(703) 652-4613
(703) 738-6359 (fax)
http://www.tiddcapital.com

TIDD CAPITAL, LLC

1563 McNeer St.
McLean, VA 22101

Fourth Quarter 2009

Intro

In the third quarter of 2009, the stock market continued the rally that started in March, with the S&P 500 index returning +15.6% during the third quarter. Tidd Capital portfolios enjoyed a second sequential greater-than-average quarterly increase, returning +23.2% during the quarter, beating our benchmark by 7.6%. From the beginning of the year through the end of Q3, Tidd Capital portfolios have returned +42.4%, compared to +19.3% for the S&P 500. This wide outperformance is obviously very rewarding after the poor performance over the preceding 6 quarters.

Despite the strong rally during Q2, I felt that stocks continued to look cheap at the end of Q2, particularly the stocks that we own, when considering the long-term perspective. Many analysts and investors had the opposite view, believing that the market fundamentals had reached a short-term peak and we were going to see some declines. Fortunately I held fast to our positions and we enjoyed substantial gains in Q3.

However, my view began to change at the end of Q3. After 2 quarters of strong rallies, bargains became hard to find. As a value investor, the lack of bargains is a warning flag, so this has made me cautious and more inclined to hold onto our cash. Fortunately, several of our positions this year rose to levels where they could be comfortably sold, or our positions were cashed out by acquisitions or distributions, so the cash has been piling up. I feel that we are well positioned to make new investments when the market provides us with some opportunities.

Beware the Ides of March

It is admittedly with some sense of relief that I can finally look back at the year 2009, which was one of the most difficult years for investors in recent memory. In fact, the year 2009 caps what was actually a very tumultuous and trying decade.

The soothsayer in Shakespeare's Julius Caesar warned, "Beware the Ides of March," and he may have been talking about this decade in the markets. The "dot com" bubble peaked right near the beginning of the decade, on March 10, 2000. The bubble subsequently burst, and the NASDAQ finally hit bottom nearly 2 1/2 years later in October 2002. We did not know it until later, but a much larger bubble began forming at this time, which would burst about 5 years later. Almost exactly 9 years after the "dot com" bubble peak, on March 6, 2009, the broader markets would hit the bottom of the worst market collapse in decades, with the S&P 500 hitting a devilish intra-day low of 666. On that day, nearly 14 years of stock market wealth was wiped out.

The period between March 2000 and March 2009 was not without other drama. The terrorist attack of September 11, 2001, aside from the tragic human cost, was also a major market event which triggered a brief recession. This period was also marked by a long string of accounting scandals including WorldCom, Enron, Adelphia Communications, and Fannie Mae, just to mention a few. By the middle of the decade, investors were thinking they could finally catch a break, and there were a few ebullient years through the end of 2006. But that is when the cracks began to form for the credit and housing bubble, which burst in August 2007. This led to the long, torturous decline that finally halted around the middle of 2009.

Here at the end of 2009, as the economy continues its slow recovery, it is hard to say to what extent the government bailout money is propping it up and to what extent it is growing naturally. On the positive side, the good news has become both frequent and diverse. Trends for rising housing starts, falling housing inventories, increased manufacturing output, increased exports, increased consumer confidence and spending, increased lending, and decreased unemployment are all improving. The inflationary trends also appear to be stable for the moment, and the untamed inflation that many analysts fear has not become manifest.

On the other hand, unemployment levels are still very high. In California, it is at a 70-year high at more than 12%, and nearly a quarter of the country has levels greater than 10%. Unemployment across the US fell modestly in October but is still high. Analysts fear a "jobless recovery", though it is too early in the recovery cycle to make predictions. The economy is still a shadow of its former self, and while things seem to be moving forward, overall economic activity seems to have gotten stuck at a reduced level.

Looking forward, I believe we will see opportunities for favorable investment, though we aren't in a big hurry to get our cash allocated. It seems unlikely that "it's all up from here" and there should be some bumps and dips in 2010.

Portfolio Updates

Q3 and the first part of Q4 provided us with more favorable portfolio developments, which I'll outline below. There is not really much news on some of our larger core holdings such as Fairfax Financial, Brookfield Asset Management, and The Washington Post, but there is news on our other holdings.

More blood from the turnip at ECC Capital

In what has been one of the most interesting liquidation sagas that I have ever been a part of, ECC Capital paid yet another large liquidating distribution in October 2009. This stock has been a frequent topic in these newsletters, but let me briefly summarize the history. ECC Capital was a sub-prime mortgage lender (remember those?) that hit the skids in early 2007 when the credit crisis first began. I watched the situation closely, and with the help of other like-minded analysts, determined that, by the end of 2007, ECC's liquidation value was likely much higher than the stock price at the time of about $0.10.

The source of the company's value was primarily residual interests in some mortgage loans, and it looked likely that the company would be able to monetize these interests and pay out the proceeds to shareholders. They also had a pending lawsuit and a cash value life insurance plan, both of which theoretically had value, but I did not think it likely that these would come to fruition.

The company met our initial expectations and paid liquidating distributions of $0.10 in February 2008 and $0.16 in August 2008, and the stock continued to trade at around $0.05 per share thereafter, which provided an extremely satisfactory 210% return in less than a year from our purchases in December 2007. At that point I did not think it likely that the company would pay any more distributions and started to sell the stock. Fortunately for us, the stock was very illiquid and it was difficult for me to sell our more than 2.5 million shares. I was actually still trying to sell the shares in September 2009, when to my surprise, they announced that they had settled their lawsuit, which enabled them to pay out another $0.12 per share in October 2009. This brought the total return from our December 2007 purchases up to over 300%. Not only is this return fantastic and above

expectations, but the cash provided from these distributions has arrived at a very good time for reinvestment, and has enabled other gains. At this point I am going to leave the golden goose alone and see if we might get one more egg out of it.

I have been searching high and low for another situation like ECC. This kind of investment, often termed a "cigar butt", is a core part of my investing strategy, and I like to always have 3 or 4 of these in our portfolio. My return expectation is usually something like 10-30% within 6-18 months, which is not spectacular but is good and tends to be weakly correlated to general market activity. These deals are not always available, and, curiously, seem to come in clusters. I will stay on the hunt and hope to secure a few more of these in coming quarters.

Berkshire and Burlington Northern

In a blockbuster deal that marks the largest deal of Buffett's long and large career, Berkshire bought the Burlington Northern Santa Fe railroad, paying about $34 billion or $100 per share. Fortunately, we had a position in Burlington and benefited from the overnight 30% increase in share price, but unfortunately the position was not as large as, in retrospect, it could have been. The deal will be for a combination of stock and cash, but considering our options, I chose to sell our stake in Burlington at a profit and expect to redeploy the funds elsewhere.

We also have a small position in Berkshire, which will be impacted by this acquisition. Uncharacteristically, Buffett paid a high price for Burlington, and as a result, the deal will not immediately have a big impact on Berkshire's per-share intrinsic value. I believe the deal is more about securing Berkshire's long-term stability and thus Buffett's legacy than about increasing earnings next year. By acquiring an enormous, entrenched, operating business, Buffett has transformed Berkshire from an overfunded, quirky conglomerate into a well-funded, diverse operating company with numerous avenues for incremental growth. Despite my general admiration for Buffett, I still have reservations about investing in a Berkshire without Buffett, and continue to explore our position in Berkshire.

Wesco Financial

Our position in Wesco has increased about 12% since we bought our shares in August, as the gap between share price and book value has closed. Book value has increased as Wesco's equity holdings have increased, as Wesco is basically a collection of blue chip stocks with a "kicker" in the form of their warrants on Goldman Sachs. The stock is nearing our exit price and I expect to be able to sell our position at a profit fairly soon.

Western Sizzlin' and Steak 'n Shake

As mentioned in the last newsletter, we bought a position in Western Sizzlin' last quarter, to hitch our wagon to young Sardar Biglari, an activist shareholder who took over the company. Our position had nothing to do with the mediocre-at-best restaurant operations at Western and everything to do with a proposed merger agreement and a young hedge fund manager shaking things up. When we bought our shares of Western, Biglari had announced but not yet consummated a deal to sell Western, a comapny he controls, to Steak 'n Shake, another company he controls. This deal was subsequently closed, and our position was transformed into a combination of debt and equity in the new combined company.

Subsequently, Steak 'n Shake announced what can only be described as fantastic numbers for the combined company's fourth quarter, and both sides of our position rallied. Mr. Biglari is young and unproven, though he says all of the right things and has already provided us with some profits, so I will cautiously join him in his endeavors for a while. The debt yields 14% and the equity portion has gained about 8%, so far we are doing okay.

Triangle Capital

Triangle Capital is a small specialty lender in which we've been invested for several years, since shortly after its IPO. While a high-yield, specialty lender probably sounds like a terrible idea during a recession, we've done okay with our shares on an absolute basis and excellent on a relative basis.

Triangle had access to one of the very few sources of capital that did not dry up or become more expensive during the credit crisis, debentures from the Small Business Association. Triangle was able to borrow this easy and cheap money at around 6% and lend it at around 12-14%, earning a spread of about 6-8%. In an environment where their funding was strong and their competition declined, they grew quickly by lending this money profitably. This allowed them to perform contrary to the declining market and pay out substantial dividends. However, I believe their growth has peaked for the time being, and the stock trades at a significant premium to book value, so it is time to take our profits.

We first started buying the stock in May 2007, shortly after its IPO, at around $14.90 per share. Since then, the company has paid $3.68 per share in dividends. We recently exited our position at about $12.50 per share, a gain of about 9% over about 2.5 years. Normally this is nothing to write about, but during this period the S&P 500 declined by about 28%, so this investment outperformed the index by about 37%, which qualifies as successful.

We held three BDC investments when the economy headed into recession -- Gladstone Investment, Allied Capital senior notes, and Triangle Capital. Just like that country song says, 2 out of 3 of these investments turned out well, though Gladstone has been something just short of a disaster. Even though BDC's are generally regarded as susceptible to recessionary trends, I was unpleasantly surprised by just how badly this affected Gladstone. In retrospect, such a concentration on BDC's was probably a mistake during times of easy credit, and the souring of the credit environment made these investments mediocre. Fortunately this was a lesson that did not come with a hefty price since, in aggregate, we beat the market with this collection of investments. I will, however, show considerably more caution with specialty finance companies in the future.

Closing

This is the time of year that we can all take time to appreciate our non-financial assets. I wish all of you and your families a joyous and fulfilling holiday season.

I hope that this letter has given you a better understanding of my investment process. As always, 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
703-652-4613
rtidd@tiddcapital.com