

January 19, 2012

Dear Investors,

Kinnaras Capital Management ("KCM", "Kinnaras", or the "Firm") Separately Managed Accounts ("SMAs") returned 12.1% net in Q4 2011. Table I presents KCM SMA performance relative to key indices. Investors should note that individual returns will vary based on the time one invested and that the composite return presented below is net of fees and is the time-weighted return ("TWR") of all Kinnaras SMAs. TWR is one of the most comprehensive and accurate ways of gauging investment performance for managed accounts but can be skewed at times due to the timing of new portfolio openings. Please note the inclusion of the Russell 2000 and Morningstar Small Cap Value indices. As investors will recall, in late 2010 I wanted to take advantage of a number of opportunities in the small and micro capitalization area. While the portfolio includes companies that have capitalizations above the typical small capitalization upper threshold of \$1B, it is still helpful to include a broader composite of indices to compare our performance.

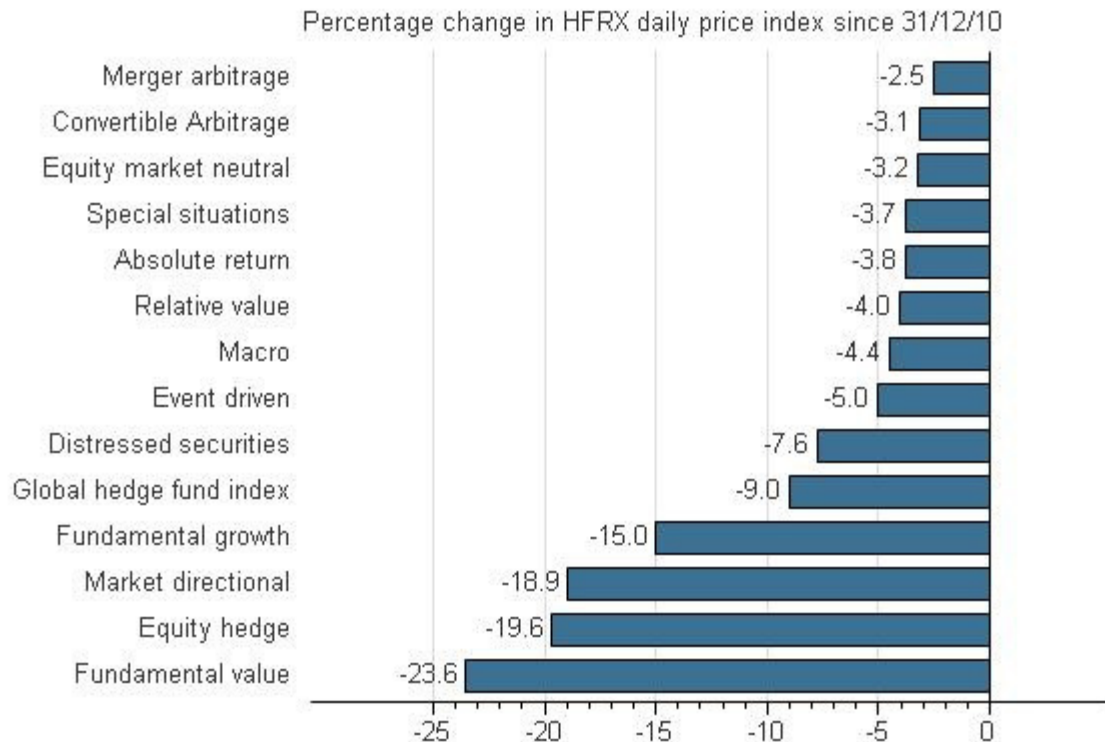
**TABLE I: 2011 SMA PERFORMANCE**

	1/31/2011	2/28/2011	3/31/2011	4/30/2011	5/31/2011	6/30/2011	7/31/2011	8/31/2011	9/30/2011	10/31/2011	11/30/2011	12/31/2011	FY 2011
KCM SMAs	1.09%	8.92%	0.31%	-0.02%	-3.05%	-4.26%	-5.18%	-8.70%	-12.81%	11.99%	-1.09%	1.24%	-13.25%
DJIA	2.90%	3.16%	0.91%	4.10%	-1.50%	-1.10%	-2.10%	-4.00%	-5.90%	9.70%	1.20%	1.60%	8.36%
S&P500	2.32%	3.47%	0.02%	3.00%	-1.10%	-1.70%	-2.00%	-5.40%	-7.00%	10.90%	-0.20%	1.00%	2.20%
NASDAQ	1.78%	3.04%	-0.04%	3.40%	-1.30%	-2.20%	-0.62%	-6.42%	-6.36%	11.14%	-2.39%	-0.58%	-1.72%
Russell 2000	-0.31%	5.40%	2.44%	2.58%	-1.96%	-2.46%	-3.60%	-8.70%	-11.20%	15.10%	-0.40%	0.70%	-4.73%
Morningstar Small Cap Value Ind	1.38%	4.20%	1.01%	1.97%	-1.23%	-2.40%	-3.70%	-8.00%	-9.90%	15.07%	-0.21%	1.89%	-2.05%

	Q1 2011	Q2 2011	Q3 2011	Q4 2011	FY 2011
KCM SMAs	10.44%	-7.20%	-24.52%	12.14%	-13.25%
DJIA	7.12%	1.41%	-11.56%	12.79%	8.36%
S&P500	5.89%	0.14%	-13.78%	11.78%	2.20%
NASDAQ	4.83%	-0.19%	-12.91%	7.86%	-1.72%
Russell 2000	7.64%	-1.91%	-21.84%	15.44%	-4.73%
Morningstar Small Cap Value Index	6.70%	-1.70%	-20.18%	16.99%	-2.05%

# Hedge fund performance in 2011



Reuters graphic/Scott Barber - data as at 16/12/2011

Source: Thomson Reuters Datastream, HFR

The prior year exhibited considerable volatility but ultimately left most major indices such as the S&P500 and DJIA flat to slightly up with a number of other key equity indices based on geography, strategy, and sector in negative territory. The chart above illustrates that the past twelve months (just short of a full 2011 trading year by 9 trading days) was challenging for a number of hedge fund strategies. As noted by Thomson Reuters:

*"Not a single major hedge fund strategy is on track to end the year with a profit, with only a week or so left of trading. Worst hit were the value strategies, with many cheap stocks – like banks – proving to be value traps, just getting cheaper with every month that passed."*

I utilize an approach similar to the "Fundamental Value" category listed in the chart above and my general guess for the strategy's disappointing performance is that headline news related to a number of events over the past year ranging from the Arab spring, Fukushima, on-going Euro-zone crisis, and US debt ceiling debate/credit downgrade may have overwhelmed potential positive company-specific factors. As a result, companies that were attractive from a valuation standpoint became even "more attractive" (lost additional value) when factoring in these headline risks.

What should be understood is that companies which exhibit attractive valuations and would more frequently comprise a Fundamental Value portfolio more often than not have some "warts" associated with them. Market participants are left to ascertain how much of a discount a company should impound based on how severe these problems are which leads to periods of volatility associated with these stocks as quarterly results are issued and investors re-assess the intensity of the company's initial problems. It's

a dynamic research process whereby skeptics and true believers can be dramatically adjusting their valuations based on the impact of new data. Investing is always a dynamic process which requires updating valuations based on new information but the impact on more value-oriented stocks can be much more acute.

For example, companies like Exxon Mobil ("XOM"), Chevron Corporation ("CVX"), and ConocoPhillips ("COP") are valued at roughly 8-10x earnings. BP, however, trades for about 6x earnings or a discount of 25-40% from its peer group due to issues related to the Gulf of Mexico spill in 2010. Supply and demand issues related to oil will impact all of these companies which can in turn impact their share prices and ultimately valuation multiples, but BP will continue to trade at a discount to its peer group until its company-specific issues are resolved.

If one's research suggests a positive outlook for the overall industry group and that BP's issues are overstated, BP could provide the best return prospects out of the four companies mentioned above. This is due to BP having the opportunity to experience valuation multiple expansion. The "clean" companies such as XOM, CVX, and COP are locked in their normal valuation range but BP is trading at a discount of 25-40% to those peers. If an analyst is correct in determining BP's problems are not as severe as current valuation multiples suggest, the stock could move from ~\$44 to \$60-73 based solely on BP trading in line with its peers. Conversely, it's also conceivable that BP warrants an even greater discount if the market is too optimistic about BP's challenges.

In 2011 market participants may simply not have cared to bother with more troubled companies. An investment team may conduct intensive company and industry level analysis on these types of opportunities but ultimately resolve to pass on what they know to be an attractive risk/reward because they feel it's pointless in the context of a world that appears to be imploding. The perception held by an investor could be "why bother with BP when there's no guarantee of being rewarded if the company analysis is correct yet still plenty of downside if wrong or if headline problems increase?"

An energy investor would instead perhaps choose XOM - the largest and perceived safest of the group - which would be bid up in terms of valuation and ignore BP which would have to experience an additional discount to entice investors. None of these companies are in our portfolio but they provide a familiar group from which to draw upon to explain how value-oriented strategies may have underperformed in 2011. In summary, there was a flight to quality - hardly news as Treasuries were one of the best performing asset classes in 2011.

This trend was also apparent in equities as the DJIA was one of the better performing equity indices in 2011. This is due to its components, the dividend yield of the DJIA, and most importantly its construction/weighting protocol. As mentioned in the oil and gas example, investors may have been too headline-fatigued to have bothered with more attractive opportunities from a valuation perspective and instead bid up larger, safer (or at least perceived to be safer) companies. The DJIA holds a number of these types of companies including XOM and CVX as well as leading global brands such as McDonald's ("MCD"), Boeing ("BA"), Caterpillar ("CAT"), and Johnson & Johnson ("JNJ"). The DJIA also returned a dividend yield of roughly 2.5% which accounted for about 28% of its total 2011 return.

Another significant influence on the DJIA's performance is the fact that it's price weighted. This means that the most expensive stocks in the DJIA on an absolute dollar basis have the largest weighting and thus impact on the performance of the index. The most expensive stocks in terms of absolute dollar price in the DJIA are currently IBM, CVX, CAT, MCD, XOM, 3M ("MMM"), and United Technologies ("UTX"). In fact, IBM alone has a greater impact on the performance of DJIA than Bank of America

("BAC"), Alcoa ("AA"), General Electric ("GE"), Cisco ("CSCO"), Pfizer ("PFE"), Intel ("INTC"), Hewlett-Packard ("HPQ"), and Microsoft ("MSFT") combined. This discussion does not diminish what the DJIA achieved last year but it's helpful to understand the underlying mechanics of the index to better evaluate performance.

In past letters I would highlight the performance of current and realized portfolio holdings along with their individual percentage gains. The problem with that approach is that it did not effectively demonstrate the contribution to the portfolio. If a company in the portfolio has a 1% weighting and is sold for a 50% loss, it costs the portfolio 0.5% of performance where as a 4% holding that declines by 25% would cost the portfolio 1% of performance. To better represent portfolio contribution, I accounted for these weightings and created the chart below which provides a much better analysis of fund-level contribution.

CHART I: PORTFOLIO PERFORMANCE CONTRIBUTION 2011

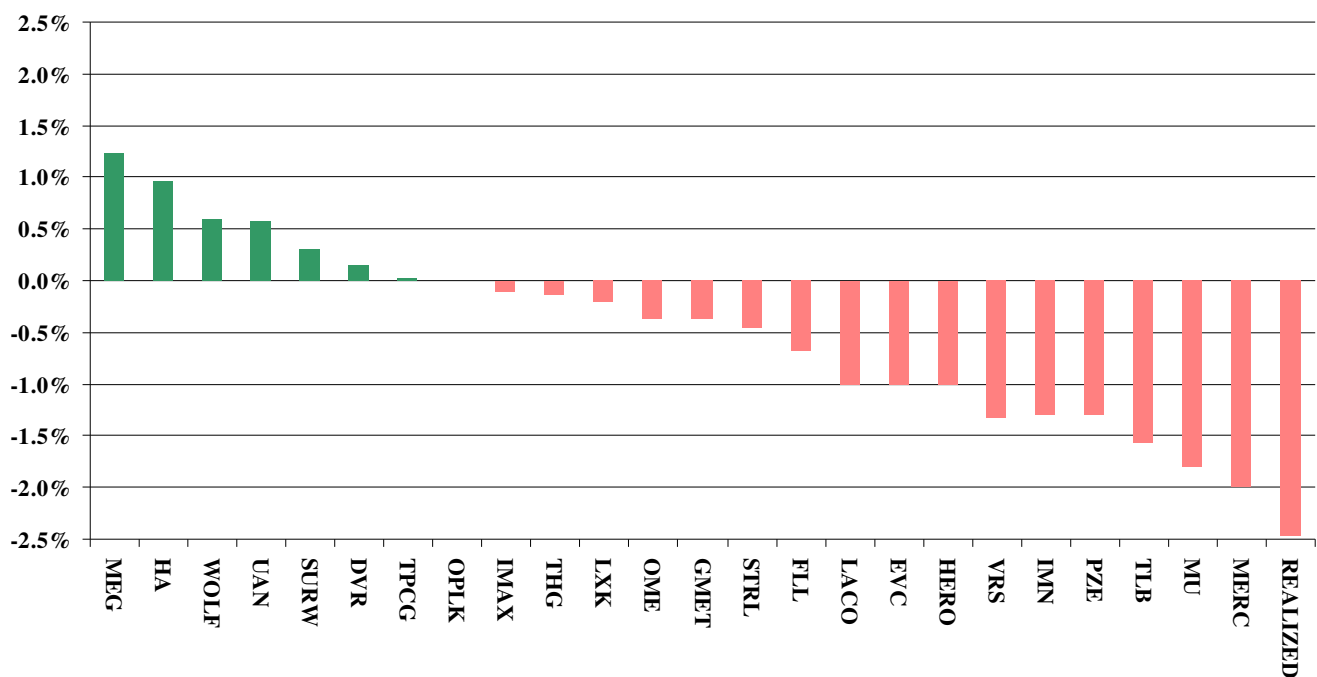


Chart I is organized whereby the level of portfolio contribution scales down from left to right. Keep in mind that this is what each security in the current portfolio contributed for calendar year 2011. This is important to note because a security that was a negative contributor in 2011 may actually still represent a gain for the portfolio.

For example, Hercules Offshore ("HERO") has an average cost basis under \$3 for the aggregate portfolio but in 2011 HERO cost the portfolio 1% in performance. This is because HERO is a significant weighting in the portfolio and began 2011 over \$5 per share, ultimately finishing 2011 down nearly 20% from that level. Companies like GeoMet ("GMET") and Lakes Entertainment ("LACO") were also similar to HERO in that they were negative contributors to performance in 2011 but still trade above their average acquisition cost.

I have discussed HERO in prior letters and did not feel inclined to sell it because I believe it represents a great opportunity provided one has a multi-year time horizon. In the past year, HERO acquired its main competitor in a prepackaged bankruptcy, increased its ownership stake in Discovery Offshore, a

Luxembourg-based high-specification jack up rig company, to nearly 30%, and most importantly saw improving utilization rates and dayrates per rig.

These improvements all occurred under a challenging regulatory environment since the BP oil spill in April 2010. While there have been considerable delays since the spill as new regulations were implemented, the drilling outlook and environment appear to be quietly improving. For example, the Louisiana Department of Natural Resources just announced that drilling off the Louisiana coast is at a new high point with 38 rigs now active as opposed to the 20 that were active at the start of 2011. The number of active rigs is just 4 below the pre BP oil spill levels. On December 14, 2011 the Department of the Interior conducted the first new lease sale in the Gulf of Mexico, generating over \$700MM for the US Treasury. Lastly, ODS-Petrodata now expects the number of deepwater rigs in the Gulf to reach 40 by the early part of 2012, which would exceed the 37 that were active prior to the BP spill. There are still hurdles to clear and the regulatory landscape is still much more challenging in a post BP spill Gulf but recent events portray an improving picture.

CHART II: NATURAL GAS RATES JANUARY 17, 2002 - JANUARY 17, 2012



Another potential positive is that natural gas prices are near ten year lows. Natural gas accounts for the majority of hydrocarbon production in the shallow water region of the Gulf of Mexico and natural gas prices are positively correlated to HERO's drilling business. The current performance of natural gas could suggest pricing is closer to a bottom but the real benefit of any potential uptick or even flat lining of natural gas prices is that shallow water rig supply has sharply contracted. There were 63 actively marketed shallow water rigs in the Gulf of Mexico in 2008 and this declined to 41 by October 2011. More importantly, 36 of those 41 rigs were contracted. This tight supply of rigs means that even a small

uptick in natural gas could lead to outsized gains in dayrates. This combination of attractive valuation, improving fundamentals, and a fixed cost structure with tightening supply/demand dynamics is what compels me to keep HERO in the portfolio. Despite company-level improvements throughout 2011, the stock cost us 1% in 2011 but I feel if one takes the view of an actual investor HERO could be a big winner.

Aside from HERO, large performance detractors included some of our highest conviction names such as Mercer International ("MERC"), Micron Technology ("MU"), The Talbots ("TLB"), and Entravision Communications ("EVC"). EVC could be a very strong performer in 2012 given the expected political ad dollars that should flow to its 53 Spanish-language television stations and 48 Spanish-language radio stations in key states such as California, Colorado, Nevada, Texas, New Mexico, Massachusetts, and Florida. EVC's stations operate in 14 of the 20 most densely populated Hispanic markets and 13 of the 20 fastest growing Hispanic markets. EVC is also engaging in shareholder friendly behavior whereby it redeemed a small chunk of outstanding debt and issued a special one-time dividend of \$0.03 in Q4. This dividend may sound pithy but given that EVC's recent trading range has been between \$1.00-\$1.80, it represents a yield of 2+%.

TLB was recently put up for sale by its Board of Directors following an unsolicited offer from Sycamore Partners in early December to acquire the company for \$3/share. Sycamore Partners had reportedly approached TLB in August with an offer estimated to be over \$4 but the Board rebuked the private equity firm which owns nearly 10% of TLB shares. Following another difficult quarter, Sycamore Partners went public with its offer in early December, suggesting it would be open to increasing its bid provided the opportunity to conduct further due diligence. In response to Sycamore's offer, TLB's Board hired its investment bankers to fully shop the company.

TLB had struggled throughout 2011, releasing poorly performing lines to its core customers. The head designer was released before the critical holiday shopping period and poor operating performance ultimately led to the CEO resigning in December 2011. Given a lameduck CEO and the potential for lawsuits for turning down a previous, higher offer, I expect that the Board will make every effort to consummate a sale. Aside from Sycamore Partners, other potential suitors could include Golden Gate Capital and strategic investors such as Ascena Retail Group ("ASNA"), which owns a number of retail concepts including TLB peer dressbarn, or Chico's FAS ("CHS").

MU produces dynamic random access memory ("DRAM") as well as NAND flash; both are forms of memory used by computers. DRAM is used primarily in PCs while NAND flash is used in mobile devices such as cell phones and tablets. NAND flash is also encroaching on traditional PC architecture with the advent of solid state drives which could eventually overtake magnetic hard drives. The PC market has generally stalled out, reducing demand for DRAM, while mobile devices have been selling well, boosting pricing in NAND flash. DRAM is a critical aspect of MU's operations and the challenges in that market led to its share price struggling for most of 2011. However, towards the end of 2011, DRAM prices began to firm up, which should benefit the company in 2012.

MU also outperformed many of its peers in Q3 2011, which was perhaps the most challenging DRAM pricing period in recent years. In contrast to a number of key participants, MU was able to better manage its downturn in revenues resulting in additional market share. This improvement in market share was not due to aggressive pricing relative to peers. In fact, MU's DRAM sells for a premium over competitors such as Hynix so its clear that MU may simply be executing better than peers during this turbulent period.

**TABLE II: GLOBAL DRAM MARKET SHARE RANKING Q3 2011**

(Ranking by Revenue in Millions of U.S. Dollars)

Q3-11 Rank	Company	Q3-11 Revenue	Q3-11 Share	Q2-11 Revenue	Q to Q Growth	Q3-10 Revenue
1	Samsung	\$3,051	45.0%	\$3,348	-8.9%	\$4,346
2	Hynix	\$1,460	21.5%	\$1,886	-22.6%	\$2,244
3	Elpida	\$823	12.1%	\$1,172	-29.8%	\$1,732
4	Micron	\$821	12.1%	\$853	-3.8%	\$1,125
5	Nanya	\$241	3.6%	\$381	-36.7%	\$439
6	Winbond	\$110	1.6%	\$106	3.8%	\$116
7	ProMos	\$61	0.9%	\$104	-41.3%	\$187
8	Powerchip	\$54	0.8%	\$0		\$292
	Others	\$156		\$198		\$198
	<b>Total</b>	<b>\$6,777</b>		<b>\$8,048</b>	<b>-15.8%</b>	<b>\$10,679</b>

Source: IHS iSuppli December 2011

Aside from improved DRAM pricing and performance relative to peers, MU also won a key lawsuit in Q4 2011 against Rambus ("RMBS"). RMBS accused MU and other competitors of conspiring to keep RMBS DRAM chips out of the memory market since 2004, claiming lost profits of \$4+B. The case was tried in California which would have allowed the \$4B in damages to be tripled if the jury sided with RMBS. With this legal overhang removed, DRAM pricing improving, and MU outperforming peers, there's a good possibility that MU can perform well in 2012.

MERC is a leading provider of northern bleached softwood kraft ("NBSK") pulp and has some of the newest and most efficient NBSK facilities in the world. NBSK is used in tissue paper and light weight coated papers. MERC, like MU, experienced pricing pressure in its key product throughout 2011 as the price per ton of NBSK declined from \$1,000+ to the high \$800s. Like DRAM pricing, the aggressive decline in NBSK prices appears to be finding a bottom.

MERC, MU, and HERO are similar in that these companies have fixed cost structures so when the pricing for their key product - NBSK pulp, DRAM, and natural gas, respectively - heads in the right direction, the operating leverage is tremendous. More importantly, in some cases they have cost or market position advantages over their peers which allows them to be one of the survivors during difficult transitory periods when weaker competitors simply can't compete.

HERO has an international drilling division as well as a liftboat division that generated cash which allowed it to survive in the wake of the regulatory environment following the BP oil spill whereas its closet competitor relied solely on its shallow water operations, ultimately succumbing to bankruptcy. Similarly, MU has operational and design advantages over certain peers which allows it to maintain a pricing premium in the DRAM market. Competitors such as Hynix, Elpida, and Nanya experienced far more severe average selling price ("ASP") declines relative to MU and as this letter is being written, there are reports that MU may acquire Elpida. This additional market share captured by MU through better execution and a potentially well priced acquisition will benefit the company when the DRAM pricing cycle eventually favors the industry.

Other key detractors in 2011 included Petrobras Argentina ("PZE") and Imation ("IMN"). IMN is a company that needs an activist to secure Board seats to effect a sale of the company. IMN has a net cash balance of \$233MM and a market capitalization of \$219MM. The market is discounting IMN this severely because management is squandering capital on ill conceived acquisitions. I am trying to discuss an activist strategy with significant current shareholders as well as potential new shareholders that may have an interest in pushing IMN into a sale as IMN holds a number of patents and intellectual

property that could be of value to a larger competitor. The main goal should be to stop management from doing a potentially stupid, large deal that blows out the majority of cash IMN currently holds.

IMN is not a significant position in the portfolio and at its current valuation has the potential to work out. IMN is expanding into data security, encryption, and scalable storage growth, acquiring niche companies in this space with the intention to leverage its recognizable brand amongst its existing customers to offer these new products. It's a difficult strategy to execute as companies like EMC have a number of subsidiaries in this area but if IMN can effectively transform itself, the market could be willing to pay a much higher multiple.

While IMN has some issues that may not be resolved, I am quite optimistic on PZE. One of the main reasons is because I believe that Argentina may move faster than market participants expect to remove price caps on various energy assets. The price of oil in Argentina is essentially capped at \$42/barrel while electricity and natural gas face strict price limits. These policies originated from Argentina's economic crisis in 2001 which led to Argentina abandoning its dollar peg in 2002. The Argentinean peso devalued significantly making energy and other basic necessities extremely expensive. In 2002, Argentina's President Eduardo Duhalde began to implement a program of price caps in response to the near depression the country was facing.

While those price caps have largely remained in place, Argentina has taken some small steps towards a more open economy. In 2008, the country passed the Oil & Gas Plus Program which raised price caps on new and "tight gas" field discoveries. More tellingly, the country removed electricity subsidies for a number of key industries including financial services, casinos, airports, telecom, and mining just a few months ago. The electricity subsidy removal was in response to the country's expanding budget deficit which is roughly 4% of GDP and inflation near 20%.

Access to international debt markets remains challenging and Argentina notched relatively strong GDP growth (9% nominal) in 2011 as opposed to the conditions faced in 2002 so there appears to be room to open up key markets such as energy in order to close a troubling budget deficit. Spanish oil company Repsol discovered a mammoth shale oil reserve in the country several months ago but the country has generally been crippled with capital that has fled due to historical price controls. When one combines a healthy GDP that is diminished by inflation and a wide budget deficit that could be closed by eliminating price caps/subsidies to attract further development of energy assets, it's possible that the country could gradually loosen these historical restrictions which would benefit PZE. More importantly, Argentina does not need to have a complete removal of price caps for PZE to perform well. Even moderate hikes in Argentina's price caps could have a significant impact on PZE's share price.

Aside from the companies mentioned above, a number of other negative contributors are stocks that still have time to play out. Companies like Full House Resorts ("FLL") and LACO are regional casino operators. LACO is a minority owner in two Ohio casinos in Cleveland and Cincinnati that are set to open in 2012. LACO's partners in this venture are Caesars Entertainment and Cleveland Cavaliers owner Dan Gilbert so these two projects have some serious muscle behind them.

There were a few new names added to the portfolio in the final weeks of Q4 - Verso Paper Corp. ("VRS"), Imax Corporation ("IMAX"), and TPC Group ("TPCG") - which collectively cost about 1.5% in performance, the bulk of which was caused by VRS. VRS has a market capitalization close to \$50MM and trades for about \$1. The stock moved from prices in the \$1.10-\$1.20 range to about \$0.95 in the final week of Q4 which represents a substantial percentage move.

VRS is a leading producer of coated groundwood paper ("CGP"), coated freesheet paper ("CFP"), supercalendered paper ("SP"), and pulp. Basically, it's the paper used in magazines, catalogs, and inserts and the advent of tablets and migration of content from print to the internet has wrecked the industry. VRS's biggest competitor filed for bankruptcy in September 2011 which could ultimately help VRS as facilities are permanently shut. In fact, VRS and other paper operators have been shuttering a number of facilities to suck out supply and improve pricing dynamics.

Verle Sutton, one of the most bearish industry analysts for the paper industry, estimated that 400k-600k tons of paper capacity needed to be removed by 2012 for pricing to improve. Keep in mind other industry sources such as RISI have been more bullish about paper pricing in 2012. Nonetheless, using Sutton's estimate suggests that VRS and other competitors are moving very close towards removing his estimate of excess capacity.

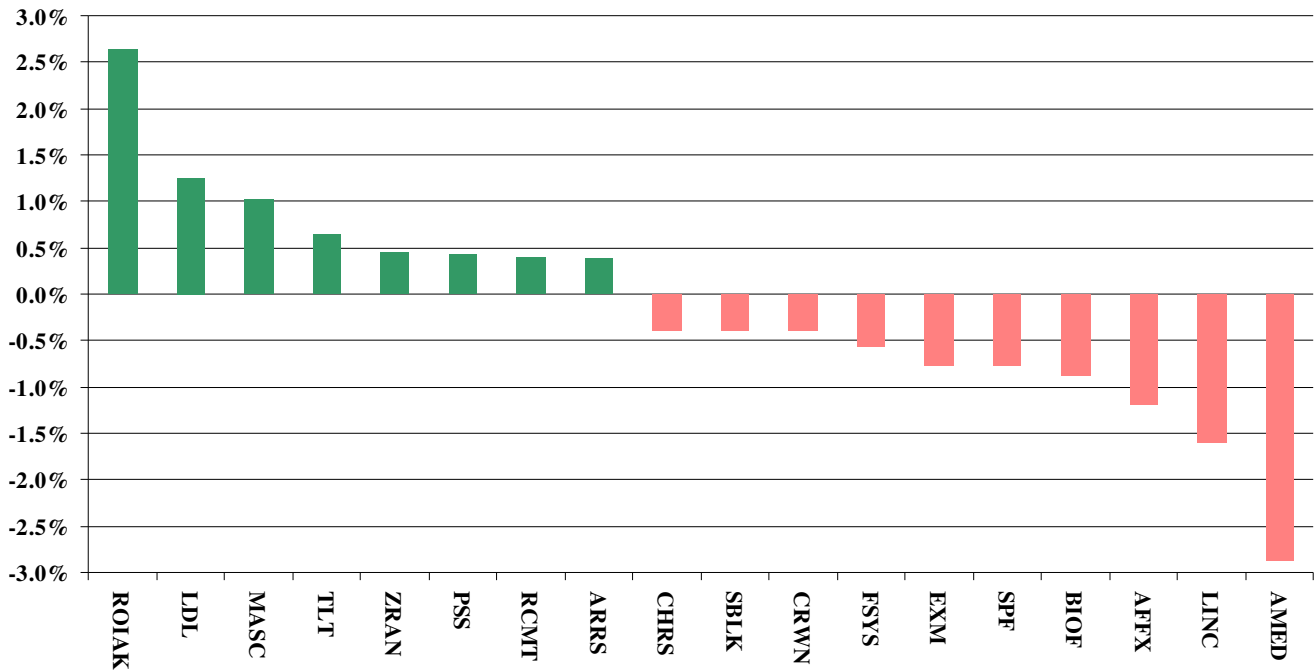
VRS recently shuttered its Sartell, Minnesota and Bucksport, Maine plants, removing about 200k tons of capacity. VRS competitor NewPage, which is currently in bankruptcy, has mothballed its money losing Port Hawkesbury plant in Nova Scotia which produces 360k tons of SP capacity. The plant appears to have a buyer in Canadian private equity firm Stern Partners but bringing the plant back online will take time given the discussion on power rates, union/non-union work force composition, and other items which could still ultimately result in no sale. These events alone have curtailed supply closer to Sutton's estimate.

The market for magazine and catalog paper globally also appears to be contracting. European paper company UPM has been permanently closing paper facilities throughout Europe. It recently announced that it would shut its Albrbruck paper mill in Baden-Wurttemberg, Germany, following plans to close its Myllykoski paper mill in Finland, and Ettringen paper mill in Germany. The combined capacity of magazine paper removed through these initiatives is nearly 1MM tons. It should be apparent that VRS offers comparable dynamics to HERO, MERC, and MU whereby there can be a period of turbulence as the industry reacts to challenging conditions but ultimately can perform extremely well once the supply/demand imbalances are corrected.

The biggest detractor to performance in 2011 was the net realized transactions in the portfolio which was under the category "Realized" in Chart I. Chart III expands the "Realized" category in Chart I, breaking down the key realized contributors for 2011, a number of which have been covered in prior letters. As the "Note" under the chart mentions, there were a number of minor realized gains and losses which were not included because the contribution on an individual basis was rather small. These transactions collectively netted out to 0% in terms of portfolio contribution. Some of these realized transactions included reductions in key names in the early part of 2011 when portions of MU and HERO were reduced.

As with Chart I, the performance contribution is based solely on calendar year 2011 and not the profit/loss on the life of the individual holding. For example, Zales Corporation ("ZLC") which is mentioned in the "Note" section under Chart III generated attractive gains over the life of the holding but because it started in 2011 at much higher levels than where it was acquired in 2010, the 2011 portfolio contribution was immaterial.

### CHART III: PORTFOLIO PERFORMANCE CONTRIBUTION 2011 - SIGNIFICANT REALIZED



Note: Chart III does not include gains/losses from MU, MSN, ZLC, MKSI, CHUX, III, GEN, THQI, JOEZ, HERO, HZO, AGX, TLAB, VOXX, SOL, AHC, CCRN, FBN as these contributions were small. These excluded transactions net to 0% contribution impact.

Successful investing involves effectively managing both winners and losers and I did a poor job with a number of our realized losers. Given our deep value strategy, I am comfortable with the losses contributed by most of our holdings. I will be wrong plenty of times but losses that cost 0.4% - 0.7% will be more than overcome by winners.

Affymetrix ("AFFX") was a significant loser which I sold because a key portion of the thesis was invalidated. I originally invested in AFFX because of its valuation, strong balance sheet, and an improving core business under the leadership of its new CEO Frank Witney. Witney had a history of fixing companies up and selling them, previously working at Dionex and engineering its sale to Thermo Fisher. Unfortunately, Witney decided to use a significant portion of AFFX's high cash balance to overpay for a much smaller company in late Q4. The high cash balance was going to be removed for debt and goodwill and AFFX was now an acquisitive company rather one that was focused on fixing existing problems and ultimately putting itself up for sale. In this type of situation I felt I was better off moving on rather than rationalize reasons to keep the stock. AFFX cost the portfolio a bit over 1% which is unfortunate but the stock was also a significant holding in the portfolio in 2011, meaning that the 1% loss was not generated by a massive hit to the position.

The losses that I am much more upset about were BioFuel Energy ("BIOF"), Lincoln Education Services ("LINC"), and Amedisys ("AMED"). BIOF cost the portfolio nearly 1% but the main problem is that the overall position size was about 1.25%. It's like having \$1.25 in a \$100 portfolio and watching that \$1.25 holding melt into about \$0.38. I will have losers but smaller positions generally need to be either added to if new information makes the holding more attractive or sold. If I did not have an interest to add to BIOF when it was a 0.9% portfolio weighting, I should have sold it for a much smaller loss. The same thing applied with LINC whereby it contributed a loss that was outsized relative to its position size.

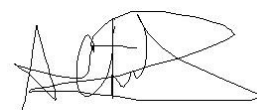
AMED was wrong from a position size and thesis. AMED is one of the largest hospice providers in the US. The majority of its hospices are Medicare-certified and Medicaid-certified and those were caught up in reimbursement reductions that were worse than expectations. Those reimbursements reductions alone would not have been a main issue. Smaller facilities with higher costs would not have the scale to compete under new reduced rates and AMED would be in a position to either acquire these businesses on the cheap or allow the weaker ones to disappear. The problem with AMED is that it started having a number of company-specific issues crop up. In late September, the Senate Finance Committee found that AMED and other for-profit healthcare companies were committing Medicare fraud. By then the stock was toast and I was looking to dump it.

AMED was a bad investment across the board. In analyzing the number of mistakes I made with AMED I think there are a few things that stand out. The first is that the majority of our holdings tend to be in truly beaten down and distressed names with market capitalizations well under \$1B. When I initially invested in AMED it had a market capitalization over \$1B and was down about 40% from its peak levels. It looked cheap in the context of projected reimbursement rate reductions but many of our holdings at the portfolio weighting AMED carried are in companies that have lost in some cases 70+% of value and are valued based on the business barely carrying on as a going concern, or in other words extremely cheap.

Another issue is that AMED did not have a tangible catalyst. This alone is not a problem as a number of our main holdings don't always have a near-term catalyst but this is offset by investing them at dirt cheap valuations whereby if it takes several years for the investment to work out, the annualized rate of return will still be very good. If a company does not have a tangible catalyst then I generally demand a much better price to invest and I did not do that with AMED. I also did not sell out earlier when afforded the opportunity. Unlike AFFX where I exited once the investment thesis was invalidated, I continued to hold onto AMED until the Senate Finance Committee's ruling on AMED made it pretty clear how poor my investment was.

While there were a number of performance detractors in 2011, the current portfolio had a few winners. I have covered MEG in a number of previous letters and investors should recall that 2012 is the reason we invested in MEG. Hawaiian Holdings ("HA") was mentioned in the previous letter and the company has been performing well, opening new routes from the US and growth markets in Asia and the Asia Pacific region. Most importantly I feel that a number of our more significant negative contributors in 2011 such as MERC, MU, HERO, EVC, and VRS can be major positive contributors in 2012. As always, feel free to contact me with any questions.

Best regards,

A handwritten signature in black ink, appearing to read 'Amit Chokshi', with a stylized, overlapping loop structure.

Amit Chokshi

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