



Wednesday, March 13, 2013

Clients,

Many of you have noticed that one of the companies in our portfolio, HMG/Courtland Properties, Inc. (ticker: HMG), recently had a greater than 200% increase in its stock price such that our position is now over 25% of our invested capital. Given the outsized gain and position size we wanted to provide an update on the company, explain the reason for the gain, and our plans for the position going forward.

Last September we sent out a client-only letter providing some background on our investment in HMG. Much of this is still helpful background for our longstanding clients, and we repeat it here for our new clients as well:

"We have recently dramatically increased the size of an existing position. Once the KSW action plays out, HMG/Courtland Properties, Inc. (ticker HMG) will become our third-largest position at roughly 8% of invested capital. This stock has always been the most undervalued of our positions, but it rarely trades and has a tiny market capitalization. Nearly 64% of the company is owned by insiders; another 12% is owned by an investor with an investing style similar to WAM. This left very few shares for sale. It took us nearly a year to build a decent-sized position, and even at that point we still wanted more stock. The good news is that we recently took advantage of the opportunity to acquire a larger stake at current market prices. We want to make you aware that any given day this stock can be quite volatile, due to the minimal trading activity and the few shares that are available for trading. As a larger position, it may swing our daily, quarterly, or even yearly results (both positive and negative) based on very little actual trading.

But the company's actual assets are anything but volatile. Its main asset is a triple net lease (rental income they receive every year) on a hotel and seven acres of land that it owns on a private island off the coast of Miami. We have always said we don't care about to day- to-day moves and are focused on long-term results. This stock is the epitome of that mantra. Very few investors have the clients and the patience to invest in this manner. But with our stable client base and long-term outlook, we can afford to invest in these situations. Currently the stock trades around \$5.00; our analysis indicates that fair value is, at a minimum, \$15.00. We cannot give you a time frame for when this value will be realized, but are confident that in the meantime the value continues to grow each year."

We were confident in September that the company was worth more than its market value at the time. In fact, in December, 2011, almost a year prior, I personally visited Grove Isle in Miami to check out the hotel and the seven acres that HMG owned at the time. While it was impossible to pin down the exact value of the property, it was clear from my due diligence that it was much higher than the value that its stock price implied.

We also mentioned in our September letter that there was no way to know when and why the gap would close between market price and intrinsic value. We thought it might take years, and planned on adding shares over that time as long as the price disconnect existed.

Then on the afternoon of Friday, March 1 HMG released a SEC filing stating that they had sold its main property for a net gain of over \$20 per share. Their stock had been trading at around \$5.50 a week before the announcement, and had traded as low as \$4 over the past year.

The following Monday we expected the stock to open at least in the \$18 to \$20 range, given that HMG had just sold its main asset for a net gain of \$20.00 per share and still owned other assets. But few market participants seemed to notice the SEC filing, and there was no press release or media report trumpeting the sale. Thus, on that same day we were able to further increase our already sizable HMG position at prices below \$9.50. Subsequently, as the market has begun to realize what has occurred, the stock is now trading in the \$16-\$19 range.

With the large price gain and the additional shares we were able to accrue after the sale, the position is now an extremely large part of W.A.M.'s portfolio. We are delighted with the gains. We also realize that many of our clients are nervous holding such an outsized position and want to know more about our future plans for it.

First the good news: After this sale, the company has nearly \$21 per share in cash on its balance sheet, and its stock price still trades below that level (\$17 at today's price). The company also holds an additional \$5 per share in marketable securities and other private equity investments on its books. On top of this, the company still owns 50% of a marina, office space and on-site restaurant in Coconut Grove; the facility has a great location, is a Coconut Grove landmark and we believe is worth about \$2 per share. HMG owns an additional 5,000 square building in Coconut Grove which we estimate to be worth another \$1-\$1.50 per share. Even if we heavily discount the value of these remaining investments, it is hard to argue that the stock is worth less than the cash on the books, and there's a good argument to be made that is worth closer to \$25-27 per share.

Thus, even though the position is large, we do not intend to sell a significant portion of our shares while there is still such a large discrepancy to the company's cash and investments.

Additionally, HMG is a real estate investment trust (REIT), and the IRS mandates that 90% of any capital gains from the sale of property must be distributed to shareholders in the form of a dividend. That payment will eventually bring the price back down and reduce our position. The exact amount of the dividend is difficult to determine because HMG has some previous losses that can offset some of the capital gains, but it will be significant. Unfortunately, HMG doesn't have to pay out this dividend until the summer of 2014. Insiders own over 60% of the company, so they should be incentivized to pay out the dividend sooner than later, but historically HMG has waited as long as possible to pay (admittedly much smaller) dividends.

We expect the dividend to automatically reduce our position size in the longer-term. As an example, if HMG paid out a \$14-per-share-dividend at today's stock price of \$17, the ex-dividend stock price would be \$3. Our new position would be about 82% smaller than its current size, and we would still own the remaining assets.

Given these factors, we do not plan on selling a significant number of shares in this company until the dividend is paid, or until its stock price better reflects the cash and investments on its balance sheet. Given our large position size, HMG's daily performance will greatly affect our portfolio's daily performance. The company's shares are still volatile, thinly traded, and have a wide bid/ask spread. The irony in this volatility is that HMG's assets are safer than before. As long as the stock is less than \$21, it is trading below the value of the cash the company holds. We remain comfortable riding out any near-term volatility in HMG.

Of course, while we are quite pleased with our investment in HMG, we'll take this opportunity to remind our clients that recent success is no indication of future performance and that our investing style will likely also lead to periods of underperformance. Thankfully, HMG has shown us our primary competitive advantage is a client base that is in tune with our investment strategy and understands our long-term investment goals. We strongly believe that the majority of Wall Street investors are unable to invest in the manner that led to our HMG gains. They will often take on any client rather than only those clients who can be true long-term partners. They are too scared to underperform in the near term, refuse to own shares in lesser-known companies, and avoid companies with illiquid or volatile stocks (no matter how safe or undervalued the underlying asset may be.) Perhaps that is why HMG still trades at a discount to the cash on its books.

I hope that this has been a useful summary of why HMG rallied, why we haven't sold the majority of our shares, and what our expectations are for the company in the future. If you'd like to discuss any of the above or have further questions please feel free to call [REDACTED] or email [REDACTED] at any time.

Sincerely,

A handwritten signature in black ink, appearing to read 'Evan', written in a cursive style.

Evan