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TIDD CAPITAL, LLC

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Fourth Quarter 2004

Welcome to the first quarterly newsletter from Tidd Capital. In this initial correspondence, I thought it would be appropriate to describe our fundamental investment principles.

Investment Philosophy

1. Value investing. We seek to buy stocks at a substantial discount to their conservatively estimated value. To coin a phrase, we want to buy dollar bills for fifty cents. I feel that this approach maximizes profits while minimizing risk. The philosophy of value investing stems primarily from the legendary work of Benjamin Graham, and modern adherents such as Warren Buffett, one of the most successful investors of our time.

2. I eat my own cooking. In fact, that is all that I eat. Substantially all of my own invested net worth exclusive of my private residence is and will be invested in the same securities held by clients of Tidd Capital. This ensures that our interests are strongly aligned. Not only this, but Tidd Capital manages funds for my father, brother, wife, aunt, mother-in-law, and several friends. So if there are any problems, you can bet I'll hear about them. Client transactions always take priority over my own.

3. A long term approach. Over short periods of time, market movements are as random as the weather. Most investments are made with an intended time frame of 2-3 years, and the investment returns should be judged over a similar period. It is absolutely imperative that invested funds will not be needed for other purposes for at least 3-5 years, since pulling funds out of a long term investment prematurely can have negative and possibly disastrous consequences.

4. Benchmark against the S&P 500. The primary goal of Tidd Capital is to deliver investment performance significantly better than that of the S&P 500 index. This index was chosen due to its broad acceptance, and the ease with which any investor can invest in the index through a no-load mutual fund. Clients should compare their performance to this index over periods of 2-3 years. If clients do not experience performance significantly greater than this index, after all fees and expenses, they should consider simply investing in an S&P 500 index fund instead.

5. Discipline and patience. Both price and quality are crucial to every investment decision. However, situations that are attractive both qualitatively and quantitatively are rare. While we are active in seeking new opportunities, we are extremely selective in our commitments. We will wait for a good pitch before taking a swing. Making no investment is better than making a bad investment.

6. Concentration. Once a good opportunity is found, we must make a substantial commitment to it. A typical portfolio will usually have less than 20 positions, implying a weighting of more than 5% per position (and often more). Anything worth doing is worth doing substantively.

7. We expect results, not activity. Our discipline, concentration, and long term view lead to a fairly small number of actual transactions – we are investors, not traders. Though clients may not see a lot of transactions, they can be assured that there is substantial activity behind the scenes. Limited trading activity also serves to keep costs down.

8. Candid reporting. Every effort will be made to communicate events and performance clearly and candidly, including both the positive and negative. Specific situations will typically only be discussed after-the-fact, which protects our mutual interests. In correspondence to clients, I strive to deliver the information that I would want to receive if our positions were reversed.

Compounding

Perhaps the most important concept in investing is compounding. It is through the power of compounding that money increases in value exponentially over time if it is invested well. To put it more colorfully, compounding is what turns money into wealth.

Consider the following table, which demonstrates the value of $10,000 if it compounds at 5%, 10%, or 15% over a period of 5, 10, or 15 years:

	5%	10%	15%
After 5 years	$12,763	$16,105	$20,114
After 10 Years	$16,289	$25,937	$40,456
After 15 years	$20,789	$41,772	$81,371

It is always startling to see how a relatively small differences in the rate of compounding lead to huge changes in value. Compounding at 5%, an investment will approximately double in 15 years. Compounding at 15%, an investment will approximately double in *five* years.

To further demonstrate this point, here is another similar table, but with compounding rates of 10% and 11%:

	10%	11%
After 5 years	$16,105	$16,851
After 10 Years	$25,937	$28,394
After 15 years	$41,772	$47,846

Over a period of 15 years, a single percentage point makes a difference of $6,073 – more than 60% the size of the original investment.

I present this data to you to make a point – at Tidd Capital, we fight for every last percentage point from every last investment, which also means doing everything possible to avoid losses. Every portfolio activity – buying, holding, selling, or abstaining – is carefully intended to maximize the long term rate of compounding of each portfolio.

This attitude also explains our focus on beating the market averages. Over long periods of time, the US stock market averages have proven to be a very good investment. To beat this hurdle by just a few percentage points will lead to truly exceptional investment performance.

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Corporate Disasterbacles

A friend of mine uses the term "disasterbacle" (i.e. disaster + debacle) for situations that are so bad that they defy explanation. Certainly, the recent spate of ever-greater corporate meltdowns has encouraged any writer covering them to reach for a thesaurus.

With the daily financial news looking like a scandal sheet, investors should rightly ask how they could have any confidence investing with US corporations these days. Some corporate executives have shown amazing creativity in pulling the wool over the eyes of investors large and small. Warren Buffett said that "in looking for people to hire, you look for three qualities: integrity, intelligence, and energy. And if they don't have the first, the other two will kill you." Many executives, unfortunately, have shown no lack of intelligence and energy.

As disheartening as these public scandals are, even numerous instances of fraud do not indicate that there are no investment opportunities remaining. It does remind us how careful we need to be. As investors, we can't throw the corporate baby out with the bath water, so we need criteria that will help us find the all-important "integrity" in corporate management. We look for corporate management that views their shareholders as business partners, which is how we view them. We employ both quantitative and qualitative measures, and run our prospective business partners through a very fine filter before "hiring" them.

Quantitatively, executive compensation is perhaps the most important criteria, and is also fairly easy to assess. Compensation defines incentives, and, by and large, incentives dictate behavior. As Charlie Munger says, "you gotta get the incentives right".

Imagine if a car salesman were paid based on the number of days he worked rather than the number of cars he sold. You should expect that the salesman to show up for work, but you probably shouldn't expect him to sell many cars. Similarly, when an executive is paid a lavish mandatory salary, with perks ranging from a private jet to a gold shower curtain, we can expect them to show up for work, but not necessarily to deliver performance.

We also look closely at stock options, and are very wary of generous options packages. The cost of options packages is typically born by shareholders, who usually don't get much in return. Options are a very one-sided form of compensation, since the recipient typically either gains substantially or doesn't gain – they can't lose. Far preferable is management with a substantial portion of their own net worth invested in the stock – not options – of the company, coupled with a reasonable cash compensation. When management will experience both the upside and downside of their decisions, their interests are much better aligned with ours.

Qualitatively, I believe that an executive's compensation package says a lot about the executive's attitude towards the company and its shareholders. If an executive receives generous cash compensation, whether from salary and bonuses or the sale of options, it begs the question – where is that executive investing that money if it isn't in their own company?

We look for executives with long, successful tenures, and who share our objectives as investors – long term results, obtained through patience and discipline. We appreciate executives who communicate clearly and candidly with us, and hold ourselves to the same standard. We insist upon an unbroken chain of incentives – from the executive, to their company, to us, their shareholders.

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The companies and executives involved in the corporate disasterbacles of the past few years failed to meet many of our criteria. Executives were given lavish "heads I win, tails I win" compensation packages. The companies focused primarily, or solely, on meeting short term goals set by Wall Street rather than their legitimate long term business goals. The news they reported was uniformly good, even when the facts indicated otherwise. Their accounting was needlessly complicated, and either unconservative or unintelligible. For these reasons, these companies were caught early in our filter, and Tidd Capital clients, like Neo in the Matrix, have remained nearly unscathed, despite numerous flying bullets.

Outlook

The fundamental business environment is generally quite good, but market valuations are also generally fair to high. Qualitatively the market is attractive, but quantitatively it is not. As a result, I am not finding a lot of new investment opportunities. Though I remain dedicated to the task, we are not making many new commitments in this environment.

The flip side is that many of our investees are reaching new levels of profitability and growth, which is delivering solid results to us shareholders. What we are holding is doing well – we are reaping the rewards of good decisions made in the past.

What matters most is not what the market as a whole does, but how our carefully selected investments perform. Going forward, my outlook is positive, but cautious. In general we only own companies of superior profitability and fairness to shareholders, at valuations that range from low to fair, so I expect them to do better than average. However, I am keeping a sharp eye out to make sure that we aren't the victim of a stray corporate bullet.

Thank you once again for entrusing your assets to Tidd Capital. If you have any questions or concerns, please feel free to contact me by phone or e-mail at any time.

Randall Tidd
President, Tidd Capital