Eidelman Virant
CAPITAL

Dear Clients & Friends,

The S&P 500 Index finished the quarter near breakeven, ending the first half of the year with a modest 1% gain. Market volatility reared its head toward the end of the quarter due to uncertainty surrounding the Greek budget deal and a volatile Chinese stock market which dropped 30% in one month. However, in just the last two weeks, both of these issues have been somewhat mitigated as the EU agreed to a deal with Greece and the Chinese government relaxed margin requirements resulting in a recovery bounce. So what do we think of the markets for the rest of the year?

We think the path of least resistance is for the market to continue to work higher. Stock valuations are still attractive relative to alternatives such as bonds. Typically at market tops, you see corporate insiders such as CEOs & CFOs unloading stock, which is not the case right now. In fact, there has recently been a spike in buying by corporate insiders. Having said all that, we still spend the vast majority of our time on seeking individual investments that are going to do well under any scenario. While big headlines like Greece can drive global markets temporarily, they rarely impact the long-term value of our portfolios.

More impactful to our portfolios was that two of our holdings received buyout offers in the past week. Just a month ago, we met with management of Remy (REMY), manufacturer of alternators for cars and trucks. Due to a complicated reorganization, this company was under the radar of Wall Street and we were confident that management could get earnings from $2 to $3 per share and grow the stock price to $30 per share vs. our cost of around $22. Fortunately, our price objective was achieved much sooner than expected. On 7/13/15, it was announced that BorgWarner (BWA), a major auto parts supplier, agreed to buy out REMY for $29.50 a share, a 40%+ premium to the prior day's closing price.

The next day, it was reported in the WSJ that Micron (MU) received a $21 buyout offer from Chinese company, Tsinghua (20% owned by Intel). While we don't think this deal will go through and it grossly undervalues the company, it highlights the value inherent in Micron's business and may spark acquisition interest from other suitors including Intel.

We are laser focused on selecting a diversified group of individual securities like Remy and Micron that meet our strict criteria: great management, strong market position in their industry, little debt, and trading at a discounted price. This strategy leads us to build a portfolio focused in three key areas: special situations, small banks, and "great" companies.

A special situations security is a stock or bond whose price stands to potentially appreciate as a result of circumstances unique to that company such as hiring new management, activism, or a corporate restructuring. As an example, Red Lion hotels (RLH) had a portfolio of assets including a $35 million property that was being underutilized as a small two-story hotel on a valuable six-acre property in Bellevue, WA (similar to downtown Clayton, MO). Red Lion recently sold this hotel, along with many others, and redeployed them into an "asset light" franchise model and are targeting to obtain 20 new franchises per year. We think this management team is outstanding and a successful execution of this strategy will result in a revaluation of the company at a much higher level.

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Small banks present another attractive opportunity. We love investing in small banks because it is one sector that a company can truly dominate their market, have great management, a strong balance sheet, and still trade at a very cheap price. How can that be? The answer: They are too small and "illiquid" for most funds to buy. Since most funds can't buy them, brokerage firms have no incentive to have their analysts follow them. The result is great, underfollowed companies that can earn high returns on invested capital with a reasonable probability of being bought out at healthy premiums. We scour hundreds of banks, including personally interviewing their management teams, to select those few banks that meet our strict criteria. We continue to be very optimistic about our portfolio of banks going forward.

Another strategy is to focus on "great companies" at a fair price. As an analogy, we are looking to sign Albert Pujols in his prime for a league average salary. Most companies with great management, large growth potential, and a dominant market position trade at deservedly higher prices. However, there are exceptions. Temporary bad news related to recalling products, litigation, legislation, commodity price spikes, or a myriad of other reasons can cause some people to temporarily shy away from a great company causing an ephemeral bargain stock price. This was the case when we recently bought shares of Centene (CNC) after a 12% stock price decline following an earnings report. Centene is an extremely well run company with one of the best cost systems in the industry with a huge tailwind of Medicaid expansion. We also think CNC could benefit from consolidation taking place and could be bought out from one of their bigger rivals.

We feel great about our clients' portfolios and think we have the right combination of special situations, small banks, and "great" companies to deliver superior investment returns going forward.

In exciting firm news, we are pleased to announce that Amy Jadav (pronounced "Ja-Doe") has joined our company. With Jane working part-time and Karen eyeing part-time status, it was the perfect time to add Amy to the team. For the past 10 years, Amy was a Vice President at CitiMortgage, Inc. She worked in the Investor Reporting and Document Processing Departments with a main focus on loan modifications. We are confident Amy's superior organization and technical skills will make our office more productive and will be a great addition.

Thank you for you continued business and support.

Sincerely,

Tom Eidelman, CFA
Managing Director