ALLUVIAL

CAPITAL MANAGEMENT, LLC

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Third Quarter 2017 Letter to Alluvial Fund, LP Limited Partners – October 23, 2017

Monthly Performance Figures

2017	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sept	Since Inception, Jan 2017
Alluvial Fund, LP, Net	2.2%	1.9%	1.0%	2.9%	3.5%	0.6%	3.5%	0.9%	2.9%	**21.0%**
S&P 500 TR	1.9%	4.0%	0.1%	1.0%	1.4%	0.6%	2.1%	0.3%	2.1%	**14.2%**
Russell 2000 TR	0.4%	1.9%	0.1%	1.1%	-1.2%	2.6%	0.7%	-1.3%	6.2%	**10.9%**

Top Holdings	%
ALJ Regional Holdings, Inc.	11.0%
Retail Holdings NV	8.1%
Contura Energy, Inc.	6.8%
New Ulm Telecom, Inc.	5.7%
Meritage Hospitality Group, Inc.	5.5%
Top 5 Positions, % of Total	**37.1%**

World Allocation	%
United States	83.2%
Sweden	8.3%
Germany	4.0%
Poland	2.7%
Norway	1.7%
Top 5 Countries, % of Total	**100.0%**

Dear Partners,

I am pleased to report another quarter of gains for Alluvial Fund, LP. For the quarter ended September 30, the partnership returned 7.4% versus 4.5% for the S&P 500 Index and 5.7% for the Russell 2000 Index. Year-to-date and since inception, our partnership has returned 21.0% compared to the S&P 500 Index's 14.2% and the Russell 2000 Index's 10.9%.

Despite our venture's auspicious start, I would caution partners very strongly against expecting future returns to be achieved in like fashion. Recent experiences notwithstanding, markets *do* decline with some regularity, and our own holdings are unlikely to avoid all losses when pessimism rules the day. My belief that Alluvial's strategy will produce attractive returns over any full market cycle is strong, but we will endure volatility and periods of moribund results along the way.

ALJ Regional Holdings, Inc.

At quarter's end, Alluvial Fund's largest holding was ALJ Regional Holdings. Capital inflows into Alluvial Fund have since reduced ALJ's weighting to the high single digits. At first glance, ALJ's significant undervaluation may not be apparent. The company's trailing reported pre-tax income is a mere $5.1 million versus a market capitalization of $122 million. The company carries meaningful debt and its most profitable segments are not high growth businesses. Despite this, I am convinced that accounting conventions are obscuring ALJ's robust free cash flow generation and the company is worth substantially more than its recent trading range.

ALJ records large amortization expenses due to the accounting treatment of certain intangible assets like customer relationships and trade names. These amortization charges greatly reduce reported earnings, yet the company's actual reinvestment needs are much smaller. Since the company took its present form in 2014, annual capital expenditures have averaged 2.5% of revenues, a level I expect to remain consistent.

ALJ's most significant segments are Faneuil, a call center and customer service provider, and Phoenix, a high-specification printing business. Both segments have substantial backlogs and produce significant cash flows. ALJ's third segment is Carpets. This business sells flooring and other interior components to homebuilders and retail customers in the Las Vegas area. While Carpets operates around break-even, it has grown its revenues at a breakneck pace and appears ready to turn the corner on profits. Just recently, ALJ has made small acquisitions to bolster the Faneuil and Phoenix segments.

I believe that together, Faneuil and Phoenix can generate approximately $37 million in annual cash flow and a little more than $30 million after maintenance capital expenditures. ALJ's annual corporate costs are $3 million or so, and cash interest expense is a little under $9 million. Free cash flow from Faneuil and Phoenix less corporate costs and cash interest expense works out to $19 million. Then there is the Carpets segment. Using various assumptions for revenue growth and eventual operating margins, it is possible to reach a very wide range of valuation estimates in good faith. Of the various public building products distributors, the cheapest I can find is valued at 25% of revenues. At a very conservative 20% of revenues, Carpets would be worth $14 million.

At a 12% yield on $19 million in free cash flow, ALJ's equity value would be $158 million. Adding Carpets' $14 million value brings total equity value to $172 million, or $4.70 per share.

But what about taxes? Well, ALJ is not a federal taxpayer and will not be for several years. The company has over $150 million in federal NOLs that do not being to expire until 2022. And why pick 12%? After all, that's a great deal higher than the free cash flow yield the market applies to many other firms. It comes down to the fact that despite its robust cash flows, ALJ does carry quite a bit of leverage. That leverage should decline quickly, as the company dedicates nearly all free cash flow to debt reduction. But for now, the company is working its balance sheet rather hard.

Near-term segment results may come in a little higher or a little lower than my estimates. I don't think it matters much in the long run. That's because looking at the numbers alone doesn't capture what I believe is the company's most valuable intangible asset: Mr. Ravich's leadership. Jess Ravich is an accomplished dealmaker and he has guided ALJ Regional Holdings to incredible growth in equity value over the last decade. While not 100% of Ravich's deals will be unqualified successes, I do think he will continue to build equity value at a rapid pace. I have no doubt that the ALJ of five years from now will be nearly unrecognizable to today's shareholders, yet it will be much more valuable.

Retail Holdings NV

If I seem to mention this particular holding in every letter, its only because there always seems to be something new to report! The end is in sight for Retail Holdings' long running liquidation. Having sold off all but a small piece of its highly valuable Sri Lankan business in September, the company now holds only its Indian and Bangladeshi subsidiaries. Singer India is worth only $3 per Retail Holdings share, while Singer Bangladesh is worth $12. I should note that a portion of the remaining Singer Bangladesh stake carries restrictions on remittance from Bangladesh. Singer Asia is seeking to remedy the situation. I assume any resolution will involve some kind of payment to the Bangladeshi government, so I think it's fair to discount the value of the restricted shares by 25% or so. That discount would cut NAV by $1.02 per share to $26.60 as of September 30.

Between now and mid- January, Retail Holdings will distribute $9 per share, or 41% of the current trading price of $22. Assuming shares fall to $13 following the $9 in distributions, Retail Holdings shares will trade at a discount to NAV of 26%. I expect the company to make distributions of at least $10 in 2018, and to complete its liquidation by mid-2019 at the latest. Even if ultimate liquidation is delayed by another six to twelve months, Retail Holdings shares offer a superior opportunity at $22.

New Ulm Telecom

New Ulm is a new position for Alluvial. While shares of the company have moved up substantially this year, the market has yet to adequately price in the impact of the FCC's new funding mechanism on rural telecom providers like New Ulm. The Alternative Connect America Cost Model or "A-CAM" provides these companies with generous subsidies to fund the buildout of broadband services in under-served rural areas. Broadband services are the future for rural telecom providers facing long-term declines in traditional wireline services. Despite the additional capex that New Ulm will be required to deploy, the net effect is a notable uplift in free cash flow. In 2016, the company produced $1.23 per share in free cash flow. This year, I expect New Ulm to produce at least $1.40 per share in free cash flow. Future years will see continued increases based on revenue growth from broadband services. Even before A-CAM, New Ulm's data and video services were growing healthily and more than making up for declining traditional telephone revenues. Data revenues grew at a 20% annual pace from 2012 to 2016, while video revenues grew at 12%. I expect the new A-CAM subsidies to only strengthen these trends.

The investment case for New Ulm is further bolstered by the firm's conservative balance sheet. Compared to most telecom companies that carry debt loads of two to three times EBITDA or more, New Ulm's debt is only 1.4 times trailing EBITDA, and declining quickly. New Ulm could very easily borrow to fund productive capital expenditures, or to return capital to shareholders. I hope they will!

At ten times 2017 free cash flow and with that free cash flow poised to increase, New Ulm makes a very attractive and conservative holding with ample upside potential.

Venturing Farther Afield

Of late, I have been intrigued by Central European markets, Poland in particular. Despite its small economy, Poland boasts an impressive number of publicly traded companies. Not speaking Polish, the vast majority of these companies are inscrutable. However, a number of Polish companies report in English and offer more than adequate data and disclosure on their operations and results. I have made investments in two of these companies. Both companies' shares are very illiquid and I may seek to acquire more, so each will remain unnamed for the time being.

One of these companies is actually located in a Baltic country, but its shares trade in Warsaw. This company is a capital goods lessor with an excellent track record. At present, shares trade at 50% of tangible book value. Cash, net of debt, exceeds 60% of the company's market capitalization. The other company is a subsidiary of an international infrastructure operator. This company trades at a gigantic discount to the present value of its contracted cash flows.

Despite the extraordinarily low valuations these businesses carry, my Polish positions will remain only a small portion of Alluvial Fund's total value. I am keenly aware of the country's tenuous political atmosphere and a larger allocation would not be prudent.

The Value Bin

Like many people, my wife and I have a drawer in our kitchen where we toss odds and ends like batteries, screwdrivers, twine, etc. All things we expect will prove very useful someday, but not right now. It's the junk drawer. Alluvial Fund has a metaphorical junk drawer that I'll call "The Value Bin." From time to time I run across very deeply undervalued securities that are so small or illiquid that building even a small position is difficult. Nonetheless, I think it makes sense to accumulate holdings like these in dribs and drabs whenever shares become available. Some recent additions to the bin include a New England thrift trading at a steep discount to tangible book value, and a recently demutualized, highly over-capitalized insurance company with growth options trading at 85% of tangible book value. If you know of any deeply-discounted, difficult to trade candidates for the value bin, I would love to hear about them!

Operational Updates

As I write, Alluvial Fund's assets exceed $14 million and we have welcomed sixteen limited partners. I am tremendously excited about our growth thus far, and I look forward to welcoming many more partners into the fund in the months and years to come. I have more investment ideas than Alluvial Fund has capital and I would like to remedy this situation!

For nearly four years, I have run Alluvial from my home, and alone. As a guy who tends to lose track of time while engrossed in spreadsheets and financial statements, it's been great! But a growing organization much change. In early 2018, Alluvial will be moving into its first real office space *and* hiring an assistant. Big changes to be sure, but good ones. I will be touch with more information at the appropriate time.

Thank you for entrusting your capital to Alluvial Fund. All of my own capital is invested in Alluvial Fund, and stewarding our capital is a charge I take seriously. Please enjoy the remainder of the autumn and the coming holidays, and I look forward to writing to you again in January.

Best Regards,

Dave Waters

Dave Waters, CFA

Alluvial Capital Management, LLC

Disclosures

All Alluvial Capital Management, LLC investment strategies are subject to market risk, including the risk of permanent loss. Alluvial's equity strategies may experience greater volatility and drawdowns than market indexes. These strategies are not intended to be a complete investment program, and are not intended for short-term investment. Before investing, clients should carefully evaluate their financial situation and their ability to tolerate volatility.

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Performance Disclosures

Performance data provided in this publications is not audited. Alluvial Fund, LP has a fiscal year end of December 31, 2017 and is subject to an annual audit.

Performance figures for Alluvial Fund, LP are reported net of all partnership expenses, management fees, and performance incentive fees. Reported performance figures assume Alluvial Fund's standard management and performance incentive fees apply.

Contact

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