above-average growth.
[3] Earnings and EPS for the Focus Equity Strategy and its underlying holdings are based upon Broad Run's calculations/estimates, with adjustments for certain amortization expenses, excess depreciation expenses, and non-recurring charges, among other items. For balance sheet-centric companies, change in book value per share, or change in Net Asset Value per share may be used to measure fundamental progress rather than EPS. EPS for the holdings/portfolio refers to aggregated EPS of individual businesses based upon their quarter-end weightings in the Focus Equity Separate Accounts. The source for [redacted] EPS is FactSet "recurrent earnings" which include consensus adjustments to reported accounting earnings. Broad Run's calculations/estimates may differ materially from consensus. Results for the most recent year are preliminary, subject to adjustment as annual reporting is finalized. Contact us for additional detail.

In the table below, we add 2018 results to the historical EPS growth and dividend yields for the businesses owned by the portfolio (column A). In addition, we include the impact of any cash held in the portfolio (B) to bridge the gap between business level and portfolio level fundamental results (C). We include portfolio market performance (D & E), and corresponding fundamental and market performance for the Russell 3000 (F & G).

| | Focus Equity Separate Accounts | | | | | [redacted] | |
|---|---|---|---|---|---|---|---|
| | A | B | C | D | E | F | G |
| Year | Business Level EPS Growth + Dividend Yield* | Impact of Cash Balance | Portfolio Level EPS Growth + Dividend Yield* | Total Return Gross of Fees | Total Return Net of 1% Fee | EPS Growth + Dividend Yield | Total Return |
| 2010 | 29% | -0.9% | 28% | [redacted] | [redacted] | [redacted] | [redacted] |
| 2011 | 19% | -1.2% | 18% | [redacted] | [redacted] | [redacted] | [redacted] |
| 2012 | 18% | -1.7% | 17% | [redacted] | [redacted] | [redacted] | [redacted] |
| 2013 | 18% | -1.1% | 16% | [redacted] | [redacted] | [redacted] | [redacted] |
| 2014 | 20% | -0.7% | 19% | [redacted] | [redacted] | [redacted] | [redacted] |
| 2015 | 12% | -0.3% | 12% | [redacted] | [redacted] | [redacted] | [redacted] |
| 2016 | 4% | -0.2% | 4% | [redacted] | [redacted] | [redacted] | [redacted] |
| 2017 | 13% | -0.5% | 12% | [redacted] | [redacted] | [redacted] | [redacted] |
| 2018 | 26% | -0.2% | 26% | [redacted] | [redacted] | [redacted] | [redacted] |
| Cumulative: | 324% | | 300% | [redacted] | [redacted] | [redacted] | [redacted] |
| Annualized: | 17.4% | | 16.7% | [redacted] | [redacted] | [redacted] | [redacted] |

[redacted] *For the Focus Equity Separate Accounts, EPS growth is a Broad Run estimate based upon reported results for the first three quarters of the most recent year and projections for the final quarter of the most recent year. For prior years, EPS growth has been updated to reflect actual reported results for the year, any changes in company level methodology, and other updates, as appropriate. May not sum due to rounding.*

We believe these results continue to show that there is a fairly weak relationship between fundamental business performance and market performance in any one year, but that the relationship strengthens as the time horizon is extended. We are pleased with the absolute and relative performance of the businesses that we have owned in the portfolio over the last nine years, and believe that our long-term investment performance is largely a reflection of these long-term business results.

*Business & Investment Outlook*

With few exceptions, we believe the businesses in the portfolio are performing well and are compounding capital for us at attractive rates. At year-end 2018, these businesses are trading 15.2x our estimate of 2019 EPS, which assumes about 14% EPS growth along with a 1% dividend yield.

The table below shows the beginning of year valuation and our beginning of year expectations for portfolio earnings growth, at that point in time. Our takeaway from this table is that despite significant market appreciation since the Great Recession, our estimate of the valuation and growth for the portfolio remains largely in line with historical levels (with, we believe, higher expected growth and similar/lower valuation than the [redacted]), giving us a favorable long-term investment outlook.

| Focus Equity Separate Accounts - Projection at Beginning of Year | | | |
|---|---|---|---|
| Beginning of Year | Business Level Price to 1yr EPS Est.*^ | Business Level 1yr Est. EPS Growth Rate* | Business Level 5yr Est. EPS Growth Rate* |
| 2010 | 14.9x | 20% | mid-teens |
| 2011 | 15.4x | 16% | mid-teens |
| 2012 | 14.1x | 16% | mid-teens |
| 2013 | 15.5x | 17% | mid-teens |
| 2014 | 17.9x | 17% | mid-teens |
| 2015 | 17.0x | 17% | mid-teens |
| 2016 | 16.6x | 18% | mid-teens |
| 2017 | 16.1x | 14% | mid-teens |
| 2018 | 16.4x | 24% | mid-teens |
| 2019 | 15.2x | 14% | mid-teens |

* *Based upon Broad Run internal estimates (may differ materially from consensus estimates), weighted by position size, excluding the impact of any portfolio level cash.*

^ *Valuation based upon prior year closing price.*

We did not make any changes to the portfolio during the fourth quarter, though the market decline and increased volatility does make for a more attractive investment environment as we begin the year. We continue to work on a number of investment candidates that could find their way into the portfolio in due time.

**Updated Thinking on Select Holdings**

While our businesses did well in 2018, we had several stocks that performed poorly during the year. Below, we share some thoughts on three companies whose shares were among the largest detractors from overall performance. Two of the businesses are housing related, and one is a specialty finance company.

*The Housing Market, NVR, Inc. (NVR) & American Woodmark Corp. (AMWD)*

In 2018, a sharp rise in mortgage rates (from about 4.0% in January to about 5.0% in November) and rising home prices reduced housing affordability to the lowest level in the last five years. These factors reduced demand for new homes, with starts decelerating from high single digit growth at the beginning of the year to modest declines at the end of the year. In 2019, we think housing starts are likely to be between flat and down 10%. This industry reset has hammered homebuilder and building products stocks, with both groups down about 40% in 2018. We own one homebuilder, NVR, and one building products company, American Woodmark. NVR was down [redacted] for the year, while American Woodmark was down [redacted] (American Woodmark is up [redacted] so far in 2019, netting to a [redacted] decline since the beginning of 2018).

Our investment cases for both companies are primarily based upon specific opportunities they have to gain market share due to their unique business models. Secondarily, we believe the U.S. housing market has only partially recovered from the Great Recession, providing a nice industry tailwind. Housing starts have increased every year for the last 9 years, yet they were just about 1.25 million units in 2018, still about 20% below the 60-year average. In addition, because starts have been so far below normal for so long, we estimate the country has underproduced about 5 million housing units over the last 15 years, implying starts may need to exceed the long-term average for an extended period of time to get back to equilibrium.

For this reason, we believe the current housing slowdown is going to be a temporary pause in the longer trend of housing recovery. Importantly, economic growth, job growth, and household formation remain very good, Millennials are just beginning to enter their homebuying years, and affordability, while lower than it has been the last five years, is in line with the average over the last few decades. We do not believe we have a “housing affordability crisis” as some industry observers claim; we are just transitioning from a period of unusually high affordability to a more normal environment. We believe new home construction will bottom in 2019 (barring a recession that undermines jobs and confidence) through a combination of buyers acclimating (financially and psychologically) to higher mortgage rates, and sellers moderating their price expectations.

NVR is the fifth largest U.S. homebuilder, with virtually all its revenue tied to the construction of new single-family homes. In 2018, NVR grew its EPS 34%, and we expect EPS to be down modestly in 2019 through a combination of mid-to high single digit sales declines, modest margin declines (due to moderating home prices and input cost inflation), and robust share repurchases. NVR's geographic footprint (Mid-Atlantic and Southeast) faces fewer affordability challenges than other geographies, and its no frills product design should appeal to cost-conscious buyers. Beyond 2019, we expect the company to resume EPS growth on its way back to a mid-teens rate of compounding. The stock trades at 14x the 2019 consensus EPS estimate, an attractive price for a business with its long-term potential.

If we happen to be wrong about the severity of the housing downturn, we believe NVR is well positioned. Its unique business model – optioning instead of owning land – provides great flexibility compared to other builders. NVR can renegotiate or walk away from land that it has under contract that it deems uneconomic, and the company's free cash flow and balance sheet give it an opportunity to be aggressive with share repurchases, acquisitions, and/or land deals when circumstances warrant. In the Great Recession, NVR was the only public builder to remain profitable. It used that downturn opportunistically to gain a foothold in a variety of new geographies that seeded growth and significant value creation in the subsequent upturn.

*For further background on NVR see our second quarter 2017 client letter.*

American Woodmark is the second largest U.S. manufacturer of kitchen and bath cabinetry. It derives about 60% of its revenue from remodeling and 40% from new construction. Remodeling activity has historically been much less cyclical than new construction, and has thus far showed no signs of a slowdown. Further, the company is gaining market share in three ways: 1) it is leveraging its unique cabinet installation service platform to win new contracts with home builders, 2) its recent acquisition of RSI is providing robust cross selling opportunity, and 3) it is a new entrant into the kitchen and bath dealer channel (the largest and most lucrative distribution channel for cabinet manufacturers) with significant runway to achieve its fair share in this space.

American Woodmark's remodeling exposure, combined with its market share gains, position it to grow even in a declining new home construction market. In 2018, American Woodmark should grow EPS 53% to $7.23 (not yet reported) due to its RSI acquisition, and we expect EPS to grow 10% in 2019 to $8.00. Input cost inflation, exacerbated by China tariffs, could cause some noise around our earnings forecast, but the company and industry have a long history of passing along cost increases within a few quarters. With the stock at $67, or just 8x our 2019 EPS estimate, we believe the market is pricing in a far more severe downturn in new construction than is probable. Over the next several years, through a combination of industry growth, share gains, RSI acquisition savings, and prudent use of free cash flow, we think EPS can grow at a high teens rate. In addition, we see opportunity for the price-to-earnings multiple to expand from 8x to a more typical mid-cycle multiple of about 14x.

*For further background on American Woodmark see our first quarter 2018 client letter.*

*Encore Capital Group, Inc. (ECPG)*, is a specialty finance company that buys defaulted consumer receivables at a deep discount to face value, then undertakes recovery efforts to collect payments on those receivables. The company is multinational and is a clear leader in the U.S. and the U.K., the two largest markets for the industry.

We believe Encore is a best-in-class operator with sustainable competitive advantages that allow for better liquidation and a lower cost to collect than its peers. As a market share leader in oligopolistic markets, Encore enjoys important operational scale and cost efficiency advantages in its specialized call centers and internal/external litigation operations. When combined with investments in data and behavioral science, Encore's proprietary debtor database provides insights into the willingness and ability of debtors to pay. We believe these operational and information advantages allow Encore to take share from its peers while earning superior IRRs.

While the stock was down [redacted] in 2018, the business continues to perform well and we believe the near- and long-term outlook is very good. In May, Encore announced an agreement to purchase the remaining economic interest in Cabot Credit Management that it did not already own (since 2013, Encore has held a 43% economic interest in Cabot). Cabot is one of the largest credit management services providers in Europe and the market leader in the U.K. and Ireland. While initially the market reacted favorably to the announcement, shares later traded lower as the valuations of comparable European businesses declined. Competition has pressured returns in many European countries; however, we believe Cabot's unique advantages should allow it to continue to earn solid returns in its core U.K. market (the U.K. represents

86% of Cabot’s estimated remaining collections). Further, as a result of the transaction, private equity firm J.C. Flowers & Co. now owns 14% of Encore's shares and this overhang is thought to be an important additional contributor to the share price weakness.

We believe the current valuation (the shares now trade near book value and about 6x consensus 2019 EPS) does not reflect the attractive economic returns being generated by the business today or its strong growth outlook; the company remains on track to generate 20% EPS growth in 2018 (not yet reported) and mid-teens growth in 2019 and thereafter. Encore will deploy more capital in the U.S. in 2018 than in any other year in its history and we believe it is earning IRRs greater than 20% on these purchases. We expect these strong returns in the U.S. to further improve in the intermediate term as the supply of paper increases with a normalization of the charge-off rate and resumption of selling by certain sidelined credit card issuers. We believe over the next five years Encore will generate mid-teens annualized EPS growth as it benefits from favorable U.S. market conditions and accretion from the Cabot transaction. Over the same time period, we see opportunity for the price-to-earnings multiple to expand from about 6x to about 10x.

<u>In closing</u>

We thank you for entrusting your capital to us. We will continue to do our best to protect and grow your investment over time.

Please let us know if there has been any change to your contact information, any change to your financial circumstances or investment objectives that might impact how we manage your account, or if you would like to add or modify any reasonable restrictions to our investment advisory services.

Sincerely,

Broad Run Investment Management, LLC

April 26, 2019

**Separate Account Client Letter**
**First Quarter 2019**

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For the quarter, Broad Run's Focus Equity Separate Accounts returned [redacted] net of fees compared to [redacted] for the [redacted]. The performance for your account will differ somewhat from these reported results due to variations in holdings and other client-specific circumstances. We remind you that we manage your account for long-term results, so we encourage you to evaluate its performance over a multi-year time frame. Long-term performance is presented at the end of this letter.

In this letter, we discuss our new position in Disney, and our decision to add to our Metro Bank position, despite its recent struggles.

New Position: The Walt Disney Company (DIS)

We have been shareholders of 21st Century Fox since 2012. During the first quarter of 2019, Disney completed its $71 billion transaction buying key assets from 21st Century Fox. We elected to receive Disney stock in the transaction rather than cash. In addition, we received shares in Fox Corporation, which holds the 21st Century Fox assets that were not sold to Disney. Subsequent to quarter end, we sold our shares in Fox Corporation and reinvested the proceeds into Disney, bringing our total Disney position to about 6% of assets in most client accounts.

The Walt Disney Company is much more than just Mickey Mouse and Donald Duck. It owns Disney, Pixar, Marvel, and Lucasfilm (Star Wars) – monetized via movies, television shows, consumer products, licensing, and theme parks. It owns ABC, the Disney Channel, 80% of ESPN, and 50% of A&E Networks (A&E, History Channel, Lifetime). After the Fox transaction, it owns additional television and movie studios, FX, National Geographic Channel, Fox LatAm, STAR India, Hotstar, and a 67% interest in Hulu.[1]

The Disney-Fox transaction was driven by the tectonic changes taking place in the media landscape, and a desire to capitalize on those changes. As you are probably aware, the outlook for traditional video entertainment has been fundamentally altered by the emergence of Netflix, Hulu, Amazon Prime, YouTube, and other streaming video services. Since 2013, U.S. cable subscribers have declined from 103 million to 93 million. At the same time, Hulu has grown subscribers from 8 million to 25 million in the U.S., and Netflix has grown subscribers from 33 million to 60 million in the U.S. (and from 11 million to 90 million internationally).

Streaming services have conditioned consumers to expect an elegant user interface, compelling content, on-demand delivery, multi-platform compatibility, few commercial interruptions, and no long-term contracts. Traditional cable television simply cannot match this value proposition due to its legacy infrastructure and business model. Cable television's competitive moat has been breached, and consumer dollars and viewing minutes are steadily migrating to streaming services.

This development has dampened prospects for most video content companies, but for Disney, it presents a unique opportunity. Disney, supplemented by the acquired Fox assets, possesses unrivaled content with global appeal. This critical mass of content, combined with Disney's brand, reach, and financial resources give it an opportunity to join Netflix atop the streaming universe. We believe it will be critically important to be among the top two or three global streaming services (other than niche offerings such as WWF and Formula One). We believe there are scale benefits to the streaming business; the largest streaming services will be able to spend the most on content and technology because

[1] Disney owned 30% of Hulu and acquired another 30% via the Fox transaction. On April 11, 2019, Hulu announced a transaction to acquire AT&T's approximately 10% ownership stake in Hulu for about $1.5 billion. We assume 60% owner Disney, and 30% owner Comcast will divide this AT&T stake proportionately to get to our 67% Hulu ownership estimate. As we go to print on this letter, there are press reports that Comcast is in negotiations to sell its stake in Hulu to Disney, which would give Disney 100% economic interest.

they can amortize that spend across the largest subscriber bases. With the most content and best technology, the largest streaming services can deliver the most value to subscribers and economic profits for themselves.

On November 12, 2019, Disney will begin offering its flagship Disney+ streaming service. This ad-free, family-friendly service will be anchored by content from Disney, Pixar, Marvel, Star Wars, and National Geographic. The service will include the historical movie and television libraries from these brands (when not prohibited by preexisting licensing agreements), in addition to at least 10 new direct-to-streaming movies and 25 new streaming shows per annum. We believe, at its announced $6.99 per month price point (or $69.99 for a 12-month plan), Disney+ will provide a compelling value with strong consumer appeal.

In addition, Disney now has a controlling interest in Hulu. Hulu offers a large collection of originals, movies, and television content targeted at adults, and will be a nice compliment to the family-focused Disney+. Hulu, priced at $5.99 per month ($11.99 for the ad-free version) has 25 million paying subscribers in the U.S.[2], with strong growth momentum. Going forward, we expect to see Disney increase Hulu's emphasis on originals, tilt content sourcing toward Disney owned studios, and prepare Hulu for international launch. In addition, Disney will eventually offer price discounts to consumers that purchase more than one Disney streaming service. We foresee a package of Disney+ and Hulu (with commercials) priced at $11.99 versus a comparably featured Netflix at $12.99.

Disney has an enormous opportunity in streaming. Today there are 1.1 billion households that have a high-speed internet connection, and at the current pace of growth, in 15 years this should double to 2.2 billion households. These are all potential Disney streaming customers. If, over the next 15 years, Disney+ can achieve 35% penetration in the U.S. (Netflix is at about 50% today), and 20% penetration of international broadband households (Netflix is at about 10% today, and just getting started), it would have nearly 500 million paying subscribers. At $12.50 of revenue per subscriber per month ($6.99 current price, inflated at 4% per annum)[3], Disney+ could generate nearly $75 billion in annual revenue. At a 30% operating margin, 22% tax rate, and 17x multiple of earnings, Disney+ could be worth $300 billion (compared to Disney's current market cap of $250 billion). And Hulu, a separate and distinct streaming offering, has a similar sized subscriber and value creation opportunity to Disney+.

Importantly, at Disney+, value creation is not limited to the direct revenue and profit contribution from the streaming service. There are synergies among Disney's various offerings. This is the beauty of Disney's business model. As consumers become more familiar with Disney's stories and characters, it increases appetite for experiencing them at the theatre, on television, at theme parks, and with licensed and consumer products. Disney+, a new direct point of contact with the consumer, should help perpetuate affinity for all that Disney has to offer.

Capitalizing on this streaming opportunity will require bold strategy and sharp execution – challenges for most incumbents attempting to embrace a new paradigm. However, we believe Disney is up to the task. The $71 billion acquisition of Fox assets was clearly a bold move driven by the streaming strategy. In addition, Disney has completely reorganized its business segments, shuffled its leadership, and changed its compensation policies to focus on winning in streaming. We think Disney is "all in" on streaming, and therefore, with time, is likely to succeed.

Of course, Disney is not immune to the challenges facing the traditional television ecosystem. Disney's U.S. television channels – ABC, ESPN, Disney Channel, A&E Networks, FX and National Geographic – do face headwinds, but we estimate they now comprise less than 25% of company enterprise value. In addition, these businesses are still growing their profits, just at a lower rate (low single digits by our estimate) than they had in the past. The other 75% of Disney's enterprise value – movie and television studios, parks, licensing and consumer products, Hulu, Indian and Latin American media assets – are all well positioned and growing nicely.

Disney will invest heavily in its streaming services over the next several years. It will develop new content, forgo content licensing income, and incur marketing and operating costs to build these businesses. We estimate the company will

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[2] This 25 million subscriber number includes the Hulu streaming service (a Netflix-like offering providing originals, movies, and recent television shows) and Hulu+, which is essentially an internet delivered traditional television service. Hulu does not provide a breakdown in subscribers between the two offerings (and Hulu+ comes with Hulu streaming included), but we estimate about 2 million of the 25 million subscribers buy Hulu+ at about $44.99 per month.

[3] This equates to about $83 per year, or about $150 per year 15 years from now. This is a significant expenditure for many households in emerging markets. Hulu currently offers an ad supported version of their streaming product for about ½ the price of the ad free version. Disney+ could elect to offer an ad supported version of Disney+ to make the product more attainable in lower income countries.

absorb nearly $10 billion in streaming-related operating losses over the next four to five years as it scales the business to profitability, yet they will be building value throughout by accumulating paying subscribers.

We forecast Disney will earn about $7.00 per share in 2020 after it digests the Fox assets and ramps up its streaming investment. Excluding streaming losses, we think earnings would be closer to $8.50. At our entry price, we paid about 16.5x our 2020 estimate for Disney, and 13.5x if we adjust out the $1.50 of streaming losses. At this valuation, we believe the stock reflects the historical modest growth profile of the business and secular concerns about its television related assets, rather than the enormous opportunity in streaming that lies ahead.

By the end of 2024, we expect streaming to reach breakeven, mid-single digit earnings compounding from non-streaming businesses, and modest share repurchases to drive earnings to about $11 per share. If we apply a 15 multiple to this earnings stream it would be worth $167 per share. In addition, using the 2024 streaming subscriber numbers forecasted by Disney at its recent analyst day, the company should have 108 to 162 million subscribers, not earning anything, but worth $56 to $85 billion (using a $600/sub value from the recent Hulu-AT&T transaction)[4]. This translates into an additional $31 to $47 dollars of value per share, for a total value of $198 to $214; a mid to high teens rate of return over the next four years from our purchase price. Longer term, we believe Disney has the potential to sustain mid-teens earnings per share compounding as streaming profitability ramps and its subscriber base expands rapidly around the globe.

## Notable Portfolio Changes

*Metro Bank plc (MTRO-LN)* – In May and June of 2018, we established a 2% position in Metro Bank. As a reminder, Metro is a young and rapidly growing bank in the U.K. offering a significantly better customer service proposition than the incumbent banks. It has grown to about 60 branches over the last decade and has ambition to become several times larger over the next decade (please see our second quarter 2018 client letter for more background on the company).

During the second half of 2018, business conditions got more difficult for Metro due to a flattening yield curve and increased competition for mortgage loans spurred by a regulatory change. To make matters worse, during the first quarter of 2019, Metro announced that it had miscalculated risk-weightings on several asset categories, and that expected regulatory capital relief would be delayed. Metro will respond to these developments by slowing its deposit growth (to about 20% from 30%-plus), altering its lending mix toward more capital efficient loan categories, and implementing cost savings programs. Metro's profit and return on equity will ramp more slowly than previously expected. To meet this new business plan, Metro intends to raise £300 million of equity capital in the next few months, and will likely raise additional equity in a year or two.

This tsunami of bad developments has sent Metro stock down about [redacted] from our 2018 purchase price; we do not expect a quick rebound. We view our initial purchase as an investment mistake. However, in these situations we do not want to compound our mistake by rashly selling the stock simply because it has gone down; we attempt to suppress emotion and rationally review the new set of facts we are presented to reach an investment conclusion. We update our model and rethink the risk-return profile.

From this point, we believe Metro's downside risk is limited because it is profitable, trading well below book value, and its asset quality remains sound. Deposit growth, cost of deposits, and customer reviews remain excellent. We believe it will be at least 18 months until some of the challenges Metro faces (flattened yield curve, mortgage market competition, regulatory capital relief, investigations, diminished management credibility) begin to abate, but we believe that they are all likely to pass with time.

We do not believe that these developments reduced the ultimate opportunity that Metro has in front of it, but the timeline has been delayed, execution risk has risen, and the equity raises will dilute returns to shareholders. Importantly, we believe the unit-level economics at mature Metro branches are excellent because very high deposit levels (2X+ more than a typical bank branch) enable good leverage on relatively fixed branch-level expenses. Of course, because most of the branches are new, they have not yet reached scale. In addition, Metro has not yet grown into its corporate costs, and its

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[4] On April 11, 2019, Hulu announced a transaction to acquire AT&T's approximately 10% ownership stake in Hulu for about $1.5 billion. With approximately 25 million subscribers, this values Hulu at about $600 per subscriber.

regulatory capital burden remains high. Ultimately, we believe Metro's attractive unit economics will prevail, enabling the company to climb out of its current predicament and deliver on its potential. If Metro is unable to regain its footing, we think it has strategic value to other banks and could be an acquisition target.

In our base case, we believe Metro will grow book value per share at a mid-single-digit rate over the next five years and trade at a premium to book value at the end of that period (returns on equity accelerate throughout the measurement period, making the business more valuable), delivering about 100% upside. If the macroeconomic environment improves (yield curve materially steepens, mortgage market corrects), and Metro exceeds our expense leverage and capital relief expectations, the stock could be multiples higher over the next five years. We see little downside given that Metro could put itself up for sale to a larger bank and probably achieve a price around book value or somewhat higher. With this in mind – limited downside, and attractive upside – we purchased additional shares in Metro in February to bring it back to about a 2% position.

## In closing

We thank you for entrusting your capital to us. We will continue to do our best to protect and grow your investment over time.

Please let us know if there has been any change to your contact information, any change to your financial circumstances or investment objectives that might impact how we manage your account, or if you would like to add or modify any reasonable restrictions to our investment advisory services.

Sincerely,

Broad Run Investment Management, LLC

July 19, 2019

**Separate Account Client Letter**
**Second Quarter 2019**

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For the quarter, Broad Run's Focus Equity Separate Accounts returned [redacted] net of fees compared to [redacted] for the [redacted]. Year to date, the Focus Equity Separate Accounts returned [redacted] net of fees compared to [redacted] for the [redacted]. The performance for your account will differ somewhat from these reported results due to variations in holdings and other client-specific circumstances. We remind you that we manage your account for long-term results, so we encourage you to evaluate its performance over a multi-year time frame. Long-term performance is presented at the end of this letter.

During the second quarter, we exited our 1.3% position in Fox Corporation. Recall from our first quarter letter that we received this position during that quarter as a result of the Disney-21st Century Fox corporate transaction. We used the proceeds from the Fox Corporation sale to increase our Disney position by 1.3%. While we believe Fox Corporation should see good earnings growth over the next several years, the business is closely tied to the traditional U.S. cable bundle which we believe will have many fewer subscribers five and ten years from now. Disney has much less exposure to this headwind, and we believe a brighter long-term future due to its Disney+ and Hulu direct-to-consumer offerings.

We also trimmed 2.1% from our American Tower position with most of the proceeds used to incrementally add to Brookfield Asset Management, CarMax, and Disney (for reference, this brings Disney to 7.0% of assets at quarter-end). American Tower's business continues to perform well, but the stock has had a strong run recently and the valuation is near its historical highs. We trimmed the position to reduce what had become an outsized weighting, and because we thought we had good alternative uses for the capital. American Tower remains among our largest, and highest conviction ideas at 9.9% of assets.

To further your understanding of what we own, and why, we will use the balance of this letter to discuss Aon plc, a top five holding at 8.6% of assets. We have owned shares of Aon since 2010 and believe it aligns well with our five investment criteria (high-quality business, large growth opportunity, excellent management, low tail risk, and discount valuation). In particular, we think a brief review of Aon's history is helpful in illustrating the critical role a management team's capital allocation skill can play in creating shareholder value.

<u>Aon plc</u>

There are two major chapters in Aon's corporate history. The first chapter, from 1971 to 2005, was under the leadership of founder Patrick Ryan. During this period, the company grew quickly through more than 400 acquisitions targeting mostly the insurance brokerage industry. The second chapter, from 2005 to today, is under the leadership of current CEO Greg Case. During Case's tenure, the company has focused on pruning and integrating Ryan's conglomerate, strengthening the firm's strategic positioning, and accelerating organic growth.

Greg Case joined Aon as CEO after 17 years at McKinsey & Co., where he was a rising star who moved rapidly through the ranks including running the insurance practice and eventually running the entire financial services practice. Case arrived at Aon with a unique perspective on insurance and financial services, a ROIC decision-making framework, and knowledge about how a world-class professional services firm should be run.

In our view, Case has been masterful in his leadership of Aon. Aon was a good business when Case arrived, and we think he has transformed it into an excellent business during his tenure. Here is a summary of the major actions undertaken by Case to remake Aon:

- Upon arrival, Case moved quickly to exit Aon's collection of insurance underwriting businesses, which he assessed as lower ROIC with less attractive prospects than insurance brokerage. He finalized the exit of these underwriters in 2008 with a series of transactions generating $2.8 billion in proceeds (at a full valuation in our view). He used these proceeds to repurchase $1.7 billion of stock and to buy Benfield Group for $1.4 billion.

Benfield solidified Aon as the clear #1 reinsurance broker (a specialized segment of the market where insurance companies insure each other) with about 40% market share.

- In 2010, Aon acquired Hewitt Associates for $4.9 billion in a 50% cash, 50% stock deal. Aon was #4 in human resources, retirement, and health care consulting, but moved to #1 or #2 in these categories with the addition of Hewitt. Aon also gained ownership of a leading benefits administration business with the acquisition; a reasonably attractive business administering large company benefit programs, but more of a data processing business model than Aon's core franchises that rely upon specialized knowledge to provide expert advice.

- In 2012, Aon redomiciled from the U.S. to the U.K. This reduced the company's tax rate by about six percentage points, increased capital allocation flexibility, improved proximity to the important Lloyd's of London market, and enhanced access to emerging markets (about 54% of revenue was from outside the U.S. at that time). Aon was the first S&P 500 company to redomicile to the U.K.

- In 2017, Aon sold its benefits administration business to Blackstone for $4.3 billion, with an additional $500 million payment contingent upon the deal achieving targeted IRRs. Proceeds from this sale were used to repurchase $2.3 billion of stock. In addition, this transaction removed structural impediments that had prevented Aon from fully consolidating its shared corporate services and information systems.

- Since the sale of the benefits administration business, Aon has focused on "Aon United". Aon United is the company's pivot to a single operating platform, single brand, modern technology infrastructure, and a new organizational structure that emphasizes broader solutions selling of the full Aon portfolio of services. Several prior restructuring plans, totaling over $1.0 billion in investment, had cut expenses and streamlined operations over the years, but Aon United is expected to be the most fundamentally transformative initiative yet.

- Aon has invested over $250 million annually collecting proprietary data and building analytics capabilities and products for clients. Aon was a first-mover harnessing the data on its insurance brokerage platform, and views this as a key differentiator and structural advantage over small and mid-sized brokers (about 70% of the industry) that do not place as much industry volume.

- Finally, Aon has found its own stock to be systemically undervalued during Case's tenure, and repurchased over $16 billion in response. This has been the biggest use of cash, and a large contributor to returns. Aon compares the ROIC available on acquisitions against the ROIC on share repurchases and other investment options, and adjusts its behavior accordingly. Management makes frequent reference to this ROIC decision making framework, a refreshing reminder of their commitment to value creation.

Today, following these maneuvers, Aon is #1 or #2 in all its major lines of business: insurance brokerage, reinsurance brokerage, retirement consulting, health care consulting, and related data and analytics. Over the last decade, adjusted operating margins have improved to 25% from 15%, ROIC has improved to 22% from 12%, and per share returns at the business level (EPS growth + dividend yield) have compounded at 14%.

While Aon's restructuring opportunities appear largely complete, organic growth has become an important contributor to value creation. Aon United is improving cross-selling, and Aon's reinvestment in data and new capabilities is yielding results. Organic revenue growth rates have accelerated from low-single digits for much of the last decade to the mid-single digits in recent years[1], and management guidance is for "mid-single digits or greater" over the long-term.

[1] Some small part of this improvement is likely due to a firming insurance pricing environment, but these growth rates also comfortably outpace other large competitors illustrating the company specific success Aon is having.

| Year | Aon Organic Revenue Growth Rate[2] |
|---|---|
| 2014 | 3% |
| 2015 | 3% |
| 2016 | 4% |
| 2017 | 4% |
| 2018 | 5% |
| 2019 *(first quarter)* | 6% |

In addition, there is significant opportunity for acquisitions, especially now that Aon is a more cohesive enterprise. The top three insurance brokers still have only about 30% global market share, and there are increasing benefits to scale from proprietary data and global reach. In fact, Aon was recently in exploratory discussions to acquire Willis Towers Watson, the third-largest provider of insurance brokerage, in what would be a transformative deal. In recent years, Aon has been increasing its acquisition of complementary service companies that address key client pain points (e.g. cybersecurity, intellectual property, etc.), and management asserts that its M&A pipeline is now "the best it has ever been" during Case's tenure.

Over the next five years, we expect 5-6% organic revenue growth and modest operating leverage to generate 7-9% operating income growth. In addition, as an asset-light business, Aon can grow organically without significant capital reinvestment, allowing for high free cash flow generation. We expect Aon to have about a 5% free cash flow yield, and to produce another 1% cash flow from sustaining its current leverage rate on its growing earnings base. We expect this cash flow to be used for share repurchases, acquisitions, and dividends, driving 13-15% total returns (7-9% operating income growth + reinvestment of 5% free cash flow yield + reinvestment of 1% cash flow from sustained leverage).

The stock is trading 20x our next twelve-month earnings expectations, a two-point multiple premium to the market. Aon has historically traded at a one to two point multiple discount to the market, but that was before organic growth accelerated from below GDP levels to above GDP levels. Overall, from this valuation level, we think returns in Aon's stock will approximate its low- to mid-teens growth in adjusted EPS. Importantly, Aon has below average cyclicality, and some positive optionality that management will achieve discontinuous value creation via a transformative acquisition like Willis Towers Watson.

In closing

Please let us know if there has been any change to your contact information, any change to your financial circumstances or investment objectives that might impact how we manage your account, or if you would like to add or modify any reasonable restrictions to our investment advisory services.

We thank you for entrusting your capital to us. We will continue to do our best to protect and grow your investment over time.

Sincerely,

Broad Run Investment Management, LLC

[2] At a constant currency exchange rate

October 22, 2019

**Separate Account Client Letter**
**Third Quarter 2019**

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For the quarter, Broad Run's Focus Equity Separate Accounts returned [redacted] net of fees compared to [redacted] for the [redacted]. Year to date, the Focus Equity Separate Accounts returned [redacted] net of fees compared to [redacted] for the [redacted]. The performance for your account will differ somewhat from these reported results due to variations in holdings and other client-specific circumstances.

We are pleased to have crossed our 10-year performance anniversary this quarter. We are proud of the results we have posted over the last decade, but continuously strive to become better investors. We are fortunate to have clients who share our long-term horizon and provide the patient capital we need to execute our investment approach. Long-term performance is presented at the end of this letter.

Below, we discuss our new position in SS&C Technologies, and our exit of Metro Bank.

<u>New Position: SS&C Technologies, Inc. (SS&C)</u>

During the quarter, we established a new position in SS&C Technologies at a 2% weighing. SS&C is a leading provider of financial record-keeping software and related services to various financial entities, including hedge funds, private equity funds, mutual funds, banks, and insurance companies.

SS&C's offerings include fund administration services, portfolio accounting software, trade management systems, and transfer agency services, among others. While each of these solutions has its own unique dynamics, a commonality across them is that they are essential services for customers. These solutions become imbedded in customer workflows and tend to have few competitive substitutes, so switching costs are high. Further, many of SS&C's solutions are interoperable, increasing their utility and further entrenching them with customers. For these reasons, SS&C enjoys 95%-plus revenue retention rates and good pricing power.

SS&C also enjoys scale advantages. For example, in its asset management software business it is more than two times larger than its closest competitor, allowing it to invest many more dollars in R&D, yet have lower overall spend as a percentage of revenue. In fund administration, again SS&C is the largest provider, allowing it to leverage its overhead expenses for strong profitability while supporting a sales staff many times larger than its competitors.

SS&C still has a large growth opportunity in front of it. While SS&C has leadership positions in many of its service areas, we believe it has less than 5% overall share of the estimated $100 billion (software and labor) U.S. financial record-keeping market, and even less share of the equally large international market. SS&C typically accounts for less than 10% of its customers' financial record keeping spend, so growing wallet share with existing clients is a good opportunity. However, the bulk of SS&C's growth will likely be driven by acquisitions – a key competency. SS&C's long-standing approach is to identify target acquisitions in the same or adjacent markets, pay a modest price, and deliver significant synergies through cost-cutting and cross-selling.

SS&C's development of its fund administration business provides an illustrative example. In 2006, SS&C had virtually no presence in fund administration. However, management recognized that banks, which were the primary providers of fund administration at the time, were not well-situated to compete as technology and high-touch service became more important to clients. In addition, regulatory changes following the financial crisis made this business less appealing to banks. From 2006 until today, SS&C has been rolling up the fund administration industry and is now the largest player with more than $1.7 trillion in funds under administration and a billion dollars in segment revenue (about 22% of SS&C's total revenue). Along the way, SS&C has acquired many fund administration businesses that had no, or low margins, and increased them to 30% or more. Despite its success and market-leading position, SS&C has just 20% fund administration market share. Management believes that consolidation will continue and that over time, SS&C can approach 40% market share.

As with any company driven by M&A activity, the quality of management is of utmost importance. CEO Bill Stone founded SS&C in 1986 with $10,000, and gradually built it into a multi-billion-dollar enterprise. Today, Bill owns more than 12.5% of the shares outstanding, amounting to an equity interest of more than $1.5 billion. Bill's leadership has been superb. Under his management, SS&C has made more than 50 acquisitions, with estimated IRRs consistently above 20%. But SS&C is not a prototypical serial acquirer that simply slashes headcount and starves a company for resources post-acquisition. SS&C invests heavily and thoughtfully in R&D, developing new products, improving existing products that have growth potential, and harvesting cash flow from mature products with high switching costs and few substitutes. In 2019, SS&C will spend nearly $450 million on product development, or nearly 10% of sales.

For the reasons cited above, SS&C has been an extraordinarily good business, earning returns on capital in the mid-teens and returns on equity in the mid-twenties. The stock, following suit, has compounded at more than [redacted] since the company's IPO in 2010.

Looking forward, we expect SS&C to continue to compound value at a healthy clip. As a baseline, we think the company can grow revenue 3-5% organically through cross-selling and price increases, and operating profit 4-6% with some modest margin expansion. In addition, at its current price, the company has an 8% free cash flow yield. If SS&C simply repurchased stock with its free cash flow, earnings per share would grow at about a 12-14% rate. However, we think it is highly likely that most free cash flow will be directed toward further M&A where the company should achieve much higher IRRs than it would on share repurchases. While the pace and magnitude of future acquisitions are unknowable, if the company deploys two-thirds of its free cash flow toward M&A and achieves IRRs that are two-thirds its historical level on these deployments, we calculate earnings per share would increase at a mid-teens rate.

We paid about 13x next twelve months estimated earnings and 11x EV/EBITDA for shares of SS&C, which is a substantial discount to the company's historical valuation range and attractive relative to the overall market. We believe two primary concerns have made SS&C available at this price. First, 2018 was SS&C's largest acquisition year, by far. SS&C deployed more than $8.3 billion into M&A during the year, a substantial investment compared to its own $10.5 billion pre-transaction enterprise value. SS&C acquired three large businesses, including the $5.4 billion acquisition of DST Systems. DST has underperformed organic revenue growth expectations since its acquisition, casting a pall over the deal and SS&C's M&A aptitude. Second, the trend toward passive investment products continues to the detriment of active investment products. Multiples of publicly-traded active equity managers have been under pressure and this pressure has extended to SS&C as a vendor to these managers.

After significant research, we have come to believe that DST is a sound business being run more efficiently and with better service levels than it was pre-acquisition. We believe the organic growth slowdown is temporary and we will see a reacceleration in the not-too-distant future. Further, we believe that DST's opportunity to win wallet share from existing customers (current clients only outsource about 50% of their transfer agent services to DST and retain 50% in-house) is underappreciated by the market and provides an attractive opportunity now that the business is executing better.

We believe the well-established headwinds that active management faces are likely to persist. These headwinds are strongest in long-only equity. Yet, contrary to common perception, we estimate SS&C generates only about 20% of revenue from long-only equity managers. This exposure is through mission-critical services under 3-5 year contracts. In most cases, a firm will need to shut down or be acquired for SS&C to suffer meaningful revenue loss. Importantly, SS&C also has several key offsets. First, we estimate SS&C generates about 10% of revenue from services to passive equity products; direct share gainers from active equity. Second, SS&C is the largest administrator of alternative assets (including hedge funds, private equity, infrastructure, and real estate) which are benefitting from robust flows as active equity strategies lose share. Third, as fee headwinds continue for active equity managers, there will be increased financial pressure to save money by outsourcing back and middle-office functions to businesses like SS&C.

We have stress-tested the company under multiple scenarios and believe that SS&C can create value even in fairly draconian scenarios for active managers. Importantly, SS&C management is smart, thoughtful, and economically aligned with us. Significant capital will be deployed over the next five years (perhaps more than the company has deployed cumulatively in its 33 years of existence). With a large opportunity set across multiple end markets for financial record keeping, if SS&C decides to redirect the business away from active management, there should be ample opportunity to do so.

If we are right in our assessment about the business, we think SS&C will compound earnings per share at a low to high teens rate and regain some of its historical premium valuation, driving at least mid-teens annualized investment returns for us over the next five years.

<u>Exited Position: Metro Bank plc (MTRO)</u>

We first purchased shares in Metro Bank in the second quarter of 2018. Metro is a small and growing bank in the UK with a highly differentiated customer service proposition. We saw much to like about the company, with a proven founder, a hard to replicate business model, and a large addressable market. However, soon after our purchase, business conditions turned negative due to a stagnating UK economy, a flattening yield curve, and increased competition.

During the first quarter of 2019, conditions turned from bad to worse. Metro announced that it had miscalculated regulatory risk weightings on several asset categories. As a result, the company had a looming shortfall in regulatory capital requiring an equity raise in the second quarter of 2019. The stock sold off sharply into the equity raise, making it highly dilutive, but necessary. The third quarter was no kinder to Metro Bank than the first two quarters of the year. Metro had difficulty raising MREL debt, which is mandated for regulatory purposes. After a failed issuance, it eventually raised the required debt, but at a very high 9.5% coupon that will consume much of the bank's profitability.

Metro finds itself stuck in a difficult position: it needs to grow to leverage its expenses and improve profitability, but to grow (or even stay the same size) it needs to raise significant capital that comes at a very high cost. This conundrum has proven costly to equity holders and there is no obvious path out of the bind. As a result, we sold all shares of Metro Bank from client accounts around quarter-end.

Metro Bank is our worst loss, by far, in the last ten years. On average, we invested 3.3% in Metro, at cost, and suffered a [redacted] loss on the investment. At Broad Run we work hard to avoid permanent loss of capital, but we failed in this case. We conducted robust research on Metro Bank – including thousands of pages of reading, site visits, management meetings, and conversations with independent industry experts – but ultimately failed to fully understand and appreciate the risk that sunk the investment: the negative feedback loop that arose when the company departed from plan, ballooning the external capital needs and capital cost for the business.

While we have learned several important lessons from this investment, and hope to improve because of it, the reality is that mistakes are inevitable when investing. It is for this reason that we conviction-weight our portfolio and generally begin new holdings at small position sizes. This position sizing discipline was effective at containing the damage from our investment in Metro Bank. While we are disappointed with how the investment turned out, our risk controls have allowed us to still add value year-to-date and over the long-term.

<u>In closing</u>

Please let us know if there has been any change to your contact information, any change to your financial circumstances or investment objectives that might impact how we manage your account, or if you would like to add or modify any reasonable restrictions to our investment advisory services.

We thank you for entrusting your capital to us. We will continue to do our best to protect and grow your investment over time.

Sincerely,

Broad Run Investment Management, LLC

January 30, 2020

**Separate Account Client Letter**
**Fourth Quarter 2019**

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For the year ended December 31, 2019, Broad Run's Focus Equity Separate Accounts returned [redacted] net of fees compared to [redacted] for the [redacted]. For the fourth quarter, the Focus Equity Separate Accounts returned [redacted] net of fees compared to [redacted] for the [redacted]. The performance for your account will differ somewhat from these reported results due to variations in holdings and other client-specific circumstances. We remind you that we manage your account for long-term results, so we encourage you to evaluate its performance over a multi-year time frame. Long-term performance is presented at the end of this letter.

**Index Update**

Broad Run's Focus Equity Strategy is benchmark agnostic - meaning we do not attempt to position portfolios vis-à-vis an index. Rather than using a market index as a starting point in portfolio construction, our portfolios are constructed using bottom-up stock selection. While we are mindful of having appropriate economic diversification across portfolio holdings, we do not let index holdings or sector weightings direct our investment decisions.

Because the Focus Equity Strategy has minimal exposure to a number of sectors, invests across the market capitalization spectrum, and is absolute return oriented, we do not think there is an appropriate benchmark for the strategy. Historically, we have presented the [redacted] in client reports as a "reference index" to illustrate the general direction of the broader U.S. stock market. The fee we pay to present this [redacted] data is set to rise so substantially that we have elected to switch providers. Going forward, after this letter, we will use S&P Total Market Index, instead of the [redacted], to reflect the general trend in the U.S. equity markets. There is absolutely no change to how we manage the strategy.

As you can see below, the performance of the two indexes is almost identical, making them excellent substitutes.

| | ANNUALIZED TOTAL RETURNS *(as of 12/31/19)* | | | |
|---|---|---|---|---|
| | 1 YR | 3 YRS | 5 YRS | 10 YRS |
| [redacted] | [redacted] | [redacted] | [redacted] | [redacted] |
| S&P Total Market Index | 30.90% | 14.52% | 11.20% | 13.40% |

**Portfolio Earnings Update**

As we have discussed before, investment returns for equities can be broken down into three factors: growth in earnings, dividends, and change in valuation. In the short term, change in valuation can have a meaningful impact on investment results, but longer term, change in valuation becomes much less important as growth in earnings and dividends accumulate to drive the majority of results.

For this reason, as long-term investors, our analytical focus is on trying to understand a business's future earnings and dividends. We track how these metrics develop at each business we own, in aggregate across all the businesses we own, and at the portfolio level taking into account the impact of cash. This analysis helps us understand how these businesses are performing by providing a measure of progress independent of the vicissitudes of the stock market[1]. Each year end we report a summary of this information to give you additional perspective on your investment with us.

[1] While this is not particularly useful to measuring progress at many types of investment strategies - for example, a high valuation-high growth strategy, a slow/no growth-deep value strategy, or a high turnover strategy - we do believe it is instructive for our long-term, business-focused strategy where we typically pay market-level valuations for businesses we believe have above-average growth.

Please note, in this letter when we refer to "earnings" or "EPS" for our businesses, we mean earnings on a per-share basis, adjusted for certain items. We make these adjustments to get to, what we believe to be, a better measure of the true economic earnings of the businesses. Please see footnote six for additional information about our methodology[2].

*2019 Business Results*

In 2019, our businesses made good fundamental progress. In aggregate, we calculate they grew EPS 13.8% and paid a 0.6% dividend. This compares to a [redacted] EPS decline and a [redacted] dividend for the [redacted]. EPS declines for the broader market were due largely to the impact of tariffs and a slowdown of global economic activity. These factors were particularly challenging to earnings growth at companies with significant international sales, and industrial and energy companies; areas our portfolio under indexes.

| | 2019 EPS Growth | | 2019 Dividend Yield | | EPS Growth + Dividend Yield |
|---|---|---|---|---|---|
| Our Businesses | 13.8% | + | 0.6% | = | 14.4% |
| [redacted] | [redacted] | + | [redacted] | = | [redacted] |

Nineteen out of the twenty-one businesses we owned this year had positive earnings growth (and one, Disney, made a conscious decision to forego near term earnings growth in order to invest aggressively in launching its Disney-plus DTC offering). Of those businesses with positive earnings growth, three grew at a single digit rate, seven grew at 10 to 13%, four grew at 13 to 17%, and five grew in excess of 17%.

*Longer-Term Business Results & Investment Performance*

In the table below, we add 2019 results to the historical EPS growth and dividend yields for the businesses owned by the portfolio (column A). In addition, we include the impact of any cash held in the portfolio (B) to bridge the gap between business level and portfolio level fundamental results (C). We include portfolio market performance (D & E), and corresponding fundamental and market performance for the [redacted] (F & G).

[2] Earnings and EPS for the Focus Equity Strategy and its underlying holdings are based upon Broad Run's calculations/estimates, with adjustments for certain amortization expenses, excess depreciation expenses, and non-recurring charges, among other items. For balance sheet-centric companies, change in book value per share, or change in Net Asset Value per share may be used to measure fundamental progress rather than EPS. EPS for the holdings/portfolio refers to aggregated EPS of individual businesses based upon their quarter-end weightings in the Focus Equity Separate Accounts. The source for [redacted] EPS is FactSet "recurrent earnings" which include consensus adjustments to reported accounting earnings. Broad Run's calculations/estimates may differ materially from consensus. Results for the most recent year are preliminary, subject to adjustment as annual reporting is finalized. Contact us for additional detail.

| | Focus Equity Separate Accounts | | | | | [redacted] | |
|---|---|---|---|---|---|---|---|
| | A | B | C | D | E | F | G |
| Year | Business Level EPS Growth + Dividend Yield* | Impact of Cash Balance | Portfolio Level EPS Growth + Dividend Yield* | Total Return Gross of Fees | Total Return Net of 1% Fee | EPS Growth + Dividend Yield | Total Return |
| 2010 | 29% | -0.9% | 28% | [redacted] | [redacted] | [redacted] | [redacted] |
| 2011 | 19% | -1.2% | 18% | [redacted] | [redacted] | [redacted] | [redacted] |
| 2012 | 19% | -1.7% | 17% | [redacted] | [redacted] | [redacted] | [redacted] |
| 2013 | 18% | -1.2% | 17% | [redacted] | [redacted] | [redacted] | [redacted] |
| 2014 | 19% | -0.7% | 19% | [redacted] | [redacted] | [redacted] | [redacted] |
| 2015 | 12% | -0.3% | 12% | [redacted] | [redacted] | [redacted] | [redacted] |
| 2016 | 4% | -0.2% | 4% | [redacted] | [redacted] | [redacted] | [redacted] |
| 2017 | 13% | -0.5% | 13% | [redacted] | [redacted] | [redacted] | [redacted] |
| 2018 | 26% | -0.6% | 25% | [redacted] | [redacted] | [redacted] | [redacted] |
| 2019 | 14% | -0.2% | 14% | [redacted] | [redacted] | [redacted] | [redacted] |
| Cumulative: | 392% | | 361% | [redacted] | [redacted] | [redacted] | [redacted] |
| Annualized: | 17.3% | | 16.5% | [redacted] | [redacted] | [redacted] | [redacted] |

** For the Focus Equity Separate Accounts, EPS growth is a Broad Run estimate based upon reported results for the first three quarters of the most recent year and projections for the final quarter of the most recent year. For prior years, EPS growth has been updated to reflect actual reported results for the year, any changes in company level methodology, and other updates, as appropriate. May not sum due to rounding.*

We believe these results continue to show that there is a fairly weak relationship between fundamental business performance and market performance in any one year, but that the relationship strengthens as the time horizon is extended. We are pleased with the absolute and relative performance of the businesses that we have owned in the portfolio over the last ten years, and believe that our long-term investment performance is to a large extent a reflection of these long-term business results.

*Business & Investment Outlook*

The table below shows a snapshot of the beginning of year valuation and our beginning of year expectations for portfolio earnings growth, at that point in time.

| Focus Equity Separate Accounts - Projection at Beginning of Year | | | |
|---|---|---|---|
| Beginning of Year | Business Level Price to 1yr EPS Est.*^ | Business Level 1yr Est. EPS Growth Rate* | Business Level 5yr Est. EPS Growth Rate* |
| 2010 | 14.9x | 20% | mid-teens |
| 2011 | 15.4x | 16% | mid-teens |
| 2012 | 14.1x | 16% | mid-teens |
| 2013 | 15.5x | 17% | mid-teens |
| 2014 | 17.9x | 17% | mid-teens |
| 2015 | 17.0x | 17% | mid-teens |
| 2016 | 16.6x | 18% | mid-teens |
| 2017 | 16.1x | 14% | mid-teens |
| 2018 | 16.4x | 24% | mid-teens |
| 2019 | 15.2x | 14% | mid-teens |
| 2020 | 18.3x | 13% | mid-teens |

* *Based upon Broad Run internal estimates (may differ materially from consensus estimates), weighted by position size, excluding the impact of any portfolio level cash.*

^ *Valuation based upon prior year closing price.*

We note that the portfolio, at 18.3x, is trading at its highest price-to-earnings multiple in the last decade, with estimated one year EPS growth of 13% and five year EPS growth of mid-teens. This compares favorably to the [redacted] trading at [redacted] with estimated one year EPS growth of [redacted] and five year EPS growth of [redacted]. We believe the higher than average valuations of the portfolio and broader market reflect expectations that interest rates are likely to remain low for an extended time, and that good economic growth can be sustained in the U.S. now that Phase I of the U.S.-China trade deal has been signed.

With few exceptions, we believe the businesses in the portfolio are performing well and are compounding capital for us at attractive rates. The portfolio is a collection of businesses that we think possess better than average competitive positions, growth opportunities, and management teams. Trading around a market multiple, we believe the portfolio provides a much better value proposition than the market overall.

**Update on The Charles Schwab Corporation (SCHW)**

On November 25, 2019, Charles Schwab announced a definitive agreement to acquire TD Ameritrade in a $26 billion all-stock transaction. We think this transaction is both strategically and financially attractive. The transaction, expected to close in the second half of 2020, should increase Schwab's assets by nearly 35%, improving its scale and low-cost position. TD Ameritrade brings improved active trader and corporate stock plan capabilities to Schwab, while Schwab brings its broad personal financial services menu to TD Ameritrade clients. Financially, we estimate the transaction will be 20-25% cash EPS accretive to Schwab in year four, with modest additional accretion beyond that point as Schwab converts residual TD Ameritrade cash balances to its own platform over the subsequent six years.

The discount brokerage industry has a long history of accretive consolidation because there are significant back office, technology, and advertising cost savings. For this reason, we are quite confident in the synergy benefits of this transaction. However, there are also important antitrust considerations. Most notably, both Schwab and TD Ameritrade are leading custodians for independent RIAs and this transaction will result in approximately 50% market share for the combined entity. Schwab's key defense is that it will have only about 10% market share of the more broadly defined financial advisor market, so much of the antitrust consideration will hinge on market definition. Schwab also points out that it has a long history of passing along cost savings to customers though lower prices, which is a supporting narrative. We observe that there are still formidable competitors in the independent RIA custody space with traditional providers such as Fidelity, Pershing, and Shareholder Services Group, emerging providers such as RBC, E*TRADE, and Interactive Brokers, as well as tech focused providers such as Folio, Altruist, and Apex. In addition, company founder and Chairman of the Board, Chuck Schwab, has been among the very largest donors to Donald Trump over the last several years. To the extent this transaction gets significant antitrust scrutiny, it may pay to have friends in high places.

We give great credit to Schwab management in positioning for this transaction. Recall that Schwab made headlines in early October with its announcement that it would cut equity trading commissions to zero. This decision caused modest pain for Schwab, reducing profitability by an estimated 7-8% and sending the stock down a similar amount. But Schwab's commission cut forced the rest of the industry to quickly follow suit. TD Ameritrade, with a higher portion of its revenue from commissions, was hammered, reducing profitability an estimated 25-30% and sending the stock down a similar amount. In addition, TD Ameritrade was in the midst of a CEO search. So, Schwab significantly weakened its acquisition target, making it more affordable to buy, at the same time that the target was lacking clear leadership and therefore more likely to be receptive to an acquisition proposal.

Despite our expectation of 20-25% cash EPS accretion in year four, Schwab stock was only up about 10% after the transaction announcement. We believe this reflects concern about potential antitrust issues and the relatively long timeline to capture the accretion (three to four years rather than a more typical one to three years). On a standalone basis we expect Schwab to grow EPS at a low teens rate over the next five years, and if this transaction is consummated, which we think is likely, we believe EPS compounding should be in the high teens. At 18x consensus 2020 EPS estimates, we continue to have a positive outlook on Schwab, and continue to hold an average 5.0% position in client accounts.

In closing

We thank you for entrusting your capital to us. We will continue to do our best to protect and grow your investment over time.

Please let us know if there has been any change to your contact information, any change to your financial circumstances or investment objectives that might impact how we manage your account, or if you would like to add or modify any reasonable restrictions to our investment advisory services.

Sincerely,

Broad Run Investment Management, LLC

April 2, 2020

**Client Letter**
**First Quarter 2020**

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For the quarter ended March 31, 2020, Broad Run's Focus Equity Separate Accounts[1] returned [redacted] net of fees[2] compared to -21.0% for the S&P Total Market Index[3]. The performance for your account will differ somewhat from these reported results due to variations in holdings and other client-specific circumstances. We remind you that we manage your account for long-term results, so we encourage you to evaluate its performance over a multi-year time frame. Long-term performance is presented at the end of this letter.

**Pandemic**

As you are certainly aware, over the last several weeks news of COVID-19 (coronavirus) has dominated the headlines, and increasingly our everyday lives. The country is using "social distancing" to slow the spread of the disease, and restrictions on human interaction and business activity continue to ratchet up. While effective at slowing disease spread, these measures are highly disruptive to our daily routines, and are causing significant hardship for many businesses and consumers.

COVID-19 is highly contagious, but fortunately its mortality rate is low relative to other pandemics that have afflicted humans. While tragic, the loss of life from this virus is not going to have a material impact on overall population, nor will it degrade our existing physical infrastructure of manufacturing plants, distribution facilities, office buildings, roads, airports, telecom networks, etc.

That said, we expect significant economic contraction in the short term, and continued pain in the intermediate term until a vaccine or highly effective therapeutic is widely available. Fortunately, fiscal and monetary response has been robust, and largely on target, limiting the risk of an uncontrolled downward spiral. With our nation's productive capacity largely intact, we think that long-term GDP and corporate profits will not be significantly affected by this downturn.

Operationally, at Broad Run, almost all employees have transitioned to working from home. We are pleased to report that it has been a smooth transition with all research, operations, trading and compliance systems functioning well.

**Our Approach**

As investors we face the challenge of how to react to various macroeconomic concerns that emerge on a semi-regular basis. Most often these concerns prove unfounded with the passage of time, but occasionally manifest in damage to the real economy and corporate profits. Our view is that it is extraordinarily difficult to make money by placing bets on macroeconomic events. The world is too complex with too many moving parts for this to be a consistently profitable exercise. Experience has taught us that we are most effective when building the portfolio one business at a time.

As long-term investors, we fully expect that our portfolio will face difficult economic environments at various points during our investment horizon. We prepare for this eventuality, not by exiting stocks at the first sign of trouble, nor by rotating our portfolio into more conservative sectors, but rather by seeking to own companies that can survive a downturn, and often use that downturn to their advantage. We seek to own superbly run companies with strong balance sheets that tend to be leaders in their industry. When times get tough, they are often in a position to go on offense by acquiring weaker competitors, introducing new products, or moving into new geographies. While the value created by such activities does not always reveal itself in the midst of a downturn, it becomes evident with the passage of time.

For example, during 2006 and 2007, O'Reilly Automotive received significant criticism from Wall Street analysts for having a balance sheet that was "too conservative". Many argued that O'Reilly should take advantage of record low

[1] See the end of this letter for historical performance and important disclosures.
[2] Net of highest applicable fee of 1.0% per annum as described in our Form ADV, Part 2A.
[3] S&P Total Market Index is a broad market index that includes 3,777 large, mid, and small cap U.S. equities (@12/31/19) that meet a minimum liquidity threshold.

interest rates to issue debt and use the proceeds to repurchase shares as other auto parts retailers had done. O'Reilly resisted that siren song, and in 2008 when a key competitor, CSK Auto, found itself in financial distress, O'Reilly attacked by launching a hostile takeover bid for the business. CSK had great strategic value because of its strong west coast footprint, which enticed other competitors to enter the bidding. However, debt markets were tight, and O'Reilly had an advantaged balance sheet, so it ultimately secured the acquisition.

O'Reilly got a great bargain acquiring approximately 1,300 well located CSK stores at a discount to what it would have cost to open a similar number of greenfield stores. The acquisition of CSK fueled outsized growth and financial performance for O'Reilly for many years after the transaction, an opportunity that would not have come about without the recession.

**Portfolio Assessment**

While we regularly analyze how our businesses might perform in a recession, a global pandemic leading to a cessation of economic activity for an extended period of time is not something we had ever specifically contemplated. We have since stressed tested each business we own for this new reality. We have considered what impact this may have on short and long-term demand, and stress tested balance sheets to see if businesses can survive three-months, six months, or even a year of nationwide social distancing.

While most of our businesses will suffer short-term revenue and profit declines, in general, we feel very good about their ability to weather this storm. We provide some brief thoughts below:

> The Good: Approximately 73% of the portfolio is in companies that we think will handle this downturn with relative ease. This includes American Tower (virtually no impact), Aon and SS&C (small negative demand impact), Alphabet and Facebook (negative advertising environment; tremendous balance sheets), Markel (mark-to-market reduction in value of public equities portfolio), O'Reilly Automotive (sharp, but short lived reduction in miles driven and parts demand), Ametek (negative demand impact; strong balance sheet for acquisitions), Brookfield Asset Management (challenged mall portfolio; significant funds for new investments), Encore Capital (short term reduction in collections due to job losses, rule changes, and court closures; intermediate term bonanza from increased credit card defaults), and Charles Schwab (lower interest rates reduce income for a while).
>
> The Bad: Approximately 24% of the portfolio is in companies that we think are facing significant short-term business disruption, but ultimately have the management team and balance sheet to see it through to the recovery. In most cases we see limited impact on long-term demand, potential for market share gains, and only minor changes to our long-term estimates of intrinsic value. This group includes Disney (parks closed; movie releases paused; sports halted [ESPN]; negative advertising environment; big boost for Disney+ and Hulu adoption), Carmax (many stores closed; negative demand for autos; boost to online delivery solution), NVR (negative demand impact for new homes; best balance sheet among public peers), Ashtead Group (negative demand impact for construction equipment; best balance sheet among public peers), American Woodmark (negative demand impact for kitchen and bath cabinets), Hexcel (negative demand impact from reduced air travel).
>
> The Ugly: Approximately 3% of the portfolio is in two companies that we think face significant disruption with risk of not recovering from the downturn. Both companies now trade at a significant discount to our estimate of net asset value, and upside is 3-4x in the next couple of years if they survive, so we have not exited these positions.

We acknowledge that the quotational value of our portfolio has not held up as well as the broader market this quarter. This is disappointing since we expected the stocks of our well run, competitively advantaged, reasonably valued businesses to do relatively well in a recession. But this downturn is just beginning to unfold. In the short term, the market has painted with a broad brush; there has been significant underperformance of the sectors we are overweight: consumer discretionary, real estate, and financials, and significant outperformance in sectors where we have virtually no exposure: technology, consumer staples, utilities, and health care. This reaction is understandable given the nature of this downturn. However, over time, we believe that the true value of the businesses in our portfolio will be recognized by the market as it becomes clear that they will not only make it through this downturn, but many will come out stronger and more profitable because of it.

**Portfolio Actions**

We have made several modest changes to the portfolio this quarter, but nothing significant. We like the businesses we own today for the reasons articulated above. Many have sold off well in excess of the change in their intrinsic values, so it is hard to find better bargains elsewhere. We have already paid a price for owning companies exposed to "social distancing"; the stocks in "The Bad" bucket have declined [redacted] on average since February 19 (the day the market began its decline) compared to a decline of 24.8% for the S&P Total Market Index. We do not think that now is the time to move to a conservative posture and load up on utility and health care stocks, now is the time to pick through the rubble to find those gems that have been unduly discarded.

We have been reviewing our watch list and are actively considering several candidates for inclusion in the portfolio. In late March, we added a new position in RH at 1% assets. RH's share price has been crushed in this downturn, declining [redacted] from its recent high. RH fits the prototype of investments we want to make now; it is cheap because it is suffering in the near term, but has solid leadership and liquidity, and should emerge much stronger after the downturn. We sold shares of American Tower – our very best performer this quarter, down just [redacted] – to fund the RH purchase. While a modest allocation, we have planted a seed that may grow into a mighty oak. We will look to plant other such seeds in the coming months and quarters.

RH (formerly known as Restoration Hardware) is a leading luxury retailer in the home furnishings marketplace. The company is in the early innings of a transformational change to its real estate/store design strategy. RH is replacing its legacy mall-based stores with larger "design galleries" located primarily in prestigious off-mall locations. RH believes there is the potential for 60-70 design galleries in North America versus 22 today. The larger design galleries produce 2x the sales volume of legacy stores on lower occupancy and expense rates, resulting in 2-3x higher four-wall profit.

Over the last 19 years, CEO Gary Friedman has transformed RH from a nearly bankrupt purveyor of home accessories into arguably the leading luxury home brand in the world. Gary has 28% beneficial ownership of RH and is relentlessly focused on ROIC and capital allocation. Even with its stores closed due to the pandemic, we believe RH's direct to consumer business (about 40% of sales) will allow the company to remain free cash flow positive. We think that RH is a well-run, high quality business with a large growth opportunity – a "compounder" – that we can likely hold for the long-term. Over time, should our continuing research reinforce our investment thesis, we will look to add to the position opportunistically.

In mid-March, we reallocated about 2% of capital to SS&C Technologies from Charles Schwab Corp. This brings SS&C to about a 4% position and Schwab to about a 3% position. We initiated a position in SS&C in the third quarter of 2019, and our conviction in our investment thesis has grown since then. While we continue to like Schwab, its profitability is hampered by the very low interest rates that have come about recently, and we now expect rates to stay low for an extended period. We also like that SS&C's recurring revenue and acquisition engine give it more control over its own destiny than Schwab in this environment. We sold Schwab at about 17x our estimate of earnings run rate and purchased SS&C at about 10x our estimate of earnings run rate.

<u>In closing</u>

We thank you for entrusting your capital to us. We will continue to do our best to protect and grow your investment over time.

Please let us know if there has been any change to your contact information, any change to your financial circumstances or investment objectives that might impact how we manage your account, or if you would like to add or modify any reasonable restrictions to our investment advisory services.

Sincerely,

Broad Run Investment Management, LLC

July 9, 2020

**Client Letter**
**Second Quarter 2020**

For the quarter ended June 30, 2020, Broad Run's Focus Equity Separate Accounts[1] returned [redacted] net of fees[2] compared to 22.1% for the S&P Total Market Index[3]. Year to date, the Focus Equity Separate Accounts returned [redacted] net of fees compared to -3.5% for the S&P Total Market Index. The performance for your account will differ somewhat from these reported results due to variations in holdings and other client-specific circumstances. We remind you that we manage your account for long-term results, so we encourage you to evaluate its performance over a multi-year time frame. Long-term performance is presented at the end of this letter.

## Portfolio Update

Last quarter we provided you an assessment of our portfolio holdings and how we expected them to be impacted by the economic downturn due to COVID-19. Now that we are three months further into the pandemic, we want to share our updated thinking.

In general, the economic downturn has been harsh, but nowhere near the extreme contraction we were modeling in our worst-case stress test scenarios. April and May were unquestionably challenging months for a number of our businesses, but demand trends got progressively better for most, and the recovery accelerated in June. Indeed, companies such as CarMax, Ashtead Group, and NVR that we thought could have an extended period of significantly reduced demand appear to have sales nearly fully recovered by quarter end.

For other companies, such as Disney, American Woodmark, and Hexcel, it is clear that full recovery will take longer due to their exposure to group gatherings, in-home cabinet installations, and air travel, respectively. We continue to believe that Disney and American Woodmark are positioned for a near full recovery once a vaccine or highly effective therapeutic is widely available, probably sometime in 2021. However, Hexcel likely has a much longer road to recovery with most industry observers expecting air travel and aircraft production to reach 2019 levels in the 2023 to 2025 timeframe. We continue to like the Hexcel investment from this level since we model a low-teens IRR even if full recovery takes until 2026.

While we are encouraged by the recent demand trends at our businesses, we expect the recovery to be lumpy with occasional setbacks due to macroeconomic factors and regional health related shutdowns. Many jobs that were lost will not return, and so we expect broader economic pain to persist well into 2021. Nonetheless, we like our portfolio of what we believe are well run, competitively advantaged, reasonably valued businesses. Many of these businesses have now pivoted to offense, looking to take advantage of their relative strength in this period of economic dislocation.

## Portfolio Changes

During the quarter we added a new position in Fastenal Company at about 1% of assets. Fastenal is a distributor of industrial MRO (Maintenance, Repair, and Operations) products including fasteners, safety products, hardware, cutting tools and much more.

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[2] Net of highest applicable fee of 1.0% per annum as described in our Form ADV, Part 2A.
[3] S&P Total Market Index is a broad market index that includes 3,777 large, mid, and small cap U.S. equities (@12/31/19) that meet a minimum liquidity threshold.

Similar to O'Reilly Automotive, Fastenal's strategy entails having a distribution system set up to provide the best parts availability and fastest delivery in its industry. For example, Fastenal has a proprietary transportation network and about 2,000 U.S. stores (7x more than its nearest competitor), enabling it to deliver parts to customers on a same-day or next morning basis compared to next-day or second day for most other MRO distributors. This can make the difference between keeping a manufacturing line up and running or having it shut down for several shifts while waiting for a critical part to arrive. In addition, by having a local store presence and a significant local sales team, Fastenal builds relationships with customers enabling them to be more responsive than a traditional MRO vendor operating remotely from a location across town or a catalogue/web site operator with a warehouse hundreds of miles away.

We have long admired Fastenal; it has a great culture, clear competitive differentiation, and best in class financials. It has compounded value at a 15%-plus rate over the last 30 years. Despite this very impressive record, its organic revenue growth rate decelerated materially this last decade, despite having just 4% U.S. market share. Indeed, large competitors W.W. Grainger and MSC Industrial Direct also appear to have hit a ceiling on growth, stuck at single digit market shares rather than the 20, 30, or 40% shares we typically see in a more mature industry structure. The large distributors are still growing and benefiting as customers consolidate to fewer vendors for efficiency, but specialization, technical expertise, and relationships still matter, so the industry has remained stubbornly fragmented.

What has piqued our interest in Fastenal is their latest major growth initiative called the "onsite" solution - essentially a dedicated Fastenal store located in a customer's production facility. This is a natural extension of service for Fastenal since it already has a very successful vending machine program that carries individualized MRO inventory at the customer's location. However, what is compelling about this solution is that it expands the Fastenal relationship beyond just an MRO part supplier to a strategic supply chain partner. As part of the onsite design process, Fastenal works closely with the customer to analyze and reengineer their MRO procurement process to make it more efficient. This is a win-win for both Fastenal and the customer. Inventory is reduced, redundant touch points are eliminated, and paperwork is streamlined. The customer saves money and Fastenal becomes embedded in the customer's work flow making for a much stickier relationship with higher switching costs.

According to our research, a new onsite installation results in two- to ten-fold increase in sales from that customer location as Fastenal gains wallet share from other MRO vendors. Further, Fastenal's historical advantages in distribution and local service leverage nicely here to make them virtually unrivaled in their ability to execute on this opportunity. In short, we believe that Fastenal has "cracked the code" to its next wave of growth; one that can get them into double digit market share and sustain value creation for more than a decade. We believe that onsite stores combined with continued rollout of Fastenal's MRO vending machines will enable it to sustain high single to low double-digit revenue growth and low to mid-teens total returns for an extended period of time. For this, we paid about 28x our estimate of 2021 earnings. This is a higher multiple than we usually pay, but this is offset by 2021 earnings estimates being suppressed due to the expected lingering effects of the pandemic, and our strong conviction in the long-term market share opportunity.

To fund the Fastenal purchase we sold our entire stake in Ametek, which was about 1.2% of assets. We held Ametek for about four years during which the business performed well. However, additional conversations with former employees provided new insights into management's operating philosophy that reduced our conviction in the company's ability to sustain that success going forward.

In closing

We thank you for entrusting your capital to us. We will continue to do our best to protect and grow your investment over time.

Please let us know if there have been any changes to your financial circumstances or investment objectives that might impact how we manage your account, let us know if your contact information changes, and let us know if you would like to add or modify any reasonable restrictions to our investment advisory services.

Sincerely,

Broad Run Investment Management, LLC

October 19, 2020

**Client Letter**
**Third Quarter 2020**

For the quarter ended September 30, 2020, Broad Run's Focus Equity Separate Accounts[1] returned [redacted] net of fees[2] compared to 9.1% for the S&P Total Market Index[3]. Year to date, the Focus Equity Separate Accounts returned [redacted] net of fees compared to 5.3% for the S&P Total Market Index. The performance for your account will differ somewhat from these reported results due to variations in holdings and other client-specific circumstances. We remind you that we manage your account for long-term results, so we encourage you to evaluate its performance over a multi-year time frame. Long-term performance is presented at the end of this letter.

After the coronavirus pandemic triggered the sharpest economic contraction in modern American history, few imagined the stock market returning to all-time highs just months later. While unprecedented fiscal and monetary stimulus certainly played an important role in the rebound, perhaps more important was the reopening of the economy after a period of coronavirus lockdowns. Society owes a debt of gratitude to the medical and scientific communities for improving our understanding of the virus and how to prevent its spread, thus saving hundreds of thousands of lives and enabling much of the economy to reopen.

Today, most industries have seen demand substantially recover and are trading at or near all-time highs. However, a few industries remain severely impacted by the pandemic (e.g., travel and leisure). For some businesses, the market appears to be discounting a very long return to normalcy, a view that is far too pessimistic in our view given that it is likely an effective vaccine will be widely available by mid-2021. While the market appears willing to ascribe ever-increasing multiples of sales to technology businesses with recurring revenue, many businesses with less near-term visibility trade at very low multiples of normalized earnings. It is in these pockets of the market where we believe the best opportunities lie.

## Portfolio Changes

During the third quarter we established a 1% position in Allegiant Travel Company, and built it to a 2% position early in the fourth quarter. Don't be fooled by its respectable sounding name, Allegiant Travel Company is more frequently referred to as Allegiant Air. An airline?! Yes, we bought shares of an airline.

We sold a 1% position in O'Reilly Automotive to fund the third quarter purchase. We continue to have a very favorable outlook for our O'Reilly investment, but the stock was near its all-time high, and exceeded our 10% position size risk guideline, so we thought it a logical place to source capital.

In the annals of business history, there may be no industry with a more terrible track record than passenger airlines. Plagued by high capital intensity, low margins, price sensitive customers, and cyclical demand, dozens of airlines went through bankruptcy over the last few decades, including every major U.S. airline but Southwest. In the inimitable words of Warren Buffett, "If a capitalist had been present at Kitty Hawk back in the early 1900's, he should have shot Orville Wright."

And yet, against this backdrop, we believe we found a gem in Allegiant. The company has carved out a very profitable niche for itself by acknowledging the challenges that most airlines face, and consciously choosing a different approach. In the words of Maurice Gallagher, Chairman, CEO, and 17% shareholder:

> *"Different is good. We enjoy being different. We consciously set out to build a different business. Yes, we use aircraft and are categorized as an airline. However, our different approach, a leisure focus, small cities, limited*

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[2] Net of highest applicable fee of 1.0% per annum as described in our Form ADV, Part 2A.
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> *frequencies and inexpensive aircraft have all been developed with the understanding that different was key to our success."*

As an upstart in the early 2000s, Gallagher established Allegiant as an ultra low-cost airline by, among other things, using much older airplanes, requiring direct booking to cut out third party travel agent fees, and eliminating free baggage handling and snack service. As a result of this lower expense base, Allegiant can offer compelling prices that are nearly half the rate of the average U.S. airfare.

In addition, Allegiant primarily targets leisure travelers from small cities where it could further differentiate itself. Traditional carriers employ "hub-and-spoke" networks requiring passengers from small cities to fly to a large city hub, then on to their final destinations. In contrast, Allegiant employs a much simpler "point-to-point" flight network shuttling passengers from their small city directly to common vacation and second home destinations (Florida, Las Vegas, Arizona, Palm Springs, etc.). This combination of a low price and direct flight service is a compelling value for the leisure traveler. In fact, the company found that its offering stimulates passenger demand that didn't previously exist.

Once established in a market, Allegiant has a lucrative and defensible niche. The incumbent, high cost hub-and-spoke carriers cannot sustainably match Allegiant on price, nor are they compelled to do so because Allegiant is mostly growing the market rather than stealing passengers. Other ultra low-cost carriers that could potentially compete on price choose not to enter Allegiant markets because the opportunity is simply too small to support two such airlines. Further, Allegiant has a reputation for aggressive competitive response when its niche is attacked, quickly slashing prices and copying any new entrant's flight schedule to bleed it out of the market. Again, in the words of Maurice Gallagher:

> *"Over the years we have consciously built our system to minimize competition. The key component is to offer service to underserved markets with the amount of capacity the market will bear. We are one of the only service providers whose offerings are based on flights per week versus flights per day. As a result, we are able to look at markets otherwise too small to attract service or a competitive response once we enter the market."*

As a result, an amazing 82% of the company's routes have no direct competition, and the next best alternative to an Allegiant flight – an expensive indirect flight on a major carrier – is a poor substitute. Allegiant was the most profitable passenger airline in the country over the last ten years with operating margins averaging 18% and returns on equity of 30%. Over that time period, Allegiant has grown from 161 routes to 521 routes, a 14% CAGR.

Despite this superb track record, it has not all been smooth flying for Allegiant. In fact, at quarter end, its stock price was down about [redacted] from the all-time high it set in 2015 despite about 60% growth in routes over the period. Three headwinds have challenged the business.

- First, the company embarked on an expensive but necessary multi-year transition of its aircraft fleet. The transition was recently completed and KPIs were recovering nicely pre-pandemic.
- Second, the company was in the early stages of launching a destination resort in Florida to capture more value from passengers' lodging spend. This was perceived by many as a risky distraction from the core business. The plan has recently been mothballed, and potentially abandoned.
- Third, the pandemic devastated demand for air travel. Allegiant passenger traffic is down 40% from last year, and fare pricing is down 14%. The company is burning $1 million of cash per day.

Since the first and second headwinds above are largely resolved (though probably still cast a pall on investor perception), our biggest fundamental concern is recovery from the pandemic. On this front, we have a high degree of confidence that the domestic leisure air travel segment will return to pre-pandemic levels once a vaccine is widely distributed. There is no Zoom call that can replace visiting grandma in person, and no substitute for the magic of taking your young children to Disney. In fact, we think leisure travel could see a surge post-pandemic as people utilize their accumulated vacation time and scratch their travel itch after being confined to home for so long. Pricing recovery will likely lag volume recovery, so if a vaccine is widely distributed by the middle or end of 2021, we expect Allegiant earnings to recover to a more normal run rate by late 2021 or 2022. If we are wrong about the timing of a recovery, Allegiant has the best balance sheet in the industry and the lowest cash burn rate. Allegiant can survive in its current state without going back to the capital markets for at least 18 months providing some margin of safety.

Longer term, we believe there are at least 500, and potentially an additional 1,000 route opportunities meeting Allegiant's parameters. Further, as a result of financial strain, large airlines are reducing service to many smaller cities creating more opportunity. Potential new low-cost airline entrants, Breeze and Xtra, could compete for these unserved routes, but they have not yet launched and were dealt a setback by the pandemic. Even if they are successful, there should still be plenty of growth opportunities to keep Allegiant busy for five or ten years.

Allegiant fits the profile of what we are looking for in the pandemic driven recession; a very good business suffering a setback, but with its long-term earnings prospects undiminished or even enhanced. Allegiant earned $14 of EPS in 2019, and was on pace to earn $17 in 2020 before the pandemic struck (estimates are now a $12 loss). We paid about 9x 2019 earnings and 7.5x "pre-pandemic" 2020 earnings for our shares. If we are correct in our recovery thesis, and Allegiant also returns to its historic valuation of about 15x earnings and 6.5x EV/EBITDA, the stock could trade around $200 or $250 in 2022, with the potential to compound EPS and share price at a mid- teens clip from there for an extended period of time.

In closing

We thank you for entrusting your capital to us. We will continue to do our best to protect and grow your investment over time.

Please let us know if there have been any changes to your financial circumstances or investment objectives that might impact how we manage your account, let us know if your contact information changes, and let us know if you would like to add or modify any reasonable restrictions to our investment advisory services.

Sincerely,

Broad Run Investment Management, LLC

January 27, 2021

**Client Letter**
**Fourth Quarter 2020**

For the year ended December 31, 2020, Broad Run's Focus Equity Separate Accounts[1] returned [redacted] net of fees[2] compared to 20.8% for the S&P Total Market Index[3]. For the fourth quarter, the Focus Equity Separate Accounts returned [redacted] net of fees compared to 14.8% for the S&P Total Market Index. The performance for your account will differ somewhat from these reported results due to variations in holdings and other client-specific circumstances. We remind you that we manage your account for long-term results, so we encourage you to evaluate its performance over a multi-year time frame. Long-term performance is presented at the end of this letter.

**Commentary**

Wow, what a year! A global pandemic, lockdowns, riots, and political unrest. The economic shutdowns in March and April drove the worst quarterly decline in U.S. GDP, and highest levels of unemployment since the Great Depression. Quick monetary policy response and government stimulus halted the downward economic spiral, and catalyzed the beginning of a rebound. By summer, better understanding of Covid-19 transmission enabled some improved mobility, and exiting 2020 we had several highly effective vaccines allowing us to look to 2021 as a year of recovery.

With this backdrop, we have more than usual to discuss in our letter so we divided it into five sections:

1) Fundamental Performance of our Businesses
2) Investment Performance
3) Investment Outlook
4) Portfolio Actions
5) Conclusion

1) Fundamental Performance of our Businesses

Considering the circumstances, we are pleased with the fundamental performance of our businesses through this tumult. The look-through earnings of our Focus Equity Separate Account portfolio held up much better than the broader market in 2020 with a 2% expected decline compared to a 19% expected decline for the S&P Total Market Index. Of course, we are only part way though the pandemic and related recession. Taking a two-year view that incorporates both the decline in 2020 and the expected rebound in 2021, our businesses still look quite good with 11% cumulative earnings growth versus 4% for the broader market.

| | 2020 EPS Growth* | 2021 EPS Growth* | **2 Year EPS Growth*** |
|---|---|---|---|
| Our Businesses | (2%) | 13% | **11%** |
| S&P Total Market Index | (19%) | 28% | **4%** |

* Consensus FactSet operating EPS except for Markel (BV/shr) and Brookfield (Broad Run estimates). Results for the most recent year are preliminary, subject to adjustment as annual reporting is finalized.

[1] See the end of this letter for historical performance and important disclosures.
[2] Net of highest applicable fee of 1.0% per annum as described in our Form ADV, Part 2A.
[3] S&P Total Market Index is a broad market index that includes 3,820 large, mid, and small cap U.S. equities (@12/31/20).

To provide a more granular view, in the table below we present the 2020 and 2021 estimated earnings performance for each of the business we owned at the beginning of the pandemic.

| | Protfolio Weight Beg. 2020 | EPS* Growth 2020 | EPS* Growth 2021 | 2 Yr EPS* Growth 2019-2021 | Pandemic Impact |
|---|---|---|---|---|---|
| Amer Tower | 10.1% | 8% | 10% | 19% | *No notable impact* |
| O' Reilly | 9.9% | 30% | 0% | 29% | *Improved comp store sales* |
| Aon Corp | 8.5% | 5% | 11% | 17% | *Modest revenue headwind on discretionary projects* |
| Alphabet | 7.9% | 5% | 19% | 26% | *Short-term ad slowdown followed by strong net increase* |
| CarMax | 7.8% | -14% | 19% | 3% | *Store closures; accelerated omnichannel adoption* |
| Brookfield | 7.6% | 14% | 12% | 28% | *Mall & office properties hurt (~20% of portfolio)* |
| Markel | 7.4% | 6% | 7% | 14% | *Managable increase in pandemic related insurance liabilities* |
| Disney | 6.6% | -60% | 26% | -49% | *Park and theatre closures; accelerated DTC adoption* |
| Amer Woodmark | 5.2% | 2% | 8% | 10% | *Short-term slowdown; intermediate-term demand increase* |
| Charles Schwab | 5.0% | -16% | -1% | -16% | *Earnings headwind from lower and flatter yield curve* |
| Hexcel | 4.7% | -93% | 88% | -87% | *Substantial reduction in new airplane builds* |
| Ashtead | 4.6% | -7% | 10% | 2% | *Modest construction slowdown* |
| Encore Capital | 3.9% | 47% | 0% | 48% | *Improved recoveries; potential incrase in charge-offs* |
| NVR Inc. | 2.4% | 5% | 35% | 42% | *Substantial increase in demand for new homes* |
| SS&C | 2.3% | 10% | 5% | 16% | *Modest headwind due to elongated selling cycle* |
| Facebook | 1.9% | 45% | 12% | 63% | *Short-term ad slowdown followed by strong net increase* |
| DriveShack | 1.5% | na | na | na | *Facility closures; construction halt; slow restart* |
| Ametek | 1.2% | -7% | 9% | 2% | *Decrease in growth rate* |
| Marlin Bus. Svc | 0.9% | -100% | nm | -37% | *Higher credit losses; loan book appears stable* |
| **Our Businesses (wtd avg.)** | | **-2%** | **13%** | **11%** | |
| **S&P Total Maket Index** | | **-19%** | **28%** | **4%** | |

* Consensus FactSet operating EPS except for Markel (BV/shr) and Brookfield (Broad Run estimates). Results for the most recent year are preliminary, subject to adjustment as annual reporting is finalized.

We think this earnings performance speaks to the quality and resiliency of the businesses we own. We always underwrite our investments with an expectation that a recession will happen during our holding period, so we did not need to undertake substantial repositioning when that eventuality occurred. We of course reassessed all our businesses in light of the new circumstances, adding four new positions and eliminating two (discussed later in this letter), but the core of the portfolio is largely unchanged.

Reflecting on the cadence of the year, at the beginning of the pandemic many of our businesses were significantly impacted by the lockdowns – particularly our retail, travel, and housing related names such as CarMax, O'Reilly, Hexcel, Disney, American Woodmark, and NVR – but most staged strong recoveries in late spring as lockdowns were relaxed; some even emerged as net beneficiaries (O'Reilly, NVR, RH) as new consumer spending patterns developed.

Around the middle of the year many of our businesses pivoted from defense to offense, taking advantage of the circumstances to improve their longer-term prospects. These are the types of businesses and management teams that we try to align ourselves with. We highlight Disney (enhanced DTC investment), CarMax (increased omnichannel investment), Brookfield (acquisition of mall and office property affiliate), RH (accelerated real estate procurement in an oversupplied market), and Allegiant Travel (launch of new routes and acquisition of airplanes in a distressed market) as the more notable examples of this. Experience has taught us that it tends to be those companies that are opportunistic in a downturn that fuel outsized value creation in subsequent years.

At present, we view Hexcel (2.9% of current assets), Drive Shack (0.8% of current assets), and Marlin Business Services (0.4% of current assets) as the only businesses we own that will not make a full recovery from the pandemic in the next year or two. We continue to hold each of those businesses after re-underwriting them using new assumptions.

2) <u>Investment Performance</u>

Our portfolio returned [redacted] for the year, net of fees. For a recessionary year, this would normally be a happy outcome, if not for the S&P Total Market Index posting a 20.8% return. We typically avoid discussing short-term performance, but given the magnitude of this relative underperformance (and its negative impact on our longer-term relative results) we want to share our perspective.

We run a concentrated portfolio, built from the bottom up without regard for sector weightings. As a result, our portfolio looks very different from an index, and we are virtually guaranteed to underperform from time to time. *We accept this as a price we must pay for the opportunity to achieve our objective of compounding capital at a superior rate, with prudence, over time*.

Our underperformance in 2020 is in large part attributable to our limited exposure (2% at the beginning of 2020) to the information technology sector. For the year, information technology returned 43%, contributing 11 points to the S&P Total Market Index return. This caps a 3-year period when the information technology sector was up 121% (30% annualized) compared to 35% (11% annualized) for non-technology companies.

We are not averse to technology. We own positions in SS&C Technologies, a software company, and CDW, a technology distributor. We own Alphabet and Facebook, which were until recently classified as technology companies. We own American Tower, a real estate company providing critical infrastructure for mobile phones, drones, autonomous vehicles, and the Internet of Things. And we own companies such as Aon, CarMax, and Disney that are investing heavily in technology to put greater distance between themselves and their competition. Sometimes it is the application of technology to a business with an established moat that creates more value than investing directly in the technology provider itself.

The world is digitizing, and there are some wonderful technology businesses creating a lot of value enabling this trend. We have many of them on our Watch List. Our low exposure is simply a result of being unable to find quality technology companies trading with an adequate margin of safety; to justify today's prices, most require aggressive revenue growth and margin assumptions far into the future.

Lofty expectations are not limited to technology companies; we see frothiness in many high growth and concept companies across sectors. Consider that U.S. companies that lose money currently have a $6 trillion market value, 3x more than at the peak of the Internet Bubble. These companies have market values dependent on far off terminal year projections which are subject to wild overestimation in periods of market ebullience. Some of the most outlandish assumptions are reserved for early-stage companies claiming to be "disrupting" a large existing industry. Many electric vehicle companies fall in this category, and there are scores of others addressing insurance, auto retail, media, banking, transportation, energy, and other industries. The flood of SPACs has further enabled this frenzy, acquiring moon-shot companies and forecasting 10x and 15x revenue growth over a five-year period to help justify their prices. When valuations look stretched on an EV/sales basis, SPAC sponsors have begun to use EV/TAM multiples, a valuation metric so dubious it is comical.

We are twelve years into a bull market and the risk pendulum has swung full range from fear to greed. There were ample signs of excessive risk taking in 2018 and 2019, but 2020 has been fuel on the fire. A zero interest rate policy, massive fiscal stimulus, and increased retail participation have all arrived on the scene. Stimulus checks and reduced spending on leisure activities boosted personal savings by a remarkable $1.4 trillion in 2020. Many people who are now working from home have found themselves flush with cash, flush with time, and dreaming of day trading their way to that new Tesla or beach home.

Successful long-term investing is often as much about what one chooses to avoid, as what one chooses to own. In our nearly 25 years as professional investors, we have only seen today's level of stock speculation once before: in late 1999 through early 2000. Clearly areas of obvious speculation should be avoided by a prudent investor, but this is also a cautionary sign about the risk environment we are in. It heightens our skepticism about many companies in information technology and other pockets of the market that have been "hot" and where valuations rely upon very rosy forecasts. Fortunately, we do not need to bet on the disrupters, or against them, or own even a single technology company to be able to populate our portfolio and achieve our investment objectives. In today's market there remain plenty of businesses available – mostly in the "not hot" sectors – that can deliver attractive long-term growth at reasonable valuations.

3) <u>Investment Outlook</u>

We underwrite our investments to target a mid-teens rate of return. We seek this return via the compounding of earnings per share over time rather than a change in valuation or clever trading in or out of a stock. As a result, our portfolio performance is primarily driven by the earnings per share growth of the underlying businesses that we own[4].

*Quite simply, our investment returns are going to be driven by the amount by which our businesses are able to grow their earnings over the next five years, not whether or not we own a particular hot market sector.*

You can see this relationship in the table below. Over the last eleven years our portfolio level earnings per share CAGR is 14.7%, inclusive of dividends [column C] compared to an investment return of 15.1%, gross of fees [column D]. In any one year this is a loose relationship but it strengthens considerably as the time period extends.

| | **Focus Equity Separate Accounts** | | | | | **S&P Total Market Index** | |
|---|---|---|---|---|---|---|---|
| | **A** | **B** | **C** | **D** | **E** | **F** | **G** |
| Year | Business Level EPS Growth + Dividend Yield* | Impact of Cash Balance | Portfolio Level EPS Growth + Dividend Yield* | Total Return Gross of Fees | Total Return Net of 1% Fee | EPS Growth + Dividend Yield | Total Return |
| 2010 | 29% | -0.9% | 28% | [redacted] | [redacted] | 42% | 17% |
| 2011 | 19% | -1.2% | 18% | [redacted] | [redacted] | 15% | 1% |
| 2012 | 19% | -1.7% | 17% | [redacted] | [redacted] | 9% | 16% |
| 2013 | 18% | -1.2% | 17% | [redacted] | [redacted] | 8% | 33% |
| 2014 | 19% | -0.7% | 19% | [redacted] | [redacted] | 9% | 12% |
| 2015 | 12% | -0.3% | 12% | [redacted] | [redacted] | -2% | 0% |
| 2016 | 4% | -0.2% | 4% | [redacted] | [redacted] | 3% | 13% |
| 2017 | 14% | -0.5% | 14% | [redacted] | [redacted] | 14% | 21% |
| 2018 | 23% | -0.5% | 23% | [redacted] | [redacted] | 24% | -5% |
| 2019 | 15% | -0.2% | 14% | [redacted] | [redacted] | 1% | 31% |
| 2020 | -1% | 0.1% | -1% | [redacted] | [redacted] | -17% | 21% |
| Cumulative: | 381% | | 352% | [redacted] | [redacted] | 151% | 325% |
| Annualized: | 15.3% | | 14.7% | [redacted] | [redacted] | 8.7% | 14.0% |

** For the Focus Equity Separate Accounts, EPS growth is a Broad Run estimate based upon reported results for the first three quarters of the most recent year and projections for the final quarter of the most recent year. For prior years, EPS growth has been updated to reflect actual reported results for the year, any changes in company level methodology, and other updates, as appropriate. May not sum due to rounding.*

Today, we are pleased with the portfolio of businesses we own. We believe them to be high quality, well run, and likely to grow earnings per share at a mid-teens rate over the next five-plus years. We will not be right about every business we own. There will be individual disappointments in the future as there have been in the past, but historically the portfolio has been able to absorb these and deliver on our overall earnings growth objective.

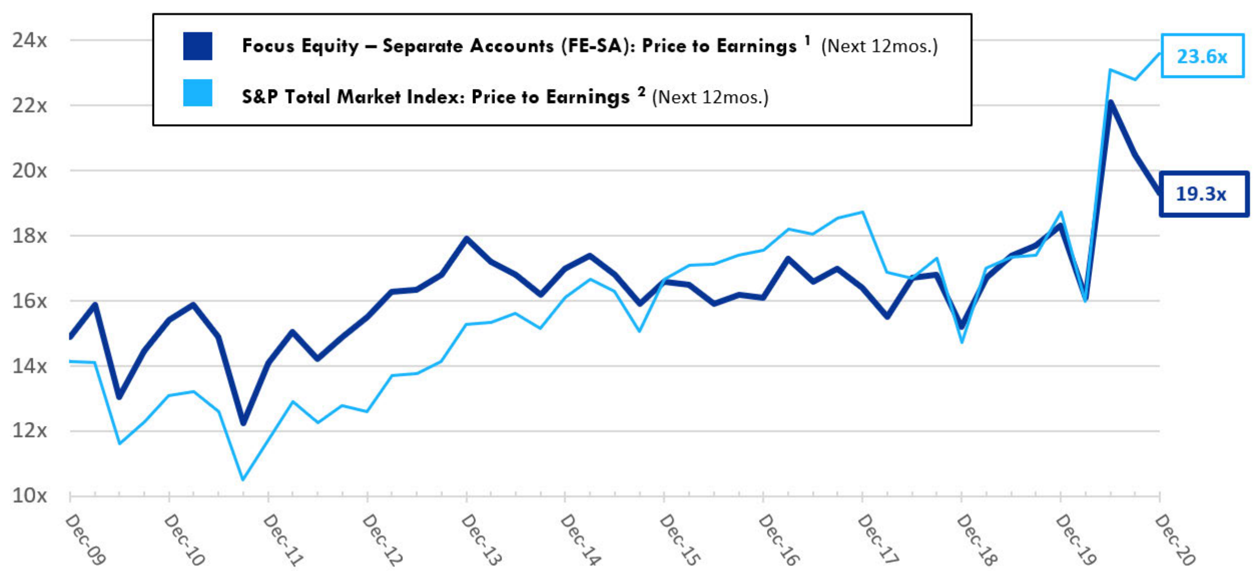
Portfolio valuation today, at 19.3x 2021 earnings estimates, is somewhat higher than it has been in the past, probably attributable to the very low interest rate environment. From this valuation level – modestly elevated, but still perfectly rational – we expect portfolio returns will closely track the earnings growth of our portfolio over the next five years, with the obvious caveat that steadily rising rates would present a headwind that could clip a few points per annum off of returns over the period.

[4] This is axiomatic, if there is no change in valuation and no dividends, stock performance will match the change in earnings per share. While earnings per share growth is not particularly useful to measuring progress at many types of investment strategies - for example, a high valuation-high growth strategy, a slow/no growth-deep value strategy, or a high turnover strategy - it is highly instructive for our type of strategy.

| Focus Equity Separate Accounts - Beginning of Year Projection | | | |
|---|---|---|---|
| Beginning of Year | Business Level Price to 1yr EPS Est.* | Business Level 1yr Est. EPS Growth Rate* | Business Level 5yr Est. EPS Growth Rate* |
| 2010 | 14.9x | 20% | mid-teens |
| 2011 | 15.4x | 16% | mid-teens |
| 2012 | 14.1x | 16% | mid-teens |
| 2013 | 15.5x | 17% | mid-teens |
| 2014 | 17.9x | 17% | mid-teens |
| 2015 | 17.0x | 17% | mid-teens |
| 2016 | 16.6x | 18% | mid-teens |
| 2017 | 16.1x | 14% | mid-teens |
| 2018 | 16.4x | 24% | mid-teens |
| 2019 | 15.2x | 14% | mid-teens |
| 2020 | 18.3x | 13% | mid-teens |
| 2021 | 19.3x | 12% | mid-teens |

* *Based upon Broad Run internal estimates (may differ materially from consensus estimates), weighted by position size, excluding the impact of any portfolio level cash.*

It is interesting to note that the market at 23.6x 2021 earnings estimates, is trading 22% above our portfolio at 19.3x, versus a history of near parity. We think this helps explain some of our recent relative underperformance and supports our view that better relative results lie ahead.




1: See the end of this letter for important disclosures regarding FE-SA. Earnings for FE-SA and its underlying holdings are non-GAAP and are based upon Broad Run's calculations/estimates; may differ materially from consensus estimates. 2: Source: FactSet. The iShares Core S&P Total U.S. Market ETF is used as a proxy for the S&P Total Market Index. The price to earnings ratio is calculated by FactSet using "recurrent earnings" which are non-GAAP and include consensus adjustments to reported accounting earnings. Investors should understand the inherent differences between the metrics in this chart.

As Mark Twain once said, "History doesn't repeat itself, but it does rhyme." When the Internet Bubble burst in March of 2000, formerly unloved and inexpensive stocks performed well even as the NASDAQ declined by 78%. Stocks that were reasonably valued on earnings marched forward while many that were valued on eyeballs or clicks plummeted. This time around we are again seeing nonsensical valuation metrics employed in the more speculative corners of the market. While we do not know the timing or the trigger, we suspect that the excesses will be wrung out and stocks of healthy businesses that are reasonably valued on earnings will outperform in the fullness of time.

4) Portfolio Actions

As mentioned earlier, we added four new positions this year: Fastenal, RH, Allegiant Travel, and CDW. We discussed the first three of these purchases in earlier quarterly letters, and discuss CDW below. We also added to our existing SS&C

position, approximately doubling it from 2% of assets to 4% during the first quarter, and added to our Allegiant Travel position in the fourth quarter bringing it to about 3% of assets.

Our general approach during the year was to look for extraordinary businesses suffering short-term setbacks (and corresponding depressed stock prices), but with their long-term prospects undiminished or even enhanced because of the pandemic. We sourced capital for purchases by selling two positions in which we had diminished conviction (Charles Schwab and Ametek), and by trimming two other positions whose businesses and stock prices had held up relatively well (O'Reilly Automotive and American Tower). In total these new positions compose about 8% of assets at year end, and about 13% inclusive of SS&C.

*CDW Corporation (CDW)* - During the fourth quarter we established a 1% position in CDW Corporation. CDW is a value-added reseller (VAR) of information technology hardware, software, and services. Its products cover the gamut from desktop computers and networking equipment to peripherals and cloud-based software.

CDW is more than twice as large as its nearest competitor in an industry where scale matters. This affords CDW larger volume discounts and increased vendor support, as well as better product breadth, availability, and delivery speeds for customers. In addition to scale advantages, CDW also enjoys consultative relationships with its 250,000 customers. These customers, which are typically generalist IT professionals within an organization, look to CDW for trusted advice selecting the best IT products and system configurations. As a result, CDW fosters strong customer relationships, and typically wins business with service, rather than price, enabling industry leading margins.

Central to CDW's success is its great sales culture that it purposefully manages though hiring, training, and commission-based compensation programs. This combination of scale and a great sales culture has enabled CDW to grow revenue organically at about a 9% rate over the last decade, outpacing the IT market by about 450 basis points per annum. Today CDW has just 5% share of its addressable market leaving a very long runway for continued growth.

One mega-trend impacting nearly the entire technology space is the transition from on-premises software and servers, to off-premises cloud delivered software and infrastructure-as-a-service (AWS, Microsoft Azure, Google Cloud, etc.). Our conversations with technology professionals and former CDW employees lead us to believe that this transition will be a meaningful net positive development for CDW. While revenue from some hardware categories will face headwinds, those are more than offset by the company's increased opportunity in cloud solutions. For a VAR, hardware is a one-time sale, and typically low gross margin, while cloud solutions are typically recurring revenue with very gross high margins (100% in some cases). While this mix shift could present an optical headwind to reported revenue dollar growth, it should provide a nice tailwind to reported gross profit dollar growth. As CDW gradually transitions to higher margins and more recurring revenue we believe it becomes a better business than it already is, with the corresponding potential for a valuation rerating by the market.

With a growing IT market, scale advantages, and a great sales culture we believe that CDW can grow its gross profit dollars at a high single digit rate, and grow earnings per share at a mid-teens rate or higher for at least the next five years. Today the stock trades at about 20x forward earnings, a discount to the market. Given its better-than-market growth and below-market valuation, we believe CDW can be a long-term compounder for us.

5) Conclusion

We thank you for entrusting your capital to us. We will continue to do our best to protect and grow your investment over time.

Please let us know if there have been any changes to your financial circumstances or investment objectives that might impact how we manage your account, let us know if your contact information changes, and let us know if you would like to add or modify any reasonable restrictions to our investment advisory services.

Sincerely,

Broad Run Investment Management, LLC

April 26, 2021

**Client Letter**
**First Quarter 2021**

For the quarter ended March 31, 2021, Broad Run's Focus Equity Separate Accounts[1] returned [redacted] net of fees[2] compared to 6.4% for the S&P Total Market Index[3]. The performance for your account will differ somewhat from these reported results due to variations in holdings and other client-specific circumstances. We remind you that we manage your account for long-term results, so we encourage you to evaluate its performance over a multi-year time frame. Long-term performance is presented at the end of this letter.

During the quarter, our businesses continued to perform well. We saw numerous upward earnings revisions as the economic recovery gained strength and company specific initiatives took hold. While relative performance was particularly good this quarter – a welcome reversal from last year – our big picture view still holds: there are lofty expectations imbedded in many areas of the market, with pockets of outright speculation. Aggressive investment behavior has been rewarded over the last several years, and prudence has been penalized. With this backdrop, we particularly like our risk-aware investment approach and portfolio of businesses that we believe can deliver attractive long-term growth at reasonable valuations.

We undertook two transactions this period: adding to long-time holding, Brookfield Asset Management, and trimming long-time holding, O'Reilly Automotive. We discuss each of these decisions below.

*Brookfield Asset Management (BAM)* **-** During the quarter we added about 2.0% to our Brookfield Asset Management position bringing it to about 9.3% of assets in most accounts; this makes Brookfield our third largest holding.

We first invested in Brookfield in 2014, and since then our initial thesis has turned out to be largely correct. Brookfield has delivered strong investment results to its limited partners allowing for robust fundraising and double-digit annualized organic AUM growth. The business has continued its shift from on-balance sheet asset ownership to third party asset management, reducing its capital intensity and improving its return on capital. And, management has navigated well through a variety of challenging environments to position the company for continued success.

Today, Brookfield is stronger, and more diversified than ever. Its private equity business has become a powerful third pillar complimenting its historical strength in property and infrastructure, and the acquisition of a majority interest in Oaktree in 2019 added a premier distressed debt / fixed income capability to the roster. Meanwhile, Brookfield has significantly broadened its base of limited partners and channels of distribution adding stability to the franchise.

Fortunately, despite more than tripling fee bearing capital since our first investment, Brookfield's growth prospects still appear excellent. Brookfield's flagship funds in real estate and infrastructure will probably reach their capacity limits in the next few years, but private equity has much more headroom, and numerous adjacent opportunities have emerged that were not previously evident to us.

As alternative assets have grown in size and importance, many allocators have sought to consolidate vendor relationships with fewer, larger asset managers that provide a wide menu of investment solutions. As one of the largest alternatives managers in the world this is a big advantage for Brookfield. Perpetual core funds, green energy / energy transition funds, technology infrastructure funds, regional funds, secondary LP funds, and life insurance asset management appear to be large growth opportunities that can sustain Brookfield for the next decade.

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[1] See the end of this letter for historical performance and important disclosures.
[2] Net of highest applicable fee of 1.0% per annum as described in our Form ADV, Part 2A.
[3] S&P Total Market Index is a broad market index that includes 3,898 large, mid, and small cap U.S. equities (@3/31/21) that meet a minimum liquidity threshold.

While very promising, it is not all clear skies ahead. Brookfield is one of the largest owners of both U.S. shopping malls and global office properties, two categories of real estate most impacted by the pandemic.

- Malls were a controversial real estate asset even before the pandemic hit. The inexorable rise of ecommerce has reduced the need for retail space with many high-profile retail bankruptcies in recent years. Despite this headwind, Class A malls had fared well, with many thriving, while class B and C malls were under obvious strain. Class A malls tend to be large, well located, high traffic assets with premier national retailers and attractive on-site restaurant and entertainment options. Class A malls are more than a utilitarian place to get shopping done, they are an experience and social outlet. Most of Brookfield's malls - and almost all of their mall net asset value - fall in this category.

  For Class A malls, the pandemic was a blow, but recovery trends are promising. Foot traffic across malls was down more than 90% early in the pandemic, but has improved and is now down just about 25% from normal levels. But purchase intention of those visiting malls today is now much higher, so store sales within malls are down perhaps 10-20% from normal. This increase in per visitor spending has surely benefitted from the massive government stimulus programs, but we are also far from fully reopened as a society. Our expectation is that most Class A malls will return to around pre-covid levels of foot traffic and store sales in the next year or so, and will reclaim their role as a vibrant and valuable part of the retail landscape.

- Office properties, in our view, have probably been more permanently impacted by the pandemic. Zoom, Slack, and other technology tools have made the home office a viable substitute to the office building. There are many good reasons for returning to the office – team building, cultural indoctrination, accountability, social, etc. – but many employees prefer working from home, at least part-time, and companies will accommodate them to varying degrees. The office will continue to be an essential hub for almost all companies with white-collar workers, but at the margin, fewer people in the office at any given time will probably mean diminished square footage needs.

  Office buildings tend to have very long lease terms; Brookfield's typical lease is more than ten years long and it has an 8.2-year average remaining lease life across the portfolio. So, any change that does occur is likely to unfold over a very long period of time as leases roll off. We do not expect a step function change in demand or office building economics, but rather a persistent headwind. Instead of our pre-covid assumption of slow and steady cash flow growth from Brookfield's office portfolio, we now expect it to be more stagnant.

Understandably, over the last year there has been much concern about Brookfield's mall and office exposure. This weighed heavily on the stock in 2020, and, while past the level of peak concern, we believe it is still contributing to negative sentiment. By our calculation, Brookfield's mall and office assets compose only a mid- to high-teens percentage of our firm-wide sum-of-the-parts value. So, malls and offices are very important, but not nearly as important to intrinsic value as the narrative around the stock suggests.

For the reasons summarized earlier, we do not believe Brookfield's malls and office properties will be a calamity; we think that they will ultimately achieve an acceptable investment return. Yet management would argue that our view is too conservative. Seeing opportunity, they have recently agreed to purchase the remaining interest in Brookfield Property Partners (the publicly listed entity holding most of its mall and office assets) that Brookfield does not already own. Upon completion, we estimate mall and office properties will compose a low 20s% of firm value.

We were able to add to our Brookfield position during the quarter at a 17% discount to our estimate of sum-of-the-parts value, and at a mid-teens multiple of our next twelve months look-through cash earnings – an appealing absolute valuation level and a modest discount to the average multiple where the stock has traded over the last several years. We believe Brookfield, even if malls and office assets languish, can grow from $280 billion of fee bearing capital today, to nearly $500 billion over the next five years. With this double-digit CAGR, and the free cash flow the business produces, we believe that Brookfield should continue delivering mid-teens compounding of cash earnings per share.

*O'Reilly Automotive (ORLY)* - During the quarter we reduced O'Reilly from a large size position at about 8.0% of assets to a medium size position at about 5.5% of assets. We continue to believe that the company enjoys a wide economic moat, and believe its competitive position is as secure as ever. However, O'Reilly has been so successful for so long that it is reaching some natural limits: it is 86% of the way to its stated potential of 6,500 U.S. stores, gross margin – up 920 bps over the last fifteen years to 52.4% – is getting more challenging to improve, its accounts payable / inventory ratio exceeds 100%, and the company should hit its target adjusted debt to EBITDAR leverage this year after an eleven-year glidepath to get there.

Further, O'Reilly has seen a big boost to demand during the pandemic. Stimulus checks and new found leisure time have translated into increased spending on vehicle maintenance. Comparable store sales were up 10.9% in 2020 and we estimate year-to-date comps are tracking up mid-teens (we expect comps to be flattish in Q2, negative in Q3, and up modestly in Q4). EPS growth in 2020 and 2021 looks set to average 20% compared to a more normal mid-teens percentage. This surge in demand will make comparisons in subsequent years much more difficult as stimulus payments end and life returns to normal (offset somewhat by vehicle miles traveled returning to normal).

We also acknowledge the growing governmental and OEM push toward EVs, which have far fewer moving parts requiring repair. While EVs, even under very aggressive adoption assumptions, should have virtually no impact on O'Reilly's economics over the next decade (and could be a net positive if the U.S. temporarily transitions to hybrids rather than full EVs) it is a growing potential threat to the business long-term.

We still think O'Reilly can compound EPS at an attractive low- to mid-teens rate over the next five to ten years, and current valuation is reasonable at 21x next twelve-month earnings. While our long-term EPS CAGR expectations are above consensus, our variant perception is not as variant as it once was, so we have reduced the position size accordingly.

In closing

We thank you for entrusting your capital to us. We will continue to do our best to protect and grow your investment over time.

Please let us know if there has been any change to your contact information, any change to your financial circumstances or investment objectives that might impact how we manage your account, or if you would like to add or modify any reasonable restrictions to our investment advisory services.

Sincerely,

Broad Run Investment Management, LLC

July 23, 2021

**Client Letter**
**Second Quarter 2021**

For the quarter ended June 30, 2021, Broad Run's Focus Equity Separate Accounts[1] returned [redacted] net of fees[2] compared to 8.3% for the S&P Total Market Index[3]. Year to date, the Focus Equity Separate Accounts returned [redacted] net of fees compared to 15.3% for the S&P Total Market Index. The performance for your account will differ somewhat from these reported results due to variations in holdings and other client-specific circumstances. We remind you that we manage your account for long-term results, so we encourage you to evaluate its performance over a multi-year time frame. Long-term performance is presented at the end of this letter.

During the quarter we added a new 1% position in AST SpaceMobile ("AST"). We funded this purchase with proceeds from a 1% trim of Alphabet, which had exceeded our 10% position size guideline. AST is a "special situation" investment for us, not meeting our typical compounder criteria, but we believe it presents a very compelling risk-return profile. We have been an investor in American Tower ("AMT"), a leading cell phone tower owner-operator, for more than two decades. Our investment in AST is an outgrowth of our industry knowledge and ongoing research related to AMT, as explained further below.

Today's mobile wireless networks, built primarily on a backbone of cell towers, cover about 30% of earth's land area (and just 10% of earth's surface area including oceans). Since most of the world's population lives in cities, this geographic coverage is sufficient to provide mobile service to most subscribers most of the time. However, outside of well-traveled areas, coverage becomes considerably less reliable. As a result, nearly all 5 billion global mobile wireless subscribers experience coverage gaps some of the time, and more than 1 billion potential subscribers have no mobile wireless coverage at all.

It is uneconomic to expand coverage to less densely populated areas using traditional cell towers. One promising solution, that has never fulfilled its promise, is to use satellite-based mobile phone service to fill the coverage gaps. Over the last quarter century, Iridium, Globalstar, ICO, and Teledesic have all tried, and failed to provide a viable mobile satellite solution with broad consumer appeal. We have had a front row seat to each of these endeavors, researching them but ultimately passing on investment due to deficiencies we saw in their economic models, technology, or functionality. All these businesses eventually went bankrupt (liquidation or restructuring), incinerating billions of investor capital along the way.

More recently, a new company, AST SpaceMobile, has emerged with a fundamentally different approach from these failed ventures. AST came to our attention early this year with its SPAC merger, and a strategic PIPE investment by AMT. We never expected to find opportunity via a SPAC, but AMT management, in our experience, has been exceptional at identifying the flaws in emerging wireless technologies, so their decision to invest in AST made us take notice.

Satellite-delivered mobile wireless service does exist today, but, among other shortcomings, it requires bulky and expensive "satphones", limiting adoption to relatively few use cases (commercial shipping, oil and gas drilling / platforms, extreme wilderness adventures, etc.). AST's vision is to be able to provide mobile broadband wireless coverage anywhere on earth, using existing handheld mobile phones. This hardware compatibility would be a key breakthrough, allowing satellite-delivered mobile wireless service to expand beyond niche applications to broad consumer use. AST plans to accomplish this using a proprietary software stack, a network of wireless carrier partners sharing their spectrum, and a constellation of 168 satellites placed in low earth orbit (LEO) – about 700 km above the earth – over the next several years.

Just as important, AST plans to provide this service on a wholesale basis to wireless carriers. In exchange for a 50/50 revenue split, these carriers will promote the service to their existing subscribers, and manage billing, customer service, and network integration, among other things. For carriers, benefits include incremental revenue, a better and more reliable

[1] See the end of this letter for historical performance and important disclosures.
[2] Net of highest applicable fee of 1.0% per annum as described in our Form ADV, Part 2A.
[3] S&P Total Market Index is a broad market index that includes 3,955 large, mid, and small cap U.S. equities (@6/30/21) that meet a minimum liquidity threshold.

network to reduce customer churn, and help meeting government requirements to bring connectivity to people in remote areas. For AST, this wholesale model should simplify its business plan, accelerate user adoption, and facilitate a high margin business at scale.

There are numerous technical, regulatory, and business hurdles to making AST's vision a reality. However, our research, including conversations with industry consultants, scientists, competitors, management, and a strategic investor, have convinced us that the company has already made substantial progress – including successful demonstrations of several key technical capabilities – and that remaining hurdles are challenging, but probably surmountable.

Supporting this view, we believe that AST founder, Chairman, and CEO, Abel Avellan, has assembled a first-rate space and wireless technical team, paired with strong commercial talent. In addition, beyond AMT, wireless heavyweights Vodafone, Samsung, and Rakuten are investors and board members, and key carriage contracts or MOUs are in place with AT&T, Vodafone, Telefonica and other large wireless carriers representing more than 1.4 billion subscribers.

The next major technical milestone for AST will be the launch of its BlueWalker 3 satellite in late 2021 or early 2022. BlueWalker 3 will be a fully functional but scaled down version of AST's future full-sized production satellites. This launch will build upon AST's BlueWalker 1 trial in 2019, and allow the company to test, among other things, the unfurling of its large solar panels and beamforming capability for efficient communication with earth.

If BlueWalker 3 goes according to plan, AST will move toward Phase 1 commercialization. Importantly, following the SPAC combination and PIPE offering, AST is fully funded to build and launch its first twenty BlueBird production satellites. These satellites, scheduled to launch in late 2022 or early 2023, will provide coverage to 49 Equatorial countries covering 1.6 billion people. Assuming reasonable adoption rates, Phase 1 alone should allow AST to scale to profitability with healthy cash flow (excluding additional launches).

Plans for Phase 2 and Phase 3 include the construction and launch of 90 additional BlueBird satellites. This will require an estimated $1.7 billion of new external capital, raised opportunistically in 2022 or 2023 through a combination of vendor financing, government support, term debt, and public or private equity. With 110 total BlueBird satellites orbiting by late 2023 or early 2024, the company should be able to offer continuous global broadband coverage to all their wholesale partners. In Phase 4, plans call for internally funding an additional 58 satellites that will allow for more capacity and faster speeds in late 2024 or 2025. There are sure to be setbacks along the way, and these plans will evolve, but in broad strokes this is AST's vision for bringing its solution to the worldwide market.

AST is attempting to solve a huge, global need. If AST can deliver this technology, modest assumptions about user adoption and ARPU tell us the company could be worth 15x or 30x more in five- or ten-years' time. But space is hard, and the risks are real. If AST cannot deliver, the equity will likely be worthless. We recognize the potential for complete loss, and have sized our investment accordingly. But our long industry history, and network of contacts have helped us form a view that this is a bet worth making.

Additionally, as part of our research process, we have assessed the impact that a successful AST could have on cell towers and our investment in AMT. Our view is that AST's service will be complementary to traditional cell towers, and poses no meaningful threat. While AST should offer a good in-fill option in the developed world and a low-cost primary solution for parts of emerging markets, at an estimated 30 Mbps and 20-40 milliseconds of delay, AST will not have the capacity, speed, or latency to compete head-to-head with modern terrestrial networks.

<u>In closing</u>

We thank you for entrusting your capital to us. We will continue to do our best to protect and grow your investment over time.

Please let us know if there have been any changes to your financial circumstances or investment objectives that might impact how we manage your account, let us know if your contact information changes, and let us know if you would like to add or modify any reasonable restrictions to our investment advisory services.

Sincerely,

Broad Run Investment Management, LLC

October 22, 2021

**Client Letter**
**Third Quarter 2021**

For the quarter ended September 30, 2021, Broad Run's Focus Equity Separate Accounts[1] returned [redacted] net of fees[2] compared to -0.1% for the S&P Total Market Index[3]. Year to date, the Focus Equity Separate Accounts returned [redacted] net of fees compared to 15.1% for the S&P Total Market Index. The performance for your account will differ somewhat from these reported results due to variations in holdings and other client-specific circumstances. We remind you that we manage your account for long-term results, so we encourage you to evaluate its performance over a multi-year time frame. Long-term performance is presented at the end of this letter.

In this letter we discuss a new 3% position in Applied Materials, and our decision to exit both Hexcel and Fastenal to help fund the purchase.

New Position: Applied Materials (AMAT)

Applied Materials is a semiconductor capital equipment (semicap) company providing wafer fabrication equipment (WFE) to semiconductor foundries – such as Taiwan Semiconductor Manufacturing Company (TSMC), Intel, and Samsung – for use in the production of semiconductor chips.

Semiconductor chips enable the digital world; they are the basic building blocks of the hardware upon which all software operates. Over the last 20 years, the explosive growth of personal computers, mobile phones, and data centers has fueled semiconductor chip industry growth of nearly 7% per annum. And the future looks similarly bright as technology continues to proliferate and impact our lives in new and unforeseen ways.

The semicap industry is dominated by five companies: Applied Materials, ASML, Lam Research, Tokyo Electron, and KLA. The industry has consolidated meaningfully over time, and today is characterized by high barriers to entry, significant customer switching costs, and rational competition. While there is some overlap in equipment sold, each company has areas it dominates leading to relatively stable market share and attractive economics. This is evidenced by Applied's roughly 30% operating margin and 40% return on equity.

Manufacturing advanced semiconductors involves over 1,000 steps to create tens of billions of transistors on a chip the size of a fingernail. This isn't "rocket science", it is much more difficult! Correspondingly, the equipment to manufacture these chips is incredibly sophisticated, continually pushing the bounds of engineering and physics. Each new generation of WFE is built upon the R&D and proprietary knowhow developed on prior generations of equipment, making it very difficult for a challenger to dislodge a technology leader.

In addition, many of the breakthrough technological advances can only be accomplished through close collaboration between semiconductor foundries and their semicap providers. For the semiconductor foundries, the risk of falling behind on the technology curve by partnering with a second tier semicap provider is too great to bear, further cementing the position of the semicap leaders.

While we like the secular tailwinds and competitive dynamics of the semicap equipment industry, we particularly like how Applied is positioned within the industry.

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[1] See the end of this letter for historical performance and important disclosures.
[2] Net of highest applicable fee of 1.0% per annum as described in our Form ADV, Part 2A.
[3] S&P Total Market Index is a broad market index that includes 4,124 large, mid, and small cap U.S. equities (@9/30/21) that meet a minimum liquidity threshold.

- First, WFE has become more complex and difficult to maintain, repair, and optimize. In addition, recent Applied equipment includes sensors enabling remote monitoring and predictive maintenance. As a result, Applied is now better positioned than customers or third parties to service and repair Applied equipment. The company has been increasing its capture rate of maintenance and service activity, and moving customers from ad hoc service calls to recurring service contracts. We expect these trends to continue, improving the persistency of Applied's service revenue and driving service revenue growth rates in the low- to mid-teens.

- Second, the company has strong product positions in several production steps – such as epitaxial deposition, selective removal, and advanced packaging – that should see above market growth as these solutions play an increasing role in next generation chips.

- And third, Applied has the broadest product portfolio in the semicap industry, giving it a presence in each of the key steps of the semiconductor manufacturing process. This portfolio diversifies Applied's exposure to any particular product step or technology, reducing the overall risk profile of the business. But it also enables an emerging strategic initiative Applied calls Integrated Materials Solution (IMS). Increasingly, Applied is attempting to bundle its equipment across production functions into a single system "under vacuum" to reduce the probability of defects and accelerate a customer's time to market. Applied is uniquely positioned for IMS, and it provides the company a pathway to gain market share by outflanking competitors offering point solutions.

In combination, we believe these factors should enable Applied to reduce its cyclicality, widen its competitive moat, and gain market share within the semicap equipment industry.

Over the next decade, we expect a continued approximate 7% annual growth rate for the semiconductor chip industry driven by proliferation of mobile phones and data centers as well as emerging demand from 5G, artificial intelligence / machine learning, electric vehicles, and a wide range of IoT and smart devices. We expect that semicap industry growth will closely approximate semiconductor chip industry growth, with Applied producing about 8% or 9% organic revenue growth. We expect this revenue growth, plus modest margin improvement, to drive low double digit operating profit growth. Free cash flow from operations plus sustained financial leverage on growing EBITDA should drive EPS compounding in the mid-teens. Our estimates could prove conservative if national security considerations cause a meaningful shift in semiconductor production out of Taiwan/Asia and into the U.S. and Europe.

We do not expect growth to occur on a smooth path. The semiconductor and semicap industries have been cyclical in the past and we expect them to continue to be cyclical in the future (albeit less so due to the growing diversity of end market applications and a more consolidated customer base better equipped to forecast demand). There are sure to be downturns over the next decade when revenue and earnings temporarily reset lower. However, we are focused on where Applied will be over the long term and are willing to look past the intermediate ups and downs that will be encountered along the way.

Beyond cyclicality, two other key risks we monitor are the growth rate of the semicap equipment industry versus the growth rate of the total semiconductor industry (i.e. the capital intensity of the industry), and the potential for Chinese copycats to replicate Applied's technology and business. On the first point, the continuously increasing complexity of semiconductor manufacturing and commentary from TSMC and other customers lead us to believe that industry capital intensity should remain relatively flat, or perhaps even increase over the next decade (which is neutral/positive for Applied). Regarding China, the country, and its national champion companies have, despite significant investment and effort, made little progress replicating the capabilities of Applied and the other leading semicap companies. Again, this is very challenging technology, requiring a sophisticated supply chain and close collaboration with customers and others within the industry ecosystem. China cannot simply reverse engineer a piece of capital equipment to leapfrog the decades of development required to get to this point on the technology curve. China has fallen well short of its stated semiconductor capability targets, and our expectation is that it will continue to struggle with little to no direct impact on Applied in the next decade. Nonetheless, it is a strategic focus for China, and therefore bears careful monitoring for a change in conditions. If successful, we expect Chinese semicap equipment adoption would be limited to domestic Chinese foundries. We estimate this market composes approximately 10% of WFE spend.

We paid about 16x our 2022 earnings estimate for Applied Materials. The industry and Applied have experienced outsized growth the last two years, probably pulling forward some demand. As a result, EPS growth is likely to slow sometime in the next few years before reaccelerating to a mid-teens rate in the intermediate term. Nonetheless, we model very attractive expected returns from our purchase price, and believe we own a business with a strong competitive position, admirable management, and compelling growth opportunity.

Exited Positions: Hexcel (HXL) and Fastenal (FAST)

During the quarter, we sold our entire position in Hexcel, which was about 2.7% of assets. We last wrote about Hexcel in our second quarter 2020 client letter. At that time the stock was down about [redacted] from its pre-pandemic highs. As we wrote then, the pandemic hit Hexcel's business hard, significantly impacting short-term demand. Further, it familiarized the world with Zoom and similar technologies, introducing uncertainty about the long-term demand for business travel. International business travel is often completed with flights on a wide-body aircraft such as the Airbus A350 or Boeing 787 Dreamliner. These aircraft are a key end market for Hexcel, and demand for them would be disproportionately harmed by even a modest reduction in long-term international business travel. In light of those negative developments, we re-underwrote the investment at the then prevailing price and concluded that it offered an attractive five-year rate of return even using conservative expectations about the future.

Since then, the stock rebounded about [redacted] while the outlook for wide-body aircraft production worsened. As a result, our five-year expected return was no longer compelling and we used Hexcel as a source of capital for our investment in Applied Materials.

We also sold Fastenal, which was about a 0.9% position. Fastenal is a high-quality business and performed mostly in line with our expectations since our purchase in Q2 2020. However, in Applied Materials we think we have found a better alternative with a higher expected growth rate and lower valuation.

In closing

We thank you for entrusting your capital to us. We will continue to do our best to protect and grow your investment over time.

Please let us know if there have been any changes to your financial circumstances or investment objectives that might impact how we manage your account, let us know if your contact information changes, and let us know if you would like to add or modify any reasonable restrictions to our investment advisory services.

Sincerely,

Broad Run Investment Management, LLC

January 31, 2022

**Focus Equity Client Letter**
Q4 - 2021

For the year ended December 31, 2021, Broad Run's Focus Equity Separate Accounts[1] returned [redacted] net of fees[2] compared to 25.7% for the S&P Total Market Index[3]. For the fourth quarter, the Focus Equity Separate Accounts returned [redacted] net of fees compared to 9.1% for the S&P Total Market Index. The performance for your account will differ somewhat from these reported results due to variations in holdings and other client-specific circumstances. We remind you that we manage your account for long-term results, so we encourage you to evaluate its performance over a multi-year time frame. Long-term performance is presented at the end of this letter.

## Commentary

Before we get into a review of how our businesses performed in 2021, our thoughts on inflation, and our investment outlook, we have two exciting Broad Run updates to share.

First, with the encouragement of a long-standing endowment client, we recently began managing their account in an even more concentrated style with approximately ten holdings (largely reflecting the top positions in the Focus strategy). We are referring to this as our Select strategy, and are making it available to clients and prospects that prefer a super-concentrated portfolio. If you would like to learn more about the Select strategy, please reach out to arrange a conversation.

Second, we recently became signatories to the United Nations supported Principles for Responsible Investment (PRI). If you are not familiar, "the PRI is the world's leading proponent of responsible investment", whose signatories commit to incorporating environmental, social, and governance (ESG) considerations into their investment analysis and decision making.

As risk-aware long-term investors, we have always considered ESG related matters in our analysis because they can have a meaningful impact on the future value of a business. Over our nearly 25 years investing, we have observed that businesses that create enduring shareholder value tend to operate in harmony with key stakeholders (employees, customers, suppliers, lenders, the broader community/environment, etc.), while businesses taking advantage of key stakeholder(s) often find their success fleeting.

Upon review, we determined that incorporating our existing ESG analysis into the PRI framework was an easy step requiring no change to our investable universe or investment principles. We hope this step will help us remain mindful of ESG risks when investing, and provide assurance to our clients that ESG considerations are a formal part of our decision-making process.

<u>Fundamental Business Performance</u>

Our businesses performed very well in 2021 after a COVID challenged 2020. Taking a two-year view to encompass both the pandemic-driven economic downturn, and subsequent rebound, we are quite pleased with the results. In the table below, we see that for the two-year period our businesses delivered 32% EPS growth (15% compounded) compared to 27% for the S&P Total Market Index (13% compounded). We note that these results were accomplished with significantly less earnings volatility than the broader market which we think speaks to the quality and resiliency of the businesses we own.

[1] See the end of this letter for historical performance and important disclosures.
[2] Net of highest applicable fee of 1.0% per annum as described in our Form ADV, Part 2A.
[3] S&P Total Market Index is a broad market index that includes 4,223 large, mid, and small cap U.S. equities (@12/31/21).

| | 2020 EPS Growth* | 2021 EPS Growth* | **2 Year EPS Growth*** | **2 Year EPS CAGR*** |
|---|---|---|---|---|
| Our Businesses | (0%) | 33% | **32%** | **15%** |
| S&P Total Market Index | (16%) | 50% | **27%** | **13%** |

* Consensus FactSet operating EPS except for Markel (BV/shr) and Brookfield (Broad Run estimates). Results for the most recent year are preliminary, subject to adjustment as annual reporting is finalized.

As a reminder, we underwrite our investments to target a mid-teens rate of return. We seek this return via the compounding of earnings per share over time rather than a change in valuation or clever trading in or out of a stock. As a result, our long-term portfolio performance is primarily driven by the earnings per share growth of the underlying businesses that we own[4]. You can see this relationship in the table below. Over the last twelve years, our portfolio level earnings per share CAGR is 14.6%, inclusive of dividends and cash drag [column C], compared to a total return of [redacted], gross of fees [column D]. Please note that there is a loose relationship between earnings per share growth and price performance in any given year, but that the relationship strengthens considerably over longer periods of time.

| | **Focus Equity Separate Accounts** | | | | | **S&P Total Market Index** | |
|---|---|---|---|---|---|---|---|
| | **A** | **B** | **C** | **D** | **E** | **F** | **G** |
| Year | Business Level EPS Growth + Dividend Yield* | Impact of Cash Balance | Portfolio Level EPS Growth + Dividend Yield* | Total Return Gross of Fees | Total Return Net of 1% Fee | EPS Growth + Dividend Yield | Total Return |
| 2010 | 25% | -0.8% | 25% | [redacted] | [redacted] | 42% | 17% |
| 2011 | 16% | -1.0% | 15% | [redacted] | [redacted] | 15% | 1% |
| 2012 | 16% | -1.5% | 14% | [redacted] | [redacted] | 9% | 16% |
| 2013 | 16% | -1.0% | 15% | [redacted] | [redacted] | 8% | 33% |
| 2014 | 17% | -0.7% | 17% | [redacted] | [redacted] | 9% | 12% |
| 2015 | 11% | -0.3% | 11% | [redacted] | [redacted] | -2% | 0% |
| 2016 | 4% | -0.2% | 3% | [redacted] | [redacted] | 3% | 13% |
| 2017 | 13% | -0.5% | 12% | [redacted] | [redacted] | 14% | 21% |
| 2018 | 20% | -0.5% | 20% | [redacted] | [redacted] | 24% | -5% |
| 2019 | 13% | -0.2% | 13% | [redacted] | [redacted] | 1% | 31% |
| 2020 | 0% | 0.0% | 0% | [redacted] | [redacted] | -14% | 21% |
| 2021 | 33% | -0.4% | 33% | [redacted] | [redacted] | 52% | 26% |
| Cumulative: | 442% | | 411% | [redacted] | [redacted] | 294% | 434% |
| Annualized: | 15.1% | | 14.6% | [redacted] | [redacted] | 12.1% | 15.0% |

** For the Focus Equity Separate Accounts, EPS growth is a Broad Run estimate based upon reported results for the first three quarters of the most recent year and projections for the final quarter. For prior years, EPS growth has been updated to reflect actual reported results for the year. With this letter we have updated the methodology for incorporating Markel s BV/share growth and applied it across all prior periods. May not sum due to rounding.*

## Inflation

Throughout 2021 we saw growing signs of inflation in the macroeconomic data, at our portfolio companies, and in our everyday lives. By December, reported inflation topped 7% for the first time in more than 40 years. Massive fiscal stimulus and a recovering economy created strong demand that collided with pandemic driven supply chain disruptions and labor shortages. Some of these pressures should abate as the pandemic recedes and supply chains catch up. But long dormant wage inflation has been awoken, and its retreat is hard to forecast. The consensus view is that inflation will return to low single-digit rates by year end, but consensus has been quite wrong about this topic so far.

What does inflation mean for our portfolio? While we do not own energy and basic materials businesses that would be direct beneficiaries of inflation, we do seek to own businesses providing differentiated, hard to replicate products or services that are valued by their customers. As a result, these businesses tend to have pricing power allowing them to recoup cost increases, and sometimes even come out ahead.

[4] This is axiomatic, if there is no change in valuation and no dividends, stock performance will match the change in earnings per share. While earnings per share growth is not particularly useful to measuring progress at many types of investment strategies - for example, a high valuation-high growth strategy, a slow/no growth-deep value strategy, or a high turnover strategy - it is instructive for our type of strategy.

In the table below, we provide a brief assessment of the impact of inflation and supply chain disruption on our businesses so far. We have had some pluses and minuses, but on the whole, we think the environment has probably been a modest net benefit for the nominal and real earnings power of the portfolio.

**Inflation & Supply Chain Impact on Business**

| | Port Wgt End '21 | Inflation Impact | Supply Impact | Comments |
|---|---|---|---|---|
| Brookfield | 10.6% | | | *No direct impact on business* |
| Alphabet | 10.4% | | | *No direct impact on business* |
| Aon | 8.7% | | | *No direct impact on business* |
| Ashtead | 8.3% | | + | *Best supply chain amidst shortages enables mkt shr gains* |
| Am. Tower | 8.2% | | | *No direct impact on business* |
| CarMax | 8.2% | + | + | *Best vehicle sourcing amidst shortages enables modest mkt shr gains* |
| O'Reilly Auto | 6.7% | + | + | *Best supply chain amidst shortages enables mkt shr gains; pricing > inflation* |
| Markel | 5.5% | | | *No direct impact on business* |
| Disney | 4.9% | | | *Elevated labor cost at parks offset by ticket price increases* |
| Encore Capital | 4.7% | | | *No direct impact on business* |
| SS&C | 4.0% | | | *No direct impact on business* |
| Applied Mat. | 3.3% | | | *No direct impact on business* |
| RH | 3.2% | | | *Production delays modestly slow rev growth* |
| NVR | 2.6% | | | *Construction delays modestly slow rev growth* |
| Am. Woodmark | 2.2% | – | – | *Squeezed between rising costs and medium-term (3-12 mo.) contracts* |
| Allegiant | 2.1% | – | | *Rising fuel cost, labor shortages drive short-term margin squeeze* |
| Facebook | 2.1% | | | *No direct impact on business* |
| CDW | 2.0% | | | *Best supply chain amidst shortages enables modest mkt shr gains* |
| AST SpaceMbl. | 0.7% | | | *No direct impact on business* |
| Marlin | 0.6% | | | *No direct impact on business* |
| Drive Shack | 0.4% | – | | *Rising construction costs reduce ROIC on new developments* |

Below, we provide some more detail about three of our businesses most impacted by inflation and supply chain disruptions.

- *O'Reilly Automotive has significantly benefited from the current environment.* First, the company is seeing auto parts cost inflation averaging 5.5% per unit. Its competitive position enables it to raise retail prices at a similar rate, and thereby achieve a 5.5% increase in gross profit on the same unit sale; a net benefit. And second, O'Reilly has the best supply chain in the industry. With industry-wide parts shortages, O'Reilly is better able to procure parts and fulfill customer orders driving customer and market share gains.

  Historically, O'Reilly has been able to hold onto price increases, and new customers - once they experience the company's superior service levels - tend to stick and become loyal repeat customers. We think that this time will be no different.

- *CarMax has benefited from the current environment.* A shortage of semiconductor chips has reduced the production rate of new vehicles leaving used vehicles as the primary relief valve for demand. This has created a favorable environment for CarMax and other used dealers, providing tailwinds for both gross profit and financing income.

  CarMax's well-established practice of buying used vehicles from the general population has helped it maintain a solid inventory position during this time of scarcity, though a shortage of reconditioning mechanics has muted some of this benefit.

  Further, in contrast to most used dealers, CarMax has not used this environment to harvest windfall profits by maximizing pricing and margins. Rather, they have adhered to an everyday-fair-pricing policy that is aligned with their brand and long-term thinking. So, profitability has benefited in this environment, but not so much so that we are concerned about a significant reset lower when new and used car supply gets back in balance.

- *American Woodmark has been significantly harmed by the current environment.* American Woodmark has been squeezed between rapidly rising costs, and customer contracts with large home centers and home builders that have locked in pricing for between 3 and 12 months. As a result, the company is earning only about 50% of what we would ordinarily expect.

We are confident that the vast majority of American Woodmark's normal profitability can be recouped. The company, and its industry, have a multi-decade history of being able to pass through cost increases to customers. Adding to our conviction is that the cabinet industry is currently facing capacity constraints with strong demand from both new home construction and remodeling activity; cabinet manufacturers should have market power amidst this healthy demand and tight supply.

The company has already implemented two large price increases in 2021 that were accepted by all important customers. These price increases were designed to recoup known cost increases at that point in time. So far, costs have continued to rise after new contracts were struck, leaving the company behind the curve.

American Woodmark is among the cheapest stocks that we own, trading at about 13x current earnings and about 7x normalized earnings, while continuing to grow revenue and earnings power at about 10% per annum.

## Investment Outlook

The second order effects of inflation, most notably higher interest rates and a higher discount rate for risk assets, are more challenging to assess. The market appears to be struggling with this question now. As we write this letter in late January, the Federal Reserve has turned more hawkish, the equity markets have become volatile, and the major U.S. indices are down 5% to 12% year-to-date.

Our big picture view is that we are 13 years into a bull market and the risk pendulum has swung full range from fear to greed. For half a generation, risk seeking has been rewarded, and prudence penalized. While some of the air has recently come out of the hottest sectors, excesses still abound. By our math, many of the profitless growth companies, already down 25%, 50%, or more, would still require extraordinary rates of revenue and profit growth for the next decade to justify current valuations. In this environment, we think being mindful of downside risk is all the more important.

At the same time, the potential for sustained inflation poses a serious risk to purchasing power for assets held in cash and fixed income. With this backdrop we particularly like our portfolio of what we believe to be high quality, well run, growing businesses, owned at reasonable valuations based upon demonstrated earnings and cash flow. At year end, our portfolio valuation of 20.6x our 2022 earnings estimates (compared to 21.8x for the broader market), is somewhat higher than it has been in the past reflecting the impact of the low interest rate environment.

**Focus Equity Separate Accounts - Beginning of Year Projection**

| Beginning of Year | Business Level Price to 1yr EPS Est.* | Business Level 1yr Est. EPS Growth Rate* | Business Level 5yr Est. EPS Growth Rate* |
|---|---|---|---|
| 2010 | 14.9x | 20% | mid-teens |
| 2011 | 15.4x | 16% | mid-teens |
| 2012 | 14.1x | 16% | mid-teens |
| 2013 | 15.5x | 17% | mid-teens |
| 2014 | 17.9x | 17% | mid-teens |
| 2015 | 17.0x | 17% | mid-teens |
| 2016 | 16.6x | 18% | mid-teens |
| 2017 | 16.1x | 14% | mid-teens |
| 2018 | 16.4x | 24% | mid-teens |
| 2019 | 15.2x | 14% | mid-teens |
| 2020 | 18.3x | 13% | mid-teens |
| 2021 | 19.3x | 12% | mid-teens |
| 2022 | 20.6x | 15% | mid-teens |

** Based upon Broad Run internal estimates (may differ materially from consensus estimates), weighted by position size, excluding the impact of any portfolio level cash.*

From this valuation level – modestly elevated, but still perfectly rational – we expect portfolio returns will track the mid-teens rate of earnings growth we expect from our portfolio over the next five years, with the obvious caveat that a sustained rise in interest rates would present a headwind that could clip several points per annum off of our expected returns.

## Conclusion

We thank you for entrusting your capital to us. We will continue to do our best to protect and grow your investment over time.

Please let us know if there have been any changes to your financial circumstances or investment objectives that might impact how we manage your account, let us know if your contact information changes, and let us know if you would like to add or modify any reasonable restrictions to our investment advisory services.

Sincerely,

Broad Run Investment Management, LLC

May 3, 2022

**Focus Equity Client Letter**
Q1 - 2022

For the quarter ended March 31, 2022, Broad Run's Focus Equity Separate Accounts[1] returned [redacted] net of fees[2] compared to [redacted] for the S&P Total Market Index[3]. The performance for your account will differ somewhat from these reported results due to variations in holdings and other client-specific circumstances. We remind you that we manage your account for long-term results, so we encourage you to evaluate its performance over a multi-year time frame. Long-term performance is presented at the end of this letter.

## Commentary

So far in 2022, inflation, rising interest rates, supply chain challenges, and the invasion of Ukraine have taken a toll on the market. While the economy remains strong, there has been some softening as consumers are not quite as confident or as flush with cash as they were six months or a year ago.

For the quarter, we lagged the S&P Total Market Index as our interest rate sensitive holdings underperformed. Many of these holdings are now trading at valuation multiples that we have not seen in several years. These stocks appear to be pricing in a near-term recession, which is a possibility, but far from certain. There has been some deceleration of growth this year, which was to be expected after a very robust 2021. But with few exceptions, these businesses continue to compound revenue and profits at a nice rate, with a favorable forward outlook.

We are becoming increasingly constructive on our opportunity set. We see good value in our existing portfolio (trading 15.6x our next 12 months earnings estimates - a level consistent with the 2016 to 2018 period) and are finding many Watch List names and new businesses worthy of study for potential investment. We are not naive about the challenges the economy faces in the coming quarters and years, but as long term, value-aware investors we cannot help but perk up when we see high quality assets on sale.

Amidst the acute tech sector and high growth sell off, we have looked closely at several tech-enabled growth businesses that we have long admired. Heretofore, we did not expend significant research resources on these businesses since they were market darlings and valued as such. But, with their stock prices down 50%-plus from 2021 highs, we dug in with some optimism. Alas, we found that they still require aggressive growth assumptions, and/or ignoring very high stock compensation expenses to justify current prices; neither of which we are willing to underwrite. Our view is that these businesses need another meaningful price correction to be investable with a margin of safety. For the time being, they sit as new entries on our Watch List, part of our actionable opportunity set if circumstances warrant.

During the quarter we made several small adjustments in the portfolio: we added about 1% to CDW and 1% to RH, bringing these position sizes to about 3.1% and 3.0% of assets, respectively. These are relatively new investments for us (we first invested in these businesses in Q4'2020 and Q1'2020, respectively). Our conviction in their long-term prospects has strengthened over time with continued research. They are also both down from their recent highs (RH significantly so). We funded these purchases by selling about 1% from Aon and 1% from O'Reilly Automotive. Both securities had been very strong year-to-date and Aon had become oversized relative to our target weight. Also, as we have articulated before (Q1'21 letter), we are patiently scaling down our O'Reilly position since the business is maturing and facing a still distant, but growing secular threat from EVs. Finally, in accounts that held Marlin Business Services, we exited that position entirely (about 2% of assets) as the business was acquired during the quarter.

After quarter end, we began adding a new position to the portfolio. We are still building this position to its target weight, so we will refrain from sharing many details now. To give you a brief preview, this is a small cap company with recurring

[1] See the end of this letter for historical performance and important disclosures.
[2] Net of highest applicable fee of 1.0% per annum as described in our Form ADV, Part 2A.
[3] S&P Total Market Index is a broad market index that includes 4,223 large, mid, and small cap U.S. equities (@12/31/21).

revenue, acyclical demand, attractive economics, and a large growth opportunity. We look forward to writing more about this investment in our next client letter.

To reiterate what we wrote last quarter, our big picture view is that coming into this year we were 13 years into a bull market and the risk pendulum had swung full range from fear to greed. For half a generation, risk seeking had been rewarded, and prudence penalized. While some of the air has recently come out of the hottest sectors, we still see many excesses. In this environment, we think being mindful of downside risk is all the more important.

At the same time, the potential for sustained inflation poses a serious risk to purchasing power for assets held in cash and fixed income. With this backdrop we particularly like our portfolio of what we believe to be high quality, well run, growing businesses, owned at reasonable valuations based upon demonstrated earnings and cash flow.

From today's valuation level we expect portfolio returns will track the mid-teens rate of earnings growth we expect from our portfolio over the next five years, with the obvious caveat that a sustained rise in interest rates from here would present a headwind that could clip several points per annum off of our expected returns.

**Kurtosis; The Hidden Pattern of Market Returns**

The most interesting and relevant financial academic research we have come across in the last five years is from Hendrik Bessembinder, of Arizona State University. Bessembinder has broken new ground studying the origin of historical market returns, including in his recent publication, *Wealth Creation in the U.S. Public Stock Markets 1926 to 2019*. For those not familiar with this publication, as the title suggests, Bessembinder analyzed the lifetime wealth creation of all 26,168 individual U.S. public companies over a 93-year period. Bessembinder defines wealth creation as the amount by which a business's listed equity returns exceed Treasury bills during the corresponding period. Some of the key observations from this work include:

- From 1926 through 2019, $47 trillion of wealth was created by publicly listed companies.
- The top performing 4% of listed businesses accounted for all of this $47 trillion of wealth creation.
- The remaining 96% of listed businesses provided no net wealth creation. This is because:
    1) Cumulative lifetime wealth creation for a majority of firms (58%) was negative.
    2) Cumulative lifetime wealth creation for a minority of firms (42%) was positive, but the wealth created by the first 38% of this 42% was needed to offset the wealth destroyed by the bottom 58%.

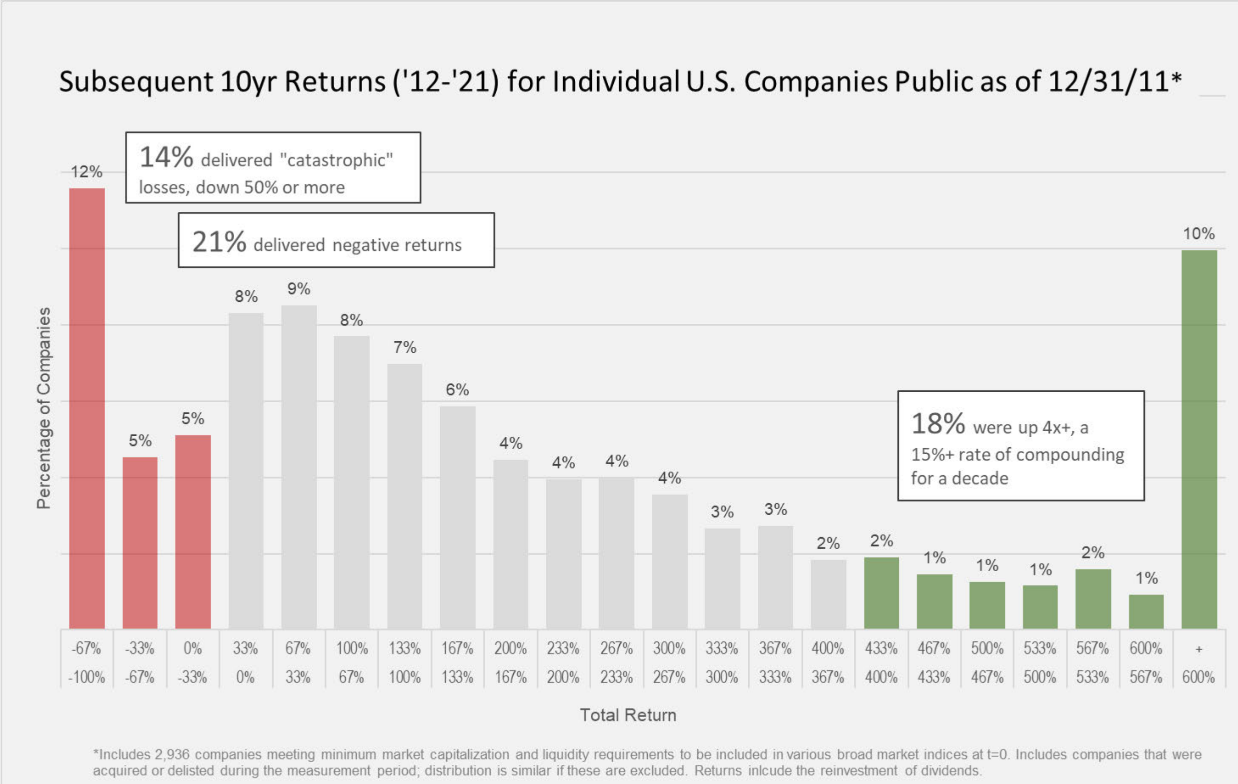
In summary, there is significant "positive skewness" to equity returns; a very small percentage of winning businesses produce an outsized portion of shareholder wealth, and most businesses are wealth destroying. These facts shatter a common misperception that a randomly selected stock / business is likely to produce market level returns. In fact, Bessembinder finds nearly two-thirds of listed businesses produced lifetime returns below an equally weighted index. So much for the proverbial monkey throwing darts!

For all its important insights, Bessembinder's research has shortcomings for us as practitioners. Most notably, Bessembinder focused on total dollars of wealth creation, which necessitates incorporating company size into the analysis. In Bessembinder's framework, if a $30 billion market cap company doubles in value, it creates 10x more shareholder wealth than if a $3 billion market cap company doubles in value.

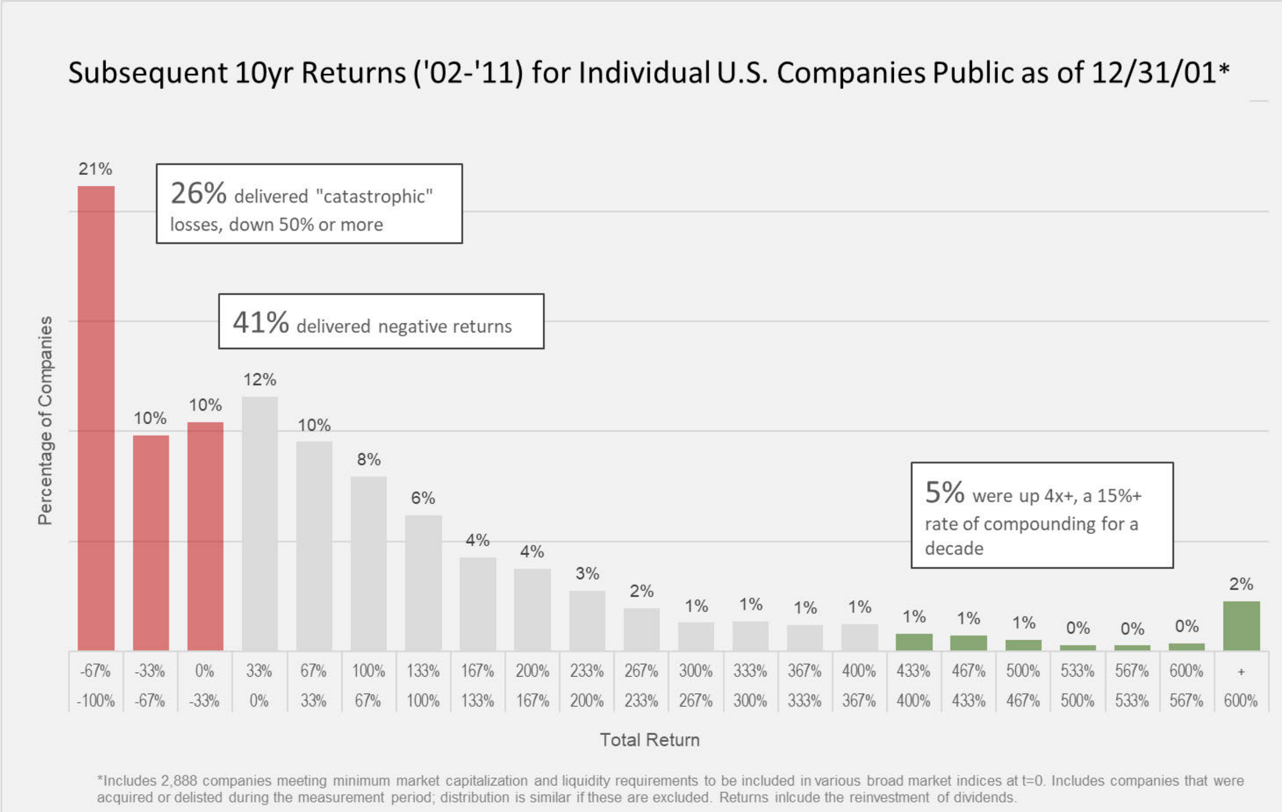
However, as investors, it does not matter to us what the market cap of a business is so long as the company is large enough to accommodate a full-size allocation in our portfolio. From our perspective, a $30 billion company that doubles in value is equally as useful as a $3 billion company that doubles in value; they both enable us to double our investment.

With some effort, we have been able to source a "point-in-time" dataset that allows us to conduct a Bessembinder-like analysis on an equal-weighted basis over time horizons more relevant to us.

In the chart below, we segment the 2,936 U.S. listed equities that were public on December 31, 2011 (meeting certain minimum market cap and liquidity requirements), based upon their returns over the ensuing 10 years. In other words, this was the opportunity set available to us about a decade ago as we entered 2012, and how that opportunity set performed over the next ten years.




The last decade saw an unusually strong stock market, with the S&P 1500 returning 16% per annum (the information technology sector alone generated a return of 24% per annum). So, we have run the same analysis on the decade beginning ten years prior (12/31/01) for added perspective. Of course, this decade was atypical as well with the S&P 1500 returning just 3% per annum. This information is presented on the next page.



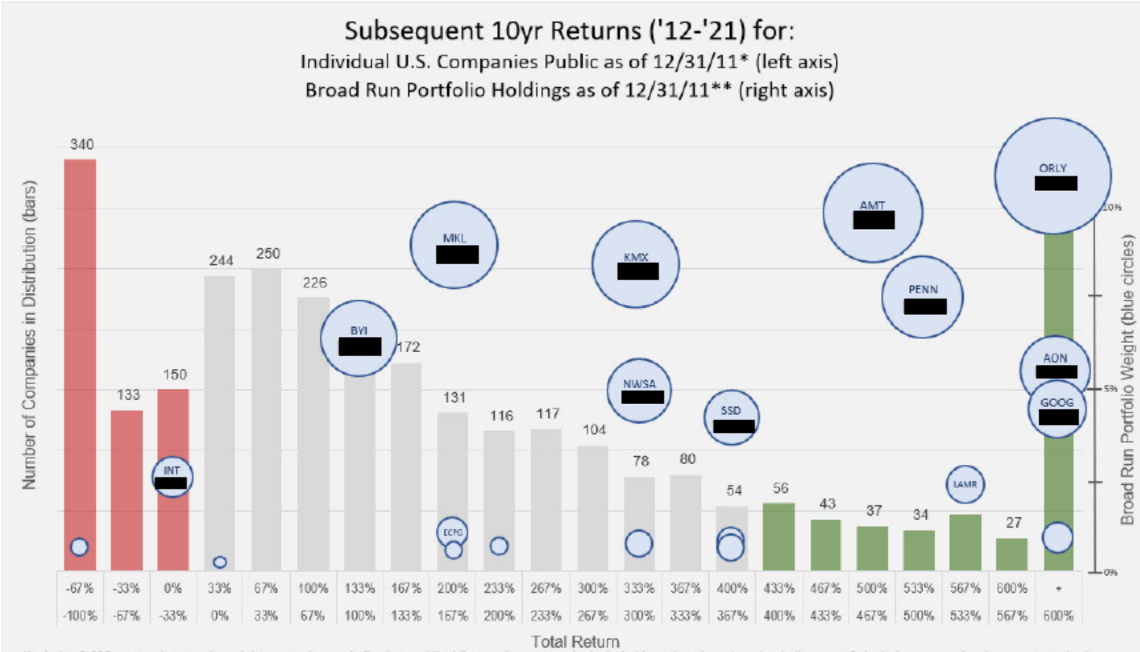

We share several observations from these charts:

- Few equites (12% of outcomes on average across the two decades) are big winners, up 4x+, which equates to compounding at a 15%+ rate for a decade (green bars)
- A substantial portion of equites (31% of outcomes on average across the two decades) are money losers over the long term (red bars).
- Catastrophic losers – those down 50% or more in the decade – are quite common (20% of outcomes, on average across the two decades), and far outnumber the big winners.

We think these charts support our logic of trying to avoid the left tail of distributions – the big losers – while simultaneously pursuing the right tail – the big winners. Indeed, we developed our five investment criteria with this in mind. Our criteria of a high-quality business, large growth opportunity, excellent management, low tail risk, and discount valuation possess both defensive and offensive characteristics.

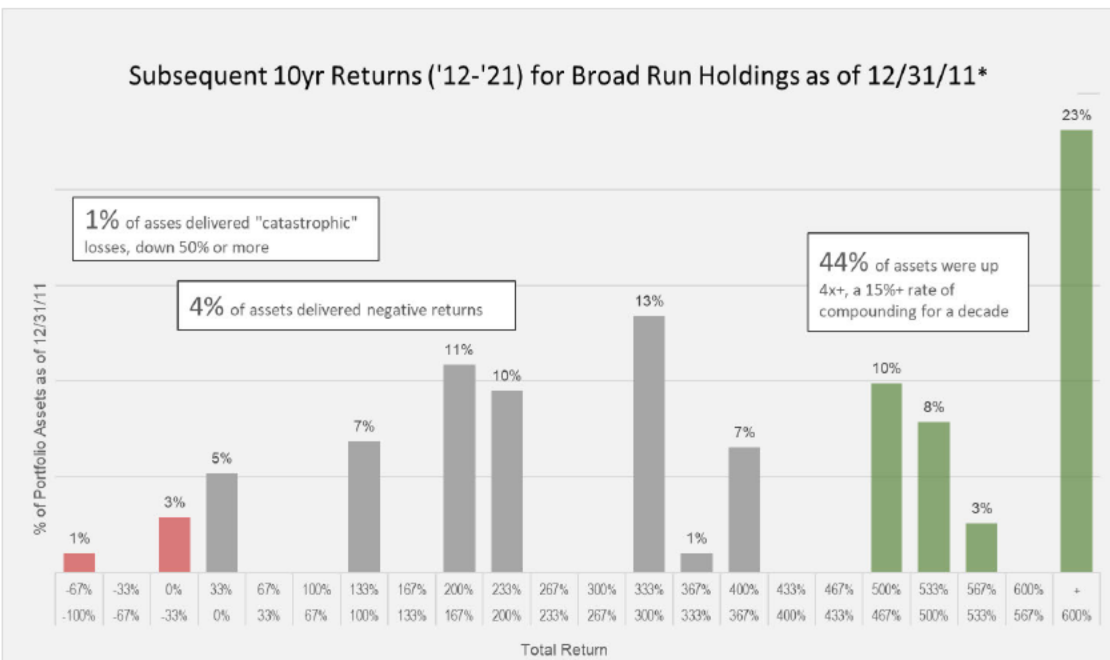
In the chart below, we overlay Broad Run's portfolio holdings at 12/31/11 on the subsequent return chart for the broader universe at 12/31/11. It is important to note that Broad Run's subsequent returns are not the same as actual investment returns received by clients. They are simply a snapshot of the portfolio holdings from 12/31/11, held static and carried forward through the end of the ten years with no buys or sells (but with dividends reinvested). This is the same methodology as is used for the broader universe. We believe this is useful analysis given the very low turnover investment strategy we employ.

In the chart, Broad Run's positions are marked as blue circles, placed horizontally within the category that corresponds with their subsequent 10-year returns, and placed vertically based upon position size within the portfolio on 12/31/11 (right axis). Each blue circle is also sized to reflect its portfolio weight (larger blue circle = larger position size) on 12/31/11. Where space permits, the blue circles are labeled with the company ticker and total return for the 10-year period. For example, O'Reilly Automotive (ORLY), the upper rightmost blue circle, was the largest position on 12/31/11 at 11.4% of assets placing it at the top of the vertical scale. It also produced a [redacted] total return over the subsequent 10-year period placing it in the rightmost "600%+" category of total returns.




*Includes 2,936 companies meeting minimum market capitalization and liquidity requirements to be included in various broad market indices at t=0. Includes companies that were acquired or delisted during the measurement period; distribution is similar if these are excluded. Returns inlcude the reinvestment of dividends. **Includes 21 companies held by Focus Equity Strategy at t=0. Excludes any changes made to holdings subsequent to t=0, so not comprable to actual returns expereinced by a Broad Run investor. Returns are presented gross of fees and include the reinvestment of dividends.

In the chart below, we build from the above chart by summing Broad Run's position weights within each return category. So, for example, in the 600%+ category we add together the position weights for ORLY (11.4%), AON (5.6%), GOOG (4.6%), and SCHW (1.5%) to determine that 23% of Broad Run's 12/31/11 portfolio assets landed in the 600%+ returns category over the subsequent 10-year return analysis.




*Includes 21 companies held by Focus Equity Strategy at t=0. Includes companies that were acquired or delisted during the measurement period; Returns inlcude the reinvestment of dividends.

As you can see, we had 44% of assets in positions that achieved 400%+ 10-year subsequent returns (green bars), and 4% of assets that delivered negative subsequent 10-year returns (red bars). This distribution of returns is starkly different from the results for the broader universe; our holdings had far less exposure to money losers (4% vs. 23%), and far more exposure to winners up 4x+ (44% vs. 20%). We think this speaks to the efficacy of our five investment criteria and our research process.

As noted earlier, we had four positions (composing 23% of beginning period assets) fall within the 600%+ total return bucket. The four positions returned [redacted] ([redacted] annualized), [redacted] ([redacted] annualized), [redacted] ([redacted] annualized), and [redacted] ([redacted] annualized), well above our mid-teens underwriting hurdle. What we did not capture were any of the 10x (27% annualized) or 20x (35% annualized) returns that were important contributors to the broader market during this extraordinary last decade. Reviewing these 10x and 20x businesses, we approximate that half of them could have been investable by us ex ante using our investment criteria. Naturally, there are many big winners – particularly last decade – that would not meet our criteria. But, the exclusion of those from our opportunity set still left / leaves plenty of others to pursue.

This data exploration leaves us more confident than ever that our five investment criteria position us well to fulfill our mission of compounding client capital at a superior rate, with prudence over time. As always, we will continue to study, learn, and refine our craft as we try to get a little bit better every day.

## Conclusion

We thank you for entrusting your capital to us. We will continue to do our best to protect and grow your investment over time.

Please let us know if there have been any changes to your financial circumstances or investment objectives that might impact how we manage your account, let us know if your contact information changes, and let us know if you would like to add or modify any reasonable restrictions to our investment advisory services.

Sincerely,

Broad Run Investment Management, LLC

July 22, 2022

**Focus Equity Client Letter**
Q2 - 2022

For the quarter ended June 30, 2022, Broad Run's Focus Equity Separate Accounts[1] returned [redacted] net of fees[2] compared to -16.8% for the S&P Total Market Index[3]. Year to date, the Focus Equity Separate Accounts returned [redacted] net of fees compared to -21.3% for the S&P Total Market Index. The performance for your account will differ somewhat from these reported results due to variations in holdings and other client-specific circumstances. We remind you that we manage your account for long-term results, so we encourage you to evaluate its performance over a multi-year time frame. Long-term performance is presented at the end of this letter.

## Commentary

The second quarter of 2022 was very much a continuation of the first. Concern about high inflation, rising interest rates, and growing economic uncertainty contributed to another big down quarter. The S&P Total Market Index declined 16.8% during the period, and is down 21.3% for the half year. This is the worst market decline for a first half in 52 years.

In general, the companies we own continue to experience solid business trends, with good demand and growing revenue and profits. The few exceptions to this are our holdings in housing and big-ticket consumer-oriented businesses where higher interest rates and stretched affordability are having some impact. Our estimates for the portfolio have come down slightly for 2022 and 2023, but we are still projecting solid double-digit earnings growth each year (similar to FactSet consensus forecasts).

Against this modest earnings adjustment (<5%) we have seen a significant ([redacted]) decline in portfolio price. Our portfolio is now trading at 14.8x our next twelve-month earnings estimates, the lowest multiple we have seen since 2011. Looking below the portfolio's surface, our businesses with the most cyclical exposure have had their stocks hit the hardest. We own a number of cyclical growth companies now trading at 8-13x earnings estimates (i.e. Ashtead Group, RH, Applied Materials, Allegiant Travel), compared to their historical 15-22x range.

With this divergence between fundamentals and prices, the market appears to be discounting a high probability of a recession (and corresponding negative earnings revisions), which is clearly a possibility, but far from certain. There are many reasons to be concerned about the economy, but there are also reasons for optimism. Notably, the average consumer balance sheet is in very good shape with a record level of home equity and cash, and the job market is strong with many more job openings than there are job seekers, and 2.7 million jobs created year-to-date.

Recession or not, we do not think it will matter much to our portfolio in the fullness of time. Near term earnings results are but a small part of the long-term stream of future cash flows that dictate what a company should be worth. And, as we have seen in past recessions, the types of companies that we typically own – industry leaders with strong balance sheets and excellent management teams – can sometimes use a recession to create a step function increase in long term value by taking advantage of consolidation and expansion opportunities that would not otherwise exist.

Of course, the economy and spending patterns have been highly unusual since the emergence of Covid-19 with demand fluctuating wildly across time and industry. It begs the question, how reliable are today's earnings as an indicator of value? Are recent earnings reflective of enduring earnings power, or are our companies over-earning a normal rate?

As a whole, we do not think our business are overearning. We own long-established companies with observable revenue and profit patterns across a decade or more. We can rewind the clock to 2019 (before Covid distortions emerged) and estimate what profitability would have been today had the pandemic never happened. Current estimates do not depart

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significantly from our "Covid normalized" analysis, giving us confidence in the underlying earnings power of these businesses and their eventual stock price recovery.

In contrast, as we highlighted in our letters a year ago, enthusiasm for growth technology/unproven concept companies resulted in excessive valuations based upon flim-flam metrics such as EV/sales, and EV/TAM. Much of that bubble has now burst, and we think most of those stocks are unlikely to ever recover to prior highs.

During turbulent times, we gain confidence from owning a portfolio of high quality, well run, cash generative businesses at reasonable valuations that we believe are going to grow their earnings significantly over the next five and ten years. At the beginning of 2022, you had to pay roughly 20x earnings for our portfolio of businesses, now you pay roughly 15x. With no meaningful change in the outlook for long-term earnings power, we like the investment setup from here.

During the quarter we added a new 2% position in Shenandoah Telecom (discussed below) and trimmed about 1% from our O'Reilly position to help fund the purchase.

**Almost Heaven: Shenandoah Telecom**

In his 1971 Platinum hit *Country Roads,* John Denver sings: *"Almost Heaven, West Virginia, Blue Ridge Mountains, Shenandoah River. Life is old there, older than the trees…"* While this ballad honors the unique beauty of West Virginia and the broader Appalachia region, John Denver could just as well have been singing about our latest investment: Shenandoah Telecom.

Shenandoah Telecom, a/k/a "Shentel", began as a rural cooperative telephone system in western Virginia in the early 1900s. It grew through the years organically and via acquisition, and now is a leading provider of telecommunications services to rural geographies in Virginia, West Virginia, Maryland, and Kentucky. As we will explain later, it is this unique geographic footprint, with low population density, mountains, valleys, and forests that give Shentel a desirable position in the broadband communications industry.

Today, Shentel has two core assets: (1) an established cable broadband business with 210K passings (110K subscribers/52% penetration), and (2) an emerging fiber broadband business with 93K recently constructed passings, and another 357K passings to be constructed in the next several years (targeting 40% eventual subscriber penetration). It also has a third non-core asset, a cellular tower network (210 towers in Virginia) that will likely be sold in the coming years.

<u>Cable Network</u>

Historically, cable broadband networks have been very high-quality assets. Their core service offering, high speed internet connectivity, is utility-like with recurring revenue, growing demand, and low cyclicality. The high fixed costs to build and maintain a network means most markets can only economically support one or two providers leading to natural monopolies and duopolies. And, low variable costs enable high incremental profit margins on incremental revenue.

However, recently cable networks have been facing increased competition from two primary sources: fiber overbuilders and fixed wireless (FW). Most cable networks appear poised to lose market share in the coming years as these new entrants gradually chip away subscribers. However, we believe Shentel, by virtue of its unique geography / topography, is much more insulated from these threats. We explore this further below.

*Fiber overbuilders.* Fiber overbuilders are spending tens of billions of dollars building new fiber optic broadband networks in direct competition with incumbent cable networks. It is estimated that 60-70% of the country will have access to a fiber broadband connection in a decade, compared to about 35% now. Fiber offers speed and reliability advantages versus cable connectivity allowing new fiber networks to carve out meaningful market share where they compete.

Key to the economic equation for fiber overbuilders is having enough population density in a target market to keep the network construction cost per passing low. The large fiber overbuilders – AT&T, Lumen, Frontier – speak of needing a cost per passing of around $1,000 to earn an acceptable return on investment. In Shentel's cable markets, because population density is low and homes are spaced far apart, it would cost an estimated $2,000 per passing, on average, to overbuild with fiber. In addition, Shentel's markets tend to have lower than average household income and have correspondingly lower broadband adoption. This reduces the number of likely subscribers per passing, making the economic equation even more prohibitive for any potential new entrant.

*Fixed wireless*. Fixed wireless is broadband internet delivered over a wireless carrier's spectrum from a cell tower to someone's home. Fixed wireless has two limitations - capacity and propagation.

Wireless spectrum has only so much capacity to handle traffic. Put too much traffic on the spectrum too quickly and speeds all subscribers experience degrade materially. As a result FW subscribers have to be added in a very judicious manner. To put numbers on it, T-Mobile, with the most aggressive FW agenda in the U.S., expects to "pass" 60mm homes with fixed wireless by 2025 with 7-8mm FW subscribers. This works out to a 12.5% penetration rate in their markets and a 5% penetration rate nationally. Even if successful, FW has a limited ability to cut into incumbents' market share.

Additionally, spectrum can only propagate so far depending on its frequency. The higher the frequency, the less far the spectrum can travel and the more likely it will be absorbed by trees, leaves, hills, etc. Low band spectrum in the 600MHz range can travel very far and go through pretty much anything in a normal environment. But the primary spectrum being targeted for use by FW is mid-band, 2.5GHz or higher, which we believe will have a much more difficult time propagating through the leaves, trees, and hilly terrain of the Shentel markets.

Overall, we think Shentel will face minor incremental encroachment (mid-single digit to low double-digit percentage passings) from fiber overbuilders in the next decade in idiosyncratic situations where the economics make sense. We think FW will have a similar modest impact, building from zero share today to perhaps mid-single digit share in the long term. However, Shentel claims just 52% household penetration with its cable broadband product, leaving about 30% of internet market still in the hands of legacy, slow speed DSL. Over time DSL's share should decline significantly, leaving room for Shentel to continue to grow cable broadband subscriber count despite the arrival of some fiber and FW.

Contrast this profile with the big cable companies:

| | Shentel | Big Cable* |
|---|---|---|
| Est. % footprint facing new fiber overbuilding (10yrs) | 5-12% | 25-35% |
| Est. % market likely to be taken by fixed wireless (10yrs) | <5% | 5% |
| Est. Broadband penetration in market / (remaining opp.) | 52% / (28%) | 75% / (15%) |

**Comcast, Charter, Cox.*

We view Shentel's cable business as a well-protected cash cow that should grow revenue organically in the low- to mid-single digits with gradual margin expansion, while providing cash flow and the backbone to propel Shentel's emerging fiber business to success. In fact, in a few short years we expect the value of the company's emergent fiber business to eclipse its cable operations.

<u>Fiber Network</u>

Shentel has a long history of intelligent network expansion. With its established cable footprint and deep local relationships, Shentel is well positioned to execute on its own fiber overbuilding plan in adjacent markets.

Shentel is targeting new fiber builds in nearby Tier 3 and Tier 4 cities that have adequate density to allow for a $1,200, or less, cost to pass. These markets are served today by only one broadband provider, the legacy cable network (typically Comcast) that enjoys a monopoly position, high prices, and high market share (75-85%).

When Shentel arrives with fiber they can offer faster speeds, higher reliability, and a lower price point (10-20% cheaper). Combined with local customer service (call centers based in western Virginia), Shentel provides an attractive customer value proposition.

Speed to market is essential since these markets can only economically support two high speed data providers. Shentel's long-standing relationships with regulators and electric companies enable accelerated access to construction rights of way, and it can move efficiently by building off of its existing operations and contractor relationships.

Since 2019, Shentel has built 93K fiber passings, and has plans to achieve 450K passings by the end of 2026. We believe there is potential for expansion beyond this, but the roadmap is not yet clear enough to include that in the investment case.

We believe the economics of Shentel's new builds should be very attractive. Modeling 38% year-five, and 40% year-seven market share in fiber markets, we believe Shentel should achieve returns on capital in the mid-teens and returns on equity in the mid-20s. We have spoken with industry experts, evaluated case studies of other fiber buildouts, and studied Shentel's to-date fiber cohort analysis to build confidence in our key assumptions.

From here, we view Shentel as largely an execution story on the fiber rollout. So, like always, management is critically important in our assessment. CEO, Chris French, has been at the company for the last thirty years. He has a long record of creating shareholder value and today owns 4% of the shares outstanding. The company has a history of making opportunistic acquisitions in both its cable and wireless businesses, and management believes they may have future opportunities when other fiber overbuilders, with less experience and more leverage, run into distress. We have confidence Chris and the rest of the management team are very focused on executing sharply on the fiber rollout and putting capital behind their highest return opportunities.

At current prices, we believe the market is assigning very little value to Shentel's fiber build strategy. If we assign a market multiple to their cell tower business and value Shentel's fiber build to date at cost, we believe the market is valuing Shentel's cable business at ~9x EBITDA, which is a two-turn discount to its closest peer, CableOne. We are not the only ones who see value in the shares today; there has been sizeable insider buying from multiple company executives over the last few months.

Looking out five years, we think the combined value of the cell towers, cable network, and fiber business will be worth >$40/share, providing us a 15% base case 5-year IRR. During this period, we expect Shentel to compound consolidated EBITDA at ~17-18% per annum driven by a successful fiber rollout. This is with a net cash balance sheet today, and a fairly conservative net leverage of just below 3x EBITDA during the peak of the fiber buildout.

<u>Conclusion</u>

We thank you for entrusting your capital to us. We will continue to do our best to protect and grow your investment over time.

Please let us know if there have been any changes to your financial circumstances or investment objectives that might impact how we manage your account, let us know if your contact information changes, and let us know if you would like to add or modify any reasonable restrictions to our investment advisory services.

Sincerely,

Broad Run Investment Management, LLC

October 14, 2022

**Focus Equity Client Letter**
Q3 - 2022

For the quarter ended September 30, 2022, Broad Run's Focus Equity Separate Accounts[1] returned [redacted] net of fees[2] compared to -4.6% for the S&P Total Market Index[3]. Year to date, the Focus Equity Separate Accounts returned [redacted] net of fees compared to -24.9% for the S&P Total Market Index. The performance for your account will differ somewhat from these reported results due to variations in holdings and other client-specific circumstances. We remind you that we manage your account for long-term results, so we encourage you to evaluate its performance over a multi-year time frame. Long-term performance is presented at the end of this letter.

## Commentary

The macroeconomic environment continues to be challenging. Persistent high inflation, rising interest rates, hawkish comments from the Fed, a rapidly strengthening dollar, and growing signs of economic slowdown contributed to another quarter of negative market performance.

Earnings growth for the S&P Total Market Index is still forecast to be a positive mid-single digit rate in 2022 and 2023, but this is down from a high single digit rate forecast at the beginning of this year.

In our portfolio, we also forecast a mid-single digit annualized earnings growth rate over 2022 and 2023, but this is down from our original expectation of a low teens growth rate. Against this backdrop we have seen a significant ([redacted]) decline in portfolio price. Our portfolio now trades at 13.8x our 2023 earnings estimates (versus 15.1x for the S&P Total Market Index), the lowest multiple since 2011.

Looking below the portfolio's surface, most businesses we own continue to experience good business trends with growing revenue and profits. It is the businesses we own with more cyclical exposure (most notably, 17% of assets are in housing and big-ticket consumer discretionary markets) that have had their stocks hit the hardest and that account for our relative underperformance. Many of these businesses are now down 40-50%-plus, and are trading at high single digit and low double-digit multiples of earnings compared to more normal high teens multiples. At these prices we think the market has already discounted a recession – and corresponding negative earnings revisions – into these stocks.

Recession or not, we do not think it will matter much to our portfolio in the fullness of time. Near-term earnings results are but a small part of the long-term stream of future cash flows that dictate what a company should be worth. And, as we have seen in past recessions, the types of companies that we typically own – industry leaders with strong balance sheets and excellent management teams – can sometimes use a recession to create a step function increase in long term value by taking advantage of consolidation and expansion opportunities that would not otherwise exist.

The economy and spending patterns have been highly unusual since the emergence of COVID-19 with demand fluctuating wildly across time and industry. This begs the question, how reliable are current earnings as an indicator of value? Are recent earnings reflective of enduring earnings power, or are our companies over-earning?

Overall, we do not think our businesses are overearning. We own long-established companies with observable revenue and profit patterns often across a decade or more. We can rewind the clock to before the pandemic to get an understanding of baseline earnings, and extrapolate from there to estimate what profitability might have been today if the pandemic had not occurred. Current estimates do not depart significantly from our "COVID normalized" analysis, giving us confidence in the underlying earnings power of these businesses and their eventual stock price recovery.

We contrast this profile with those of the many speculative high growth technology and "story" stocks that are valued based upon projections of huge margin expansion and revenue growth far in the future. While some of these businesses

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[2] Net of highest applicable fee of 1.0% per annum as described in our Form ADV, Part 2A.
[3] S&P Total Market Index is a broad market index that includes 4,223 large, mid, and small cap U.S. equities (@12/31/21).

will achieve their promise, we suspect that most will not, and equity holders will suffer a permanent impairment of capital.

To illustrate the point about our holdings, let's review CarMax, one of the hardest hit cyclical growth stocks in our portfolio, down about [redacted] year-to-date, and down about [redacted] from a year ago.

In the fiscal year ended February 2020 (just before the impact of the pandemic), CarMax earned $5.33 in GAAP EPS, which climbed nicely over the preceding five years at a 15% CAGR.

| | *F'15* | *F'16* | *F'17* | *F'18* | *F'19* | *F'20* | *CAGR* |
|---|---|---|---|---|---|---|---|
| *EPS* | $2.65 | $3.03 | $3.31 | $3.60 | $4.79 | $5.33 | 15% |

Key drivers to this EPS growth were new stores, market share gains at existing stores (comparable store sales), and repurchasing stock to reduce shares outstanding (plus a modest boost from the 2018 reduction in corporate tax rates).

| | *F'15* | *F'16* | *F'17* | *F'18* | *F'19* | *F'20* | *CAGR* |
|---|---|---|---|---|---|---|---|
| *Stores* | 144 | 158 | 173 | 188 | 203 | 216 | 8.4% |
| *Comps* | 7% | 3% | 3% | 3% | 2% | 10% | 3.4% |
| *Shares* | 219 | 206 | 192 | 186 | 176 | 167 | -5.3% |

Importantly, during this period CarMax's growth in EPS was not driven by a rapidly growing end market nor sharp improvement in profitability. Used car industry turnover approximated 40 million units, as it does almost every year, and CarMax's profit margins were in a range of 6.1% to 6.8%, where they had held steady for a decade prior to the pandemic.

If we fast forward to today, we see that two of CarMax's key value drivers – store count, and share count – are still marching forward (comparable store sales have been highly volatile due to the pandemic). The company has grown store count by more than 8% since February 2020, and reduced its share count by more than 4%.

| | *F'20* | | *Aug'22* | *Change* |
|---|---|---|---|---|
| *Stores* | 216 | → | 234 | 8.3% |
| *Shares* | 167 | → | 160 | -4.2% |

If we isolate these two value drivers it translates into about a 13% increase (8% more stores over 96% as many shares) in EPS from the $5.33 in Fiscal 2020, to $6.00 of earnings power today. This compares to recently reduced consensus EPS estimates for calendar 2023 of about $4.50 per share (down from actual results of $6.97 reported in calendar 2021). CarMax, at $61, is trading 13.5x this consensus $4.50 estimate, or just 10x our normalized earnings power estimate. Applying CarMax's 10-year average 17x multiple to $6.00 in earning power implies a fair value of $102 per share, about 65% above the current price.

Of course, reality is more complicated than the simple $6.00 key value driver analysis we present above, but we believe this analysis is roughly correct and illustrates our broader point about observable earnings power providing a reliable underpinning for our intrinsic value estimates. One such complication: SG&A expenses at CarMax are elevated (as a % of gross profit) relative to history due to significant investment in digital initiatives, wage inflation, and the recent decline in unit sales (-8% retail unit comps in the just reported quarter). We believe that the step-up in digital spending over the last several years has plateaued and there will be significant expense leverage from here as volume grows on this relatively fixed cost base.

CarMax is now trading at a similar stock price to March 2020 when nearly all stores were closed and corporate survival was in doubt. There is no such existential threat facing CarMax today. CarMax is the leader in used car retail and has an investment grade balance sheet. It has survived three recessions since its founding and has emerged stronger each time. While industry sales are down for macroeconomic reasons, CarMax continues to gain market share – as it has nearly every year since its founding. In fact, we would argue that CarMax is now in its best competitive position in a long time. It is making breakthrough progress on its unique omnichannel retailing capabilities at the same time that Carvana, its most formidable challenger, is facing capital constraints and the very real possibility of bankruptcy (the business is encumbered with massive debt and negative free cash flow; the stock is down 95% from a year ago).

We believe that CarMax offers a compelling value for the long-term investor; the best risk-adjusted return profile we have seen in the stock since the depths of the GFC.

During turbulent times we gain confidence from owning a portfolio of high quality, well run, cash generative businesses - such as CarMax - at reasonable valuations that we believe are going to grow their earnings significantly over the next five and ten years. At the beginning of 2022, you had to pay roughly 20x earnings for our portfolio of businesses, now you pay roughly 14x. While our expectations for near term earnings growth have diminished, our long-term outlook is largely unchanged. We view this as a very attractive investment setup.

During the quarter we sold our entire 1.4% position in Meta Platforms, Inc. (formerly Facebook, Inc.), which we discuss next. We will redeploy these funds shortly in a market where opportunities are plentiful.

**Exited Position: Meta Platforms, Inc.**

We established our Meta position about four years ago amidst the fallout from its Cambridge Analytica scandal. We liked that Meta was a big beneficiary of the secular shift of advertising from offline to online, and thought we bought a durable business opportunistically. Social networks can be very good businesses, but are not as durable as a utility service such as Google search. Nonetheless, we thought Meta could maintain a firm grasp on its social media leadership by acquiring or fast-following new threats as it had done in the past with Instagram (acquired) and Snapchat (fast-followed).

As is now quite obvious, Meta was caught flat footed by the rapid rise of TikTok. While not a direct substitute to Meta's social media services, TikTok provides a highly engaging short form video platform that competes for user time and online advertising dollars. Meta is attempting to fast follow, but TikTok is probably too large and well established to defeat. Acquiring TikTok is not a viable strategy as it is Chinese owned, and regulators have largely closed the door on future Meta acquisitions.

In addition, earlier this year Apple implemented privacy changes via its ATT policies that have proven more disruptive to Meta and many other online advertisers than initially expected. Meta should be able to offset some of the negative impact over time through increased reliance on AI, but this may result in permanently higher operating expenses and capital expenditures. This episode further highlights for us the vulnerabilities in Meta's business model.

Alphabet, at about 10% of assets, has always been our favored way to participate in the secular growth of online advertising. Meta, at about 2% of assets (at cost), has always been a much smaller position for us. With Meta stock down significantly and trading optically cheap on a sum-of-the-parts basis, we evaluated adding to our position, but ultimately could not get comfortable with the durability of the business. In addition, in order to conclude that Meta is cheap, one must believe that the massive amounts of capital it is deploying on Facebook Reality Labs are NPV positive. While the metaverse is interesting in concept, it remains a highly speculative investment – one that we are not willing to ascribe much value to. For these reasons, we concluded that there are better uses for the capital and exited the Meta position.

Conclusion

We thank you for entrusting your capital to us. We will continue to do our best to protect and grow your investment over time.

Please let us know if there have been any changes to your financial circumstances or investment objectives that might impact how we manage your account, let us know if your contact information changes, and let us know if you would like to add or modify any reasonable restrictions to our investment advisory services.

Sincerely,

Broad Run Investment Management, LLC

January 23, 2023

**Focus Equity Client Letter**
Q4 - 2022

For the year ended December 31, 2022, Broad Run's Focus Equity Separate Accounts[1] returned [redacted] net of fees[2] compared to -19.5% for the S&P Total Market Index[3]. For the fourth quarter, the Focus Equity Separate Accounts returned [redacted] net of fees compared to +7.2% for the S&P Total Market Index. The performance for your account will differ somewhat from these reported results due to variations in holdings and other client-specific circumstances. We remind you that we manage your account for long-term results, so we encourage you to evaluate its performance over a multi-year time frame. Long-term performance is presented at the end of this letter.

**Commentary**

2022 was a difficult year. We avoided the bubble in speculative tech and aggressive growth stocks, but own a number of consumer discretionary, real estate, and financial sector businesses that were impacted by the slowing economy and rising interest rates.

In addition, as has been the case for many years now, we did not have any exposure to the red-hot energy sector (+64% in 2022), or traditional economic "safe havens" such as consumer staples (-1% in 2022), health care (-3% in 2022), or utilities (+2% in 2022). As a reminder, we view energy companies as primarily driven by the price of underlying commodities that are inherently difficult to predict, and view utility businesses as too constrained by regulated rates of return. There are many consumer staples and health care businesses we would like to own, but have found them trading at high prices in relation to their growth prospects in recent years.

We are disappointed to deliver market lagging results, particularly in a year with the market down so much, but this is a risk in running a concentrated, benchmark-agnostic strategy. We regularly measure our portfolio's overall cyclical exposure, and attempt to manage / mitigate this exposure with a ballast of acyclical and countercyclical businesses. Unfortunately, several of these ballast positions – most notably American Tower and Encore Capital – also had a difficult year in 2022.

Importantly, despite some of our stocks being down 30, 40, 50%-plus for the year, we do not have concerns about the viability or long-term cash generative capacity of these businesses. Some are suffering from a slowdown in demand and/or rising costs, but we believe that these headwinds will prove temporary due to their advantaged competitive positions and the enduring nature of the products and services they offer. In fact, some are likely to use industry distress to consolidate market share and end up in a better place than they otherwise would have been. This is most clearly illustrated by CarMax (which we discussed at length in our third quarter letter), but is likely to be true of other holdings as well.

Our objective is to own a portfolio of businesses that deliver a mid-teens rate of compounding over the long term, without incurring significant risk of permanent capital loss. We remain steadfast in this pursuit, and, despite 2022's setback, believe that we are well positioned to deliver on our objective.

In the table below, we provide updates on some of our largest detractors from performance in 2022. We believe that many of these businesses have declined far in excess of what can be justified by their fundamentals, and therefore represent among the best opportunities in the market today. Indeed, some of these stocks have already rebounded sharply since the beginning of the year with only modest evidence that inflation and interest rates have crested.

[1] See the end of this letter for historical performance and important disclosures.
[2] Net of highest applicable fee of 1.0% per annum as described in our Form ADV, Part 2A.
[3] S&P Total Market Index is a broad market index that includes 4,272 large, mid, and small cap U.S. equities (@12/31/22).

| | '22 Perf. | Port. Wgt.* | Comments |
|---|---|---|---|
| *CarMax* | [redacted] | 8% | In 2022, high used vehicle prices combined with rising interest rates to hurt affordability and drive industry-wide used car unit sales down an estimated 11% from 2021. This level of annual sales volume (Cox estimate of 36.2 million units) is in line with the worst rates seen over the last 35 years (36.9 million in '92, 36.5 million in '08, 35.5 million in '09, 36.9 million in '10 and '11, and 35.8 million in '13) and is about 10% below the average volume over the period. Demand weakened further toward the end of 2022 (down at a mid-teens rate) implying that 2023 volumes could be lower than 2022. Amidst this challenging industry backdrop, poorly prepared competitors such as Carvana, Vroom, and Shift, find themselves hemorrhaging cash and retrenching to survive while CarMax remains nicely profitable and continues investing in its key strategic initiatives. We believe CarMax is taking market share - as it has for nearly its entire corporate history - and will achieve record unit sales and profit when industry volume returns to normal. As a secondary market, used car prices adjust to find equilibrium between supply and demand, dampening cyclicality. Already, affordability has begun to improve with the Manheim used car price index down 13.7% in mid-January versus a year ago. Consensus calls for CarMax to earn about $3 per share in calendar 2023 (down from about $7 in 2021 and $3.50 in 2022), and we estimate normalized earning power of $6+ today (and growing over time). At a historical 17x multiple on $6 of earnings CarMax would trade at $102 per share, 52% above its latest price of $67. Longer term, with just 4% market share of late model used car sales, we see a pathway for CarMax to more than double its share as its emerging omni-channel capabilities further differentiate the company from competition. |
| *RH* | [redacted] | 3% | Sales of RH's home furnishings are highly sensitive to luxury home turnover and equity markets. In 2022, the dramatic rise in mortgage rates and the decline in the stock market hurt housing affordability and consumer confidence. As a result, luxury home sales were down 38% YoY for the three months ended 11/30/22 according to Redfin (the largest decline on record). With one quarter remaining in its fiscal year, RH expects revenue for the fiscal year ending January 2023 to be down 3.5%-4.5%, implying that fiscal Q4 revenue will be down ~12%. This top line performance stands in stark contrast to the 32% revenue growth reported the prior year. There is no doubt that the pandemic and 2021's robust level of housing turnover brought forward some home furnishings demand. We expect demand for the furniture industry to slow further in 2023, but expect several company specific growth initiatives (the rollout of RH Contemporary, opening of RH England, and introduction of a large number of new products across other collections) will allow RH to report just a 5%-10% revenue decline in the upcoming fiscal year. We expect that 2023 will mark the low for housing turnover (at a level not seen since 1980) and trough earnings for RH. At quarter end, RH had more than 35% of its market capitalization in cash on the balance sheet. The company under the stewardship of CEO Gary Friedman has a history of aggressive and well-timed share repurchases (having repurchased ~60% of its shares from FY16-FY18). We know from a recent regulatory disclosure that RH repurchased ~6% of its shares between 12/15/2022 and 1/3/2023. We expect the company to use the majority of its remaining cash balance to repurchase shares. Today, shares trade for 16x our base case estimate of NTM EPS. Over the long-term, we expect RH to compound EPS at a ~20% clip as it generates 10%+ sales growth (driven by pricing power, the continued rollout of its domestic large gallery strategy, and its nascent international rollout), a 25-30% operating margin, and uses its free cash flow to opportunistically repurchase shares and make strategic acquisitions. We continue to believe that RH has the opportunity to move from a roughly $3.5B revenue business to greater than $20B as it establishes itself as the only scaled global luxury furniture brand. |
| *Disney* | [redacted] | *5%* | Disney had a year of solid fundamental progress in 2022 with its theme parks continuing to recover from COVID (Parks & Experiences revenue up an estimated 70%) and continued subscriber growth at its emerging direct-to-consumer streaming services (up an estimated 25%). As expected, Disney's cable networks continued their steady subscriber declines, with pricing increases keeping cable revenue and profits roughly flat. Total company revenue, operating profit, and EPS for the calendar year are estimated to have increased 19%, 39%, and 42%, respectively. However, sentiment turned substantially negative on Disney in the first half of 2022 when Netflix - a primary competitor and key valuation comp - reported a surprise decline in subscribers compared to expectations of healthy growth. This called into question the size and health of the DTC streaming market casting a pall on Netflix, Disney, and others in the space. Netflix stock was down 51% in 2022, and we think much of Disney's underperformance for the year can be attributed to this factor. Other negative surprises have included higher than expected FQ3 losses in DTC, and lower than expected FQ3 profit in theme parks, culminating in a sudden leadership change with long-time former CEO Bob Iger returning to the helm. However, not all recent surprises were negative, with Shanghai Disney reopening after a long Covid shutdown and recent movie release Avatar: The Way of Water surpassing $2B in box office sales (making it the #6 all-time grossing film) |

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| | | | giving hope to the post-COVID return of the theater business. By our math, the current stock price imbeds little value for Disney's DTC business, yet we believe that this business will prove to be large and enormously valuable. We believe DTC is a global scale business and we expect Disney and Netflix (and perhaps Amazon) to be the ultimate winners. Netflix already has 20% operating margins, and is on a trajectory toward 30% margins, so we have confidence that Disney, with more unique content, will ultimately achieve significant DTC profitability in time. Our sum-of-the-parts math (base case) implies a $190 share price for Disney in five years, providing roughly a doubling of value from today in one of the world's preeminent business franchises. |
| *Alphabet* | [redacted] | 10% | Emerging from COVID in 2021, Alphabet's revenue recovered more quickly than the company could hire to fill open roles. As a result, Google Services margin expanded unsustainably in 2021 to nearly 40%. This dynamic reversed in 2022 as revenue growth slowed but hiring remained elevated to backfill roles. This dynamic was further exacerbated by currency changes as most costs are in the U.S., whereas most revenue comes from outside the U.S. As a result, despite Google Services revenue growing 10% YoY for the first nine months of 2022, operating income was down slightly as margins compressed from 39% last year to 35% in 2022. We expect 2023 to be a year of modest revenue growth and cost control. Along with other technology companies, it appears Google has begun to drive efficiencies in its core operations as well as reduce spend on more speculative projects. This fall Google's courtroom battle with the DOJ will begin over its position as the default search engine on both Android and Apple devices. We do not believe a judgment against Google would jeopardize the search business given Google Search's position as the highest quality search engine as well as the cognitive default in the consumer's mind for discovering information. We expect the core search business to continue to grow revenue in the high-single-digit range over the next five years driven by continued growth of ecommerce/omnichannel shopping, continued improvements in vertical search categories, and innovation in the general search experience. Combined with the continued growth of less mature businesses such as YouTube and GCP, a net cash balance sheet, and a 7% free cash flow yield we expect Google to continue to compound its per-share value at a mid-teens or better rate |
| *App. Mat.* | [redacted] | 3% | 2022 was a year of fears being worse than reality for Applied Materials. Revenue was up 12%, EPS was up 13%, and the year ended with record order backlog. In addition, the company returned about 8% of its market cap to investors through share repurchases and dividends. However, this fundamental performance was not enough to overcome the market's concern about a looming downturn in the semiconductor cycle. So far, we have seen weakness in the memory portion of the semiconductor market. Micron, a memory focused chip manufacturer, reported fiscal first quarter revenue down almost 50% versus the prior year as its customers curtailed orders to work through high levels of inventory. This memory downturn is making its way through the supply chain to Applied and other equipment manufacturers since Micron has guided to a 50% reduction in capex. On the other hand, TSMC, the leading global logic manufacturer, has guided for 2023 capex to only be down about 7%. All told, 2023 will certainly be a down year, but to what extent is yet to be determined. We believe that in a typical industry downturn scenario where Applied's end markets contract by 30%, the company would still produce about $6.30 of cash earnings per share. That would put the stock at a very reasonable 17x trough earnings (up from 12x in October). Additionally, unlike other members of the semiconductor market, Applied will still produce substantial free cash flow and enjoys a pristine balance sheet – both of which it can deploy during the worst of the cycle. We expect the semiconductor industry to continue growing at a mid-single-digital rate per annum over the long-term and that equipment suppliers such as Applied should grow about 1.5x faster driven by increasing capital intensity in the manufacturing process. Combined with margin expansion and the ability to return 6-7% of capital annually, we expect Applied to compound earnings per share at a mid-teens or better rate over a full cycle. |
| *SS&C* | [redacted] | 4% | In 2022, SS&C was impacted by slowing revenue growth, labor cost pressure, and rising interest expense. In its GlobeOp business, market volatility pushed hedge fund redemption requests to a multi-year high resulting in flattish AuA and revenue for the year. Other key business units, including Alts, Eze, Intralinks, and ALPS all saw revenue growth slow sequentially in Q3'22 and likely Q4'22, leading to company-wide revenue growth of an estimated 4% for the year versus an initial expectation of high single-digits. EBITDA margin for 2022 is expected to contract about three percentage points to 37.6% due to labor cost inflation and the mix effect of adding Blue Prism which had negative EBITDA margin at the time of acquisition. Additionally, rising interest rates pushed up the borrowing cost on the company's revolver by several hundred basis points. Overall, EBITDA is on pace to decline 4% for the year and cash earnings per share about 7%. For 2023, we expect EBITDA and cash EPS to each grow about 7%. Management continues to work diligently to improve Blue Prism's margins and believes its integration into internal SS&C processes will result in substantial labor savings. Acquisitions (a key ingredient in SS&C's value creation formula) have remained hard to find, but rising debt cost and declining valuations have increased the chances of targets meeting the company's underwriting standards. Against this |

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| | | | backdrop, and the broader software industry sell off, SS&C has seen its valuation multiple contract from about 12.5x NTM EBITDA to about 9.5x. In response, the company will direct about half its free cash flow to share repurchases which are particularly attractive now with the stock at just 10.5x 2023 cash earnings. SS&C provides mission critical, utility-like software and services to its clients with high switching costs and low churn. We expect organic revenue growth to trough in 2023 then reaccelerate as new product introductions and pricing actions take hold. We also expect margin pressure to abate as wage inflation eases in the technology industry and Blue Prism begins to replace low value-add internal labor. Overall, we think SS&C is safe and cheap, with a high probability of 10%-plus compounding over the next five years, and a very good chance of mid-teens-plus compounding with the right acquisition(s). |
| *Ashtead* | [redacted] | 8% | Ashtead continued to produce stellar financial results in 2022, including revenue, EBITDA, and adjusted EPS up 28%, 26%, and 31% YoY in the most recently reported quarter. Despite the strong results, shares declined for the year as fears of a recession, and related decline in non-residential construction, increased. However, we believe these fears are based upon the market's backward-looking understanding of Ashtead and miss some critical considerations. First, and perhaps most important, Ashtead has significantly diversified its business since the last recession. Today, because of its push into specialty rental categories (e.g., Power and HVAC, Climate Control & Air Quality, Flooring Solutions), less than 45% of end market exposure is to construction related markets compared to 55% heading into the GFC. Second, this non-residential construction cycle is likely to be very different from the last one because (a) government funded programs (the Infrastructure, CHIPS, and Inflation Reduction Acts) should add nearly $150 billion of demand per year, on average, over the next five years, on the existing non-residential construction market base of $900 billion, and (b) there are an abundance of megaprojects (projects > $400 million in value) in the planning and pre-bid phases (including data centers, airports, LNG plants, and EV battery plants). These megaprojects are highly likely to move forward despite the current macroeconomic environment and represent about 30% of construction starts value today, more than double what they were pre-GFC. Finally, we observe that interest rates have risen for more than a year now, yet, despite that, the Dodge Momentum Index, which measures future projects in planning, is at its highest level ever. We believe these considerations, combined with Ashtead's continued steady market share gains, will power the business through a recession. We continue to expect Ashtead to compound its earnings per share at a mid-teens or higher rate per annum over the next decade as its market share increases from about 12% today to more than 20%. Trading at about 15x our estimate of NTM EPS, we believe that shares offer a compelling value. |
| *Am Wood* | [redacted] | 2% | American Woodmark's business had a good year, with 2022 sales up an estimated 10% and EPS up 35%. Much of this improvement was driven by successful price increases passed along to home center, builder, and dealer-distributor customers. EBITDA margins increased to about 10% from 9% in the prior year. Longer term we expect EBITDA margins to return to the low- to mid-teens, where they were for many years prior to the recent inflationary surge. However, industry demand is waning as new home construction (about 45% of end market demand) slows due to affordability issues. Remodeling activity (about 55% of end market demand) has slowed as well but we expect it to be more resilient than new home sales due to an aging housing stock, record high home equity, and consumers "locked-in" to their existing home due to ultra-low mortgage rates at their time of purchase. New home building permits are down 28% versus a year ago, and single-family building permits are pacing about 730,000 units per year now, well below the 1.1 to 1.2 million units needed to support population growth. American Woodmark earned an estimated $6 per share in 2022, and is expected to earn $6-plus in 2023 despite the demand slowdown (it also earned $6+ in 2018, 2019, and 2020). With the stock at $53, this is less than 9x 2023 EPS, equating to an 11% earnings yield on what should be near trough earnings. Normalizing housing starts and EBITDA margins would drive EPS to around $9, and we think company specific improvement initiatives should be additive from there. This business is cash generative and should repurchase significant shares outstanding over the next several years at what we believe to be bargain prices. |
| *Encore* | [redacted] | 5% | After a stellar 2021 (appreciating [redacted]), Encore gave up some of its prior year gain in 2022. In order to understand the forward opportunity for this countercyclical business, it is helpful to summarize the events of the last few years. In 2020/2021, the personal savings rate spiked as historic levels of government transfers boosted household income while consumer spending was severely curtailed by social distancing. As a result, Encore's cash collections benefited as many consumers used a portion of their excess savings to pay off debts. This dynamic had both positive and negative effects on Encore. In 2021, Encore's cash generation reached exceptional levels allowing the company to repurchase 23% of its shares outstanding while reducing its leverage ratio to the low end of its target range. At the same time, the credit card charge-off rate fell to half its long-term average level, reducing the supply of paper available to purchase. Heading into 2022, we thought the company was well positioned to take advantage of an eventual normalization |

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| | | | of the charge-off rate on credit cards loans. To our surprise, the build in delinquencies and eventual charge-offs has taken longer to develop because of accumulated consumer savings and low unemployment. The data is clear that Americans are now growing more reliant on credit cards amid inflation and depleted savings. We expect the charge-off rate to rise from 1.9% today to 3%-4% by year end 2023. With a limited number of buyers of freshly charged-off credit card paper and an influx of supply, prices of portfolios should decline over the coming years resulting in higher returns and earnings for Encore. Encore has one of the strongest balance sheets in its industry, low borrowing costs, and one of the most efficient collections platforms, so we think it is poised to deploy capital at excellent returns for the next several years. Shares trade at a very modest 7.5x our estimate of NTM owner EPS, despite earnings being suppressed at what we think is the bottom of the charge-off cycle. |
| *NVR* | [redacted] | 3% | After years of home price appreciation, a near doubling of mortgage rates in 2022 severely impacted housing affordability and buyer confidence. As a result, the pace of single-family new home sales has fallen 28% versus a year ago to 730,000 annualized units, well below the estimated 1.1 to 1.2 million units needed to accommodate population growth. We like the setup from here as homebuilders are an early cycle industry and we expect mortgage rates to ease as inflation subsides and spreads normalize. We have already seen some progress toward this with the latest 30-year mortgage rate at 6.15% compared to about 7.08% at the peak in November of 2022. Over a full housing cycle, we expect NVR to expand revenue about 7-12% per annum, composed of 5-10% organic unit growth and about 2% pricing growth. With a 35%-plus ROE, NVR should have significant free cash flow to direct toward share repurchases, pushing total earnings-per-share growth to about 13-16% per annum. We think housing production will begin to return to a normalized level in 2023, and that pricing in NVR's all-important Washington, D.C. metro market will not be down as much as feared. Shares trade for 10x TTM EPS and about 15x 2023 EPS (on what we think should be trough earnings), a premium multiple to other homebuilders, but more than fully justified, in our view, given the much better economics of its flexible and asset-light business model. |

**Portfolio weight as of 12/31/21.*

**Portfolio Changes**

During the fourth quarter, we established a new position in Cogent Communications at a 1% weighting, roughly doubled the Applied Materials position to about 4% of assets, and exited the Drive Shack position. We added further to the Cogent Communications position in early January bringing it to a 2% weighting in most accounts. We discuss these portfolio changes below.

<u>New Position: Cogent Communications</u>

Cogent Communications is a provider of fiber-based internet services to businesses. It provides two primary flavors of such service today: "direct internet access", and "transit".

Direct internet access connects businesses in large multi-tenant high-rise office buildings to the internet with enhanced speed, reliability, and security. Cogent, with its fiber-based network, typically competes in a building with one other fiber-based provider and the incumbent telco (AT&T, Verizon, etc.) that relies on copper-based technology. Cogent, unlike the competition, prewired these buildings enabling much faster install times (days instead of weeks or months) and lower marginal install cost. In addition, compared to the copper-based telco, Cogent's fiber can offer far faster data speeds (30-60x faster). This is a very steady business since customers have long-term office leases and rarely change their internet service provider. In this market, Cogent competes by charging a similar price as the competition but offering a far superior service. Cogent has about 15% customer penetration in its buildings, with a long history of steady share gains as tenants become aware of its value proposition.

The internet is a network of smaller networks, and if the smaller networks want to exchange data with one another they need to physically connect in some manner. Transit is a service providing that physical connection for the 5,000 or so smaller networks as well as the 4,000 or so largest content companies that need to deliver their content around the world. Cogent has established one of the most complete and efficient transit networks through opportunistic fiber acquisition and lease arrangements (IRUs). A low-cost position allows Cogent to go to market with a comparable service to others but with much lower pricing. This strategy has enabled Cogent to grow from 0% market share 15 years ago to about 15% revenue market share today (and about 24% volume share), with prospects for further gains ahead.

These are two good businesses that combine to make a great financial profile. From 2005 through 2019 Cogent's revenue compounded at 11% without a single down year, and EBITDA margins expanded from 8% to 34%. The pandemic has been a net negative for Cogent, with the direct internet access business hurt by an increase in office vacancy rates, partially offset by huge volume increases in transit with Zoom and DTC streaming video adoption. Overall, revenue growth decelerated to the low single digits the last three years with modest margin expansion. Over the next several years we expect a gradual recovery in direct internet access growth and deceleration in transit growth leading to combined company growth rising to the high single digits (below the long-term historical 11% rate).

We find these two existing businesses attractive, but they are not core to our thesis on Cogent. To understand the opportunity driving our interest, it is important to take a step back to understand Cogent's origin story. Dave Schaeffer, founder and CEO, built the company through opportunistic acquisition in the aftermath of the telecom bubble in the early 2000's. Dave made numerous acquisitions of distressed businesses and assets at that time. In total, he acquired about $14 billion of assets (at original cost) for only $60 million. In other words, Dave bought these assets for less than a penny on the dollar. However, since 2004, Cogent has not completed a single additional acquisition despite reviewing many prospects.

In September 2022, that story changed. Cogent announced it would be making its first acquisition in 18 years, acquiring Sprint's enormous wireline network for the princely sum of $1.00. Further, T-Mobile (parent company of Sprint) will pay Cogent $700 million over the next four years for taking this old Sprint asset off its hands. Why would T-Mobile pay Cogent nearly $700 million to take this asset? Because revenue has been in decline for twenty years and the asset is losing $280 million of EBITDA per year. This asset is strategically non-core, and T-Mobile is ill equipped to fix it on its own. Regulatory oversight and overlapping corporate customers make it impractical to shut the business down.

So, why does Cogent want this asset? In short, one man's trash is another man's treasure. On its own, the Sprint network is not valuable (indeed, it has negative value), but when combined with Cogent's existing network and other capabilities, it has the potential to create extraordinary value. This value creation will come from both cost and revenue synergies.

At the time the deal was announced, Sprint's wireline network sold 28 services, of which 24 were gross margin negative. Eliminating these 24 services will reduce revenue by $120 million, but also reduce EBITDA losses by $100 million. The remaining Sprint business will generate revenue of about $440 million with EBITDA losses of $180 million. This Sprint wireline network is predominantly long-distance fiber, requiring Sprint to lease 93% of its local fiber connections from third parties to provide service. Cogent's network has extensive local fiber with excess capacity. Migrating Sprint traffic off of third-party routes and onto Cogent's network will save $180 million in lease expense and bring the Sprint asset to near EBITDA breakeven. Further network rationalization and head count eliminations should save an additional $40-$50 million allowing Cogent to bring the Sprint network to about $45 million of positive EBITDA in three or four years.

However, the largest value creation lever comes from Cogent's ability to enter the North American wavelength services market. Wavelengths are a form of high capacity, point-to-point data transfer used by large corporations (Google, Amazon, Microsoft, Charter, Comcast, etc.) to move massive amounts of data between their data centers. On its own Sprint could not compete in this market because of its lack of local fiber and data center connections (Sprint is in only eight carrier neutral data centers). Cogent solves this problem by bringing a dense local fiber footprint and connections to over 800 carrier neutral data centers. Cogent on its own could not compete in the wavelength market due to its lack of long-distance fiber capacity. Sprint solves this by providing Cogent with 19,000 miles of long-distance fiber networks along unique pathways. Separately, neither company possessed the assets to compete in the wavelength market, but together they have the capabilities to be a substantial player.

Leaders in the wavelength market today include Lumen and Zayo, followed by dozens of competitors each with low market share. Similar to its transit business, to win market share Cogent will probably offer a comparable service to the market at a substantially reduced price. Additionally, Sprint's network was originally built along rail lines so it has many unique routes with no overlapping wavelength provider. These unique routes will be appealing to network engineers who seek redundancy in the event that one network pathway is cut – which happens surprisingly often.

Cogent is targeting 25% wavelength market share within about seven years of closing the Sprint deal. This would equate to about $500 million of incremental revenue. The marginal cost to provide this service is low, so the company expects incremental EBITDA margins exceeding 90%. This incremental $450 million-plus EBITDA from wavelength is an enormous opportunity compared to Cogent's $230 million base of EBITDA today.

Cogent is still led by its founder, Dave Shaeffer, who owns about 10% of the business. Big picture, we view an investment in Cogent as a way to partner with Dave, one of the most accomplished capital allocators we know of, as he embarks on perhaps his biggest acquisition ever. That is measured by network size and assets, and not the acquisition purchase price of $1.00! However, we have also conducted many channel checks with competitors, consultants, and former employees to validate the asset quality, cost synergy, and wavelength opportunity ourselves.

We think Cogent's established businesses of transit and direct internet access can earn about $480 million of EBITDA in 2030 compared to $230 million in 2022. Cost synergies from the Sprint wireline transaction should add an additional $45 million of run rate EBITDA by 2030. Lastly, we assume in our model that Cogent realizes about half of its revenue goal in the wavelength market, achieving 12% market share which translates into about $220 million of incremental EBITDA. Combining these three items, we believe Cogent can compound EBITDA at 16% from $230 million today to $750 million by 2030. With the addition of Cogent's roughly 6% dividend yield we believe we can earn a 20% annualized return, or better, from our purchase price.

<u>Other portfolio changes</u>

During the fourth quarter we also added to our position in Applied Materials, roughly doubling the position size from 2.3% to 3.9% of assets. As our understanding of the semiconductor industry has grown, we have strengthened our conviction in our Applied thesis. The market helped by presenting us an opportunity to add shares at a significant discount from our initial purchase price, and near historical trough valuation levels. Our Applied Materials purchase was largely funded with proceeds from our sale of Meta Platforms, Inc. in the third quarter.

We also fully exited our position in Drive Shack in the fourth quarter. Drive Shack was a "special situation" investment for us. It was a traditional deep value investment purchased in 2017 at a steep discount to our appraisal of liquidation value. Our thesis was that a new management team and new business plan would convert idle balance sheet assets into productive cash flowing assets with attractive economic returns. Unfortunately, management bungled opportunity after opportunity, depleting most of the balance sheet value in the process. Drive Shack was always a small position size (2.3% at cost), but it resulted in nearly a full loss. We pride ourselves on avoiding permanent losses of capital, and think we have a good track record on that account, but we got it wrong here.

The lessons learned from this investment are many, but perhaps the most important is to avoid marginal ideas. From the beginning, we recognized that the Drive Shack investment was unlikely to ever become a medium- or large-sized allocation because we viewed its management team and business model as average, at best. When the stock moved against us, and we did not have conviction to add to the position, it should have been a signal to cut our losses and exit entirely, despite the stock appearing very inexpensive. This is a learning we are increasingly trying to incorporate into our decision making and recently applied with the exit of our Meta position in the third quarter of 2022 (discussed in our third quarter letter).

**Portfolio Earnings Update**

As we have discussed before, investment returns for equities can be broken down into three factors: growth in earnings, dividends, and change in valuation. In the short term, change in valuation can have a meaningful impact on investment results, but in the long term, change in valuation becomes much less important as growth in earnings and dividends accumulate to drive the majority of results.

For this reason, as long-term investors, our analytical focus is on trying to understand a business's future earnings and dividends. We track how these metrics develop at each business we own, in aggregate across all the businesses we own, and at the portfolio level taking into account the impact of cash. This analysis helps us understand how these businesses are performing by providing a measure of progress independent of the vicissitudes of the stock market. At the end of each year, we report a summary of this information to give you additional perspective on your investment with us.

Please note, in this letter when we refer to "earnings" or "EPS" for our businesses, we mean earnings on a per-share basis, adjusted for certain items. We make these adjustments to arrive at what we believe to be a better measure of the true economic earnings of the businesses.

## 2022 Business Results

In 2022 our businesses faced headwinds posed by inflation, rising interest rates, and declining affordability. In aggregate, we estimate they grew EPS 0.3% and paid a 0.6% dividend. The broader market is estimated to have done modestly better with 3.3% EPS growth and a 1.6% dividend for the S&P Total Market Index.

| | 2022 EPS Growth | | 2022 Dividend Yield | | EPS Growth + Dividend Yield |
|---|---|---|---|---|---|
| Our Businesses | 0.3% | + | 0.6% | = | 0.9% |
| S&P Total Market Index | 3.3% | + | 1.6% | = | 4.9% |

*Consensus FactSet operating EPS except for Markel (BV/shr), Brookfield (Broad Run estimates), and American Tower (AFFO). Results for the most recent year are preliminary, subject to adjustment as annual reporting is finalized.

As a reminder, we underwrite our investments to target a mid-teens rate of return. We seek this return via the compounding of earnings per share over time rather than a change in valuation or clever trading in or out of a stock. As a result, our long-term portfolio performance is primarily driven by the earnings per share growth of the underlying businesses that we own[4]. You can see this relationship in the table below. Over the last thirteen years, our portfolio level earnings per share CAGR is 13.4%, inclusive of dividends and cash drag [column C], compared to a realized total return of [redacted], gross of fees [column D]. Please note that there is a loose relationship between earnings power and price performance in any given year, but that relationship strengthens considerably over longer periods of time.

| | **Focus Equity Separate Accounts** | | | | | **S&P Total Market Index** | |
|---|---|---|---|---|---|---|---|
| | A | B | C | D | E | F | G |
| Year | Business Level EPS Growth + Dividend Yield* | Impact of Cash Balance | Portfolio Level EPS Growth + Dividend Yield* | Total Return Gross of Fees | Total Return Net of 1% Fee | EPS Growth + Dividend Yield | Total Return |
| 2010 | 25% | -0.8% | 24% | [redacted] | [redacted] | 42% | 17% |
| 2011 | 16% | -1.0% | 15% | [redacted] | [redacted] | 15% | 1% |
| 2012 | 16% | -1.5% | 15% | [redacted] | [redacted] | 9% | 16% |
| 2013 | 16% | -1.0% | 15% | [redacted] | [redacted] | 8% | 33% |
| 2014 | 17% | -0.7% | 17% | [redacted] | [redacted] | 9% | 12% |
| 2015 | 11% | -0.3% | 11% | [redacted] | [redacted] | -2% | 0% |
| 2016 | 4% | -0.2% | 3% | [redacted] | [redacted] | 3% | 13% |
| 2017 | 13% | -0.5% | 12% | [redacted] | [redacted] | 14% | 21% |
| 2018 | 20% | -0.5% | 20% | [redacted] | [redacted] | 24% | -5% |
| 2019 | 13% | -0.2% | 13% | [redacted] | [redacted] | 1% | 31% |
| 2020 | 1% | 0.0% | 1% | [redacted] | [redacted] | -15% | 21% |
| 2021 | 33% | -0.4% | 32% | [redacted] | [redacted] | 55% | 26% |
| 2022 | 1% | 0.0% | 1% | [redacted] | [redacted] | 5% | -20% |
| Cumulative: | 447% | | 415% | [redacted] | [redacted] | 321% | 329% |
| Annualized: | 14.0% | | 13.4% | [redacted] | [redacted] | 11.7% | 11.9% |

** For the Focus Equity Separate Accounts, EPS growth is a Broad Run estimate based upon reported results for the first three quarters of the most recent year and projections for the final quarter. For prior years, EPS growth has been updated to reflect actual reported results for the year. May not sum due to rounding.*

## Investment Outlook

As we stated earlier, some of our businesses are suffering from a slowdown in demand and/or rising costs. We believe that most of these headwinds will prove temporary due to the advantaged competitive positions of the businesses we own

[4] This is axiomatic, if there is no change in valuation and no dividends, stock performance will match the change in earnings per share. While earnings per share growth is not particularly useful to measuring progress at many types of investment strategies - for example, a high valuation-high growth strategy, a slow/no growth-deep value strategy, or a high turnover strategy - it is instructive for our type of strategy.

and the enduring nature of the products and services they offer. 2022 was a year of below target earnings growth for our portfolio, and 2023 is shaping up to be subdued as well. We forecast a 6% rate of earnings growth in 2023 (7% inclusive of dividends) for our portfolio, which is roughly in line with consensus forecasts for the broader market. We expect 2023 to be a year of adjustment, and potentially recession, for the economy as consumers and businesses acclimate to higher inflation and interest rates. We believe that the fundamentals for our businesses will strengthen and move back toward our mid-teens expected compounding in the intermediate term after this period of economic adjustment.

At year end, our portfolio valuation of 15.2x our 2023 earnings estimates (compared to 17.0x for the broader market), is at or below where it has been over most of the last 13 years reflecting the macroeconomic uncertainty and expectations for subdued near-term growth. From this valuation level we expect portfolio returns will meet or exceed the rate of earnings growth produced by our portfolio over the next five years.

**Focus Equity Separate Accounts - Beginning of Year Projection**

| Beginning of Year | Business Level Price to 1yr EPS Est.* | Business Level 1yr Est. EPS Growth Rate* | Business Level 5yr Est. EPS Growth Rate* |
|---|---|---|---|
| 2010 | 14.9x | 20% | mid-teens |
| 2011 | 15.4x | 16% | mid-teens |
| 2012 | 14.1x | 16% | mid-teens |
| 2013 | 15.5x | 17% | mid-teens |
| 2014 | 17.9x | 17% | mid-teens |
| 2015 | 17.0x | 17% | mid-teens |
| 2016 | 16.6x | 18% | mid-teens |
| 2017 | 16.1x | 14% | mid-teens |
| 2018 | 16.4x | 24% | mid-teens |
| 2019 | 15.2x | 14% | mid-teens |
| 2020 | 18.3x | 13% | mid-teens |
| 2021 | 19.3x | 12% | mid-teens |
| 2022 | 20.6x | 15% | mid-teens |
| 2023 | 15.2x | 6% | mid-teens |

* *Based upon Broad Run internal estimates (may differ materially from consensus estimates), weighted by position size, excluding the impact of any portfolio level cash.*

Conclusion

We thank you for entrusting your capital to us. We will continue to do our best to protect and grow your investment over time.

Please let us know if there have been any changes to your financial circumstances or investment objectives that might impact how we manage your account, let us know if your contact information changes, and let us know if you would like to add or modify any reasonable restrictions to our investment advisory services.

Sincerely,

Broad Run Investment Management, LLC

April 24, 2023

**Focus Equity Client Letter**
Q1 - 2023

For the quarter ended March 31, 2023, Broad Run's Focus Equity Separate Accounts[1] returned [redacted] net of fees[2] compared to 7.2% for the S&P Total Market Index[3]. The performance for your account will differ somewhat from these reported results due to variations in holdings and other client-specific circumstances. We remind you that we manage your account for long-term results, so we encourage you to evaluate its performance over a multi-year time frame. Long-term performance is presented at the end of this letter.

## Commentary

Leading economic news in the first quarter included the dramatic collapse of Silicon Valley Bank and Signature Bank, and the fire sale of Credit Suisse. While these banks took the ignoble headlines, their struggles drew attention to the broader stresses in the banking system caused by the rapid rise in interest rates over the last year and a half.

Financials compose about 30% of our portfolio, but we do not own any banks or have any direct exposure to this banking crisis. Our businesses categorized as financials include Aon (an insurance broker), Brookfield (an investment manager), Markel (a specialty insurer), and Encore (a debt collector). They are highly differentiated from each other in both their business models and our investment theses, and are not exposed to the same asset-liability duration mismatch as the banking industry. They each have varying sensitivity to the credit cycle and capital markets, but nothing so tied to the banks that it warrants a callout in this letter.

Surveying our broader portfolio, there is just one business that stands out as likely impacted by this banking crisis – Ashtead Group (about 9% of assets in most accounts). Roughly 40% of Ashtead's revenue comes from renting equipment to contractors working on non-residential construction projects. Banks are the primary lenders for these projects, so future projects (those that are a year or two out from breaking ground, given construction lead times) are at risk if bank lending is more restrictive. Reflecting on the state of the credit environment, we have tempered our expectations for non-residential construction activity in 2024 and 2025, and modified our expectations for Ashtead accordingly.

Non-residential construction is cyclical. In isolation, we would expect higher interest rates and tighter credit conditions to trigger a normal non-residential construction recession. However, we have recently experienced abnormal government largess; the CARES Act, the CHIPS Act, and the Inflation Reduction Act are rolling out and will provide a major tailwind to non-residential construction over the remainder of the decade. In addition, entirely new categories of demand have emerged with post-COVID supply chain nearshoring projects and large-scale long-duration decarbonization projects (such as EV battery plants, solar and wind farms, and transmission lines) providing a boost that may be enough to avoid a non-residential construction contraction.

Ashtead is a business firing on all cylinders. In its most recently reported quarter (announced March 7th) it reported revenue up 23% and EPS up 30%, and raised guidance for its fiscal year. Over the last five years, Ashtead has posted annualized revenue growth and EPS growth of about 14% and 17%, respectively. This compares to annualized non-residential construction industry growth of about 5% over the same time period. Ashtead is outgrowing the non-residential construction industry—powered by a secular share shift from equipment ownership to equipment rental, same-store market share gains, new store openings, tuck-in acquisitions, rising rental prices, and product expansion into specialty categories.

[1] See the end of this letter for historical performance and important disclosures.

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

[3] S&P Total Market Index is a broad market index that includes 4,272 large, mid, and small cap U.S. equities (@12/31/22).

With these numerous revenue drivers, our expectation is that Ashtead could grow through a mild or even moderate non-residential construction recession. In a severe downturn, which we do not expect, Ashtead would likely see a temporary decline in sales and earnings. However, with the best balance sheet, business model, and management team in the industry, we would also expect to see a period of supercharged market share gains as the company outcompetes and acquires distressed competitors as it did in the GFC.

Looking at the bigger picture, Ashtead remains one of our highest conviction long-term investments. From about 12% market share today, we are confident the company will reach 25%-plus market share over time by simply continuing to use the same strategy it has successfully employed over the last decade. With a highly fragmented industry, clear scale advantages, superior service offering, and 30% mid-cycle ROE, we expect Ashtead's EPS to compound at a high-teens rate over the next decade, or longer.

Ashtead's stock is down about 20% since the banks took over the headlines in March. The recent developments in the banking industry and the resulting tighter credit environment are incremental negatives for the company in the short- to intermediate-term. But with our long-term investment horizon, this is just one of those unavoidable bumps along the road in the value creation journey. We think that the recent stock price decline more than compensates for the risk of a downturn. From today's modest starting valuation of 13.4x NTM price-earnings (6.9x NTM EV/EBITDA), we expect a 15-20% rate of compounding in our investment over the next decade, inclusive of an industry downturn or two along the way.

*Cogent Communications*

During the quarter we again added to our Cogent position, increasing it to about 3% of assets. Since our last update in our Q4'22 client letter, published in late January, we have continued to follow Cogent closely and deepen our understanding of the business. Our recent research has included additional conversations with management, participation in recent company conference presentations, speaking with more current and former Cogent customers, and speaking with another buy-side investor knowledgeable about the business.

New revelations and learnings have been almost universally positive, including:

- The Sprint acquisition is on pace to close in Q2'23 rather than Q4'23, nearly 6 months ahead of our initial expectations.
- Wavelength sales have already begun under a licensing arrangement with T-Mobile/Sprint. While not financially material, this early start will enable Cogent's sales force to build familiarity with the offering and generate some early bookings prior to the closing of the transaction.
- The company now believes that it can get the legacy Sprint corporate business up to a 20% EBITDA margin over time, rather than the 10% margin target management initially shared.
- We believe dark fiber is likely to be a $50M-plus run-rate revenue business in several years' time, at 90%-plus gross margins. In addition, we believe Sprint data center assets can eventually be ramped to about $30 million of revenue and $15 million of EBITDA. Neither of these opportunities was explicitly included in our original underwriting.

We have updated our model to reflect these developments, which has increased our expected IRRs and increased our conviction in a favorable long-term investment outcome.

*Allegiant Travel*

Finally, we sold the entirety of our Allegiant Travel position during the quarter to help fund the additional purchase of Cogent. In most accounts, Allegiant was about a 1% weighting.

We purchased Allegiant in the summer of 2020 in the midst of the pandemic lockdowns. Our thesis was that Allegiant was a fundamentally good airline business that would recover quickly as vaccines became widely available and leisure travel rebounded. In addition, we believed there was attractive growth opportunity beyond the rebound as Allegiant continued to roll out its high return business model to additional U.S. markets.

While we were generally right about the rebound in leisure air travel, we failed to anticipate that a slow rebound in business travel would leave other airlines with excess capacity that would be directed to the leisure market, creating oversupply. In addition, the unanticipated surge in inflation beginning in 2021 made it hard to raise prices without destroying demand from Allegiant's price-sensitive customers. Earnings never rebounded to the extent we expected, and with significant additional inflationary costs on the horizon (new union contracts), we determined that we had better, higher conviction uses for this investment capital.

Conclusion

We thank you for entrusting your capital to us. We will continue to do our best to protect and grow your investment over time.

Please let us know if there have been any changes to your financial circumstances or investment objectives that might impact how we manage your account, let us know if your contact information changes, and let us know if you would like to add or modify any reasonable restrictions to our investment advisory services.

Sincerely,

Broad Run Investment Management, LLC

July 21, 2023

**Focus Equity Client Letter**
Q2 - 2023

For the quarter ended June 30, 2023, Broad Run's Focus Equity Separate Accounts[1] returned [redacted] net of fees[2] compared to 8.4% for the S&P Total Market Index[3]. Year to date, the Focus Equity Separate Accounts returned [redacted] net of fees compared to 16.2% for the S&P Total Market Index. The performance for your account will differ somewhat from these reported results due to variations in holdings and other client-specific circumstances. We remind you that we manage your account for long-term results, so we encourage you to evaluate its performance over a multi-year time frame. Long-term performance is presented at the end of this letter.

**Commentary**

The stock market continued to climb a 'wall of worry' in the second quarter, with the recession – long-anticipated by the market – yet to materialize. Despite lingering inflation, a rapid rise in interest rates, and some quantitative tightening, the job market and consumer spending remain healthy. The strong first-half performance of the information technology and consumer cyclical sectors, and flattish performance of the utilities, consumer staples, and health care sectors, reflect the market's revised view that the economy is now on track for a soft landing.

Recall, it was our big-ticket consumer discretionary and cyclical growth stocks that suffered the most last year. While higher interest rates and post-COVID spending trends had some negative impact on these businesses, the quotational markdowns were, in our view, reflecting expectations of a forthcoming hard economic landing and severe deterioration in fundamentals.

This year, and especially in the second quarter, we saw a positive inflection in fundamentals at some of these businesses, and a related change in investment sentiment. Last year's laggards have become this year's leaders, with CarMax up [redacted], RH up [redacted], Alphabet up [redacted], Applied Materials up [redacted], American Woodmark up [redacted], and NVR up [redacted], as of quarter end. These recent price moves closed some of the discount to our estimate of intrinsic value, but we believe there remains much more opportunity ahead.

Surveying the portfolio more broadly, at the beginning of the year we forecast a 6% increase in earnings for 2023. At the half-way point, we believe this forecast remains largely on target, and compares to a low single digit consensus growth estimate for the S&P Total Market Index. While this year's 6% is below the mid-teens rate of compounding we underwrite to (over a five-year horizon), we expect a reacceleration in 2024 as these businesses adjust to higher interest rates and the new operating environment.

We like the portfolio we own, and took no investment actions in the second quarter. With no new positions to review, we will use the balance of this letter to update you on Alphabet Inc. (formerly Google Inc.), a large and longtime holding that we have not discussed in depth in many years. We first purchased Alphabet in the Focus Equity Strategy in 2011, and since that time it has compounded revenue and EPS at 20% and 18%, respectively.

*Alphabet Inc.*

Our current thesis on Alphabet (we will refer to Alphabet and Google interchangeably from here on) is underpinned by three drivers: continued growth in digital advertising, growing profit contribution from Google's cloud business, and capital returns via share repurchases.

[1] See the end of this letter for historical performance and important disclosures.

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

[3] S&P Total Market Index is a broad market index that includes 4,272 large, mid, and small cap U.S. equities (@12/31/22).

Digital advertising has seen tremendous growth over the last decade. Much of this growth has come from Google's own advertising properties: Search, YouTube, and the Google Network. Combined, these three businesses generated over $220 billion of advertising revenue in 2022 compared to a $770 billion, traditionally defined, global advertising market. Many observers see Alphabet's current market share and assume that its ad businesses must be running out of growth opportunity. But we believe this view is too simplistic, missing how structural changes in customer discovery benefit Alphabet and grow the entire advertising pie.

Historically, a business's physical store served as a place for customers to browse and transact, but also as a means to build awareness and foot traffic. In an increasingly digital world, where many consumers start their journey online, building awareness and traffic requires advertising rather than paying rent. This has been cleverly summed up by an industry saying: "CAC is the new rent".

Although this phenomenon impacts all businesses, it is most striking when viewing ecommerce native companies. Compared to their traditional peers, ecommerce native companies spend 3-5x more on advertising per dollar of revenue. Instead of paying rent to inform consumers of their presence, these companies spend money on digital advertising. Google's properties, especially Search, are unavoidable tolls that businesses must pay to attract customers.

We believe continued growth in ecommerce, omnichannel shopping, and online discovery of product and service businesses will support high-single digit to low-teens revenue growth across Google's advertising properties. Incremental advertising margins are very high, but Alphabet will likely reinvest this margin in innovation (such as AI) to drive sustained growth, with overall ad division profits slightly outpacing revenue growth.

Second, Google's cloud business turned profitable in the first quarter of 2023 with a revenue run rate of $30 billion, growing 28% year over year. Since 2020, Google's cloud business has transformed its negative 43% operating margin to a slightly positive margin while doubling its revenue. Google's cloud business should continue to see strong revenue and profit growth driven by the increasing movement of IT spend to the cloud and Google's expertise in AI related workloads. Using Amazon's AWS cloud business as a guide, we believe Google's cloud business will contribute about 10% of Alphabet profits in five years, and a growing percentage beyond that.

Finally, Google has begun to use its substantial free cash flow generation for capital returns via share repurchases. From 2012 to 2021, Google's cash on its balance sheet ballooned from $40 billion to $140 billion. Starting in 2021 and accelerating throughout 2022, Google has begun to use 100% of free cash flow on share repurchases. This situation is somewhat reminiscent of Apple a decade ago. Up until 2013, Apple had retained the tremendous cash it had generated on its balance sheet. At the end of 2013, Apple had net cash and securities of $140 billion. Starting in 2014, Apple began a share repurchase program and retired nearly 40% of its shares over the next decade, helping Apple compound EPS at 18% over that time period. Going forward, we believe Google will employ a similar strategy and retire about 4-5% of its shares per annum. Combined with 10-13% earnings growth from continued advertising and cloud growth, we think the company is positioned to compound EPS at a mid- to high-teens rate for many years to come.

Google, like all the mega cap tech companies, receives a fair amount of scrutiny in the press. Lately, media attention (and analyst attention!) has been focused on two areas: regulation / antitrust and the evolution of AI and LLM (large language models). We discuss these topics below.

Google has been the subject of three recent antitrust / regulatory cases (two ongoing and one concluded for now): Section 230, the Google Network, and Google's position as the default search engine on Apple and Android devices.

The first of the three, Section 230, was resolved in May. Section 230 has its origins in the Telecommunications Act of 1996 and has served as the legal underpinning of the internet ever since. In essence, Section 230 says internet platforms are not liable for what third parties post on their sites. This could include videos on YouTube, posts on Facebook, or photos on Instagram. In May, the Supreme Court declined to consider the application of Section 230 in the case brought against Alphabet, effectively drawing this matter to a close.

In January of this year the DOJ filed an antitrust suit against Google alleging that its ad tech business, the Google Network, is an abusive monopoly in the ad tech ecosystem. Without getting into the complexities of how this market works (the DOJ complaint was 150 pages), we think that Google has a strong defense. First, advertisers, the lynchpin of

Google's strength in the ad tech ecosystem, are not forced to use Google's service, but freely choose to do so because of the convenience of buying Search, YouTube, and third-party ads all in one place. There are no lock-in or exclusive agreements. Second, Google's strength is partially the result of its acquisition of DoubleClick for Publishers. This acquisition took place 16 years ago and was reviewed and approved by the FTC at the time. We think both of these facts will make it difficult for the DOJ to win this case. If Alphabet were to lose and be forced to modify or sell parts of its ad tech business, the financial impact should be modest; the Google Network is about 10% of the company's revenue and an even lower share of profits.

The final case against Alphabet regards Google's use of exclusive agreements with Apple, and other manufacturers, to be the default search engine on their devices. Google is paying Apple (an estimated $15-$20 billion this year alone) to be the default search engine in its Safari mobile web browser. The vast majority of other device manufacturers are licensing Google's Android mobile operating system rather than developing their own systems internally. In exchange for use of Android, these manufacturers agree to pre-install Google as the default search engine on their phones.

Starting with Apple, most legal analysts do not think Google is in violation of current U.S. antitrust law. Violating this law requires three conditions to be met: market dominance, damage to competition, and a reduction in consumer welfare. It is difficult to conclude that Google has reduced consumer welfare in any way as a result of its payments to Apple. Additionally, Apple customers can easily download any other search engine they want for free; as Google co-founder Larry Page says, "competition is a click away". Lastly, Google won the default position in Safari through a competitive bidding process, which is how open markets work. We think Google has a strong legal defense, and substantial mitigants if it were to lose. In a loss, Google would save the tens of billions it pays to Apple annually, and due to a superior product and brand, we think a substantial percent of Apple users would elect to use Google's search engine even though it was not the default option. We believe the net financial impact would be slightly negative, and perhaps even neutral.

Regarding Android, we think Google has a weaker case. Google already lost a similar case in Europe over this exact issue. However, we think the outcome either way will be neutral for Google. In Europe, the EU required Google to offer a choice screen for the default search engine on Android devices. This requirement had no impact on Google's market share in Europe as quality of product and brand has resulted in consumers choosing Google the vast majority of the time. We would expect a similar outcome with U.S. users.

The final issue we want to discuss is the advent of AI and LLM. When ChatGPT launched last November, and joined forces with Microsoft's Bing in January, there was much concern over whether Google's dominant position in Search was under threat. We think Google has a leadership position in AI built on almost a decade of research and use of AI in its products. Google began to highlight this capability at its developer conference in May. There, Google demonstrated its history of deploying AI in its offerings and laid out a roadmap for how AI will improve its family of services across Search, Maps, advertising, and elsewhere. We can also see Google's commitment in other actions it has taken including the combination of its two leading AI research labs, DeepMind and Google Brain, into one entity and the movement of these costs into its corporate segment - an indication that the money spent on AI will be widely applicable to all of Google's services.

For two decades Google has been the best place to find and discover information. We believe Google's existing competitive advantages – its brand, distribution, and data – will enable it to use AI to improve and enhance its products - especially Search. We believe the advent of LLMs will enable Search to evolve from a place to discover information to a place where information is discovered, synthesized, and action is taken. Today, Search can surface relevant information that its users are looking for. In the future, Search will not only be able to find information but also be able to tailor it to the needs of the individual user, given the vast trove of data it has and will continue to accumulate. Further, we imagine that in the future Search will be able to take actions on behalf of the user: such as making reservations and appointments, creating itineraries, and booking flights. Ultimately, we believe AI will be a net positive to Alphabet's product quality, competitive differentiation, and economics.

We view Alphabet as a dominant business that is positioned to provide more value to users while continuing to compound EPS at a mid- to high-teens rate over time driven by the opportunities outlined above. We are happy to own this business at about a market multiple of earnings, a bargain in our view for a business with this quality and growth profile.

Conclusion

We thank you for entrusting your capital to us. We will continue to do our best to protect and grow your investment over time.

Please let us know if there have been any changes to your financial circumstances or investment objectives that might impact how we manage your account, let us know if your contact information changes, and let us know if you would like to add or modify any reasonable restrictions to our investment advisory services.

Sincerely,

Broad Run Investment Management, LLC

October 23, 2023

**Focus Equity Client Letter**
Q3 - 2023

For the quarter ended September 30, 2023, Broad Run's Focus Equity Separate Accounts[1] returned -5.0% (and Broad Run's Focus Equity Composite returned -5.7%) net of fees[2] compared to -3.3% for the S&P Total Market Index[3]. Year to date, the Focus Equity Separate Accounts returned 10.9% (and the Focus Equity Composite returned 8.8%) net of fees compared to 12.4% for the S&P Total Market Index. The performance for your account will differ somewhat from these reported results due to variations in holdings and other client-specific circumstances. We remind you that we manage your account for long-term results, so we encourage you to evaluate its performance over a multi-year time frame. Long-term performance is presented at the end of this letter.

## Commentary

The stock market gave back some of its robust first half gains in the third quarter. A nearly 100 basis point rise in long-term interest rates caught most by surprise and added to growing concern about a slowing economy. While the consensus forecast is that the U.S. will avoid a recession, this outcome remains uncertain. We are yet to see the full impact of the higher interest rate environment, and rising geopolitical tensions pose an additional threat to the global economy.

In our view, the recent rise in long-term interest rates makes it likely that the Federal Reserve is approaching the end of its nearly 18-month long rate hiking cycle. While headline inflation remains above the Fed's target, alternative data taking a more forward-looking view suggests inflation is trending down on a glidepath back to its desired level.

Within our portfolio, our cyclical and financially levered stocks underperformed in the third quarter reflecting the macroeconomic climate. Near-term fundamentals at these businesses remain mixed, but their valuations are compelling and their long-term prospects are unchanged. In response to this uncertainty, we remain focused, as always, on owning a portfolio of durable compounders with a good margin of safety.

## Portfolio Changes

During and shortly after the quarter we established a new position in Altus Group Ltd. at a 1% weighting, and fully exited our 3% position in SS&C Technologies in separate accounts. We discuss these portfolio changes below. We also increased Cogent Communications from a 3% weight to 6% since evidence continues to build that its recent acquisition will enable significant value creation. Finally, we trimmed our Alphabet position modestly because it had appreciated above our target weighting.

New Position: Altus Group Ltd.

We are admirers of software and information services business models, but have generally found such opportunities too richly valued to own over the past several years. However, in Altus Group, we believe we have found such a business – with recurring revenue, monopolistic market positioning, high customer retention, and significant growth potential – at a reasonable multiple of current cash earnings.

[1] Returns presented for the Focus Equity Separate Accounts are the aggregate returns of all of the separate account portfolios in the Focus Equity Composite, which excludes any equity mutual fund(s), UCITS fund(s), and private fund(s). Broad Run believes this information is most relevant to institutional separate account investors in the Focus Equity Strategy; this information is supplemental to the GIPS® Composite Report provided on page 8 of this document. See the end of this letter for historical performance and important disclosures.

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

[3] S&P Total Market Index is a broad market index that includes 4,272 large, mid, and small cap U.S. equities (@12/31/22).

Altus Group is a provider of a portfolio of software and services to the commercial real estate (CRE) market in Canada, the U.S. the U.K., France, Germany, and Australia. Altus's solutions are primarily focused on property valuation for the purposes of tax appeals, investment underwriting, transaction facilitation, investor reporting, insurance claims, and litigation.

Altus Group was created in 2005 through the merger of three leading Canadian property tax appeals consultants. Over the next six years Altus focused on growing its share of the tax consulting market before making an important pivot in 2011 with the acquisition of Argus. Argus was then, and is still today, the leading software used by institutional CRE owners to model and value commercial properties. Since that pivot, Altus has made several acquisitions of CRE-related software businesses and today revenue is split about evenly between software and services.

*Services - Property Tax Appeals*

Altus's original business of property tax appeals is a high-quality, cash generative business contributing about 35% of overall revenue.

Property taxes are one of the largest expenses for CRE owners, so contesting tax authority assessments is a common practice with an attractive ROI. In fact, the industry tends to be counter-cyclical with revenue increasing in more difficult times when tax authorities are slow to recognize decreases in property values. Revenue is primarily earned on a contingency basis where Altus receives a percentage of the tax savings achieved on behalf of clients.

Altus is often the largest, or one of the largest providers of tax appeal services in its markets. Its market share in Canada, the U.K., and the U.S. is about 60%, 25%, and 7%, respectively, providing credibility, and unmatched data and resources. Customer relationships tend to be sticky; once Altus is familiar with a client's property portfolio and successfully delivers savings, it becomes difficult to displace.

This business has a solid financial profile with modest growth and 30%-plus EBITDA margins. We expect this business to grow revenue organically at a 3-5% rate with possible revenue and margin upside from the introduction of more technology enabled services.

*Services - Property Appraisal & Development Consulting*

Altus also provides property appraisal and development consulting services, composing about 15% of overall company revenue.

Clients come to Altus for valuation appraisals used in investor NAV calculations, litigation support, and general due diligence. Similar to the property tax appeals business, engagements tend to be recurring and relationships sticky based upon trust and historical familiarity with client properties. In development consulting, Altus primarily provides feasibility studies for new CRE construction.

This business is the lowest margin segment at Altus, but it is capital light and provides a further touchpoint for Altus across its client base. We expect this business to continue growing revenue in line with its historical 3-5% rate and to maintain EBITDA margins in the mid-teens.

*Software & Analytics*

Altus's largest business, composing about 50% of revenue, provides CRE software and analytics on a subscription basis.

As mentioned above, the core of this business is Argus, which was acquired in 2011. Argus is the de facto standard modeling and valuation tool used in the CRE industry in North America and parts of Europe. Argus software is used to model and value CRE properties in great detail including hundreds or even thousands of property specific data points.

Argus's dominant position is the result of high switching costs and network effects. Many Argus users spend the majority of their day inside of the software modeling and analyzing properties they are looking to buy, optimize, or sell. There are few substitute products, and to switch to them would be very disruptive to employee productivity.

Most CRE owners are regularly buying and selling properties to optimize their portfolio and generate returns. There are typically many constituents involved in a CRE transaction including the seller, buyer, brokers, advisors, and banks. Throughout the transaction process, these parties are exchanging Argus models with one another. If one party attempted to use a different software it would throw sand in the gears of the transaction, forcing parties to convert files back and forth with the risk of delay, data loss, and human error. In many cases using an alternative software is not even an option since Argus is contractually specified for use in the transaction.

Argus models are essentially "the language" that CRE industry participants speak. It is taught in over 200 universities, is reinforced through daily use, and is the basis of trade in high stakes transactions. These strong competitive advantages are evident in Argus's gross retention rate, which is in the mid-to-high 90 percent range. When customers do churn, in the majority of cases it is because they were acquired or went out of business.

*New Management with a New Vision for Software & Analytics*

Argus has been the dominant CRE valuation tool for several decades, and it had grown nicely along the way. But prior leadership of the company came from the tax consulting business, so it was slow to begin the transition of Argus to the cloud, and its various other CRE software acquisitions were never fully integrated.

In 2020, the Board brought in a new management team with a track record of success in directly applicable software / data / analytics businesses. That new team, consisting of Jim Hannon as CEO, Jorge Blanco as CPO, Ernie Clark as CMO, and Dave Ross as CTO, had worked together at companies including FICO and Callcredit. In Argus they saw an excellent business that was not realizing its full potential. By applying their playbook from prior experience, they saw an opportunity for significant improvement and value creation.

Since taking over, management has continued the transition to the cloud and introduced numerous other actions to improve the products, reorient the go-to-market strategy, refine pricing, and open up new growth opportunities. Argus, and the other CRE software products, are now integrated in logical solution sets based upon customer needs rather than siloed offerings with independent sales teams. Financial results and market feedback have been very good so far, and Argus remains in the early innings of harvesting the benefits of this transformation.

One of the biggest opportunities for growth and value creation will come from introducing proprietary CRE data and analytics tools. A key benefit of moving to the cloud is that Argus now has visibility into its customers' CRE valuation models. Historically that information was stored locally at the customer premises. Using a "give to get" business model, Argus customers agree to contribute their proprietary data from their existing models into an anonymized central database in exchange - for a fee - for access to the datasets and analytics tools Argus creates from that database. Argus now has access to detailed data on nearly one million unique commercial properties, enabling insights heretofore unavailable to the industry. Key use cases include performance benchmarking and predictive analytics to understand future asset performance and acquisition / improvement / divestment opportunities.

Argus is bringing "big data" to the CRE industry, with the potential to add alpha for users, which would be tremendously valuable. The first of these products is just now rolling out so we do not yet know how commercially successful the offerings will be, but one of management's core theses in coming into Altus was that such solutions could be transformative for the business.

We believe Argus can grow its revenue at a high-single-digit to low double-digit rate over the next five-to-ten years. We believe the low end of this range is attainable even if new data and analytics offerings receive a tepid response. Further, Argus has roughly 20% EBITDA margins today, well below the 35-40% margins typically seen at scaled leading software and analytics businesses. With very high incremental margins, we expect high-single-digit revenue growth to drive EBITDA margins in the high 30% range over a five-to-ten-year horizon. In total, we are projecting mid-teens or higher EBITDA growth at this segment.

When we blend Argus with the slower growth services businesses, we believe the overall company will grow revenue at a high-single-digit rate and EBITDA at a low double-digit rate over the next five to ten years. Today, Altus trades for about 22x our estimate of 2024 cash earnings. This is a discount to what comparable quality information services and vertical market software providers trade at, especially considering Altus's superior revenue growth and margin expansion profile. Further, we expect the company to begin to use its free cash flow to return capital to shareholders over time, delivering a roughly mid-teens rate of EPS compounding over the long term.

It is important to note that the CRE end market has been under significant pressure over the last year due to sharply rising interest rates and secular challenges in the office segment. In the second quarter of 2023, total CRE transactions were down 63% year-over-year. However, we believe Altus is well insulated from this stress. As we've mentioned, Altus's property tax appeals business displays counter-cyclical attributes, and the Argus software business is a subscription-based offering with contracts averaging three years in duration. Argus's revenue is not tied to transaction volume, and it has multiple growth drivers working in concert to move the business forward. Finally, we observe that Altus's software business grew recurring revenue 19% year over year in the first half of 2023, despite the challenges facing the end market.

Exited Position: SS&C Technologies

We initiated a position in SS&C Technologies in the third quarter of 2019. The company is a leading provider of software and outsourcing solutions to customers in the financial services industry. Its products are essential to customers with high switching costs and recurring revenue. It is led by founder and 13% shareholder Bill Stone. Bill has built the business over the last 37 years via opportunistic acquisition, buying high quality but fairly mature assets, and creating value via aggressive cost cutting.

Our original thesis was that, with just 5% global market share, there was substantial additional runway for SS&C to continue its acquisition driven business model. If successful deploying capital at just one half the volume it had done historically (at the same ROI), returns for shareholders would compound at a 15-20% rate. And if attractive acquisitions were not available, low-to-mid single digit organic revenue growth and share repurchases would allow for low double-digit EPS compounding.

Unfortunately, in the four years that we have owned the business, the acquisition environment has been very challenging with few deals consummated by SS&C. We believe this is partly a function of the company's price discipline, but also a function of significant private equity activity, including a dramatic rise in capital under management at software focused buyout firms such as Thomas Bravo, Vista Equity Partners, and Francisco Partners. Perhaps the higher interest rate environment will reward SS&C for its patience, but our belief is that the market for these types of acquisitions is more competitive now and this challenge is more secular than cyclical.

Further, SS&C has faced a large increase in operating and financial costs. Wage inflation has been a headwind, and SS&C has not yet demonstrated pricing power sufficient to offset these increased costs. Additionally, the business has financial leverage and rising rates have added to interest expense. There remains a reasonable pathway for SS&C to find its footing and generate adequate organic growth and price increases to get back to its historical margins, but we do not have enough conviction to base our thesis on that scenario. We sold our 3% SS&C position during the quarter and redeployed funds into Cogent Communication and Altus Group where we see better opportunity.

Conclusion

We thank you for entrusting your capital to us. We will continue to do our best to protect and grow your investment over time.

Please let us know if there have been any changes to your financial circumstances or investment objectives that might impact how we manage your account, let us know if your contact information changes, and let us know if you would like to add or modify any reasonable restrictions to our investment advisory services.

Sincerely,

Broad Run Investment Management, LLC

# Disclaimer

The specific securities identified and discussed in this commentary should not be considered a recommendation to purchase or sell any particular security. Rather, this commentary is presented solely for the purpose of illustrating Broad Run's investment philosophy and analytical approach. These commentaries contain our views and opinions at the time they were written, they do not represent a formal research report and are subject to change thereafter. The securities discussed do not represent an account's entire portfolio and in the aggregate may represent only a small percentage of an account's portfolio holdings. These commentaries may include "forward looking statements" which may or may not be accurate in the long-term. It should not be assumed that any of the securities transactions or holdings discussed were or will prove to be profitable. **Past performance is not indicative of future results. All investments involve risk and may decrease in value.**

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**Focus Equity Separate Accounts Disclosures:** Some of the writings in this compilation refer to information computed for the Focus Equity Separate Accounts (FE-SA). The information presented for FE-SA is derived from representative portfolios from the Focus Equity Composite. The representative portfolios are: (i) for the period September 1, 2009 to February 28, 2013 the sole portfolio in the composite, which is a single equity mutual fund; and (ii) for the period after February 28, 2013 (Broad Run accepted its first separate account in February of 2013) all of the separate account portfolios, which excludes any equity mutual fund(s), UCITS fund(s), and private fund(s). Broad Run believes this information is most relevant to institutional separate account investors in the Focus Equity Strategy; this information is supplemental to the GIPS® Composite Report provided in this document. The information presented for FE-SA also excludes securities (e.g., broad market ETFs) temporarily held in client account(s) that were purchased with the proceeds from client-directed tax loss sales.

**Other Disclosures:** Some of the documents in this compilation have been reformatted to better fit this publication, and certain elements have been redacted for compliance purposes. Additionally, certain organizational updates pertaining to firm personnel have been removed. We have included commentary written by the investment team for a sub-advised mutual fund's annual and semi-annual reports filed with the U.S. Securities and Exchange Commission ("SEC") from October 2009 through October 2012. Please note that the investment team did not have portfolio management responsibility for the fund prior to August 21, 2009. Commentary from subsequent SEC filings has been excluded from this compilation because it largely overlaps with the content in Broad Run's quarterly separate account client letters.

# Broad Run Investment Management, LLC
# Focus Equity Composite GIPS Report

| | |
|---|---|
| **Reporting Date** | September 30, 2023 |
| **Composite Inception** | September 1, 2009 |

**GIPS Compliance and Verification Status.** 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, 2022. The verification report is available upon request. A firm that claims compliance with the GIPS standards must establish policies and procedures for complying with all the applicable requirements of the GIPS standards. Verification provides assurance on whether the firm's policies and procedures related to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance, have been designed in compliance with the GIPS standards and have been implemented on a firm-wide basis. Verification does not provide assurance on the accuracy of any specific performance report.

Policies for valuing portfolios, calculating performance and preparing compliant presentations are available upon request. A list of composite descriptions is available upon request.

**Firm Information.** 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.

**Composite Description.** 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 the firm believes are high-quality growth-oriented companies trading at discounts to Broad Run's assessment of their intrinsic value. The strategy holds a portfolio of approximately 20 securities. 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 invests across the market capitalization spectrum.

The Focus Equity Composite was created in October 2012; its inception date is September 1, 2009. From 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. From 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.

**Fee Schedule.** Broad Run's standard annual asset-based management fee schedule is 1% of the account's total assets on the first $5 million 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.

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 Broad Run's highest applicable annual management fee of 1.00% ("Model Net Fee"), as described in the firm's Form ADV, Part 2A (without the benefit of breakpoints) from the monthly composite gross return.

**Reference Index Disclosure.** The S&P Total Market Index (TMI) is designed to track the broad U.S. equity market, including large-, small-, and micro-cap stocks. The index is 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 index data below is supplemental information. The index's performance returns are included to illustrate the general trend of the U.S. equity market and are not intended as a benchmark for the composite.

**Other.** All returns presented in the table below (including the reference index) include the reinvestment of dividends, interest income, and capital gains. Valuations are computed and performance is reported in U.S. dollars. GIPS® is a registered trademark of CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein. ***Past performance is not indicative of future results.***

| | Focus Equity Composite | | | S&P Total Market Index (TMI) | | | | | Firm |
|---|---|---|---|---|---|---|---|---|---|
| | Gross Return (%) | Net Return (%) | Standard Deviation [2] | Return (%) | Standard Deviation [2] | Number of Portfolios | Internal Dispersion [5] | Composite Assets (USD millions) | Assets (USD millions) |
| **Calendar Year** | | | | | | | | | |
| **2023 (thru 9/30)** | 9.62 | 8.81 | 22.25 | 12.42 | 17.96 | 174 | n.m. | 827.6 | 834.9 |
| **2022** | -25.02 | -25.79 | 27.40 | -19.53 | 21.53 | 181 | 1.66 | 908.9 | 914.9 |
| **2021** | 33.37 | 32.07 | 22.68 | 25.66 | 17.95 | 190 | 0.64 | 1,678.2 | 1,757.2 |
| **2020** | 7.91 | 6.83 | 23.25 | 20.79 | 19.44 | 175 | 0.92 | 1,569.7 | 1,574.5 |
| **2019** | 36.22 | 34.89 | 11.35 | 30.90 | 12.22 | 170 | 1.16 | 2,576.9 | 2,579.0 |
| **2018** | -9.09 | -10.01 | 11.25 | -5.30 | 11.21 | 155 | 0.64 | 2,326.8 | 2,330.3 |
| **2017** | 21.43 | 20.24 | 10.31 | 21.16 | 10.09 | 137 | 0.96 | 3,309.6 | 3,311.2 |
| **2016** | 8.83 | 7.76 | 12.06 | 12.65 | 10.89 | 101 | 0.31 | 2,671.8 | 2,794.1 |
| **2015** | 4.40 | 3.37 | 11.30 | 0.47 | 10.57 | 52 | 0.13 | 2,266.5 | 2,268.6 |
| **2014** | 11.76 | 10.66 | 9.44 | 12.46 | 9.32 | 41 | 0.10 | 1,618.5 | 1,619.5 |
| **2013** | 37.18 | 35.85 | 12.52 | 33.40 | 12.58 | 30 | n.m. | 1,454.0 | 1,459.8 |
| **2012** | 18.27 | 17.11 | 16.80 | 16.44 | 15.75 | 1 | n.m. | 781.2 | 781.2 |
| **2011** | 5.13 | 4.08 | - [3] | 0.92 | - [3] | 1 | n.m. | 672.2 | N/A |
| **2010** | 26.40 | 25.16 | - [3] | 17.30 | - [3] | 1 | n.m. | 772.8 | N/A |
| **Sep – Dec 2009 [1]** | 8.64 | 8.29 | - [3] | 10.22 | - [3] | 1 | n.m. | 812.5 | N/A |
| **Annualized (09/30/23)** | | | | | | | | | |
| **1 Year** | 17.68 | 16.52 | n.m. [4] | 20.49 | n.m. [4] | | | | |
| **3 Years** | 6.97 | 5.91 | 22.25 | 9.27 | 17.96 | | | | |
| **5 Years** | 7.04 | 5.98 | 23.99 | 9.01 | 19.44 | | | | |
| **10 Years** | 9.47 | 8.39 | 18.46 | 11.20 | 15.33 | | | | |
| **Since Inception** | 12.55 | 11.44 | 17.62 | 12.60 | 15.12 | | | | |

**1:** Annual Performance Results reflect partial period performance. The returns presented are calculated from September 1, 2009 to December 31, 2009. **2:** Standard deviation measures the variability of the gross returns of the composite and the reference index. All standard deviation figures are calculated using monthly gross performance numbers. Figures presented for calendar year and YTD periods are three-year annualized standard deviations. **3:** The three-year annualized standard deviation is not shown due to having less than 36 months of composite returns. **4:** n.m. - Not statistically meaningful for periods less than 3 years. **5:** 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; not statistically meaningful (n.m.) for periods less than one year, or when there are five or fewer accounts in the composite for the entire year.

**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.

**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. Therefore, it should not be assumed that the future performance of any specific investment or investment strategy (including the investments and/or investment strategies recommended and/or undertaken by Broad Run Investment Management, LLC) made reference to directly or indirectly in this commentary will be profitable, equal any corresponding indicated historical performance level(s), be suitable for your portfolio or individual situation, or prove successful. 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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