RF Capital Management LLC

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Dear Investors,

RF Capital returned 6.95% net in the fourth quarter and 7.68% net for the year. Please login to your Interactive Brokers accounts to view your exact returns. While the performance of accounts may differ slightly depending on when funds were available and when investments were made, year-end returns should be roughly the same over time. All accounts are managed the same way. Every account is invested in the same stocks with nearly identical position sizes.

As a review, RF Capital typically invests in 5 to 10 stocks that can double in 2 to 3 years. We focus on distressed companies because they tend to trade at large discounts to intrinsic value. Our investment checklist is: 1) a great business, 2) a great price, and 3) a great management team. While our checklist may seem standard, most fund managers seem to compromise on one, two, or all three of those checklist items. For us, a great business has an after-tax return on capital of over 20%. A great price is a 50% discount to intrinsic value as well as single-digit EV/EBIT, EV/EBITDA, and FCF multiples. Finally, a great management team is one that allocates capital well via share buybacks, dividends, debt repayment, acquisitions, and corporate transactions such as spinoffs.

In this letter, we will first provide an overview of how our firm thinks about various categories of investments. Next, we will discuss performance tests and benchmarks in relation to evaluating our firm's performance. Finally, we will review our holdings and provide our 2020 outlook.

OTHER CATEGORIES OF INVESTMENTS

Although we prefer high-quality companies, we occasionally initiate small positions in asset plays and companies at an inflection point. Prior to establishing these positions, we are aware that these types of companies are more susceptible to significant declines in stock prices when compared to "compounders" – especially if these companies don't execute on their business plans and guidance numbers. Thus, we seek to "trade" these positions rather than "buy and hold" them. Additionally, we limit position sizes for these types of investments to 5% of the fund.

Asset plays are interesting because of the margin of safety on the balance sheet. Furthermore, asset plays aren't as dependent on good earnings reports as other types of investments are. Examples of asset plays include net cash companies and classic Ben Graham net-nets. A net cash company could be a great opportunity because debt probably isn't a huge concern. Also, any surprise on the upside in earnings will likely lead to an increase in stock price. A floor is built into the price as well when a company's market cap is less than all of its cash and investments combined on its balance sheet.

Although it is a difficult category, a company at an inflection point tends to be a multi-bagger if the thesis is correct. Markets hate uncertainty and it is difficult for market participants to build a model for a company with erratic and/or negative earnings. Because the Street is so focused on the next quarter, it is unable to look out 3 or 5 years into the future. Quants are the same. They rely on patterns and predictability. Their models and algorithms can't identify or value companies that are at an inflection point. For example, it probably takes a quarter or two of positive earnings (if the company has historically reported negative earnings) before the markets and quants realize that the company has turned the corner. Funds tend to flow in when a company's earnings are positive – not when earnings are negative or close to breakeven. Thus, we try to identify value in these types of companies beforehand.

Additionally, we are opportunistic and invest in special situations as well. Corporate transactions and events provide a catalyst for realizing value. Because transactions and events typically have a timeline, it is possible to calculate the IRR on an investment if the closing date is known. For example, spinoffs, mergers, and tender offers have specific closing dates. As long as you know when the transaction will close, all you need to calculate IRR is to know what the spread or intrinsic value is. In contrast, a general investment in common shares lacks the timing component. If could take 3 years, 5 years, or 10 years for a stock to realize its intrinsic value. There is no specific transaction or known event that will cause the current price to converge with fair value. Only improved revenues, earnings, and capital allocation are likely to send the share price up. Thus, we favor special situations if the upside-downside ratio and IRR fits our criteria. Position sizing for these types of positions depends on the risk/reward profile as well.

No matter what category our investments fall under, the overall objective is to be right on our largest positions. The majority of our returns will come from our top five holdings, especially since our fund is so concentrated. We would like to have a high batting average on all of our small positions as well, but a few mistakes here or there won't adversely affect the fund's performance. Mistakes are bound to occur due to the higher degree of difficulty and complexity when analyzing asset plays, companies in transition, and event-driven situations.

PERFORMANCE TESTS

Our performance should be judged based on full market cycles. A full market cycle includes both a bull market and a bear market. Some investment strategies perform better in a bull market. Other strategies perform better in a bear market. Therefore, it is important to capture both market environments together when assessing the performance and investment strategy of an investment firm. The markets haven't experienced a bear market since the Great Financial Crisis of 2008 and 2009. Thus, the full market cycle test isn't applicable to our investment firm's performance yet. (Our firm launched in the fourth quarter of 2017.)

An alternative method of assessing performance is the 5-year test. (3 years is the absolute minimum.) Five years seems to be a long enough period of time to determine if a fund is performing well or not. Although we have no empirical data to draw from, five years seems to be an acceptable time period since we evaluate investments in the public equity markets on a similar time horizon. If we don't see upside potential in a company over the next 3 to 5 years, we simply

pass on the opportunity. Since we are approaching our firm's third full year of operation in October 2020, the 5-year test isn't quite applicable yet either.

Thus, investors must be patient and wait for either a full market cycle, or five years, before drawing conclusions about the quality of our firm's performance. In the interim, the fund may experience large drawdowns or it may generate exceptional returns on the upside. Volatility is expected given our firm's concentrated portfolio. Therefore, investors must keep the big picture in mind and think in terms of full market cycles and rolling 5-year periods.

BENCHMARKS

We believe in generating absolute returns for our investors. We aren't focused on comparing our performance to benchmarks or even other funds. In the fund management business, beating the benchmarks and other funds is the goal for most managers. Understandably, it's an easy way to judge performance. However, our clients invest with us because they want to make money over the long-term – not to be down less than the markets or to brag to their friends that they're invested with the "hot hand" at the moment.

Beating the market indices and outperforming other funds over the long term would be a great accomplishment. However, comparing ourselves to the indices and other managers would to be a fool's errand. Running our own race is very important. We have our own investment strategy, areas of expertise, and cognitive biases. We are not aware of any market index that matches our concentrated small-cap value strategy.

Similarly, there are no other investment managers out there with our exact same experience, skillset, and portfolio holdings. Every manager has their own unique educational background, work experience, and psychological makeup. And while we may have similar holdings with other funds, our portfolios never have 100% overlap. Thus, we simply focus on our own investment process day in and day out. Great returns will come if we've done good company analysis and valuation work. Envying the success of others and chasing returns is a recipe for disaster.

Instead, investors should keep opportunity cost in mind and compare our firm's performance to their other current investments. Since our investors tend to be high net worth individuals, we'll use an individual investor as an example. Let's say the investor's portfolio of passive investments includes cash, U.S. Treasuries, gold, income properties, and RF Capital. After a full market cycle or five years, the investor should compare returns across all of their passive investments and draw a conclusion. If RF Capital's annualized return exceeded the returns of those other investments, we would like to be praised for our good work. If we underperformed everything else in their portfolio, then the investor has to think about whether or not to remain invested with us. Assessing performance in this manner is better than randomly comparing our track record to the S&P 500 or some well-known investment firm that runs a different strategy, such as a large-cap, long/short fund.

TOP 5 HOLDINGS

Zagg (ZAGG) – The company didn't report a great third quarter. Compared to the prior year, net sales increased by 4% and gross profit remained the same, but net income, diluted EPS, and adjusted EBITDA were all down. However, market share of InvisibleShield screen protectors appears to have stabilized at 45%. Management also maintained its full-year guidance of $520-$550 million in net sales, gross profit margin in the mid-30's, adjusted EBITDA of $52-$62 million, operating EPS of $0.75-$1.00, and an annual tax rate of approximately 25%.

Zagg has also become an activist play. Arex Capital disclosed a 7.5% stake in October. Arex is a value-oriented investment firm founded by Andrew Rechtschaffen, a former partner at Greenlight Capital. The firm believes that there is no benefit for Zagg to remain a public company given investors' focus on short-term results and inability to properly value Zagg's cash flows. Additionally, Arex believes the Board seems to be holding out for a better price given Zagg's past trading levels. ACCO Brands already made a bid for the company and a private equity firm offered to pay as much as $9 per share.

Aimia (AIM.TO) – Aimia had a decent third quarter. Although revenue was down, there were reduced losses in adjusted EBITDA and FCF. The Loyalty Solutions business also generated positive EBITDA and operating expenses declined by 16%. Additionally, Aimia ended the quarter with $437 million in cash and cash equivalents.

The company also sold its entire stake of Cardlytics for net proceeds of $131.5 million. Aimia worked with AeroMexico to increase distributions from PLM as well. Full-year PLM distributions are expected to be $35 million. PLM continues to perform well with PLM member growth up 12% and gross billings up 10%. Furthermore, PLM appears to be worth at least 10x EBITDA. Virgin Australia intends to buy back 35% of Velocity for A$700 million, which pegs the multiple at 11x EBITDA.

Additionally, Charles Frischer and the Requisitioning Shareholders have cancelled the Special Meeting. They reached a settlement with Aimia and plan to reconstitute the board no later than February 28th, 2020. Philip Mittleman and CEO Jeremy Rabe will be the only incumbents up for reelection.

Garrett Motion (GTX) – Industry trends remain compelling, and there continues to be strong revenue visibility. Turbocharger growth trends look strong due to tougher CO2 regulations and increased production of turbocharged cars by 2025. Win rates continue to be robust with ~50% of competitions won. For 2021E, the revenue breakdown is 91% awarded, 4% replacement, and 5% new business. For 2023E, the breakdown is 68% awarded, 15% replacement, and 17% new business. Organic growth continues to outperform global auto production. In the third quarter, GTX's organic growth outperformed by five percentage points. In fact, GTX has outperformed global LV production every quarter since going public.

Current guidance for the year remains unchanged for the most part. Organic net sales growth remains -1% to +1% and the adjusted levered free cash flow conversion rate is still 50-55%. However, adjusted EBITDA has been lowered to $580-$600 million due to impacted margins by gas products sales exceeding diesel sales.

GTX also filed a complaint against Honeywell (HON) on December 2nd. In the complaint, allegations include: 1) top Honeywell executives devised the spinoff to offload its asbestos liabilities, 2) HON did not negotiate the one-sided Indemnification Agreement with GTX, 3) the Indemnification Agreement violates NY law, 4) onerous and unlawful covenants in the Agreement affects GTX's key corporate decisions for 30 years, and 5) HON breached the Agreement it wrote for itself.

In the complaint, GTX also alleges that the company did have proper legal representation. HON retained the same lawyers for both HON and GTX. GTX also believes that the Indemnification Agreement illegally requires GTX to indemnify HON for punitive damages, which are meant to punish HON. Additionally, GTX thinks the Agreement hobbles the company's ability to refinance debt and engage in corporate transactions such as an M&A deal. Since GTX also has no right to prepay Honeywell for the liabilities, HON is essentially in control for 30 years. Also, GTX alleges that HON failed to provide information regarding the asbestos liabilities despite repeated requests for more than a year.

Although Mr. Fan has a legal background, our firm is not in the business of predicting the outcomes of lawsuits. Instead, we incorporate the worst-case scenario when valuing the company. Thus, we view a successful lawsuit by GTX as a free option. Prior to investing in GTX, we assumed the company would pay $175 million every year until the expiration of the Agreement. If GTX is successful in the lawsuit, it would certainly help the markets reassess the company's value in a positive light. If GTX is unsuccessful, however, it wouldn't affect our investment thesis either. We established a full position size prior to the lawsuit, and we were fully aware of GTX's debt load and asbestos liabilities.

Graftech International (EAF) – Steel production and graphite electrode consumption has slowed in key regions. Sales volumes and net sales were down 7% in the third quarter. FCF was also down 2%. However, the long-term outlook for EAF steel making growth remains strong and EAF continues to take market share. Management expects business to pick up in the second half of 2020 as destocking occurs in the first half of 2020. Also, management thinks there could be a recovery of the broader steel group as well.

Brookfield also launched a secondary block trade and sold 11.18 million shares to Morgan Stanley. Despite the sale, Brookfield still owns a controlling stake in Graftech. Graftech also bought back $250 million of common stock at the block trade price.

Please see below for an overview of the company.

Stage Stores (SSI) – We did not intend for Stage Stores to become a Top 5 position in our portfolio. However, our investment doubled in just a few weeks after we purchased shares. Our initial purchase price was $4.24 per share, and it gained substantially to become a sizable position.

Although we provided a brief overview of Stage Stores in our "New Holdings" section, please note that the situation has changed as we write this letter currently. We would not recommend

investing in the stock at current prices without performing complete due diligence first. We will provide an update on the situation in our upcoming Q1 2020 letter.

Please see below for our thoughts on SSI.

COMMENTS ON ADDITIONAL INVESTMENTS

The Joint Corp. (JYNT) – We have exited our position in JYNT. Although we still believe JYNT is a high-quality business with runway for growth, the valuation exceeded intrinsic value and got ahead of the fundamentals. We sold our remaining shares at an average price of $19.25 per share.

NEW HOLDING – Graftech International (EAF)

Graftech produces ultra-high performance (UHP) graphite electrodes and sells them to steel and metal producers via long-term contracts or spot sales. EAF is the only large graphite electrode manufacturer that is vertically integrated into petroleum needle coke. Seadrift is a subsidiary of EAF and is the second largest producer of petroleum needle coke, which is used to manufacture graphite electrodes. The Seadrift facility provides at least two-thirds of Graftech's long-term needle coke needs and the production cost is well below third party prices.

A UHP graphite electrode is a highly-engineered and mission-critical industrial consumable. There is no known substitute for graphite electrodes in the electric arc furnace (EAF) steelmaking process. It takes 3 to 6 months to produce graphite electrodes but only 8 to 10 hours to consume them. Also, electrodes are typically only 1% to 5% of steel production cost.

One of EAF's competitive advantages is the high barriers to entry in the industry. Graphite electrodes and needle coke are difficult to produce. Production requires extensive product and process knowledge, long lead times, adherence to a stringent regulatory process, and high initial capital investment. It takes at least five years to plan, permit, and build a new plant. Thus, the industry is fairly consolidated with the top 5 players holding ~82% of total capacity. The largest producers aside from Graftech are Showa Denko, Graphite India, Tokai Carbon, and HEG.

EAF's take-or-pay, three-to-five year contracts also lock in spot prices and provide revenue visibility. 71% of sales in 2018 came from these long-term agreements while the remaining revenue came from spot sales. For the 2018-2022 period, take-or-pay contracts represented ~674,000 metric tons (MT) averaging $9,700 per MT. These contracts have significant termination payments of 50% to 70% of remaining contracted revenue with collateral arrangements and possible parent guarantees.

Additionally, EAF's vertical integration of needle coke is a tremendous advantage. Needle coke demand is likely to double or triple due to electric vehicles. Currently, almost no spare needle coke supply exists. Unlike competitors, Graftech can supply itself with ~75% of its needle coke needs whereas competitors have to buy their entire supply. When 80% of COGS for graphite electrodes comes from petroleum needle coke, it is important to procure needle coke at the lowest possible prices.

Despite Graftech's moat and revenue visibility, shares of EAF continue to trade at a low multiple. The Street continues to be concerned about steel demand. Steel prices were down 25% in 2018 and prices continue to be impacted by tariffs and Chinese oversupply. However, the Street is overlooking EAF's take-or-pay contracts. Spot prices are locked in for the next three to five years. Therefore, EAF is protected if prices drop significantly. Although it could be possible for customers to get out of the long-term agreements, they face a steep termination penalty if they choose to do so. Additionally, prices of graphite electrodes are unlikely to decline significantly given that prices are dependent on petroleum needle coke prices. Steel prices dropped in 2018 but spot prices reached a record high due to the increased demand of needle coke and increased production of lithium ion batteries for electric vehicles.

The Street is also concerned about rising needle coke costs. Due to high demand, the market likely believes that the rising cost of needle coke will affect EAF's margins and earnings. However, EAF will actually benefit from rising costs and demand. Companies that aren't vertically integrated like EAF will actually see decreased margins and earnings while Graftech will be able to maintain lower COGS and higher margins. Furthermore, EAF is the only company in the industry that employs take-or-pay contracts because of the vertical integration of needle coke. Graftech's competitors don't have the same luxury of revenue visibility and control over the supply of needle coke.

We believe Graftech is an undervalued business with high returns on capital and durable competitive advantages. Brookfield also controls the company and owns 73.7% of shares outstanding. Although it is difficult to estimate earnings given spot prices and declining steel demand, we believe shares of EAF are probably worth somewhere in the low $20's per share. We initiated a 10% position last quarter at $11.14 per share.

NEW HOLDING – Stage Stores (SSI)

Stage Stores is a retailer that focuses on small markets. The company operates 625 specialty department stores (Bealls, Goody's, Palais Royal, Peebles, and Stage) and 158 off-price stores (Gordmans) in small towns and rural communities. 86% of its stores are in markets with populations of 150,000 or less, and 61% of its stores are in markets with populations of 50,000 or less.

Management plans to convert all of the specialty department stores into Gordmans by the end of 2020. So far, 89 department stores have been converted to off-price and have yielded significant comps. Off-price conversions so far have generated a comp sales increase of 40%. Off-price stores tend to be successful because they have less inventory, operate with lower SG&A, and don't require a large amount of capital for conversion. Only $40,000 is needed to convert a department store to off-price.

Off-price retailers are currently favored by the market. Competitors include Ross, Five Below, Burlington, Ollie's, and TJX. All of these comparables trade at 2.0-2.5x EV/Sales and 24x-32x P/E. Valuations for these off-price retailers aren't surprising given the current economic environment. Consumers are more price-conscious and are starting to spend less.

SSI could be a multi-bagger if management is able to execute the conversion plan. If all 700 off-price stores perform just as well as the initial 89 converted locations, we believe the stock price will increase dramatically. However, that doesn't necessarily need to happen for us to make money on our investment. The stock is so cheap at 0.3x EV/Sales that a few quarters of good progress may be enough to drive the stock price higher. Earnings will improve and the multiple will rerate when the Street recognizes the comps and growth.

However, SSI is a risky investment. We are essentially betting on management to execute on the off-price conversion plan. The company continues to have negative earnings, and the balance sheet has a lot of debt and operating lease liabilities. There is bankruptcy risk given the cash burn and debt load, and the stock could potentially go to zero.

Thus, we sized our SSI position at 5%. Our average cost was $4.24 per share. We do not plan on increasing the position size and view this investment as a "trade" rather than a long-term investment.

OUTLOOK

We are well-positioned to take advantage of mispricings and market dislocations in 2020. Currently, we have a 30.5% cash position across all managed accounts. Thus, we are able to act immediately when opportunities become available. Additionally, our current 10 holdings are well-diversified.

Although we are satisfied with our cash position and holdings at the end of 2019, we continue to seek new investment opportunities. Our job is to work diligently every day to find and add new ideas to our research pipeline and watchlists. Given the current market environment, our opportunity set is expanding and we look forward to adding new companies to our portfolio.

Thank you for your support, continued interest, and referrals. Please call me at +1626.623.6012 or email me at roger.fan@rfcapitalmanagement.com if you have any questions, concerns, or comments.

Best regards,

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