ALLUVIAL

CAPITAL MANAGEMENT, LLC

First Quarter 2015 Letter to Clients

	Performance Since Inception (March 31, 2014)	Q1 2015	2014*
Global Focused Value	**19.4%**	**3.0%**	**15.9%**
Global Value	**17.7%**	**4.8%**	**12.2%**
Russell 2000 Index	7.9%	4.3%	3.4%
Russell Microcap Index	3.8%	3.1%	0.6%
MSCI ACWI Small Cap Index	1.7%	4.0%	-2.3%
Global Quality & Income	**6.4%**	**0.6%**	**5.7%**
50% MSCI ACWI Small Cap Index/50% Barclays US Aggregate Bond Index	3.7%	2.7%	0.9%

*From March 31, 2014

With the first quarter of the year gone by, I am pleased to report that all of Alluvial's strategies recorded gains for the period. I am less pleased to report the **Global Focused Value** and **Global Quality & Income** strategies lagged their benchmarks as global stock markets continued their climb. Global Focused Value in particular was hindered by a large decline in one portfolio holding. Each of Alluvial's strategies now has a full year of reportable performance, and I am pleased with how each has performed. Despite the mediocre quarter just completed, I believe the returns achieved by the strategies thus far support my core assertion: that a disciplined application of value investing principles to inefficient market segments can result in attractive returns. This belief was the impetus for founding Alluvial, and I will endeavor to use these principles to achieve strong returns for Alluvial clients for years and years to come.

The numbers that flash on our trading platforms and scroll across the bottom of the TV screen are mesmerizing and we are all delighted when we see our holdings rise. But investors must never forget that stock investments represent proportional ownership in real operating businesses, and share prices are ultimately driven by the success of these businesses. For the most part, I am very pleased with the business developments at portfolio companies in the quarter. I'll take some time to highlight some of these developments, and also to discuss the one notable disappointment.

Sotherly Hotels

2014 was a banner year for US hotels, with revenue per available room up strongly over the previous year. Sotherly's hotels fared well, with hotel-level earnings rising 38% in 2014. For the whole year, adjusted funds from operations were $1.09 per share/unit, and the company expects 2015 AFFO per share/unit to reach $1.20-$1.28. Despite the excellent outlook, Sotherly's share price continues to meander between $7 and $8. In 2015, Sotherly will complete multiple hotel renovations and will continue integrating its recent acquisitions. Assuming all goes well, Sotherly's growing cash flows will support increased dividends.

On Sotherly's fourth quarter earnings call, a shareholder asked CEO Drew Sims about his view on the company's share price. Mr. Sims delivered an unusually frank response, estimating the company's NAV in the low-to-mid teens and noting that in recent financings, banks estimated the company's asset value at around $500 million, $200 million higher than the company's financial statements show.

BFC Financial and BBX Capital

BFC and BBX remain bedeviled by legal uncertainly. It appears the SEC will get its wish and CEO Alan Levan will be barred from serving as an officer in a public company, but he won't be going quietly. The appeals process could stretch on for a long time, but not indefinitely. However, until the legal process is resolved, I don't expect BFC and BBX to trade based on their substantial asset and earnings value.

Backing out BFC's 51% stake in BBX, the combined companies trade at a market capitalization of $430 million or so. That's only 4x the 2014 earnings of BFC and BBX's most valuable asset, Bluegreen Vacations. In addition to Bluegreen, BBX and BFC together own hundreds of millions in real estate and loans, and won't pay taxes for a long, long time due to massive NOLs.

BFC is tendering for an additional 30% BBX at $20 per share. By bringing its ownership in BBX to over 80%, BFC and BBX can begin filing a consolidated tax return. One of the conditions of the tender offer is that BBX shares remain listed on a national exchange, indicating the companies still intend to merge, likely once Levan's fate has been determined.

Rand Worldwide

At first glance, Rand Worldwide's results for the quarter ended December 31 appeared weak. But these results included a number of one-time items, including the costs of the company's self-tender that gave control of the company to value investor Peter Kamin. Excluding the costs, operating expenses decreased. Revenues appeared to decline year-over-year, but this was due to a large one-time order booked a year ago. Excluding that order, revenues rose 7.6% and gross margin improved. The company has made good progress in reducing the debt it took on to fund its tender offer.

As a leading reseller of Autodesk's software products, Rand's future earnings are levered to those of Autodesk, and there's good reason to be optimistic. Autodesk reported a 13% rise in revenues for the fourth quarter of 2014, and the company's transition to subscription-based software appears to be progressing well.

It's rare to have a chance to buy a company with Rand's bright outlook and rapidly deleveraging balance sheet at a single digit multiple of operating income. As long as Peter Kamin can execute his usual business plan (improving earnings via revenue growth and good cost control) then Rand shares are worth quite a lot more than the last trading price around $2.00.

Otelco

Otelco is perhaps the most boring business of all of Alluvial's picks. Nobody gets too fired up over traditional telephone services in backwater markets. If there's anything "exciting" about Otelco, it's the highly-leveraged balance sheet. However, Otelco's predictable flows continue to make a bigger and bigger dent in the company's debt. Fourth quarter results indicated a stable total client base, with growth in the business-oriented segment offsetting reduced retail-oriented revenues. EBITDA declined due to one-time severance costs. Excluding these costs, EBITDA was consistent with third quarter results. At today's trading price, Otelco's forward-looking levered cash flow yield to the enterprise is north of 15%, more than twice that of larger competitors. As the debt declines, more and more of those cash flows will accrue to the company's equity.

As long as Otelco can continue to amortize debt more rapidly than its EBITDA declines, I don't believe the company will have difficulty refinancing its debt before it comes due in April, 2016. Access line equivalents remained flat or grew in the second half of 2014, a very positive sign for the company's revenue base. If the market refuses to take notice of the company's progress, eventually a competitor or private equity buyer will.

And now to this quarter's fly in the soup, **Paul Mueller Company**. Paul Mueller reported an unimpressive fourth quarter and the stock promptly fell 30%. Some of the drop was deserved, but I think the decline is severely over-done. Then again, that's the risk of owning thinly-traded microcaps, which can plummet or soar on minimal volume.

Paul Mueller's poor fourth quarter results were due to a strong dollar and weak margins in the industrial fabrication division. Investors were also spooked by a large increase in the company's reported pension deficit. A large part of Paul Mueller's dairy tank profits are earned in the Netherlands, and those earnings shrank as the Euro fell against the US Dollar. In the industrial fabrication division, the company ran into issues of cost overruns and poor demand. The attempted turnaround of the struggling industrial division remains frustratingly slow to materialize.

Despite the quarter's weakness, 2014 was in many ways a good year for the company. Profits from the dairy tank division hit a new high, up 48% from 2013. Revenues rose 11% while net debt declined 13%. For the full year, Paul Mueller earned $5.56 per diluted share. Excluding a charge due to a ruptured tank, diluted EPS would have been over $7.

In a phone conversation with Paul Mueller CEO David Moore, I was able to question him about the poor quarter and came away very satisfied with his explanations and plan to correct the company's performance issues. Mr. Moore believes the company is finally close to bringing an attractive lineup of tanker trucks to market, which should bring the industrial division back to profitability. He also expressed optimism that the dairy division's strength will continue, and that the company will be successful in improving its balance sheet. When I asked him about the increased pension deficit, he noted the change was due solely to more conservative return and discount rate assumptions, and that the frozen plan's contribution requirements will remain low for many years to come.

Paul Mueller trades 4-5 times my estimate of normalized earnings, making it a very attractive holding at the current price. Yet, the company still has material issues that must be addressed for its profits to experience real growth and for a robust balance sheet to be realized. While I have faith in management's plan to address these issues, my patience will not last forever and I'll need to see consistent progress for Paul Mueller to remain a core portfolio holding.

My most recent addition to Alluvial portfolios is **Command Center, Inc.** Command Center is a provider of temporary labor, mostly to blue collar industries like construction, hospitality, sanitation and manufacturing. Command Center is enjoying the results of a multi-year consolidation and cost control effort lead by CEO Frederick “Bubba” Sandford, who assumed the role in 2013. Command Center’s top-line results have remained steady for the past few years, but profits have rocketed due to Sandford’s emphasis on winning high-margin business and making manager’s directly responsible for their storefront’s profitability.

In 2014, Command Center earned operating income of $6.5 million, up nearly 50% from 2013. Command Center’s business requires little reinvestment, so cash has built up on the balance sheet year after year. Command Center now has net cash of $5.7 million and is poised return capital to shareholders, or to make productive acquisitions. The temporary labor industry is extremely fragmented and the company has stated that “mom and pop” operations can often be purchased for 2-3x cash flows.

Command Center’s valuation is a very undemanding 7.1x operating income. With the company’s earnings likely to grow significantly in coming years, shareholders should do very well.

I receive a good number of inquiries from investors interested in knowing where I see value in today’s soaring markets. There is still value to be found in US markets, but I am finding many more attractive stocks in markets like France, Germany, and other markets where small companies go overlooked. There’s a good chance that one of more of these names will show up in Alluvial portfolios in 2015.

Thanks again for being an Alluvial client. Little else is as rewarding as finding attractive investments for you. I look forward to profiting together for many years to come. As always, I welcome questions and comments. Please don’t hesitate to contact me any time.

Regards,
Dave Waters, CFA
Alluvial Capital Management, LLC

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