To: Clients of Eagle Point Capital
From: Matt Franz and Dan Shuart, Principals
Subject: Fall 2019 Update
Date: October 1, 2019

In this update, as in previous, our objective is to explain what you own and why you own it. First, however, we briefly discuss our view on tariffs, as it's the number one question we get asked. Next, we review each of our current investments and recent transactions.

Finally, we conclude by attaching a short reminder of our fundamentals which reiterates our goals and methods. Investing is simple but not easy, and success is made or lost on the application of fundamentals.

If you're still looking for more, we encourage you to visit our website, www.eaglepointcap.com, where we archive past letters and blog about what's catching our eye in the market. If you're not already subscribed to our mailing list (all current clients are) you can sign-up on our website to ensure you don't miss an update.

Your Q3 Interactive Brokers statements will soon arrive in the mail. The statement will include your quarterly performance and holdings. You can access more detailed account information on the Interactive Brokers website. Please contact us (matt@eaglepointcap.com or dan@eaglepointcap.com) with any questions.

As a reminder, we manage all accounts *pari passu*. However, new accounts will only purchase existing positions if the current price, relative to value, makes sense. Eventually all accounts will "sync up", but this could take a while. Until then please be aware that you may not hold all of the investments discussed in this letter.

We are pleased with our portfolio's performance year-to-date and continue to see a promising future for our investments. No matter what surprises the world has in store for us, we think our investments are virtually certain to earn more in the years to come.

Tariffs, and Navigating the Unpredictable

Lately we've been asked for our view on tariffs. This surprised us, since we actually give them little thought.

We think about the world in terms of a four quadrant matrix like the one on the next page. The world can be divided into the knowable and unknowable and important and unimportant.

	Knowable	Unknowable
Important		
Unimportant		

It goes without saying that it's best to focus exclusively on the knowable and important quadrant.

What is knowable is, at least to us, humblingly little. The majority of the world is inherently unpredictable. We were as surprised as anyone by Brexit, Trump's presidency, Europe's negative interest rates, and the legalization of cannabis. We simply don't know how the trade war will end and if it will get worse before it gets better.

Fortunately, we don't need to predict any of this to achieve our investment goals.

Once, a reporter asked Jeff Bezos, the founder of Amazon, "What do you think is going to change most in the next 10 years?" Mr. Bezos replied, "That's a good question. But a better question is: What's not going to change in the next 10 to 20 years?"[1] He elaborated that what won't change is the desire for lower prices and faster delivery.

Amazon's success has not been due to its ability to predict the future. Mr. Bezos had no idea his modest online book retailer would one day own one of the largest cloud computing businesses in the world or have a logistics network threatening to rival UPS and FedEx.

Instead, Mr. Bezos focused on providing the lowest prices and fastest delivery. This started a positive feedback loop — low prices attract customers whose scale allow Amazon to lower prices further, thereby attracting more customers. Today Amazon's scale and cash flows give it a competitive advantage and allow it to respond to unpredictable circumstances from a position of strength.

[1] https://www.diamandis.com/blog/what-wont-change-in-20-years

For example, Amazon can force merchants to swallow a large portion of tariffs because the merchants can't afford not to sell through Amazon. While prices might rise on Amazon, they will rise less than elsewhere and remain the lowest. Businesses with strong competitive advantages give managers lots of options for dealing with unpredictable circumstances.

The best businesses throw managers a bunch of softball pitches. Difficult businesses throw curve balls. In investing, as in business, there are no points for difficulty. We want to own businesses throwing softballs.

Warren Buffett, CEO of Berkshire Hathaway, likens a competitive advantage to a moat that protects a company's economic castle. The deeper and wider the moat, the safer the castle, and the greater the profits.

We don't rely on predictions to deal with uncertainty. Rather, we try to identify what won't change and invest in businesses with demonstrated and enduring competitive advantages. Buying businesses with wide and deep moats, run by managers committed to widening and deepening them further, and paying only a reasonable price, is the best way to achieve our investment goals, no matter what the future holds.

An example of this in action is our recent investment in Wells Fargo. We were shocked and angered when Wells Fargo's fake accounts scandal broke in September 2016.

As the scandal broke and intensified, we studied the business. We noticed that, despite public outrage, Wells Fargo was not losing customers. Think about this — when was the last time you moved your checking account? Most of us rarely, if ever, move it. Checking accounts are sticky because the marginal gains of moving it are outweighed by the potential costs: missing a paycheck or bouncing a check. Even Wells Fargo's fake accounts scandal couldn't cause a meaningful number of customers to leave.

All banks make loans at about the same rates. They distinguish themselves with their cost of funding. Wells Fargo's moat is its exceptionally low cost of funding, driven by large numbers of non-interest bearing deposits.

We reasoned that if Wells Fargo could maintain its competitive advantage in the face of its fake accounts scandal, it could weather almost anything. At the same time, Wells Fargo was out of favor with investors and trading for less than ten times earnings. To top it off, Wells is taking advantage of its low valuation by buying back an extraordinary amount of stock. It plans to return 15% of its market cap via dividends and buybacks between July 2019 and June 2020.

Our investment in Wells Fargo has nothing to do with where we think interest rates will go, what GDP will be next year, or inflation, for that matter. It's predicated on our belief that Wells Fargo has an extraordinary competitive advantage yet is priced as if it is a run-of-the-mill bank.

Tariffs will come and go. So will presidents, wars, and interest rates. We are not aware of anyone who has consistently predicted them. Instead, we focus on the knowable and important — demonstrated and enduring competitive advantages that allow businesses to navigate unpredictable circumstances from a position of strength.

Altria

We bought Altria in late September when it became indisputably cheap relative to its unprecedented pricing power. Pricing power — the ability to raise prices without a commensurate drop in demand — is the most desirable quality in a business. Raising prices produces an infinite return on investment: it costs nothing and produces pure profit. Pricing power insulates a business from inflation and, in Altria's situation, declining cigarette volumes.

Altria's cigarette volumes have declined 3% annually the past four years. Meanwhile, Altria's operating income has compounded 5% annually, thanks to higher prices. Altria's pricing power comes from regulations that prohibit advertising. Without advertising, it's impossible for upstarts to launch a competing brand. This has proven an insurmountable moat: Marlboro has been the best-selling cigarette in the U.S. for 40 years.

Altria owns Marlboro and other Philip Morris trademarks in the U.S. They also own 10% of AB InBev, 35% of Juul Labs, and 45% of Cronos. They have broad exposure to leading alcohol, tobacco, e-vapor, and cannabis brands. We don't know exactly how e-vapor, cannabis, or heat-not-burn tobacco products will fare, but sleep well knowing Altria has its bases covered.

Altria has significant optionality that is not reflected in its stock price. Altria's stake in AB InBev has a $16 billion market value. Altria's $76 billion market cap implies its core cigarette business is worth $60 billion or ten times earnings.

This is a no growth multiple, which doesn't seem appropriate given that Altria has raised its dividend 53 times in the last 49 years and targets 7-9% earnings per share growth. This price also values Juul and Cronos at zero, even though Altria paid $13 billion for them. At our cost, we get the optionality of Altria's investments for free plus any growth from Altria's cigarette pricing power.

Why does this opportunity exist? Much like our investment in Facebook and Wells Fargo, headlines, not fundamentals, are driving Altria's stock price. Investors are concerned that:

- Altria overpaid for Juul and Cronos

- The FDA will ban or limit vaping
- The FDA will ban menthol cigarettes
- Altria might merge with Philip Morris

None of these bother us. Most importantly, Altria's stock price already prices Juul and Cronos at zero. Altria has a manageable debt load it can service without them. Besides, historically speaking, regulation has helped, not hurt, Altria.

Next, a ban on menthol will only force menthol smokers to find a new brand. They might even try one of Altria's premium brands, increasing profits. Finally, the merger with Philip Morris has since been called off.

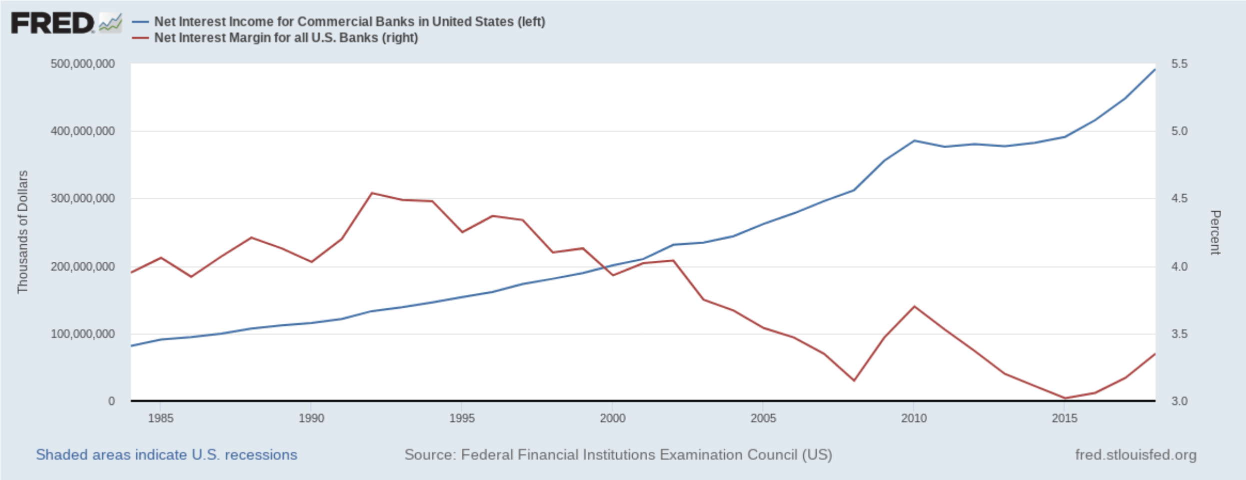
We bought Altria near a five-year low and paid nine times estimated forward earnings, a 40% discount to its historical valuation. At our cost ($40) the stock yields 8.4%. Buybacks bring the total yield close to 10%. We expect some growth, driven by pricing power, and think the stock deserves to trade closer to its historical valuation. Together, these factors make Altria a compelling investment.

Bank of America

In June the Fed approved Bank of America's capital return plan for the year ahead. The plan calls for $30 billion of share repurchases, net of equity compensation, and $6 billion of dividends. Bank of America is worth $275 billion which implies a total shareholder yield (buybacks plus dividends) of 11%. Some GDP-like growth on top ought to make for a satisfactory long-term compound return.

Bank of America's business continues to thrive. Their Q2 report showed $75 billion of new deposits, $37 billion of which came from retail consumers. Net charge-offs remain unchanged at 0.38%. Despite the doom and gloom in the news, American consumers remain strong.

Today Bank of America trades at an undemanding ten times earnings. We think the market is overly concerned that lower interest rates will crimp bank profits. History, however, does not support this theory. The chart below shows the interest income (blue) and net interest margins (red) for all U.S. banks back to 1985.



Source: Federal Reserve Bank of St. Louis[2]

Although net interest margins fell from a peak of 4.5% to a low of 3.0%, total interest income increased every year except for two during the financial crisis. In fact, since U.S. interest rates peaked in 1982 total bank interest income has increased in 35 of 37 years.

In short, bank profits do not correlate directly with interest rates or net interest margins. It's more useful to fixate on a bank's low cost of funding and loan quality — two measures where Bank of America excels.

Berkshire Hathaway

Berkshire owns a collection of businesses of unparalleled quality and has one of the strongest balance sheets in the United States.

Berkshire's market value is roughly $500 billion. This includes around $120 billion of excess cash and $200 billion of stocks. Subtracting these, the market values Berkshire's operating businesses at $180 billion.

What do you get for this $180 billion? You get $17 billion of industrial earnings from businesses like BNSF, Berkshire Hathaway Energy, and Precision Castparts. Berkshire's insurance companies, like GEICO, also hold $125 billion of float. Historically they've earned a 2% underwriting profit on float. That brings expected after-tax operating earnings to $19 billion.

Berkshire's operating businesses are valued at less than ten times earnings, which is unusually low. Individually each of these businesses would be worth more than ten times earnings. Together, as a part of Berkshire, they should be worth even more.

[2] https://fred.stlouisfed.org/graph/?id=USNII,#0

Berkshire's conglomerate structure allows it to move capital, tax free, between its subsidiaries. For example, See's Candy, which cannot reinvest its profits, can transfer its profits, tax free, directly to Berkshire Hathaway Energy, which can earn a guaranteed 10% on additional capital. Berkshire's diverse earnings streams also allow it to underwrite huge reinsurance policies it faces little competition for.

Berkshire currently trades near the low end of its historical valuation range. If its valuation gets much lower, we expect Berkshire to aggressively repurchase its own shares. If large public or private businesses trade at lower valuations, we expect Berkshire to aggressively spend it's $120 billion of excess capital on acquisitions. In this sense Berkshire is truly "antifragile" because it will gain from market disorder.

Brighthouse Financial

August marks the second anniversary of Brighthouse Financial's spinoff from MetLife. Since then Brighthouse's leadership have executed and delivered on their pre-spin commitments. Our investment thesis remains intact, even if the stock continues to trade modestly below our cost.

Brighthouse's annuity sales are growing 30% annually. Costs continue to decline, and Brighthouse's capital buffer continues to grow. The stock has been a strong performer (+30% year-to-date) after a tumultuous 2018. Nevertheless, we continue to see substantial upside in this investment. Brighthouse trades at just 40% of book value and five times earnings. We feel 80% of book value or ten times earnings is a more appropriate long-term valuation.

Brighthouse has the capacity to pay dividends, but favors share repurchases. We're pleased with this given the stock's discount valuation. Since the third quarter of 2018 Brighthouse has repurchased $300M of shares. The company may be able to repurchase up to a third of its shares by the end of 2021.

Management appears to be as enthused about Brighthouse as we are. In August managers spent over $1 million of their own money (not company compensation) to buy Brighthouse shares on the open market. Actions speak louder than words.

Exor

We fully exited our investment in Exor in September. We sold because we found higher quality businesses at steeper discounts to intrinsic value.

We first purchased shares in October 2017 and bought more in March 2018. Our average cost was EUR 54.61. We sold in March, April, and September 2019 at an average price of EUR 61.33. We collected two dividends, EUR 0.35 and EUR 0.40 June 2018 and June 2019. Our total return was 13.3% in Euros and approximately 6.0% in U.S. Dollars.

When we invest abroad we don't hedge our currency exposure. We have no view on currency fluctuations — if we did, we'd trade them directly. Hedging currency costs money. Without hedges, sometimes we will win and other times we will lose. We expect it to net out over time. Unfortunately, this time our currency exposure went against us.

Our modest U.S. Dollar return trailed the S&P 500 over our holding period. Our primary goal is "don't lose money." We cleared this bar while reinforcing important lessons along the way.

We bought Exor because it traded at a 30% discount to the sum of its parts. We sold it at a 22% discount. We thought a fair or realistic discount was inside of 10%. We also thought Fiat, one of Exor's holdings, was trading at a discount to intrinsic value itself, making for a compound mispricing.

Exor is a prime example that it is far more important to focus on an asset's cash flow than it's net asset value. Exor traded at a clear discount to its net asset value, but never produced substantial cash flows. Fiat, while profitable, must reinvest the vast majority of its profits just to remain competitive. This leaves little cash left for owners.

Our enthusiasm for Exor further waned after the passing of Sergio Marchionne. Mr. Marchionne was a miracle worker. We were willing to look past Fiat's poor economics so long as he was at the helm. We have no complaints about Fiat's new management, but acknowledge that it takes an extraordinary leader to make real money in a tough industry like autos.

The Agnelli family knows this better than anyone. They are actively looking to merge or sell Fiat-Chrysler to generate economies of scale and reduce their exposure to a difficult business.

We decided to take advantage of Exor's strengthening stock price to redeploy our capital into businesses that generate more cash flow.

Facebook

Facebook's stock price continues to be substantially more volatile than it's business. Last year shares slid 70%, peak to trough. Year to date they're up 40%. In the last 52-weeks shares fluctuated between a low of $123 to a high of $208. That's a difference of $204 billion of market value. Facebook is an excellent reminder of how Mr. Market can materially mis-price even the largest and best-known businesses. The market's mistakes are our opportunities.

A look under the hood paints a steadier picture. Facebook's Q2 report showed both daily and monthly active users increased 8% year over year. This is the mark of a healthy and strengthening network. Facebook's Q2 revenue grew 28% compared with the year-ago quarter and its cash and securities on hand surpassed $46 billion — almost 10% of Facebook's market value.

Net earnings have temporarily dipped as the company increased investments in privacy and security. Operating margins are "only" 28%. We expect margins to return to the mid 40s, if not higher, in the coming years, as investments mature and operating leverage materializes. Earnings may be lower, but Facebook's earnings power has never been higher.

Facebook's rally since our initial purchase in December puts it at a price we're comfortable holding but not buying. Newer accounts therefore, may not own shares. We will likely be eager buyers if renewed pessimism puts Facebook shares on sale again.

Kontoor Brands

This summer, VF Corp spun off Kontoor Brands. Kontoor owns denim brands like Lee and Wrangler. Kontoor had all of the indications of a classic spinoff mispricing: it was much smaller than parent VF Corp, was in a mundane, low-growth business, and was loaded with (manageable) debt.

Kontoor had little appeal to VF Corp's growth-oriented shareholders, who sold the stock indiscriminately. We bought Kontoor for eight times earnings, a valuation which implies a shrinking business. At worst we expect the business to hold steady and at best grow modestly. Managers need only clear a "one-foot bar" to drive the market's valuation higher.

Buried in its spinoff documents, Kontoor disclosed that they would pay a $2.24 annual dividend. At our cost, this amounts to an 8% yield, which is extraordinarily high for a healthy business. We expected investors hungry for yield to bid up shares once Kontoor declared its first dividend.

So far, that's exactly what has happened. The stock is up 25% since our purchase and we think it has further to go.

Lee and Wrangler are well-known brands sold at approachable prices with extraordinary margins. Even in 2008, the worst recession in a generation, sales only slipped 10%. We like Kontoor's steady cash flow and expect management, unburdened from VF Corp's bureaucracy, to cut cost and invest in growth.

National Beverage

National Beverage is the soft drink company behind LaCroix. It was a stock market darling during 2018's "summer of seltzer", trading at multiples most tech companies could only dream of. This summer, it crashed down to earth and overshot reality. As investor Howard Marks says, sentiment seemed to swing from "flawless" to "hopeless" overnight.

Why do investors suddenly think National Beverage is hopeless? One reason is a frivolous lawsuit that alleges LaCroix doesn't use strictly "all natural" flavors. This claim has been scientifically dismissed several times, but the negative publicity has hurt. Another reason is the entrance of new competition.

We don't think competition is a death sentence for LaCroix. Soft drinks have such exemplary economics that even a non-dominant brand can make serious money. Further, soft drink markets are often dominated by two brands (Coke and Pepsi, 7 Up and Sprite, Monster and Red Bull). Given that LaCroix is the incumbent number one, we think it will be one of the two brands left dominating. The sparkling water market is likely to grow so much that LaCroix can afford to give up a little market share and still grow as its slice of the pie gets bigger.

While La Croix's growth has certainly slowed, its economics remain excellent. The company enjoys market-leading returns on equity and total capital employed, maintains a pristine balance sheet, and is run by an owner-operator (albeit a quirky one) with skin in the game.

We bought National Beverage for ten times pre-tax earnings. This is a no-growth multiple, so any future growth is free. National Beverage is an above average company trading at a 40% discount to the S&P 500. We don't see how it would trade at this valuation in a privately negotiated sale.

Parker Drilling Company

Parker Drilling is a small arbitrage position we recently bought. The advantage of being small is that we can move quickly on these micro cap deals when we find them.

In September Parker announced that they would voluntarily delist from the New York Stock Exchange to reduce costs. In order to withdraw its SEC registration, Parker must have fewer than 300 shareholders. Management, who control the company, announced their intention to buy out anyone who owns 99 shares or fewer at $30 per share. A third party valuation pegged the company's fair value at $20 to $30 per share. We bought each account 99 shares at $20 per share.

Parker's board of directors will hold a special meeting in Q4 to vote on the buyout. Managers hold a majority of the votes, so the meeting is a formality. After the vote, the transaction will close as soon as possible. We expect this to wrap up by the end of the year.

Retail Value

We sold our Retail Value shares for $37 this summer. This was a successful investment, and a good reminder of the three most important words in investing — "margin of safety."

We bought Retail Value a year ago after DDR Corp spun it off. Retail Value owns retail real estate in the U.S. and Puerto Rico and is liquidating.

We bought shares at $32 thinking they were worth $50. We based our valuation on a 2017 lender's appraisal and comparable sales.

However, as sales closed it was clear we had over valued their properties. The stock's price rose while our estimate of intrinsic value shrunk. They finally met in the middle at $37, where we sold.

We made 20% on this investment, which doubled the market's return over our holding period. The investment worked out in spite of our error because we had a wide margin of safety between our cost and estimate of intrinsic value.

Our goal is to avoid losing money, even when we're wrong. Mistakes are part of investing. Instead of living in denial, we expect them and leave room for error. Retail Value shows how we can make money even when we're wrong if we have a large enough margin of safety.

Southern Bancshares

Southern Bancshares Q2 report showed strong year-over-year growth. Total deposits increased 7%, and non-interest bearing deposits increased 11%. Book value increased 16%, driven mostly by Southern's First Citizens stock.

Southern's First Citizens stock is worth $80 million today, net of deferred capital gains taxes. Southern's $305 million market value implies its operations are worth $225 million or 7.5 times earnings.

Another way to think about Southern is to value its look-through earnings. Southern's share of First Citizens income is $8 million. Southern Bank and Trust earned $30 million itself which makes $38 million total. At a $305 million, Southern trades for eight times look-through earnings.

We believe Southern's bargain price is due to its structure, not its economics:

1. It is too small ($305M market cap) and too illiquid for institutional investors.
2. It is not registered with the S.E.C., though it does publish audited financial reports.
3. It is not traded on a national stock exchange, but rather trades over the counter.
4. It owns $80 million of First Citizens stock, which it does not draw attention to.

We're happy to invest alongside the Holding family, which owns and operates the bank, knowing they have skin in the game. They have the biggest incentive of all to focus on collecting low-cost deposits, making high quality loans, and buying back stock when its available at a discount to intrinsic value.

Walgreens Boots Alliance

We purchased Walgreens in August after studying the business for over a year. Walgreens exhibits all of our favorite investment qualities: an entrenched business gushing cash and a low valuation due to temporary uncertainty.

We bought Walgreens for about seven times our estimate of owner's earnings. The market gave us this opportunity because of pessimism over:

- Future drug reimbursement rates
- Fewer generic launches (on which Walgreens earns higher margins)
- Amazon's acquisition of Pill Pack, an online, mail-order pharmacy

Walgreens is best understood as a front-line distributor of pharmaceuticals and health care. They are efficient, convenient, and lower cost than alternatives, like hospitals. 78% of Americans live within five miles of a Walgreens.

We're confident that their competitive position will allow them to earn adequate rates of return no matter how the government regulates health care. Amazon doesn't scare us because Walgreens has already been in the mail-order pharmacy business for years.

Walgreens' CEO Stefano Pessina has plenty of skin in the game, to the tune of a 15% personal stake in the company. He's led an aggressive stock repurchase program while the stock price languishes. Walgreens' is currently repurchasing about 8% of its shares annually and sports a 3.5% dividend yield. Together they make for an 11.5% shareholder return. We expect modest growth to add to this and make for a compelling total return.

Wells Fargo

We already touched on our reasons for buying Wells Fargo in the section titled "Tariffs, and Navigating The Unpredictable" so we'll only expand briefly here.

In our experience, the best investments are the ones journalists hate but customers still use. That was true of our investment in Facebook and again with Wells Fargo.

We think Wells Fargo is a wonderful business, primarily because its customer relationships are very sticky and provide it with lots of low cost funding. We bought it at a discount to its historical valuation and at a discount to its peers.

One reason for the discount valuation is the asset cap imposed by the Fed. The Federal Reserve currently prohibits Wells Fargo from expanding its balance sheet, as punishment for its fake accounts scandal.

We don't think this is entirely bad, as most seem to. First, it won't be forever. We can't predict when the asset cap gets lifted, but know sooner or later it will be. Second, the asset cap is forcing Wells Fargo to increase the quality of their assets since they can't increase the quantity. Ten years into an up cycle, this seems prudent. Finally, the asset cap has left Wells Fargo with excess capital and an undervalued stock. Wells is taking full advantage of this.

In June the Fed approved Wells Fargo's capital return plan, which includes a $23 billion share repurchase between July and next June. This amounts to an 11% yield. Wells Fargo also raised its dividend and currently yields 4%. In total, Wells yields 15%, which is extraordinary for a first class business in a low rate environment.

In Closing

We would like to thank you for your continued support and trust. Investment managers can only afford to be as patient as their clients allow. Your patience and trust contribute as much to our success as anything we do at Eagle Point Capital.

Please contact us (matt@eaglepointcap.com or dan@eaglepointcap.com) with any questions about your account or your investments.

If you know any like-minded investors who would enjoy this letter, please forward this to them or put them in contact with us.

You can expect to hear from us again next spring for another portfolio update. In the meantime you can read our old letters and blog at www.eaglepointcap.com. We encourage new readers to join our mailing list to receive future updates.

On the following page you will find a short memo on our fundamentals. It explains our goals and methods. Investing is simple but not easy, and success is made or lost on the application of fundamentals.

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Past performance is no guarantee of future results.

Once, after winning two consecutive national championships, the Green Bay Packers lost a game due to sloppy play. Coach Lombardi called a meeting the very next day. When all the players were assembled, Lombardi held a football high up in the air and declared, “Gentlemen, this is a football!” From the back of the room, running back Paul Hornung shouted back, “Coach, can you slow down?”

In investing, as in football, success is made or lost on the application of the fundamentals.
This document sets forth the fundamental operating principles of Eagle Point Capital. Through the up and down markets ahead, we will always return to the principles below to inform our attitudes and actions.

- Our objective is to avoid the permanent loss of capital while maximizing the increase in long-term, after-tax purchasing power of our funds. Put another way, we aim to build an indestructible long-term compounding machine.

- To achieve this objective we seek to make concentrated investments in businesses that:
  (1) We understand.
  (2) Have a demonstrated and enduring competitive advantage.
  (3) Have a resilient balance sheet.
  (4) Have honest and able management who run the company for the benefit of shareholders.
  (5) Can be purchased for a reasonable price that affords a margin of safety.

- In other words, we aim to purchase, at a rational price, interests in easily-understandable businesses whose earnings are virtually certain to be materially higher five, ten, and twenty years from now. We prefer cockroach-like businesses — very hardy and almost impossible to kill — that are drowning in cash.

- We think independently and do our own research. We don’t rely on the opinions of analysts or journalists, both of whom may have different motivations than ours. We rely primarily on S.E.C. filings for information.

- We do not diversify excessively. Good investments are hard to come by and we would rather concentrate our capital into our best ideas than spread among many mediocre ones. We typically own eight to ten businesses and put 10% of our capital, at our cost, into each.

- We think and act like business owners. As owners, we focus on the fundamentals of the business and do not obsess over price fluctuations. When possible, we use periods of unjustified pessimism to purchase high quality companies at attractive prices. Likewise, we prefer to use periods of unjustified optimism to sell companies for more than we feel they are reasonably worth. The market is our servant and not our master.

- The best way to measure our success is to compare Eagle Point Capital's return, after fees, to the S&P 500's total return (including the reinvestment of dividends) over five-year periods. Measurement over a shorter timeframe may reflect luck more than skill. The S&P 500 is our benchmark because it is widely followed, offers the potential for large, low-cost investments, and, we expect, will produce satisfactory long-term returns. Over time, we expect good relative returns to the S&P 500 to become excellent absolute returns.

- All accounts are managed *pari passu*. A two percent annual fee on assets under management is charged to all accounts. Fees are accrued daily and deducted quarterly in arrears.

- Clients will receive a letter twice a year detailing what they own and why they own it. Our reports will be candid, emphasizing the positive and negative factors important to appraising intrinsic business value. Our guideline is to tell you the business facts we would want to know if our positions were reversed. We owe you no less.

- Eagle Point Capital is not in the business of predicting the general stock market or business fluctuations. If you think we can do this or that it is essential to an investment program you would be best suited looking elsewhere.

- We cannot guarantee results to clients. What we can and do promise is that:
    - Our investments will be chosen on the basis of value, not popularity;
    - We will attempt to bring risk of permanent capital loss (not short term quotational loss) to an absolute minimum by obtaining a wide margin of safety in each investment; and
    - We have virtually our entire net worth invested alongside Eagle Point Capital's clients. We eat our own cooking.

Many of you who are already familiar with Eagle Point Capital may feel, like Paul Hornung, that this material is unduly repetitive. However, we would rather have many bored clients than a single client with any basic misconceptions. As Charlie Munger says "A majority of life's errors are caused by forgetting what one is really trying to do." A firm grasp of our fundamental operating principles will help us stay the course in the future.