

The following excerpt, reprinted with permission, is from a feature interview with Jim Roumell of Roumell Asset Management that appeared in the April 30, 2009 issue of *Value Investor Insight*.

“Quirky is fine with me”

Jim Roumell would have no problem filling his portfolio with big name stocks hammered by the bear market, but that's just not where he thinks the value is.

While he considers himself more focused on risk than his investing peers, Jim Roumell takes issue with what he sees as the rationale behind too many investment ideas today. “Most seem predicated on the notion that 'you shouldn't get hurt too badly here,’” he says. “That’s important, but it should not be the primary standard for owning something.”

Roumell's investment standards have

proven quite high since he founded his own firm at the end of 1998. His equity portfolio has returned an annualized 7.3% net of fees since then, vs. -2.5% for the S&P 500.

Armed with a flexible mandate, he is finding value today mostly in small-cap stocks and high-yield bonds in such industries as software, refrigeration, energy, real estate and mobile satellite communications.

INVESTOR INSIGHT



Jim Roumell
Roumell Asset Management

Investment Focus: Seeks companies trading at steep discounts to estimated net assets, private-market values or discounted future cash flows – preferably all three.

Investor Insight: Jim Roumell

Jim Roumell of Roumell Asset Management describes why he's leery of “blue-chips-are-on-sale” arguments, the part of an investment's return he'll leave to people like Warren Buffett, the “liberating” insight he got from Marty Whitman, and why he believes QAD, Tecumseh Products, KVH, Tejon Ranch and certain closed-end bond funds are mispriced.

You've credited Third Avenue's Marty Whitman [VII, May 22, 2005] with illuminating your path as an investor. How did that happen?

Jim Roumell: I had been a broker primarily selling bonds and mutual funds when in the early 1990s I got much more interested in individual securities analysis. I read as widely as I could and a light bulb just switched on when I read everything Marty Whitman wrote. I was thinking it was critical to understand the ins and

outs of how the stock market really worked, but his basic message was to ignore the market, which was just the bazaar through which you had to make trades. He was all about valuing what a company was worth – independent of what the market was saying it was worth at the time – and buying when the market was giving you a big discount and selling when it was paying you a premium.

As obvious as that sounds, it was very liberating to come across such a straightforward approach. Using whatever ana-

lytical tools I want, whether it's valuing net assets, calculating private-market values, or discounting future cash flows, I can arrive at a clear estimate of what a company is actually worth. From there, the actual buying and selling decisions aren't that hard.

Another mantra of his that has saved me countless times from trouble is his avid aversion to debt. MBAs learn all about optimizing capital structures, but I've been quite content sticking with companies that have extra-safe balance

sheets. I'll trade return on equity for safety any day.

Your portfolio today looks a bit quirky, consisting primarily of small-cap stocks, a variety of closed-end bond funds, and individual fixed-income securities. Is that typical?

JR: Quirky is fine with me. We're truly not constrained in where we look for opportunity. We'll look across asset classes, industries and cap sizes and try to focus on the areas that appear most inefficiently priced. Right now that means we have a lot of exposure to cash-rich, small- and micro-cap stocks and to below-investment-grade corporate debt. Our focus a year ago was different, and it will likely be different a year from now.

Where do your best ideas come from?

JR: A lot of it is just being out there. We read everything we can get our hands on and we talk to people. For example, I've gotten to know and trust Jay Allison and Roland Burns, the CEO and CFO of Comstock Resources, which is a publicly traded oil and gas company whose equity we've owned off and on for years and whose debt we recently purchased for the first time. Whenever I get the chance, I'll ask them about what's going on in their business: What rig day rates are they paying? How much is acreage in Haynesville going for right now? Conversations like that are the best sources of information and ideas.

I'm far more likely to pursue an idea when I have that kind of industry resource. One of our biggest holdings up until three years ago was Datastream Systems, a seller of software and services that help companies maintain capital assets like manufacturing equipment and real estate. Datastream ended up being sold, but I've stayed in close touch with its former president, Alex Estevez, and will ask him to look at any software-related idea we come across. He'll start asking detailed questions about headcount or the composition of maintenance revenues or how the sales staff is managed, and you quickly realize how much we often don't

know about the businesses we invest in. If I don't know an industry cold, I work very hard to find someone like Alex to ride shotgun with me.

Let's dive into your specific areas of interest today, starting with cash-rich micro-caps. What's the general thesis there?

JR: The buzz right now is about how superior, large-cap companies are on sale. There's certainly some truth to that, but it's hardly an undiscovered notion. We've studied ten of the most interesting of what I call "dominant battleships" – including Microsoft, Intel, Fluor, 3M and Exxon – and they typically trade at free-

cash-flow yields (based on average free cash flow over the past three years) in the 8-10% range. That's not bad, but it isn't nearly as interesting as what we're seeing in smaller-cap stocks that have just been slammed as credit spreads have widened and risk premiums have gotten so big. In an environment where fear is widespread, nobody wants to talk about micro-caps, which is why we think there are opportunities to be had.

Walk us through some examples, starting with software company QAD [QADI].

JR: The company specializes in enterprise software that helps mostly manufacturing

INVESTMENT SNAPSHOT

QAD, Inc.
(Nasdaq: QADI)

Business: Provider of enterprise software applications and support services, primarily used in the management and maintenance of manufacturing facilities.

Share Information
(@4/29/09):

Price	2.70
52-Week Range	2.14 – 8.09
Dividend Yield	3.8%
Market Cap	\$83.0 million

Financials (TTM):

Revenue	\$263.4 million
Operating Profit Margin	(-3.3%)
Net Profit Margin	(-8.1%)

Valuation Metrics

(@4/29/09):

	QADI	S&P 500
Trailing P/E	n/a	13.5
Forward P/E Est.	n/a	14.9

Largest Institutional Owners

(@12/31/08):

Company	% Owned
JGD Mgmt Corp	6.9%
Royce & Assoc	2.9%
Roumell Asset Mgmt	2.8%
Renaissance Technologies	2.6%
Dimensional Fund Adv	2.6%

Short Interest (as of 4/9/09):

Shares Short/Float	1.6%
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QADI PRICE HISTORY



THE BOTTOM LINE

The market's relative aversion to tiny companies has contributed to it undervaluing the solid long-term business prospects and significant asset value behind this software provider, says Jim Roumell. While acquisitions are commonly done at 3x such companies' "maintenance" revenues, he says, QAD's shares trade at only 0.5x such sales.

Sources: Company reports, other publicly available information

companies run all aspects of their business. The classic appeal of a business like this is that once the systems are installed, they're tough to pull out – roughly 95% of QAD's customers renew annual maintenance contracts. Overall, half its annual revenues are recurring in nature.

The company has traditionally generated \$10-15 million per year in free cash flow (after working-capital adjustments), which fell to around \$2.5 million in the fiscal year ended in January. The drop seems to have finally gotten management's attention to start addressing an unnecessarily high cost structure – they recently announced a plan to cut annual expenses by \$14 million – so we're comfortable QAD will remain solidly cash-flow positive even if revenues fall 6-7% this year, as management expects.

To give you an indication of how low the valuation has gone, acquisitions of companies like this are usually done at around 3x the level of maintenance revenues. The margins on maintenance are typically extremely high, so acquirers can almost get their purchase price back within three years while getting a free option on selling new licenses. At the current share price [of \$2.70], taking out \$19 million of net cash on the balance sheet, QAD's enterprise value is only \$64 million. That's just 0.5x the level of maintenance revenues.

Is an acquisition in this environment a reasonable assumption?

JR: That is one of the main risks here. The founders, Karl and Pamela Lopker, own 60% of the shares and have shown no real inclination to sell. If you speak with them, they're very worried about what would happen to the level of customer service if QAD was sold to a bigger firm. On the one hand that's great, because the emphasis they put on service is a big reason their customers love them. On the other hand, it makes one avenue of value realization less likely, at least in the near term.

So that leaves us with the economics of the business, which we believe are ultimately quite healthy, and one other thing: the company is situated on 27 acres in

Santa Barbara, California, looking out at the Pacific Ocean. On the land they have a building complex, which takes up three acres, and the rest is essentially open space. We hired an independent appraiser to study what they could do with the property and how much it could be worth under different scenarios. The range of values is wide, but we think a conservative value of the real estate is around \$50 million. That's nearly 80% of the enterprise value right there. While we doubt we'll see them sell the business any time soon, we think they may do something with the real estate, which would likely have a significant impact on the share price.

Is compressor maker Tecumseh Products [TECUA] more of a turnaround bet?

JR: Tecumseh was founded in the 1930s, so has a well-established installed base of its compressors for air conditioners and refrigeration units worldwide. It has around 40% of the light-refrigeration compressor market in North America and Europe. These products break and wear out, so when the 7-Eleven down the street sees its ice cream melting, they call their distributor to order a compressor that fits their particular unit. If it's already a Tecumseh compressor, it's highly likely the replacement will be a Tecumseh com-

INVESTMENT SNAPSHOT

Tecumseh Products
(Nasdaq: TECUA)

Business: Manufacturer of air conditioning and refrigeration component parts and systems, sold through both in-house and independent sales representatives.

Share Information
(@4/29/09):

Price	10.85
52-Week Range	3.00 - 37.79
Dividend Yield	0.0%
Market Cap	\$200.5 million

Financials (TTM):

Revenue	\$968.9 million
Operating Profit Margin	(-4.9%)
Net Profit Margin	(-5.2%)

Valuation Metrics

(@4/29/09):

	<u>TECUA</u>	<u>Nasdaq</u>
Trailing P/E	n/a	12.3
Forward P/E Est.	n/a	17.9

Largest Institutional Owners

(@12/31/08):

<u>Company</u>	<u>% Owned</u>
Franklin Templeton	9.0%
Dimensional Fund Adv	8.4%
Barclays Global Inv	7.3%
Donald Smith & Co	6.5%
Neuberger Berman	6.5%

Short Interest (as of 4/9/09):

Shares Short/Float	5.4%
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TECUA PRICE HISTORY



THE BOTTOM LINE

Fears over cyclically bad sales results and a price-fixing investigation have been excessively discounted into the company's share price, says Jim Roumell. At today's price, the market is ascribing an \$80 million enterprise value to a \$900 million-plus annual-revenue business that should grow over time and earn 6-10% operating margins, he says.

Sources: Company reports, other publicly available information

pressor. The result has been that almost in spite of themselves – the company operated without a CEO for six months in 2007, for example – they can't get out of the way of having \$800-900 million in annual compressor revenues.

From that relatively stable base, we expect the business to benefit over time from a global secular trend toward more refrigeration and air conditioning use. The company is already well established in India, where the chain of refrigeration for food and drinks is still in an early stage of development, and it also has manufacturing plants in Brazil, France and Malaysia.

Recent sales results would indicate the business is quite cyclical.

JR: The distributors that sit between manufacturers and customers cut back significantly on orders at the end of last year, meeting demand mostly through inventory drawdowns. That caused Tecumseh's sales to fall 35% year-over-year in the fourth quarter. We're not expecting the first quarter to be great either, but that kind of inventory depletion can't go on for long. The level of maintenance and replacement demand and the wide variety of products just won't allow it.

You mentioned their having no CEO for a time in 2007. Does current management give you confidence?

JR: Let's say I'm cautiously optimistic. The company has not distinguished itself as an operator. They've made big blunders in hedging exposure to things like copper prices and the Brazilian real. I also am angry about the way the board has been wasting an incredible amount of money in trying to dilute the voting rights of the largest shareholder, the Herrick Foundation. All that said, however, they have done a decent job of growing sales in South America and Asia, and I believe the new CEO, Ed Buker, is honest and working on the right things so Tecumseh can better take advantage of its position.

The shares are up sharply in the past few weeks. At \$10.85, how cheap do you consider the stock?

JR: The company ended last year with net cash of \$100 million. We estimate it will have negative free cash flow this year of \$25 million, but that should be more than offset by recaptured money from an overfunded pension plan and some tax refunds in the U.S. and abroad, so we estimate they'll end 2009 with \$120 million – around \$6 per share – in net cash.

So at an effective \$4.85 per share, you're paying around \$80 million in enterprise value for a \$900 million revenue business, which should grow over time and produce operating margins of 6% to 10%, which is what they made prior to the last few years. That to us looks extremely cheap. The company also has a net operating loss carryforward of \$478 million which I'm not including in my valuation, but that's clearly worth something.

Another thing I'd mention is that John Reilly, who runs the largest compressor-distribution business in North America, United Refrigeration, has recently become a significant shareholder in Tecumseh. There's probably not a person on the planet who knows more about compressors than John Reilly, so I'm very happy to see him buying at today's prices.

The Justice Department is looking into anti-competitive pricing in the compressor business. Is that a risk for Tecumseh?

JR: It's very hard to find a deep-value idea without some hair on it. Ed Buker, the CEO, was actually the one who notified the Justice Department about the potential issues, so Tecumseh has been given conditional immunity based upon its cooperation. That exempts the company from any criminal charges or governmental fines. It also precludes it from facing treble damages in a civil suit. I have no idea how it all turns out, but we don't believe Tecumseh's exposure here is that high.

Is KVH Industries [KVHI] more of a growth story?

JR: Yes. Value investors have lessons to learn from growth investors, and a big one for me has been the importance of identifying and getting in front of secular trends. I still want to buy \$1 worth of assets for 50 or 60 cents, but I've learned from experience that if that \$1 is in decline and there's no real catalyst to value being realized, you can get stuck with a lousy investment for a long time. You can still make money in those situations, but you should be paying 20 or 30 cents on the dollar instead.

With KVH we see both an extremely low valuation and extremely high growth potential. The company today is in two main businesses: two-thirds of revenue comes from selling high-end communications antennae used in things like recreational vehicles and boats, and the rest is from selling navigation guidance and stabilization products to the military. The consumer applications include things like providing a mobile satellite connection for television service. The military applications are focused on providing stabilizing gyros that facilitate the remote control of weapons. These gyros, for example, help allow tank operators to stay below while maneuvering their vehicles.

There are two primary components to the growth story. The first is how well the defense business is positioned to prosper as the remote control of weaponry becomes a greater and greater priority for the military. KVH is one of two primary suppliers worldwide with the gyro technology capable of delivering the accuracy these types of systems need. We think the growth runway in this business is quite long.

The game-changer, however, is KVH's new TracPhone V7 satellite antenna for commercial users, which delivers a full broadband package including Internet and phone services. What's particularly appealing about this from a business-model perspective is that the company and its partner, ViaSat, are selling not only the equipment, but also the regular

service delivery that generates an ongoing revenue stream.

For customers, primarily marine-based, the V7 systems are much smaller and less expensive than those offered by the dominant competitor in the market today, Inmarsat. KVH's technology uses a different spectrum band – the "Ku" band instead of the "L" band – that has far more capacity available, so it can provide a comparable level of service for maybe one-third the \$75,000 per year that Inmarsat would charge. KVH hasn't reported this, but we estimate over the past year it has sold more than 300 V7 systems – to both private industry and

the U.S. Coast Guard – so it is starting to get some early traction. Given the service revenue attached, the margins on this business should ultimately be around twice what they earn in their traditional businesses.

Is this showing up in the numbers yet?

JR: The continued growth in the defense business and the new V7 revenue is so far being masked by the declines in sales in the traditional land and leisure-marine markets. Do I think those traditional markets will stay miserable forever? No, but I'd have to say it honestly

doesn't make a big difference to our investment thesis.

How is Inmarsat responding to all this?

JR: That's an important question. An argument could be made that they have such a big share of the commercial maritime market – around 90% – that they would be better off letting their business get slowly chipped off while they work on alternatives, rather than cut prices across the board by two-thirds. Their response is something we're watching very closely.

At KVH's recent share price of around \$5.20, how are you looking at valuation?

JR: The current market cap is only \$72 million. By the end of the year we expect net cash to be around \$40 million, leaving an enterprise value of \$32 million – less than half annual revenue.

In such an open-ended idea that it's not worth putting too fine a point on it, but to give a sense of the potential upside, the target market for the V7 system consists of about 100,000 ships. If within five years KVH gets 5% of that, that's 5,000 ships on which they're earning \$24,000 each in annual service revenue, or \$120 million. At a 35% operating margin, that's \$42 million in operating income, or \$3 per share. If anything close to that happens in this one business, you're looking at a share price that is a multiple of the current one.

One thing I'd add is that the company is still run by the founding family, who couldn't care less if anyone buys their company's stock, but who are 100% focused on building a prosperous, high-quality business based on cutting-edge technology. We're happy to partner with owner/operators like that.

Your next idea, Tejon Ranch [TRC], is a long-time favorite of your mentor's, Mr. Whitman.

JR: We've owned it for years as well and I would say that value realization here has been a long time coming. But that hasn't at all dimmed my enthusiasm for the stock.

INVESTMENT SNAPSHOT

KVH Industries

(Nasdaq: KVHI)

Business: Provider of navigation, guidance, and stabilization products and satellite-based mobile communications systems to retail, commercial and defense markets.

Share Information

(@4/29/09):

Price	5.17
52-Week Range	2.81 – 10.15
Dividend Yield	0.0%
Market Cap	\$72.3 million

Financials (TTM):

Revenue	\$82.4 million
Operating Profit Margin	3.5%
Net Profit Margin	3.7%

Valuation Metrics

(@4/29/09):

	KVHI	Nasdaq
Trailing P/E	24.3	12.3
Forward P/E Est.	15.2	17.9

Largest Institutional Owners

(@12/31/08):

Company	% Owned
Royce & Assoc	13.5%
Roumell Asset Mgmt	9.4%
Wisconsin Inv Board	8.8%
Systematic Financial Mgmt	6.4%
Renaissance Technologies	3.6%

Short Interest (as of 4/9/09):

Shares Short/Float	0.6%
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KVHI PRICE HISTORY



THE BOTTOM LINE

With more than half of its current market value in cash, a growing defense business selling gyro technology for the remote control of weaponry, and a potential blockbuster new product offer in broadband mobile communications systems, Jim Roumell considers shares in the company a relatively low-risk bet with "open-ended" potential upside.

Sources: Company reports, other publicly available information

The company owns 270,000 acres of land northeast of Los Angeles on a completely unlevered basis. There are a lot of moving parts here, but the three primary developments through which the company is looking to create value are a 1,500-acre industrial park straddling Interstate 5 between L.A. and Bakersfield, the Tejon Mountain Village resort community, and the Centennial master-planned housing community.

The industrial park is up and running, with one giant petro-station complex (plus another on the way), warehouse operations for companies like Ikea, and a wide variety of restaurants and shops

servicing both the employees working at the park and travelers. Tejon Mountain Village and Centennial, however, have yet to break ground, slowed down by roadblocks thrown up by environmentalists, as well as an exceedingly drawn out local-government entitlement process.

Last summer the company reached a global settlement with a consortium of environmentalists that basically laid out what it could and couldn't do in the two developments. It was an extensive agreement, but Tejon essentially agreed to put in trust 140,000 acres that can't ever be developed, in return for going forward basically as planned with Mountain

Village and Centennial. That paves the way for entitlement at the county level, because both Kern and Los Angeles counties (where the developments are to be located) called for just such an agreement prior to giving their OKs. Nothing is done yet, but Kern County is expected to vote on Mountain Village in the fourth quarter of this year, while the L.A. County Board of Supervisors should give its opinion on Centennial by the first quarter of next year. Basically, we believe we're in the ninth inning of the entitlement process and that it will go in the company's favor.

Which still leaves some pretty strong headwinds for the company from the real estate and economic environment.

JR: True, but we believe the current valuation makes it more than worth our while to wait. The current market cap [at a recent price of \$24] is \$408 million. The question then is what the many different assets of Tejon Ranch are worth.

To be conservative, we've knocked one-third off our prior valuation of the industrial park – which we now value at \$150 million. Cash on hand is about \$35 million, after accounting for the additional spending necessary to complete the new petro station on the east side of I-5. Putting a multiple on annual oil lease payments the company receives and valuing the working farmland they own, that adds at least \$75 million in value. They also lease out quarry and power-plant capacity on their land, the present value of each we estimate to be \$25 million. Finally, there is plenty of land left over that the company could just sell off to something like a conservation land bank, a prospect we've studied closely and which we believe could generate a minimum of \$60 million.

Add that all up and we see existing asset value of about \$370 million. That means the market is valuing Centennial, Mountain Village and a vast array of yet-to-be-determined development options at less than \$40 million. How far off could that eventually be? Just one data point: Lennar bought the partially entitled

INVESTMENT SNAPSHOT

Tejon Ranch
(NYSE: TRC)

Business: Development and commercialization of largest contiguous private landholding in California, comprising 270,000 acres located 60 miles north of Los Angeles.

Share Information
(@4/29/09):

Price	24.00
52-Week Range	18.40 – 44.25
Dividend Yield	0.0%
Market Cap	\$407.9 million

Financials (TTM):

Revenue	\$40.1 million
Operating Profit Margin	3.7%
Net Profit Margin	10.2%

Valuation Metrics
(@4/29/09):

	TRC	S&P 500
Trailing P/E	102.6	13.5
Forward P/E Est.	64.9	14.9

Largest Institutional Owners
(@12/31/08):

Company	% Owned
Third Avenue Mgmt	28.8%
Wesley Capital	13.1%
Fidelity Mgmt & Research	4.4%
Barclays Global Inv	3.5%
Towerview LLC	2.7%

Short Interest (as of 4/9/09):

Shares Short/Float	4.5%
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TRC PRICE HISTORY



THE BOTTOM LINE

Jim Roumell believes the bleak real estate environment has caused the market to ignore good news about the company's Centennial and Mountain Village development projects. Given his sum-of-the-parts analysis of other producing assets, the significant potential of the two projects is almost entirely absent from today's share price, he says.

Sources: Company reports, other publicly available information

Newhall Ranch property in California – very similar in makeup and size to Centennial – for around \$850 million in 2004, before the bubble really took hold. If you divide that by the number of lots Newhall was expecting to entitle, it came out to \$38,000 per lot. Apply that to the expected 23,000 lots at Centennial and that gives you \$875 million.

You can start to cut that down, say to \$600 million, because Newhall is closer to Los Angeles and deserves a premium. You can take that \$600 million down another 50% because Tejon put the Centennial property in a joint venture with three other homebuilders, to cover all the entitlement costs. But even after all that, you're left with Centennial land alone that we believe is worth \$300 million today, which is nearly \$18 per share. If the entitlements come through as we expect, Centennial will be fully entitled, which would increase that value even further.

Do you expect the stock to pop if and when the entitlements finally come through?

JR: The evidence for how valuable those entitlements are is in how long it has taken the company to get them. I took some profits in 2005 and 2008, but I've owned this stock since 1998 and I can tell you that sometimes it's been like watching paint dry. I don't believe today's stock price reflects at all the entitlements being granted. In the end, though, we're just focused on the fact that we own a fabulous asset that can't be duplicated and that the value resident in it will eventually be its own catalyst.

You have also been very active in the corporate-debt market. Why?

JR: We believe corporate debt right now presents a better risk/reward opportunity than S&P 500-type common stocks. One aspect of that is that debt should hold up better in a prolonged, depressed economic environment – you get income to ride out the storm and a priority claim on assets if a restructuring is necessary. The second part is just pricing, as credit

spreads have gotten so wide that you can truly find equity-like returns without as much economic risk.

I go back to those dominant battleships I mentioned earlier, which are the types of big companies we would find most attractive to own. Again, those are companies like Intel, Autodesk and 3M, with great balance sheets, generating lots of cash and with dominant market positions. As I mentioned, they're trading at historical free-cash-flow yields of around 8-10%, at a time when cash flow is almost certain to go down given the con-

ON CLOSED-END FUNDS:

One attraction is that trading in them is retail-dominated, creating inefficiency when brokers capitulate as they have.

traction in the global economy.

Compare that with corporate debt, where we're finding yields to maturity of 10-20%, with low or manageable risks of default. The analysis is clean – we don't really have to handicap earnings, and we certainly don't need to handicap what multiple will be placed on those earnings. We just have to make sure there are sufficient assets and/or earnings to insure we get our interest and principal payments. All other problems – and there may be many – accrue to the equity holders.

We're assuming you don't think economic recovery is close at hand.

JR: I read all the articles about how things are getting better, but every person I speak with who is on the front lines of a business is in an absolute funk. A contact of ours in the hotel business told me a few days ago that she had met the night before with a very senior person at one of the big hotel chains, who asked her for directions to the subway because business was so bad that he wasn't allowed to take a cab. When I'm constantly hearing things like that it's hard for me to be opti-

mistic. I think too much of the recent rally is a function of what a broker told me recently, "I'm sick and tired of being sick and tired." The rally feels more driven by happy talk than economic reality.

Give us an example or two of individual debt issues you're finding interesting.

JR: We own a large position in the unsecured notes of real estate company **SL Green**, some maturing in two years and some maturing in five. At market prices, we locked in a yield to maturity on the shorter-term notes of 16% and on the longer-term notes of 15%. Using the notes maturing in 2011 as an example, we value the debt at our level or senior to us at around \$5.1 billion – using par value for the more senior debt and market value for our debt. If you subtract from that the cash the company has and other investments we value at 25% of book, we arrive at net debt of \$3.9 billion. That works out to roughly \$200 per square foot for the real estate assets backing us up, most of which are in Manhattan.

So what matters to us is whether the assets behind our debt are worth more than \$200 per square foot, and there's a strong case to be made that they are. One of the highest-profile distressed sales recently of Manhattan real estate, 1540 Broadway, just went for \$400 per square foot. The New York Times Co. just sold 42 floors of its building for \$350 per square foot. On top of that, there's an equity market value on the publicly traded **SL Green Realty** that is now more than \$1 billion. So before our mid-teens yield to maturity is threatened at all, that equity value would have to go away and the real estate properties would have to depreciate a further 40-50%. That's a risk/reward we can live with.

In general, we're only investing in individual debt issues that are ultimately backed by saleable hard assets. **SL Green** can sell a building if it needs to without affecting the rest of the portfolio. That gives them much more flexibility in this type of environment than a company whose operating income is the primary thing backing the debt.

An even more straightforward example of corporate debt we find attractive is that of **Comstock Resources**, which I mentioned earlier. The company owns 580 billion cubic feet-equivalent of natural gas and oil reserves. They also own 70,000 not-yet-producing acres in the resource-rich Haynesville Shale formation primarily located in northwest Louisiana. All you really need to know is that the company has \$160 million of net debt and an equity market cap of \$1.6 billion. We bought 7%-coupon bonds maturing in 2012 at a yield to maturity of 12% – which is almost unheard of for a company with that kind of capital structure. The market would have to get the valuation of

the company's reserves wrong by 90% before we lose a nickel.

What appeals to you about closed-end bond funds like the Credit Suisse Asset Management Income Fund [CIK]?

JR: One general reason we're attracted to closed-end funds right now is the fact that trading in them is typically retail dominated, which creates greater inefficiency when you see the kind of broker capitulation that has gone on in the past six months. On top of that you have debt being mispriced relative to risk, which we've already discussed. That's resulting in closed-end bond funds, say, trading at

60 cents on the dollar, which is effectively pricing in 40% defaults with zero recovery. When we stress test many of these portfolios, we think the resulting risk/reward is highly favorable.

CIK is a high-yield corporate-debt portfolio holding bonds with \$200 million in par value. There's no leverage, the average coupon is 8.5% and the average remaining security life is around five years. The fund price has moved up a bit from where we bought it, but at the current price of around \$2.50, the portfolio is trading at just over 60% of par value, or a market value of \$125 million.

Let's assume the portfolio defaults at 10% – per year – for four years in a row. Let's also assume in every default that we only get 20 cents back on the dollar. If we run those numbers from today's market price, through the five-year average life of the portfolio, that gives us a yield to maturity of 14%.

Given the credit debacle, there's good reason to believe default rates will be higher this cycle than usual and recovery rates lower. But what we've assumed in our stress test would be by far the worst experience ever. In the last cycle, after the dot.com blowup, the cumulative default rate on high-yield debt was about 25% in total and the recoverable for loans was about 70 cents on the dollar and for bonds was about 40 cents. So with the yield we're getting, we feel we have plenty of cushion if the default experience is even worse than we're assuming – we'd still get our money back if 50% of the portfolio defaulted with no recovery. If things turn out better than we've assumed, that annualized yield will be much higher than 14%.

Are you making assumptions on credit quality for each holding in the portfolio?

JR: No. We do look fairly closely at the top ten holdings, but what we primarily watch out for is too much concentration in any one issue. You want a fund to have only 1% to 2% positions so nothing big can blow up on you. This portfolio so far – based on actual defaults – is performing much better than the market.

INVESTMENT SNAPSHOT

Credit Suisse AM Income Fund
(Amex: CIK)

Business: Closed-end fund invested primarily in high-yield corporate debt securities. Average credit quality: B rating.

Share Information
(@4/29/09):

Price	2.54
52-Week Range	1.66 – 3.70
Dividend Yield	8.5%
Market Cap	\$126.8 million

Financials (TTM):

Revenue	\$19.6 million
Operating Profit Margin	92.6%

Valuation Metrics
(@4/29/09):

NAV per share	CIK 2.74
Discount to NAV	8.8%

Largest Institutional Owners
(@12/31/08):

Company	% Owned
Renaissance Technologies	4.1%
Roumell Asset Mgmt	3.5%
Wells Fargo	1.6%
Advisors Asset Mgmt	1.5%
Claymore Advisors	1.3%

Short Interest (as of 4/9/09):
Shares Short/Float n/a

CIK PRICE HISTORY

THE BOTTOM LINE

Assuming the high-yield corporate debt in this highly diversified closed-end fund defaults at 10% per year for four years in a row and recovery rates on such defaults average 20% – “by far the worst experience ever” – Jim Roumell calculates he'd still earn a 14% annual yield through the roughly five-year average life of the portfolio.

Sources: Company reports, Roumell Asset Management, other publicly available information

Describe your general strategy with respect to selling.

JR: It's nothing fancy – when the stock price gets within our estimated range for intrinsic value, we're sellers. To my mind, capturing a discount to a conservatively estimated intrinsic value is a far easier proposition than betting on the growth of intrinsic value over time. Someone like Warren Buffett, who has an incredible gift for imagining how a company's business and market develops over time, is going to be much better than I am at seeing the potential for growth. There are exceptions, but I usually leave that part of a stock's upside to people like him.

Have you been re-thinking any aspects of your strategy or approach?

JR: We've always been dedicated, bottom-up investors, fully believing in that old line from Peter Lynch that if you spend 15 minutes a year studying the economy, you've wasted 10. While I'm not prepared to renounce that position, I do believe we need to do our bottom-up work with a greater appreciation for what's going on in the world.

This isn't a real example, but from a purely bottom-up perspective we might have thought we were getting a huge discount if we bought into SL Green 18 months ago at the equivalent of \$500 per

square foot, as long as Manhattan real estate was going for \$800 per square foot. But if the asset you're counting on is overvalued, that discount to "intrinsic" value can disappear quite quickly – not because the stock price goes up, but because the intrinsic value goes down. I have a healthy respect for how hard this is to do, but we are going to focus more on understanding what external factors might be affecting valuations.

Describe a specific-stock mistake you've made recently.

JR: We still own shares of Belo Corp. [BLC], which spun off its newspaper business last year to focus on owning and operating local television stations. Local TV has traditionally been a fabulous business with huge cash flow, and last year we started buying Belo stock because we thought concerns that the networks would circumvent local stations or continue to erode the benefits they bestow upon them were overdone. After spending a great deal of time and money on the secular issues, we concluded that well-run, successful stations like Belo's were too important to the networks for them to be cut off in any dramatic way.

Our mistake was in focusing so much on the big secular issues that we didn't pay enough attention to the cyclical risks – when advertising tanked, so did the stock price. While we've dug ourselves a

big hole, at this point we still think the secular concerns are overstated and that at \$1.70 per share, the potential upside far exceeds any more downside. Only two years ago the company made \$1 per share in earnings.

How well prepared was your portfolio for the arrival of the bear market?

JR: On the plus side, we benefited by getting out of financials in late 2007 before the worst hit in 2008. That was a broad-based call I made by recognizing that even if the housing downturn was at the very low end of what people were expecting, these companies, given their leverage, were in big trouble.

The biggest mistake I made was in not asking strongly enough, "If you're so pessimistic about the balance sheets of financials, isn't it likely the rest of the economy will be affected in a big way as well?" Had I made that connection more directly, we would have been a lot better off.

We have had and continue to have a lot of cash, now around 30% of the portfolio. We've found a fair amount to buy, but as credit spreads have come down a bit and the stock market has gone up, we're in no hurry to spend all our cash. Given that I don't think we're at all out of the woods from an economic standpoint, I'm still expecting plenty of opportunity for bargain hunting in the months to come. **VII**

Disclosure

Please refer to the Annual Disclosure Presentations for our Equity and Balanced Composites which have been prepared and presented in compliance with the Global Investment Performance Standards (GIPS®). Performance reflects Roumell Asset Management's deep value investment strategy with a focus on total return. Returns are reported net of all management fees and applicable trading costs and include the reinvestment of all income. Investors should understand that past performance is not indicative of future performance. Investors should not assume that investments made on their behalf by Roumell Asset Management will be profitable and may, in fact, result in a loss. Ashland Partners & Co. LLP, our independent verifier, completed its examination of the firm's performance returns for the period of 1999 (inception) through 2008.

The specific securities identified and described do not represent all of the securities purchased, sold, or recommended for advisory clients and the reader should not assume that investments in the securities identified and discussed were or will be profitable.



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Roumell Asset Management, LLC, founded by James C. Roumell in 1998, is an opportunistic deep value focused investment manager. Roumell is neutral as to company size and/or capital structure placement: it will buy small, medium or large size companies as well as common stocks or bonds depending on what it views as the best risk/reward opportunities present in the marketplace. We will hold cash for extended periods of time in the absence of sufficient investment opportunities. We manage equity, balanced and dedicated fixed income portfolios.