T11 Capital Management

One Park Plaza, Suite 600
Irvine, CA. 92614
tel: 949-441-5152 fax: 949-441-5099
www.T11Capital.com

email: mail@T11Capital.com

- Largest **winning** position in February: BFCF +31.21%
- Largest **losing** position in February: None
- New additions to portfolio: HH, IWSY, SPNS
- New liquidations in portfolio: None
- Portfolio exposure as of February 28th: 95% long/5% cash

- Long Positions as of February 28th: **WMIH, CIDM, BFCF, HH, IWSY, SPNS**

Portfolio Highlights For February

- **BFCF** experienced a substantial gain for the month. The first half of the month for the name saw steady accumulation taking place, with a moderate rise in the share price. On February 14th, BFCF filed an S-4 document, which is a registration statement pertaining to a merger. This document is related to the pending merger of BFCF with BBX. Following the filing of the S-4, BFCF went from $3 per share to as high as $3.82, ending the month at $3.70.

  The S-4 document didn't tell us anything we don't already know with respect to the various businesses involved. What the S-4 did shed light on is the fact that the SEC trial, that has been an impediment to the merger plans of BFCF and BBX, has been delayed until November of this year.

  This is a significant development in that it allows investors to focus on the value proposition that is apparent in BFCF without the imminent danger of an adverse court ruling disrupting that process. The delay also increases the probability of a settlement taking place before the November date between Levan (CEO of BFCF/BBX) and the SEC.

  The surge in share price following the revelation that the trial had been delayed is an expression by investors of the optimism surrounding these unusual circumstances. The SEC doesn't typically delay trials that are open and shut cases. Especially with respect to an issue that essentially was born out of economic crisis.

  It is fair and perfectly acceptable to assume that if the real estate credit crisis of 2008/2009 had never occurred, the SEC wouldn't be pursuing charges against Levan of making false statements to investors. The hyper-vigilance that brought this case to bear was born from a witch hunt mentality that ensued following a crisis of confidence in the banking system. In order to restore the appearance of stability, government will often times nitpick their way to litigation. This

seems to be the case with BBX and Levan for statements that were made during a conference call in 2007.

The SEC is alleging that Levan didn't properly disclose the risk contained in loan portfolios held at BBX. Further, they are alleging that Levan painted a positive picture to investors while internally expressing doubts regarding the quality of the loan portfolios.

The 11th Circuit Court of Appeals has already ruled in this case following a class action suit by shareholders against BBX and Levan in 2010. In that case the appeals court ruled, "None of its evidence excluded the possibility that class members' losses resulted not from anything specific about BankAtlantic's commercial real estate portfolio that Bancorp hid from the public, but from market forces that it had warned of – and that would likely have caused significant losses for an investor in any bank with a significant credit portfolio in commercial real estate in Florida in 2007."

When you put all of these facts together paired with the substantial delay in the trial, you can only assume that the SEC's case is not built on the most solid foundation. For that reason, it is proper for the market to discount a negative outcome going forward, with the belief that the case will be settled at some point between now and November. If that were to occur, the merger between BFCF/BBX would proceed without further hindrance and the tremendous value contained in the various businesses and real estate holdings realized.

- **CIDM** experienced a gain of 11% during the month of February. The stock is now up close to 100% since being initiated as a position in April of 2013.

  A majority of the position in CIDM was sold during the month of February at prices ranging from the 2.60 range up to the 2.80 range. It is now a small position in the portfolios, with the possibility of being increased over the next few months depending on how it trades going forward.

  There exist in the current market risk/reward propositions that exceed what I see for CIDM over the next few months. In order to allocate into those positions, it was necessary to scale back on one of our current holdings.

  CIDM did release earnings during the month which caused some volatility in the name. The unease with which the stock price traded following the announcement came as a result of two conflicting factors: 1) The extensive run-up in share price left little wiggle room for anything less than stellar in earnings 2) The transitory nature of their earnings report didn't match expectations of the run-up.

  The company reduced guidance due to a revenue recognition issue, which is really a minor blip, if anything at all, in the overall structure of the company's growth.

- **WMIH** experienced a gain of 7.45% for the month of February. The stock continues to trade in a tight range awaiting news of what KKR will bring to the table in the coming months.

  There isn't much in the way of fundamental news to discuss beyond what I've already discussed

in the name over the past 20 months. The only question on my mind as a significant investor in WMIH is whether the NOLs will be utilized over a 2-3 year period or much longer period going forward? The indication of speed with which the NOLs will be depleted should come with the announcement of the initial merger partner. And that depletion rate will determine the extent of the appreciation in share price for WMIH from here. It really is that simple.

Technically speaking, the extremely tight range that the stock has been trading in, while being pinned near its all-time highs, suggests that there are substantial bidders competing against each other to get shares. It further suggests that the bidders are sophisticated in nature, understanding the ramifications of throttling the ask price, causing premature volatility in the name. They are simply sitting on the bid, happily taking shares from any sellers who may step into the market.

It is bullish price action, with expectations that the next run will match similar moves that took place in December 2012, May 2013 and December 2013. These were all moves that were built off similar tightly wound bases.

- A new position was taken in the portfolios in shares of Hooper Holmes (**HH**:NYSE). I have sent out the research report, as well as posting it online. If you haven't read it already, you can find the report here.

  There are certain opportunities that come along in the financial markets that require a good deal of probing. Case in point: WMIH and BFCF. There are other opportunities that are equally substantial, but require much less in the way of piecing together the puzzle. HH is one such opportunity that is abundantly simple in nature, but overlooked due to its history and share price.

  As detailed in the research report, HH recently divested a unit that had weighed on the company for over a decade. This unit was bleeding revenues as consistently as companies like Google have created them over the past several years.

  It took a new CEO that was focused on restructuring the company to finally peel this unit off, getting cash in exchange for its sale. This has bolstered the balance sheet of HH, while allowing them to focus on what has been and will be the key driver for the company going forward: Health and Wellness. This unit becoming unencumbered and unattached, while at the same time becoming the focus of the company going forward, is the most positive step towards consistent growth that HH has taken in over a decade.

  Health and Wellness is a growth industry that is incentivized by the ACA (Affordable Care Act) for companies and those individuals that they insure. On a standalone basis, HH's Health and Wellness unit has grown revenues by nearly 200% since 2008. A fact that was missed by the market as the Portamedic unit that was recently divested essentially buried these positive results. The CEO has said that the company will be generating revenues in excess of $100 million in 4-6 years, with a majority of those revenues being created from the Health & Wellness side of the business.

  The current price in the .50 cent range, representing a market cap of $38 million, is an extremely low risk proposition, with classic asymmetric properties built in. It would take a

grand display of buffoonery for management to impede the progress HH can make on an organic basis alone in the coming years. Given the incentivized nature of the new CEO's compensation, along with his experience, that display of buffoonery is a low probability event.

- **SPNS** was added back to the portfolios in February, representing a small position overall. SPNS is a holding that allows cash to be put to work in a name that I have grown very familiar with over the past two years. That familiarity creates confidence that most importantly creates risk adjusted short-term gains that can be counted on while the market is rallying.

  Fundamentally, the company remains in a predictable growth cycle in the insurance and banking software sector that is being conservatively navigated by a judicious management team. Management here does not go out of the way to overstate results or create the impression of fireworks ahead, simply taking an approach that is slow and steady in nature. This conservative approach is reflected in the share price as SPNS lacks the general volatility you would find in other software names.

  I have found SPNS to be a conservative parking place for cash during bullish periods of time. As far as trading positions go, this is as close to one as you will find in the current portfolios.

- **IWSY** was added back to the portfolios after being sold in the middle of last year following a profit in excess of 150% in just a few months. It has declined roughly 25% from our average selling price, currently sitting at 1.90 per share.

  The fundamental picture really hasn't changed here much since the position was sold. They haven't had much of a surge in revenues from any of their biometric offerings. Their government business remains cyclical and volatile in nature. What IWSY is and always has been is a play on an under-recognized company in an emerging sector. Further, IWSY is a play on larger tech companies being absolutely and unequivocally preoccupied with their core business to bother starting up a biometric segment that is highly dependent on patented technology that is difficult for inexperienced companies to replicate. Additionally, larger companies need biometrics as it is the future of mobile identity verification.

  Case in point: AAPL buying AUTH in July of 2012 for a near 100% premium over closing price. I was long AUTH at the time it was bought by AAPL, originally publishing research on the name when it was in the mid-$3 range. AAPL bought AUTH in the $8 range.

  Authentec had a variety of patented technology that AAPL needed for their biometric fingerprint verification that is being used in the IPhone 5. Could AAPL have replicated such a technology? Possible, if not probable. However, the time involved and the speed with which the mobile cycle evolves didn't allow them the luxury of taking a couple years to set up, recruit, discover and execute the technology necessary.

  It will be much the same with IWSY. The eventuality here will be that a much larger company will have a need for the entirety or a piece of their current technology and will be willing to pay a premium for it. The technology cycle will not allow that large company the luxury of sitting around waiting to develop the technology themselves. This is the strength of IWSY in the current market at this point in time in overall technology cycle.

  The precarious part of this delicate trek forward for IWSY is that without a larger company

involved I can't see them pushing ahead fast enough to avoid having to raise more cash before the end of this year. This is why either a merger or an outright acquisition may be the only way forward here. In either case I believe this eventuality is bullish for the current share price, with time being the most sensitive factor.

Looking Ahead To March

The ancient Greek philosopher Heraclitus once said, "Dogs bark at what they don't understand."

To be conventional in the markets is to expect conventional results. When outperformance of the S&P 500 doesn't exist, the value proposition an asset manager brings to table similarly doesn't exist. There is no reason for an investor to pay a fee to an asset manager when similar results can be achieved simply by purchasing an ETF for a fraction of the cost.

The conventional asset manager cannot expect to exceed the gains of the S&P 500 by any significant sum because his methodology is simply a derivative of the S&P 500. In fact, the conventional investor or asset manager can be expected to underperform. The reason being that not only will the methodology be a reflection of the S&P 500 but it will be a flawed reflection because the participant will inevitably and consistently make decisions that have a negative long-term expected value.

What you end up with in the asset manager that subscribes to the various folklore regarding sound portfolio construction, asset allocation and analysis is an inordinately priced exchange traded fund with various degrees of human error that negatively influence performance. A mala fide ETF, if you will.

Proof of this fact can be found by simply looking past one's nose. The performance of the mutual fund, hedge fund and financial advisor industry is a reflection of conventional investment philosophy that is further degraded by decision making that is less than proficient.

Over the past 26 months, T11 has exceeded the gains of the S&P 500 by 14,000 basis points. All the meanwhile, the maximum drawdown on a rolling month to month basis has been 12%.

This has been done in a portfolio that is contradictory to every accepted rule of traditional portfolio management that exists. Further, this has been done utilizing a methodology that is repeatable over time, with very defined parameters for everything from asset allocation to the opportunities we get involved with.

There is no diversification here. My 6 best ideas are better than ideas 7 through 20. The asset allocation of the portfolios should reflect this fact.

There is no attention paid to the ideas of analysts, investment groups or any individual, regardless of how well regarded. If my screens don't pick up on a company, then that company does not exist.

I use **technical** screens to find great **fundamental** ideas. I don't utilize fundamental screens to

find great fundamental companies. Fundamentally sound ideas can bury an investor over the short to intermediate term. Technically sound ideas that are equally impressive on a fundamental basis do not.

There is no desire to talk to management of companies believing that their incentive is to get me to invest. My research into any special situation should be enough to uncover every detail of the investment sufficiently. It is my philosophy that if I cannot understand a company on my own, I shouldn't be invested.

I use a mechanical, technically based system to determine my asset allocation. I take myself out of the equation believing that there are certain aspects of portfolio management that I shouldn't be involved in.

There is a desire to be involved in situations that are as murky, convoluted and difficult to assess as possible. The lack of adequate fundamental information and coverage creates outstanding risk/reward or asymmetric opportunities. The market severely discounts situations where information is difficult to come by or subject to various interpretation. Information on a company that is readily available and agreed upon creates a premium in share price, leaving little in the way of opportunity. I welcome the uncertainty and the ability to use imagination to form scenarios that are outside of any available filings or research. Responsibly embracing uncertainty, in its numerous forms, has historically been proven to create significant outperformance.

All of the methods described above are purposely put in place to differentiate the construction of the managed portfolios from the S&P 500 or any benchmark, for that matter. The separation is what creates the outperformance.

When an investor directly contradicts their benchmark in terms of methodology, allocation and structure you can expect one of two results:

A) Disaster in abundant proportion
OR
B) Success in abundant proportion

There can be no correlation because the product that has been created is so far removed from the benchmark.

The degree of success (disaster) will directly depend on the experience and resulting skill of the investor.

There is not a right way or wrong way to manage a portfolio. I have seen investors who have done well utilizing fundamental methodology without regard for much else. I have seen investors who have done well utilizing purely technical methodology without regard for much else. I have seen investors that interpret macro events, turning them into vast profits. I have seen investors who are activists, and create tremendous value for their investors.

In each and every case, these investors have had a tangible edge that separates them from their

respective benchmark. All of these investors have realized early on in their careers that their success is directly dependent on separating themselves from the tenets of traditional portfolio management.

It is in blind acceptance that mediocrity is born. It is in blind practice that underperformance thrives.

As you will continue to see, neither have a place in this methodology or at this firm.

Regards,

Ali Meshkati