COHO CAPITAL

Coho Capital Management, LLC

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February 2, 2013

Dear Partners,

Please find attached your year-end statement for 2012. For the quarter ended December 31, 2012, Coho Capital increased 9.9% and finished the year with a gross return of 41.5%. Net returns for the year after incentive compensation were 38%. This compares to a gain of 16% for the S&P 500 for the year.

It is a truism of value investing that volatility and fear lead to price misappraisals. The upheaval experienced by the markets in 2011 sowed the seeds for our success in 2012. In our year-end 2011 letter, we wrote the following, "At present, the holdings that make up Coho Capital are the cheapest relative to intrinsic value than at any time since the market bottom of March, 2009." That proved to be the case with Coho Capital netting its second highest annual return since inception. It should be obvious that in stock investing, the less you pay upon purchase, the more you will make in the end.

While low purchase prices were a primary ingredient in Coho Capital's success in 2012, we also benefitted from a more discerning market. To reference our state of mind at the end of 2011 once again, we wrote the following, "A recent reduction in stock correlations should lead to a more rational pricing environment for equities. In the future, we believe stock prices will be less affected by macro stimuli and more influenced by the fundamental merits of their business prospects. This will allow stock picking to once again return to the fore in the generation of investment returns." Last year saw the herd mentality that dominated the "risk on/risk off" period of 2010-2011 crumble away. Increased confidence in Europe's near-term prospects took the Euro crisis off the front pages allowing for a less frenzied market environment.

At present, macro tides have receded. Nonetheless, we continue to have a US centric portfolio as the possibility of "sneaker waves" from foreign shores possesses the potential to roil markets. That is not to say that we won't invest in foreign markets given the right prices, we are just demanding a greater margin of safety given the attendant risks.

Last year's rise in the markets caught many flat footed and seemed to awaken the animal spirits dormant within investors' hearts. As an asset class, stocks are fairly valued but pockets of opportunity remain.

Whereas last year cheap valuations and an abatement of macro worries provided the fuel for the market's rise, this year, the economy will need to achieve escape velocity to push the markets higher. After several false starts, many are not yet convinced that the economy is on firm footing. We think the economy will surprise to the upside. A renaissance in domestic oil and gas production has profoundly positive implications for economic growth. In addition, a healing of the residential real estate market should lead to lower unemployment and increased consumer confidence. Equities continue to be under-owned and could advance considerably should a return to economic prosperity take root.

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Portfolio Activity

We fully exited a number of our positions during the second half of the year including the following:

Apple (AAPL) – We liquidated our stake in Apple at an average price of $594 for an average gain of 56%. Recall that we sold 40% of our position earlier in the year for a gain of 68%. Our decision to sell was motivated by Apple's move toward intrinsic value and our concerns regarding the sustainability of Apple's hardware margins.

Seagate (STX) – We sold down the rest of our position in Seagate for a gain of 153% after selling half of our stake earlier in the year for a gain of 118%. Aggressive insider selling, coupled with lackluster demand in the PC channel, prompted our decision to sell.

eLong (LONG) – We wrote about eLong in our last letter. We always aim for tax efficiency and typically expect to hold our positions for two to three years before intrinsic value is reached. Ideally, we benefit from a change in operating fundamentals, which spurs earnings higher, and a concomitant rerating in valuation multiples as the market begins to price in a more favorable future. If everything works out smoothly, then the above mentioned scenario will unfold. Things rarely work out smoothly in investing, however. Our sell discipline is guided by three decisions:

1) Has our thesis changed or been rendered irrelevant by new information?
2) Does the stock remain attractively valued given new company or industry dynamics?
3) Are there better opportunities for deploying capital on a risk/reward basis?

In eLong's case, the stock quickly sprinted 33% higher only months after our purchase making the valuation less tempting. Further, eLong and its primary competitor, Ctrip, launched a scorched earth pricing war that made the economics of China's online hotel booking space much less attractive. There are no victors in price wars. We decided it was better to collect our gains and move on.

Weight Watchers (WTW) – In Weight Watchers case, our decision to sell was prompted by persistent attendance woes. Meeting attendance results have typically been volatile but given the myriad of new initiatives that management has put in place, along with a steady increase in marketing spend, we had expected to see greater traction. Attendance in North America meetings was down 9.4% during the third quarter after a 9.9% drop during the second quarter. International results did not fare any better with UK attendance down 17.4% after a 14.6% drop in the prior quarter. These results are not as bleak as they appear with a spike in online attendance responsible for some of the erosion in offline meeting metrics.

There is a near one to one relationship between Weight Watchers' meetings attendance and earnings. Given the precipitous fall in meetings growth, we thought caution was in order and decided to sell our shares for a 6% gain. We think opportunities for growth within both the government and corporate channels are exciting but we would like to see stabilization in meetings attendance before committing capital.

Homex (HXM) – Home building is a challenging business marked by high capital intensity, commodity inflation, and regulatory complexity. It is deeply cyclical and opportunities for competitive differentiation are few.

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Despite these challenges, we decided to invest in Homex because we thought the market was not giving the company credit for the stable cash flows to be derived from its agreement with the Mexican government to construct penitentiaries. It appears that no matter which side of the law you are on, crime does not pay. Rather than providing a stable source of revenues with which to buffet its housing business, Homex' foray into the penitentiary business consumed cash at an alarming rate with numerous delays and construction miscues eroding the economics of Homex' original agreement with the Mexican government. Paradoxically, Homex' home building business threw off significant cash flow last year providing buffer for the capital demands of the prison construction business. Without the margin of safety provided by the penitentiary business, Homex became a much less intriguing option. This is an example of where our thesis was incorrect. We sold our shares for a 6% loss.

We have maintained our stakes in the following positions:

Bank of America (BAC) – BAC was the top performer in the Dow Jones last year rising 116%. Despite its advance, BAC trades at a compelling valuation at roughly half its reported book value offering tremendous upside from current levels. BAC continues to aggressively pay off its debt and has recapitalized its balance sheet through the sale of $60 billion in assets. The bank is already in compliance with Basel III requirements for a Tier 1 capital ratio of 9%. At present, BAC is at 9.25%, a full six years before the new global regulatory requirements are due to take effect.

BAC's improved capital position has allowed it to absorb litigation charges associated with the purchase of Countrywide and Merrill Lynch under former CEO Ken Lewis. Litigation charges will continue to be a drag on earnings this year but less so than the last couple of years with organic earnings on the horizon in 2014. BAC earns close to $40 billion a year in pre-tax, pre-provision earnings. Once provisions for soured loans and litigation expenses subside BAC's true earnings power will emerge.

Brian Moynihan has done a masterful job of cleaning up the mess left by his predecessor and returning BAC to its main street banking roots. With its much improved liquidity, BAC can now focus on returning capital to investors. BAC's management team has indicated its shareholder orientation with Mr. Moynihan declaring in a staff meeting last month "all of the capital we have above the level we need, which is nine percent, will go back to the shareholders at some point." That point is close with the next round of bank stress tests scheduled for early March. Given BAC's strong capital position, we think a return of capital to shareholders is imminent and will highlight the strength of BAC's story. Meredith Whitney, one of the few banking analysts to foresee the global credit crisis, upgraded BAC in December and stated *"I have not seen an opportunity like this in four or five years."* We share her enthusiasm.

Yahoo (YHOO) – Yahoo advanced 23% for the year. It was a busy year for Yahoo with the company finally able to broker an agreement to sell half its stake in Chinese Internet company, Alibaba, and changes in the executive suite bringing in new CEO Marissa Meyer. Unlike previous CEO, Scott Thompson, who embellished his resume with a degree in computer science, Meyer has no discrepancy in her tech bona fides. After earning a computer science degree at Stanford, Meyer became the 20th employee at Google and oversaw the launch of some of Google's most important products, including Gmail and Google Maps. Most importantly, Meyer presided over Google's search business between 2000-2011.

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Meyer's hiring has cast a halo around Yahoo and generated excitement around the company for the first time in years. In her six months at the helm, Meyer has populated Yahoo's senior ranks with a number of high profile Google hires and improved morale through an enhancement of employee perks. In short, Yahoo feels like a start-up again.

We expect 2013 will be a transition year for Yahoo as Meyer restructures Yahoo to be better equipped for the era of mobile computing. While display advertising dollars have drifted toward Facebook and smart phone apps, Yahoo continues to exhibit impressive reach. Yahoo reaches more than 75% of US based Internet users on a monthly basis. Globally, over 700 million users utilize Yahoo services on a monthly basis in 30 languages. According to Internet measurement service comScore, Yahoo is number one in ten content categories, including finance, sports, news, entertainment and real estate.

The challenge for Yahoo has been getting its advertisers to believe that advertising is as valuable on mobile devices as on the desktop given lower click through rates. At the end of the day, advertisers want a large, engaged audience. Given the loyalty exhibited by Yahoo's users, as well as the personalization offered by its services, we suspect Yahoo will be able to successfully transition its desktop users to mobile versions of its services. The advertising dollars will follow the audience.

Yahoo remains cheap on a sum-of-the-parts basis. Much of the media focus on Yahoo's Asian assets has focused on its ownership stake in Alibaba but Yahoo's ownership stake in Yahoo Japan has added meaningfully to Yahoo's value recently. Yahoo Japan is considered the Google of Japan and is a significant e-commerce player in the country. Double digit growth in earnings and revenue have sent shares of Yahoo Japan up 61% during the past year. The company commands a higher valuation than California based Yahoo at just under $24 billion dollars. Yahoo's 35% stake in Yahoo Japan is worth $8.4 billion or $5.5 billion after adjusting for taxes.

Like Yahoo Japan, Alibaba has experienced runaway growth over the past year. The company surpassed $160 billion dollars in transactions on its Tmall and Taobao online shopping sites this year, up 150% from 2010. For 2012, Alibaba is expected to have generated $40 billion in revenue. Euromonitor expects Tmall's revenues to hit $120 billion by 2017. For comparison, Amazon generated revenue of $61 billion last year and has a market cap of $120 billion. At its current revenue run rates, it's conceivable that Alibaba would trade at an Amazon like valuation once it goes public. At Amazon's current price to sales ratio of 2.2x, Alibaba would be worth $88 billion. Yahoo's 24% ownership of Alibaba would then be worth $21 billion or $12.6 billion after adjusting for taxes.

If we put it all together, Yahoo's core business is available for a song. Yahoo has $4.1 billion in cash and its Asian assets are worth $18.1 billion dollars after assuming a 40% haircut for taxes and fees. In aggregate, that equates to a value of $22.2 billion dollars before assigning any value to Yahoo's core business. Yahoo has a market cap of $22.9 billion dollars. We expect Yahoo's core business to generate $800 million in free cash flow next year, so at present one can purchase Yahoo's business for less than one times cash flow. Not only do we expect Yahoo's Asian assets to continue to accrue value but we believe Meyer will be effective in optimizing Yahoo's valuable collection of web properties for the mobile computing age.

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Howard Hughes Corp (HHC) – HHC is a real estate development company with 50 properties under development. We outlined our thesis on HHC in last year's end of year letter. Shares rose 64% last year as investors closed the discount between the company's market value and price to book. Despite the advance, we continue to hold our shares as we believe HHC's book value is well below the current market value of its assets. We think development of those assets will bring their market value to light and result in appreciation of the shares. The company has a strong balance sheet with low net debt that is primarily non-recourse and its real assets that are a hedge against inflation.

New Purchases

Investor Richard Pzena once had the following to say about value investing:

"This is why value investing has always worked. It's always worked because when you make your buy list, it makes you want to throw up." – Richard Pzena, Pzena Investment Management

That sentiment provides an appropriate segue way into the discussion of our next two holdings.

AIG (AIG) – Like many of the securities we purchase, AIG is misunderstood. It's the poster child for reckless financial engineering and its implosion was at the heart of the credit crisis requiring a $180 billion dollar bailout. Those facts are well understood and understandably have cast a pall upon AIG. Today's company, however, bears little resemblance to its previous incarnation. Under new CEO Robert Benmosche, the company has sold down its derivative book and streamlined operations by selling down an unwieldy complex web of assets. AIG has used the money from its asset sales to pay back the government and strengthen its balance sheet. The rationalization of AIG's portfolio of assets should lower its cost of capital and allow for the return of capital to shareholders.

AIG is back to being an insurance company with insurance revenues comprising over 90% of revenues. This is a business where AIG is primed for success with world class expertise and global distribution. AIG is the number one player in the Property and Casualty (P&C) space and the second largest provider in the life insurance space.

Benmosche has also set about reducing complexity within AIG's insurance business, focusing on profitable underwriting rather than premium growth and reducing business in lines that require the company to hold more capital. Within its P&C unit, AIG has reduced risk by reducing its exposure to longer tail events in favor of shorter tail outcomes and more consumer focused lines. Increased discipline with its underwriting should help AIG reach its goal of double digit ROE by 2015. AIG also has the wind at its back with a hardening of pricing producing high single digit price increases in premiums. If AIG achieves it goal, then its share price should approach book value which we expect to reach $77 by year end 2014. This compares to a current price of $38.

AIG is a dramatically different company from the one that was laid low with bets on subprime mortgages and issuance of credit default swaps. Yet the company trades as if the sins of the past will forever cloud its future. As AIG continues to execute on its operational turn-around and memories of the financial crisis fade, we expect AIG to trade in-line with other insurance companies.

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"Great investing requires an independent spirit, and the courage to acquire assets the crowd disdains. Disdain creates bargains." – Peter Lynch

Citigroup – Like AIG, Citigroup was also at the scene of the crime during the credit crisis. The company was also guilty of taking on an ungodly amount of risk to capture profits. Importantly, Citigroup is now under new leadership. For the first time in ages, Citigroup has a banker at the helm. Its last CEO, Vikram Pandit, was a former hedge fund manager and his predecessor was Chuck Prince. A lawyer by training, Prince was once asked by the Financial Times if the credit fueled boom might end badly. He famously remarked, *"as long as the music is playing, you have got to get up and dance."*

New CEO, Michael Corbat is a veteran of Citigroup and his background as a banking operative should enable him to restructure Citigroup's bloated cost structure. We have seen this movie before, with our BAC holding, when Brian Moynihan took over as CEO. Much like Moynihan, we expect Corbat to return Citigroup to its banking roots and rationalize its operations. The market is not giving Citigroup any credit for anticipated cost efficiencies but we believe that this lever alone can add meaningfully to earnings growth in future years. Further, much like BAC, as legal and provisioning expenses normalize, Citigroup's true earnings power will become apparent.

Citigroup has the premier franchise in global banking with operations in over 100 countries. Value investor Shelby Davis once remarked that Citigroup was like an embassy with outposts in every country. Citigroup already earns more than half its profits from developing markets. Few banks come close to rivaling Citigroup's presence in emerging markets. The company has 28 million customers in Latin America with $470 billion in assets. In Asia, Citigroup has 50,000 employees. Citigroup's footprint in developing markets is significant because it provides the company a growth engine for years to come. For example, the Asian Development Bank expects consumers in developing Asian markets to undertake $32 trillion in annual spending by 2030 compared to $4 trillion in 2008. Citigroup's higher growth profile should eventually result in a higher valuation relative to steady GDP growth peers.

While developing markets will provide an earnings engine for years to come, Citigroup is also enhancing its growth prospects in the developed world. The Eurozone crisis has led to a retreat from European banks. Deleveraging of assets under tight time constraints had led to uneconomical selling. In response, Citigroup has strengthened its distressed debt teams on the continent and is well positioned to capitalize on the turmoil.

An effort to break up Citigroup into its geographic parts could be a catalyst for material price appreciation. Santander, Spain's largest bank, has utilized this technique to ring fence its international assets from the near Depression conditions in Spain. The potential value to be unlocked through such a move is enticing. Using Santander's Mexican IPO as a template, Citigroup's Banamex arm would fetch a $20 billion valuation were it to be accorded the same multiple. Credit Suisse estimates that a spin of its Asian assets would result in a $40 billion valuation. These are just two examples of the value that Citigroup could surface through an IPO approach. Citigroup could also elect to IPO its Transaction Services business. A key cog in the world's financial plumbing, Citigroup's Transaction Services business has over $13 trillion assets under custody and processes $3 trillion worth of assets per day. The division throws off $4 billion a year in net income. At the same 12x multiple as peer provider, Federated Investors, Citigroup's Transaction Services unit would fetch $48 billion in an IPO. Netting out these three component parts would enable us to buy the rest of Citigroup's investment

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banking business, its institutional securities and wholesale banking arm, and the remaining geographies in its global consumer banking franchise for just $20 billion dollars.

There are multiple paths to value creation for Citigroup. It is not often you can acquire a premier global brand at nine times trough earnings. Banking may be cyclical, but like insurance, it never goes obsolete and will always be in demand. We think shareholders capable of looking beyond the headlines will be richly rewarded for their patience.

We presented two ideas at the Best Ideas conference put on by Value Conferences the first week of January, FXCM and Calamos.

FXCM (FXCM) – FXCM is the largest online foreign exchange (forex) broker in North America and second largest in the world. It is a toll booth business that collects a transaction fee off each currency trade executed on its platform. Unlike a broker, FXCM's "Agency" model relies upon trading volumes for fee revenue rather than market making. This equates to a much safer, more transparent, operating model than its competitors which take balance sheet risk by committing inventory to market making activities.

The economics of FXCM's business are extremely compelling. The business requires minimal capex and as a result is highly cash flow generative. Despite limited capex requirements, barriers to entry are high due to a patchwork quilt of complex regulatory requirements across country borders and regional trading blocs. Increased regulatory demands have favored the incumbents who possess the capital and government relations expertise to navigate the greater transparency required of today's markets. This presents an advantageous competitive backdrop for FXCM.

A combination of increased accessibility through technological innovation and an increased interest in macro investing have led to explosive growth in foreign exchange (forex) trading. Retail forex trading has grown at a 47% CAGR since 2001. Forex trading should benefit from multiple long-term growth drivers including globalization, increased interest in alternative investment classes and improved access to forex trading platforms.

Despite favorable long-term growth trends, recent forex trading volumes have been tepid due to a sustained drop in volatility. This is a negative for FXCM as increased volatility drives trading volumes with revenues rising in tandem. In our view, unprecedented action by central banks throughout the developed world in debasing currencies presage a return to elevated volatility.

We're not capable of determining when volatility will ramp but like that FXCM is attractively priced at 13x depressed earnings. GAAP EPS understates FXCM's true earnings power due to high amortization costs from past acquisitions. On a cash earnings basis, FXCM trades for 9.9x 2013 earnings. If we net out the $147 million in excess net cash on FXCM's balance sheet, then shares trade for 8x cash earnings.

Because FXCM is cheap on existing earnings, we get a free call option on a return to volatility. When you consider that FXCM has four times the client equity it had in 2008 when it earned record EBITDA of $135 million, the potential lift in earnings power from an increase in volatility would be substantial.

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Calamos Asset Management (CLMS) – Calamos Asset Management manages $34 billion dollars in assets spread out amongst mutual funds and total return vehicles. It's two largest funds, Calamos Growth Fund and Calamos Growth and Equity, comprise 47% of mutual fund assets and have good long-term track records. Money management is a relatively simple and highly profitable business. It requires minimal capital intensity, features recurring free cash flow, is eminently scalable and tends to maintain profitability throughout the business cycle. During strong markets, the returns can be significant because costs do not move in lock-step with revenues. Thus the business features inherently high operating leverage. During healthy markets, net profits can run 25-30%.

Calamos has a unique structure for a publicly traded company which clouds the true value of the company. Calamos Asset Management owns a 22.1% economic interest in Calamos Holdings LLC with the remainder held by Calamos Family Partners. The financials consolidate the results of Calamos Holdings and thus one has to make some adjustments to arrive at pro-forma results for Calamos Asset Management.

In addition to its ownership stake in Calamos Holdings, Calamos has $3.18 per share in cash and $1.72 per share in deferred tax assets. Calamos has an additional claim on 22.1% of the net cash held at the consolidated company level, equating to $3.48 per share in cash.

When you put it all together, Calamos holds deferred tax assets and cash worth $8.48 per share. Netting that out from Calamos' current price of $10.36 equates to a per share price of $1.88. For less than $2 per share you get an annual earnings stream of $0.90 for a PE multiple of 2.1x. Not a bad price to pay for a business with a pristine balance sheet and attractive industry dynamics.

As an emerging fund, we are always looking for new investors. If you are happy with your experience with Coho Capital please consider sharing your opinion of Coho with others. We believe our process of investing with conviction in names that have broad downside support offers a pathway to superior risk adjusted returns over time. We thank you for joining us on the journey.

Respectfully yours,

Jake Rosser
Managing Partner
Coho Capital Management