



400 W. Louisiana St.
McKinney, TX 75069

214.425.7027

Status Report

Wednesday, July 13, 2016

Dear Kopion Clients,

As you will remember, we entered a stormy market last summer. This environment continued through the first half of 2016 with the market lurching from one potential crisis to another. The first of these was a slowdown in the Chinese economy, followed by acutely low oil prices and most recently, Britain's decision to leave the European Union. Like the rest of the market, Kopion's portfolio fell sharply in early 2016. We then recovered almost all of that decline, only to be dealt another setback by the British referendum at the end of June. In the end, Kopion finished the first half of the year down 5.9% before fees (-6.4% after fees). The S&P 500 and Russell 2000 returned +3.8% and +2.2%, respectively.

The S&P 500 finished the first half near its all-time high, but that belies widespread anxiety throughout the market. For example, cash is the most defensive asset, and fund managers have allocated an average of 5.7% of their portfolios to cash, which is the highest level in nearly 15 years. In a similar vein, allocations to equities are at four year lows, reflecting a level of risk aversion usually seen during recessions.¹ Even among equities, investors are favoring sectors such as utilities that they perceive to be safer. (This has ironically pushed the valuation of utility stocks to their highest level in at least 20 years.)² Many investors have thus moved away from small companies like the ones that Kopion focuses on in favor of larger, more defensive ones. Because we have remained in a very difficult environment for our types of stocks, I decided to provide a brief "status report" on the main factors that have been afflicting our portfolio:

LOW OIL PRICES

Oil prices remain quite low, which has led to additional declines in development spending across the globe. For example, the number of rigs that are actively drilling in the US has plummeted about 77% from its peak, and a staggering 69% of the fracing equipment in the US has been idled. Global oil production thus began declining early this year. This has led to a modest recovery in oil prices, and a variety of factors suggest that this improvement will continue, albeit

¹ Ben Eisen, "Fund Managers Are Stockpiling Cash," The Wall Street Journal, June 14, 2016.

² Ken Brown, "Desperate for Yield? Utility Stocks Are More Dangerous Than They Look," The Wall Street Journal, July 6, 2016.

unevenly. I am thus cautiously optimistic that the worst of the oil downturn has passed for our energy stocks.

THE STRONG US DOLLAR

The strength of the US dollar has been a stiff headwind for many of our companies because it has caused their international revenues and earnings to translate into fewer US dollars. This can be thought of as a “foreign exchange penalty.” In recent months, this penalty has become much smaller, and if exchange rates hold steady, it should dissipate over the balance of the year. I am thus hopeful on this front as well.

HIGHER RISK AVERSION

As mentioned previously, this headwind intensified during the first half. Investors’ emotions are inherently unpredictable, which makes it impossible to know when the market will become less edgy. That said, we seem most likely to face continued challenges in this area as investors grapple with various sources of uncertainty such as Britain’s departure from the European Union and a US Presidential election that promises to be more like a demolition derby.

TOUGH LUCK

Alfred and I are extremely diligent in our research efforts, but the year to year results of that work are sometimes affected by luck. As some of you might remember, at the end of 2013, I noted that part of that year’s phenomenal performance was due to good luck. Over the last couple of years, however, I believe that we have been dealt a surprising amount of bad luck as an unusual number of our companies have suffered temporary setbacks. Furthermore, the market’s heightened risk aversion has amplified the declines in those stocks. Fortunately, each of these companies is making concrete progress overcoming their individual challenges.

There are thus preliminary signs that we may be turning a corner with some of these headwinds, but others seem likely to persist. The good news, however, is that this adversity has provided opportunities to judiciously add to some positions at incredible bargain prices.

In summary, we continue to make the best of what has been a very difficult hand, and I believe that from a long-term perspective, our portfolio has tremendous upside. In addition, I recognize that this has been an uncomfortable and protracted season, and I greatly appreciate all of your patience, support and trust through this time.

Best regards,

Terry Ledbetter, Jr., CFA

PERFORMANCE DISCLOSURES

Period	Kopion, Gross	Kopion, Net <small>Max Fee</small>	S&P 500	Russell 2000
1st Half of 2016	-5.9%	-6.5%	3.8%	2.2%
Annualized*				
1 Year	-17.5%	-18.5%	1.4%	-4.4%
3 Years	6.9%	5.5%	15.1%	11.7%
5 Years	7.5%	6.2%	12.6%	9.2%
Since Inception [†]	13.8%	12.5%	13.8%	12.6%

Period	T Ledbetter, Gross	T Ledbetter, Net <small>Max Fee</small>	S&P 500	Russell 2000
1st Half of 2016	-5.9%	-6.5%	3.8%	2.2%
Annualized*				
1 Year	-17.5%	-18.5%	1.4%	-4.4%
3 Years	6.9%	5.5%	15.1%	11.7%
5 Years	7.5%	6.2%	12.6%	9.2%
10 Years	10.1%	8.8%	7.3%	6.8%

*Ending 12-31-15

[†]Since 8-23-09

Past performance does not guarantee future results. Investments with Kopion may lose value.

Terry Ledbetter, Jr. began managing his first diversified investment account on 2-4-04 while employed by Friedberg Investment Management (FIM). Mr. Ledbetter left FIM on 7-31-09 and founded Kopion Asset Management, LLC (Kopion), which became a legal entity on 8-24-09. Importantly, when Mr. Ledbetter founded Kopion, he continued to manage the same accounts that he had been managing while employed by FIM. The accounts, investment strategy, and investment process all remained the same. The performance information cited throughout Kopion's marketing materials includes all of the diversified investment accounts managed directly by Mr. Ledbetter since 2-4-04, which is when he began managing his first diversified investment account. This information is provided for both Mr. Ledbetter's entire performance history as well as for the portion of Mr. Ledbetter's performance history that occurred after Kopion was founded and became a legal entity.

The performance information cited throughout Kopion's marketing materials has been thoroughly documented, and it has been calculated using normal industry protocols, which are described in more detail below. This information has not, however, been audited by an independent third party. Dividend and interest income in these accounts was reinvested. Returns for these accounts have been asset-weighted to calculate historical returns. Said another way, the accounts were aggregated into a single group and then performance was calculated for that single group. This group includes some sub-accounts and securities that were carved out of larger accounts in order to exclude assets like mutual funds that Mr. Ledbetter did not manage directly. Those mutual funds were managed by professionals at third party firms, and Mr. Ledbetter's involvement was limited to being a passive shareholder of those mutual funds. In addition, some of those mutual funds followed fixed income strategies, which were very different from the strategy used by Mr. Ledbetter when he was employed by FIM and later at Kopion.

Performance information that includes assets like mutual funds that were not managed directly is available, and Kopion will provide it promptly upon request.

Kopion reports its Time Weighted Returns (TWRs). TWRs make adjustments for deposits and withdrawals so that those transactions do not influence performance results. Consequently, deposits do not increase the return, and withdrawals do not decrease the return. TWRs thus allow for performance comparisons between Kopion's (and Mr. Ledbetter's) history and market indices.

Kopion reports both "gross returns" (which are returns before Kopion's management fee) and "net returns" (which are returns after deducting Kopion's management fee). Kopion's management fee schedule is graduated, which means that the fee rate begins to decrease after an account's dollar value exceeds a certain threshold. The label "Net _{Max Fee}" indicates that the net returns being presented reflect Kopion's maximum fee rate for all periods presented. The words "net" or "after fees" without the words "Max Fee" in subscript lettering indicates that the net returns being discussed reflects actual fees.

Kopion has provided the returns of the S&P 500 and the Russell 2000 indices in order to provide the broader stock market context of Kopion's (and Mr. Ledbetter's) returns. The S&P 500 tracks the performance of relatively large publicly traded companies, and the Russell 2000 tracks the performance of relatively small ones. Kopion does not "benchmark" its portfolio against indices in the traditional sense of carefully managing the portfolio for comparison against a specific index. Instead, these two indices are used as broad indicators of the stock market's performance. Mr. Ledbetter has primarily focused on small and medium sized firms, but he has also invested in some large companies as well. This is why Kopion has provided the results of both the S&P 500 and Russell 2000. These indices cannot be invested in directly, but mutual funds and exchange-traded funds that track these indices ("index funds") are available in the market. Kopion's (and Mr. Ledbetter's) investment strategy carries more risk than investing in an index fund that tracks either the S&P 500 or the Russell 2000. This is primarily because Kopion's (and Mr. Ledbetter's) strategy involves investing in a relatively small number of stocks and those stocks are primarily for small to medium sized companies. This approach results in greater volatility and greater risk of capital loss than index funds tracking either the S&P 500 or the Russell 2000.

Indices' performance figures have been obtained from sources believed to be reliable.