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Portfolio Manager
Artko Capital LP

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Dear Partner,

For the third calendar quarter of 2017, a partnership interest in Artko Capital LP returned 1.9% net of fees. At the same time, an investment in the most comparable market indexes—Russell 2000, Russell Microcap, and the S&P 500—gained 5.7%, 6.7%, and 4.5%, respectively. For the first nine months of calendar 2017, an interest in Artko Capital LP returned 6.6% net of fees, while investments in the most comparable aforementioned market indexes were up 10.9%, 11.6%, and 14.2%, respectively. Our monthly results and related footnotes are available in the table at the end of this letter. Our results this quarter were somewhat muted due to our increasing use of hedging and moving to a larger cash position offset by strong performances by Spartan Motors and Viad.

| | 4Q16 | 1Q17 | 2Q17 | 3Q17 | CY 2017 YTD | 1 year | Inception 7/1/2015 | Inception Annualized |
|---|---|---|---|---|---|---|---|---|
| Artko LP Net | 11.2% | -3.5% | 8.3% | 1.9% | 6.6% | 18.3% | 47.8% | 19.0% |
| Russell 2000 Index | 8.8% | 2.5% | 2.5% | 5.7% | 10.9% | 20.7% | 22.8% | 9.6% |
| Russell MicroCap Index | 10.1% | 0.4% | 3.8% | 6.7% | 11.6% | 22.3% | 19.7% | 8.3% |
| S&P 500 Index | 3.8% | 6.1% | 3.1% | 4.5% | 14.2% | 18.6% | 28.2% | 11.7% |

**On Management Incentives**

*"I will tell you a secret: Dealmaking beats working. Dealmaking is exciting and fun, and working is grubby. Running anything is primarily an enormous amount of grubby detail work . . . dealmaking is romantic, sexy. That's why you have deals that make no sense." – Peter Drucker*

This quarter can be described as one of tepid disappointment in management teams of some of our holdings. One of the hardest things in active—but not activist—investing is making sure the management incentives of portfolio companies are aligned with those of minority shareholders. It is even harder in the small capitalization space, where corporate governance is often less sophisticated and occasionally mismanaged. There is no precise science to quantify the benefits, but ensuring that the incentives of shareholders and management are aligned through direct ownership or compensation structures is a significant way to limit the investor downside risk. We tend to favor companies where the CEOs and board members either own a substantial amount of stock or can create a substantial financial windfall for themselves through successfully increasing the value of the companies they manage.

Unfortunately, throughout our career we've found that after a certain financial threshold of ownership, the psychological motivations of wealth creation can move up the Maslow Pyramid into those of ego boosting, which may not align with those of other shareholders. In other words, after a certain amount of money is made, there may be less worry about the money and more worry about legacy, reputation, and control. On the other side, an argument can be made that having substantial wealth and reputation tied to a company creates an additional margin of safety where management is also motivated by capital preservation and is unlikely to take on value-destroying initiatives. There is no perfect solution, and finding a way to thread the needle of aligning management incentives with those of shareholders is often a challenging task. This quarter, we faced various transactions by management teams of our holdings that show the difficulty of aligning shareholder incentives with those of management:

- National Research Corp. B Shares (NRCIB) – Our original thesis for investing in the B shares of what is now called NRC Health was the attraction to the oligopolistic high margin, recurring revenue business model engaged in rating the quality and patient satisfaction of hospitals and doctors in the United States. Additionally, the benefit of the B shares was that they received six times the voting and economic power of the A shares, including regular and special dividends, while trading at less than three times the value of the A shares. Founder and CEO Michael Hays controlled 54% of the A shares and 60% of the B shares, effectively controlling 56% of the company and receiving 56% of the dividend cash flows. We felt that being invested alongside the CEO and the board of directors in the B shares at a 50% discount to economic parity of the A shares provided a significant margin of safety in this special situation. Since our initial purchases two years ago at $33 per share, the B shares have paid out $6.34 cents per share in dividends (or close to 20%) and have appreciated in value to $54 for another 60% return. However, by September 2017, the discount between the economic parity to A shares has widened to over 70%, and the CEO saw the opportunity to recapitalize the company by buying back the B shares he did not already own at the current stock price. While a shrewd and opportunistic move to increase control of the company through a partial leveraged buyout, an exit scenario we always felt was the most probabilistic, we were extremely disappointed in the no premium, tender offer price significantly below the economic value of the B shares. We sold our 10% position at ~$54 per share and while pleased with the total returns we were dissatisfied in the transaction over which we had little control.

- State National Companies (SNC) – During the quarter, our 11% investment in SNC received a buyout offer from Markel Corp. at $21 per share—a 15% premium to the price at the end of the previous quarter and 110% above our initial purchase price 10 months earlier. There are few things as prestigious as and validating of your personal success than having an insurance company that you founded be bought out by a venerable insurance institution like Markel. It is no surprise that the managing Ledbetter family, which owns 54% of the outstanding shares and has always had an interest in keeping SNC private, readily accepted the offer and committed to voting its ownership stake in favor of the deal where they would continue to grow the company within Markel. The $919 million offer would net the family close to half a billion dollars and allow the opportunity to continue to grow their legacy at Markel. However, we felt the $21 per share offer price was too low and allowing competing, but not necessarily as favorable to the family interests, bidder into the process would have netted offers of $25 per share or above, closer to our estimate of the company's true value. This was another example of where we, as minority shareholders, had little recourse in addressing what we felt were decisions made not in the best interest of all shareholders. We have not yet sold our position given the high probability of the deal close in this current quarter, our partners are better served paying taxes on long-term gains rather than the higher taxes on short-term gains. We expect to convert this position to cash in the current quarter.

- USA Technologies (USAT) – In our biggest disappointment this quarter, we sold our 11% position in USA Technologies at approximately $5.45 per share. USAT was one of our favorite stories of the last two years, with a significant runway to increase its leadership position in the six million vending machine payments market from its current base of over 500,000 connections. The market agreed with us, and the stock appreciated almost 100% from our initial purchase levels. However, the journey to this point has not been without its bumps. Four CFOs, internal control issues, continuous cost overruns, and an out-of-control CEO have contributed to the deterioration of our confidence of our original thesis.

Unlike the prior two positions, where managers with substantial ownership created additional shareholder value, during the quarter the company announced an unexpected and highly dilutive equity raise, for no reason we could find other than to get favorable coverage from a sell side institution. The company refused to answer our communication with respect to the equity raise, despite knowing we've been long-term shareholders. CEO Stephen Herbert chased us in the hall at a recent conference in San Francisco to express his displeasure at us asking a question about the equity dilution at a Q&A event. While this isn't the first time a CEO of a public company got upset with our line of questioning with respect to our investment in their company, we decided to exit our investment as a result due to the heavy concerns about Herbert. We realized Herbert's attitude toward USAT shareholders changed from a willing seller of a company to one of a "trust me" empire builder. While owning less than 1% of the stock outstanding, or approximately $2.5 million in equity, Herbert's salary climbed to over $1 million a year from $500,000 a few years ago, a high number for a small, $100 million/year revenue, company. A highly accretive sale of the company to a strategic acquirer would net Herbert an additional $1 million-$2 million, while he would surely lose his job or lucrative salary in any potential acquisition. Instead, it appears Herbert is focused on deal making, which as Peter Drucker said earlier in this letter, beats working. There is a good chance that this company will capitalize on its opportunities and the stock price may yet double from here. However, as a concentrated portfolio investment strategy, we believe our partners are better served being invested in management teams whose interests are aligned with our own.

If it seems like we are disappointed in our investments that doubled in value over one or two years, it is because we are. We do not like to leave money on the table, and we will continue to refine our focus on management incentives as part of our research process.

*Enhanced Portfolio Sales*

- AIG 2021 Warrants (AIG-WT) and MMA Capital Management (MMAC) – In addition to the aforementioned Core Portfolio sales of NRCIB and USAT, we sold our combined 2.6% position in the two financial sector securities. As we continue to monitor and be concerned about the valuation of the markets and the interest rate environment, we felt that our partners would be better served by harvesting the 15% and 90% gains we've made in these small positions. We were not impressed with AIG's new CEO and his growth strategy, which we felt would not close the wide gap between the stock price and the book value of AIGs assets by the warrant expiration date (about three years from now). We still like MMAC and admire its management team that continues to buy back stock for themselves and the company on the open market. However, we felt MMAC's fixed income portfolio's negative exposure to rising interest rates outweighed the potential benefits of management's ability to unlock the value of the firm's hidden assets. We would consider getting back into MMAC in the future at better prices and interest rate environment.

*Enhanced Portfolio Additions*

- Research Solutions (RSSS) – We added a 3% position in the leading distributor of scientific research. The $27 million market capitalization company processes over 800,000 transactions per year from the leading corporate and academic institutions in distributing the relevant scientific published research to meet their significant needs. The Transactions segment is a nice business, pulling in $25 million in repeat revenue per year and growing in mid-single digits. However, what really excites us is the new Software as a Service (SaaS) Platform segment, which will really drive the growth and profitability of the firm for the near future. The new, ~80% gross margin, platform product, which aims to be the

"Bloomberg of Scientific Research," has been well received by the marketplace and has a tremendous opportunity to be a staple in the $7 billion platform market. The company's founder, Peter Derycz, who owns close to 15% of the company, has a reputation of an excellent operator, having founded and sold a company in the research distribution space earlier in his career. Additionally, the company has an excellent balance sheet with $6 million in net cash and $4 million revolver availability and reputable shareholder base with board representation. We saw a good opportunity to buy this company at less than .8X recurring revenues and combined with a strong balance sheet and incentivized management provided a good margin of safety for us. We believe that if the company is able to capitalize on the new product suite it will be worth many multiples of today's stock price and our margin of safety lies in the going private enterprise value of the company. Given its concentrated ownership is close to 70%, the stock is thinly traded exposing us to some liquidity risk. Given that our current capital base has a multiyear commitment to the partnership, we felt this was not a significant enough risk to deter our investment. We will continue to monitor the progress of the company on its growth initiatives and may consider making this position a Core Portfolio holding in the future.

**Other Portfolio Updates**

- Hudson Technologies (HDSN) – We continued the wild ride in our favorite name with the stock gaining 20% this quarter on an announcement of a great acquisition, only to fall 25% by quarter end on misleading reports by the short-selling community. During the quarter, the company announced the acquisition of Airgas's refrigerants business for $220 million or approximately 10 times our estimate of Airgas's 2017 earnings. This was a fantastic deal that upon closing will massively grow Hudson's scale to process reclaimed gas, increasing its bargaining power with suppliers and customers. Hudson will have an exclusivity agreement to supply gas to Airgas and their hundreds of store locations as well is diversify its own distribution channel. Additionally, the combined entity will be in an excellent position to profit from the next leg of its growth thesis from the phase out of HFC gas. While Hudson is taking on a large debt load of $185 million to fund the acquisition, it should immediately be accretive on a cash basis and we expect the company to pay down the debt in the near future.

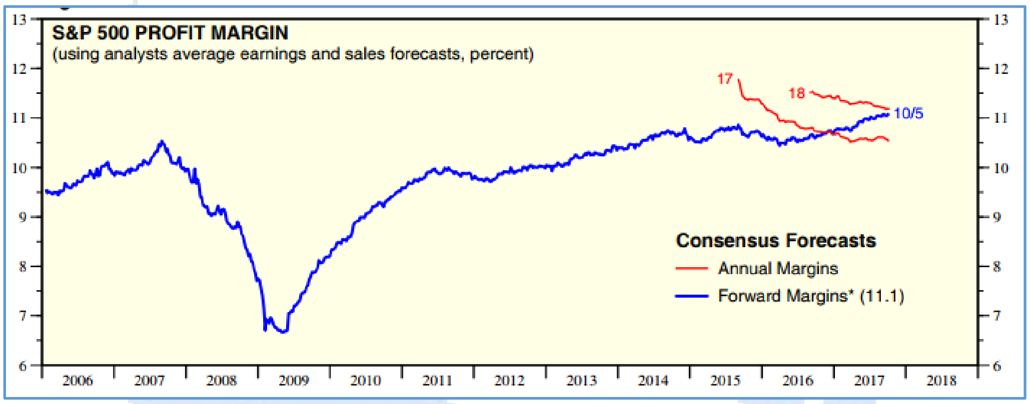
  As quickly as the market got excited over the acquisition, driving the stock to its all-time highs of $10.40 per share, it got just as manic when a scary sounding short-seller report drove the stock down to $7.81 at quarter end and to below $6 by mid-October. While the reports' "scary points" on Hudson's ability to process mixed gas, lack of inventory to meet future demand, and its Department of Defense contract were decidedly false, the market reacted negatively. Additionally, valid concerns about softening R-22 gas prices and potential higher demand for R-22 gas substitutes have also contributed to the stock slide, as well as a disappointing 3rd quarter result pre-announcement. We took advantage of these short-term concerns and stock price fluctuations to add an additional 2.5% to our 7.5% position, as we continue to believe that Hudson has the long-term potential and the management team to get it there, to return over a 100% from today's price levels.

- Spartan Motors (SPAR) – Last mile delivery van and emergency vehicle manufacturer Spartan has continued to be a pleasant surprise for us returning 30% during the quarter. Additionally, on Oct. 12, the company held its analyst day, where it outlined its path toward achieving $100 million in Earnings Before Interest, Depreciation and Amortization (EBITDA) by 2020, from an expected $30 million in 2017. The market reacted favorably to the guidance, driving the stock to over $16 from our $8.60 initial purchase price levels in May 2017 in anticipation of the announcement and on the actual news, as well as favorable Wall Street coverage. As our initial 8% position almost doubled, we have begun to take some profits and are reducing our position to manage portfolio risk.

- Our other significant portfolio performers this quarter were Viad, which continued its slow but steady climb to over $60 from $26 in July 2015 on consistently strong results, and our under 1% investment in the call options of manufactured housing company, which performed strongly an anticipation of a pick-up in demand after a destructive hurricane season.

**Market Outlook and Commentary**

The markets continued their relentless march upward, with the S&P 500 returning 4.5% this past quarter, and the small-cap markets leading the way with the Russell Microcap index returning 6.7%. At the same time, earnings estimates continue to come down for 2017 and 2018 on what seems to be a consistent lowering of expectations for operating profit margins (see chart below). The market's forward 12 months P/E ratio has expanded to 18.0x from 17.5x last quarter and 15.5x two years ago, implying that most of the markets returns continue to be driven by interest rate fueled multiple expansion rather than fundamentals.




While we are impressed with resiliency of the current economic expansion at a consistent 2% GDP growth rate, we believe the risks to the current full employment economy, and a fully valued market with little room for margin for error, are tilted more toward a downside scenario than an upside one. As we forecasted last quarter, we began our move toward active preservation of the partnership capital by harvesting some of our profitable investments into a 20% cash position and initiating a 30% short hedge position in the Russell 2000 index. Additionally, we are taking advantage of historically low interest rates and volatility and opportunistically buying cheap index put options. In the short term, we are likely to deploy new capital toward smaller, special situation positions rather than larger, economically sensitive core positions as we are waiting for a better valuation environment to deploy our cash. While our absolute returns may continue to be somewhat muted given our hedges in the near future we sleep better at night knowing we have a safety net in the current tight rope market environment.

**Partnership Updates**

We welcomed two new partners to the partnership this quarter, bringing our total to 23 at the end of September. We are excited about the continued partnership growth and are planning our annual partner event in early February in San Francisco. Finally, you should begin to receive communication from our audit firm M.D. Hall & Company in the coming months as we prepare for our year-end 2017 audit.

**Next Fund Opening**

Our next partnership openings will be Nov. 1, 2017, and Dec. 1, 2017. Please reach out for updated offering documents and presentations at info@artkocapital.com or 415.531.2699

**Appendix: Performance Statistics Table**

| | Artko LP Gross | Artko LP Net | Russell 2000 Index | Russell MicroCap Index | S&P 500 Index |
|---|---|---|---|---|---|
| Jul-15 | 2.1% | 1.7% | -1.2% | -3.2% | 2.1% |
| Aug-15 | -3.7% | -3.7% | -6.3% | -5.4% | -6.0% |
| Sep-15 | 1.6% | 1.4% | -4.9% | -5.8% | -2.5% |
| Oct-15 | 1.7% | 1.5% | 5.6% | 5.4% | 8.4% |
| Nov-15 | 4.1% | 3.3% | 3.3% | 3.8% | 0.3% |
| Dec-15 | 0.2% | 0.0% | -5.0% | -5.2% | -1.6% |
| Jan-16 | -5.2% | -5.4% | -8.8% | -10.4% | -5.0% |
| Feb-16 | 0.9% | 0.8% | 0.0% | -1.5% | -0.1% |
| Mar-16 | 8.9% | 7.5% | 8.0% | 7.1% | 6.8% |
| Apr-16 | 1.4% | 1.1% | 1.6% | 3.2% | 0.4% |
| May-16 | 3.5% | 2.7% | 2.3% | 1.3% | 1.8% |
| Jun-16 | 2.3% | 1.8% | -0.1% | -0.6% | 0.3% |
| Jul-16 | 12.4% | 10.0% | 6.0% | 5.2% | 3.7% |
| Aug-16 | 0.5% | 0.4% | 1.6% | 2.6% | 0.1% |
| Sep-16 | 0.1% | 0.1% | 1.1% | 2.9% | 0.0% |
| Oct-16 | -1.5% | -1.3% | -4.8% | -5.7% | -1.8% |
| Nov-16 | 13.5% | 11.0% | 11.2% | 11.6% | 3.7% |
| Dec-16 | 1.8% | 1.4% | 2.8% | 4.6% | 2.0% |
| Jan-17 | -2.2% | -2.3% | 1.5% | 0.4% | 1.9% |
| Feb-17 | 2.3% | 2.2% | 1.9% | 1.0% | 4.0% |
| Mar-17 | -3.4% | -3.5% | 0.1% | 0.9% | 0.1% |
| Apr-17 | 2.7% | 2.7% | 1.1% | 1.0% | 1.0% |
| May-17 | 0.1% | 0.1% | 2.1% | 2.4% | 1.4% |
| Jun-17 | 6.6% | 5.4% | 3.5% | 5.2% | 0.6% |
| Jul-17 | 3.4% | 2.7% | 0.7% | -0.6% | 2.1% |
| Aug-17 | -2.0% | -1.7% | -0.5% | -1.4% | 0.3% |
| Sep-17 | 1.1% | 0.9% | 6.2% | 8.2% | 2.1% |

| | Artko LP Gross | Artko LP Net | Russell 2000 Index | Russell MicroCap Index | S&P 500 Index |
|---|---|---|---|---|---|
| YTD | 8.8% | 6.6% | 10.9% | 11.6% | 14.2% |
| 1 Year | 23.6% | 18.3% | 20.7% | 22.3% | 17.8% |
| Inception 7/1/2015 | 65.1% | 47.8% | 22.8% | 19.7% | 28.2% |
| Inception Annualized | 25.0% | 19.0% | 9.6% | 8.3% | 11.7% |
| Monthly Average | 2.0% | 1.5% | 1.1% | 1.0% | 1.0% |
| Monthly St Deviation | 4.3% | 3.7% | 4.3% | 4.8% | 3.0% |
| Correlation w Net | - | 1.00 | 0.77 | 0.70 | 0.62 |

*Legal Disclosure*

The Partnership's performance is based on operations during a period of general market growth and extraordinary market volatility during part of the period, and is not necessarily indicative of results the Partnership may achieve in the future. In addition, the results are based on the periods as a whole, but results for individual months or quarters within each period have been more favorable or less favorable than the average, as the case may be. The foregoing data have been prepared by the General Partner and have not been compiled, reviewed or audited by an independent accountant and non-year end results are subject to adjustment.

The results portrayed are for an investor since inception in the Partnership and the results reflect the reinvestment of dividends and other earnings and the deduction of costs, the management fees charged to the Partnership and a pro forma reduction of the General Partner's special profit allocation, if applicable. The General Partner believes that the comparison of Partnership performance to any single market index is inappropriate. The Partnership's portfolio may contain options and other derivative securities, fixed income investments, may include short sales of securities and margin trading and is not as diversified as the indices, shown. The Standard & Poor's 500 Index contains 500 industrial, transportation, utility and financial companies and is generally representative of the large capitalization US stock market. The Russell 2000 Index is comprised of the smallest 2000 companies in the Russell 3000 Index and is generally representative of the small capitalization U.S. stock market. The Russell Microcap Index is comprised of the smallest 1,000 securities in the Russell 2000 Index plus the next 1,000 securities (traded on national exchanges). The Russell Microcap is generally representative of the microcap segment of the U.S. stock market. All of the indices are unmanaged, market weighted and reflect the reinvestment of dividends. Due to the differences among the Partnership's portfolio and the performance of the equity market indices shown above, however, the General Partner cautions potential investors that no such index is directly comparable to the investment strategy of the Partnership.

While the General Partner believes that to date the Partnership has been managed with an investment philosophy and methodology similar to that described in the Partnership's Offering Circular and to that which will be used to manage the Partnership in the future, future investments will be made under different economic conditions and in different securities. Further, the performance discussed herein does not reflect the General Partner's performance in all different economic cycles. It should not be assumed that investors will experience returns in the future, if any, comparable to those discussed above. The information given above is historic and should not be taken as any indication of future performance. It should not be assumed that recommendations made in the future will be profitable, or will equal, the performance of the securities discussed in this material. Upon request, the General Partner will provide to you a list of all the recommendations made by it within the past year.

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