OTSI KETA QUARTERLY

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OTSI KETA CAPITAL

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Otsi Keta Quarterly is designed to share insight on both current performance and future potential.

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QUESTIONS...

Contact us at:

312.473.3982
888.563.7349

F. William Schwarz, III
bill@otsiketacapital.com

Frederick P. Rollins, Jr.
fred@otsiketacapital.com

WHY THE MIDWEST?

Second of four articles in a series for 2012

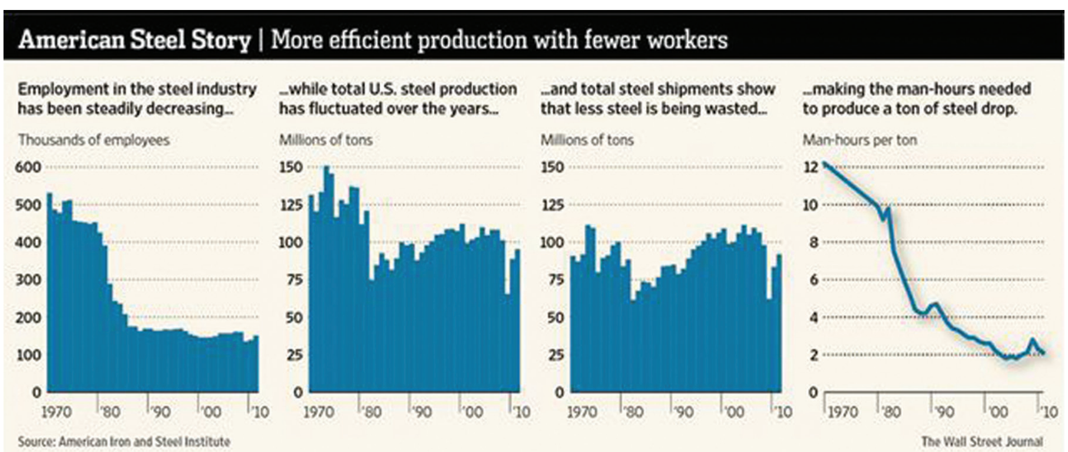
Iron ore shipments on the Great Lakes totaled 6.8 million tons in May, an increase of 12 percent over April, and 11.5 percent ahead of a year ago and the month's 5-year average.

Through May, the iron ore trade stands at 18,754,424 tons, 23 percent better than the 5-year average for the January-May timeframe.

The conclusion to these numbers is shipping in industrial commodities continues to show tremendous health despite weak economic outlooks. We tend to favor the "bird in hand" approach to investing and analysis. The Midwest continues to pleasantly surprise. These figures were taken from the Lake Carriers Association.

What the country has yet to realize fully is that the steel industry today has been modernized from the perceptions of the past. A facility that formerly required 5,000 employees is now being run with 1,000 with increased output. On a recent drive through Gary, Indiana, you could still sense why the steel industry is discounted as a leader in the Midwest. A quick glance off to the right and we saw the hulking bodies of industry created decades ago. To my left, lay the ruins of a once vibrant downtown (Gary).

Now, we have touched on the trappings of municipalities in previous letters, so we will avoid that topic today. What the steel industry says to us is that they have lost their "curb appeal." What you perceive from the exterior is not reflected in the interior of today's steel plants. At Otsi Keta Capital, we love the industries of yesteryear in the Midwest, if they have been retooled to perform in today's economy. The remaining steel industry is no exception.



Continued on page 2...

"HOTEL CALIFORNIA"

"You can check out anytime you like, but you can never leave."

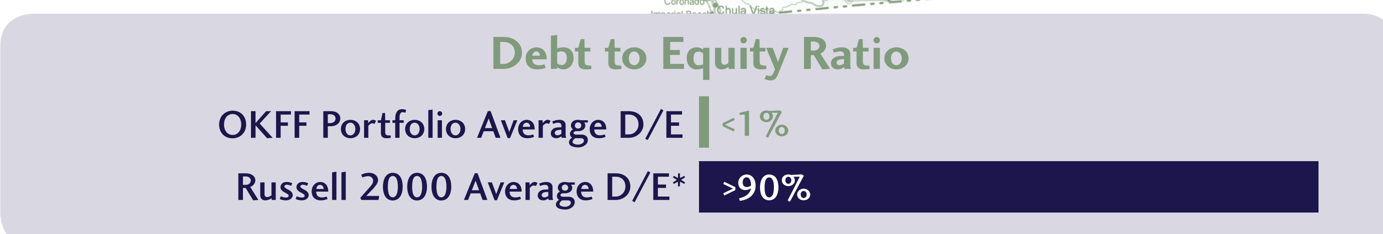
– The Eagles

Some decisions you truly own. Make enough bad decisions, and even a rising tide won't raise your clipper ship. On September 10, 1999, California legislators approved a retroactive pension increase for more than 100,000 state workers and decided that investment returns would pay the entirety of the enhanced benefits. If returns fell short, taxpayers would pick up the difference. Bad decision. Taxpayers in the state have had to chip in $20 billion in additional tax dollars to make up the growing annual shortfall. Worse still is the logic used to justify the 1999 decision…"promise today, pay tomorrow." The implicit assumptions used in making their decision had the Dow Jones Industrial Average at 25,000 by 2009 and 28,000,000 by 2099 (Source: Bloomberg).

California owned that decision. The decision itself, the implicit assumptions and the logic used say a lot about the legislators who made the decision. The state will be less attractive to new and current citizens for years to come. The world tends to focus on the cycle itself and never truly realizes the outcomes of a decision. We can easily get distracted before the outcome becomes apparent.

At Otsi Keta, we look closely at the decisions we think management owns, particularly those with long tails. We think three areas in particular merit extra focus: debt, retirement benefits and executive compensation. Management owns these decisions, and their actions speak volumes to long-term investors like Otsi Keta.

We have written in the past about the executive compensation and post-employment liabilities within our portfolio, so below we compare the debt of our portfolio companies to the broader market. Companies that have promising products and customer opportunities today can be hindered in the long term by bad decisions that commit large portions of future cash flows to obligations that don't build equity value for shareholders. We believe long-term risks and rewards are derived from the decisions, choices and restraint of management…not just the market cycle.



*Source: Bloomberg

…Why the Midwest? continued from page 1

What the graphs on page 1 do not reflect is the infrastructure that was in place around this business. We would argue that the infrastructure at one point in time was discounted to zero; shipping, iron ore mines, railroads, trained workers, etc. This infrastructure and work ethic still remain in the Midwest and are ready to re-engage at a moment's notice (see "Window Indicator" on page 3). We are happy to have the steel industry in the Midwest, and we welcome all of the wonderful businesses that surround it as potential holdings for Otsi Keta Focus Fund Limited Partnership.

OUR PORTFOLIO

“Conviction keeps you in your seat during rough times, while discipline forces you to do the hard stuff.”

– Otsi Keta Capital

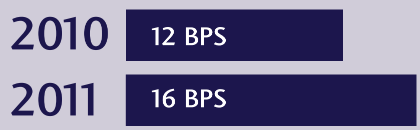
Portfolio turnover was minimal during the quarter. We used the volatile market to put new money to work opportunistically—in our best ideas, both new and existing. We continue to believe in our research process; focusing on fundamentally solid businesses gives us a significant conviction advantage. People paying too much attention to the market’s daily ebb and flow often miss unique individual company opportunities that occur when the macro news cycle is negative. We think investing should take longer than a news cycle.

Clearly, conviction is relative. Recent data reveals that the average holding period for investors in the largest exchange traded fund, the SPY, was just five days. We understand the appeal of ETFs, but we also think they accentuate some of the worst tendencies inherent in human beings. People have a tendency to over invest in mental shortcuts. Difficult questions and decisions are substituted for easy ones by over simplifying and changing the questions to be answered. ETFs allow people to avoid the tough investing questions like “How well do I understand this company and what is this company worth?” Today’s investor class has decided to play by feel and gut instinct. Don’t know what will happen to the Euro? Play the game day to day with the SPY. We prefer not to play day to day.

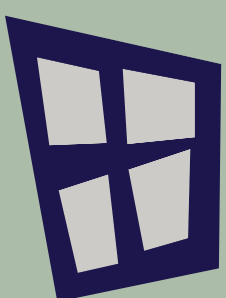
We exited one position during the month of June. The company’s equity price had run up more than 100 percent over the last 24 months, and it reached our estimate of intrinsic value. Most investors would agree deciding when to sell a stock, whether up or down, is more difficult than deciding when to buy. We agree. At Otsi Keta we use a discipline of “two to buy” and “one to sell.” Both managing partners must agree to initiate a position, but only one is required to initiate the sale of a position. The one to sell rule creates the incentive to develop greater insight into our holdings and takes advantage of human nature, as neither managing partner wants to pull the sell card solo. We like rules that force us to do the hard things. It’s called discipline.

OKFF Portfolio Trading Costs as a Percentage of Fund Assets

Discipline Leads to Less Trading, Which Leads to Lower Trading Expense



The Window Indicator



The 2012 shipping season is off to a strong start, with the weather cooperating earlier than normal this year. The St. Lawrence Seaway and the Soo Locks opened at the end of March. There are currently 64 of 69 U.S. flagged freighters in service this year. This is a number that mirrors 2011.

Grain shipping was temporarily interrupted in June due to heavy rains experienced in Northern Minnesota. Hard to believe there are heavy rains anywhere in the Midwestern U.S. in the month of June. The ports of Superior, Wisconsin, and Duluth, Minnesota, were directly affected. Both ports are back to normal operations with grain, coal and iron ore.

Shipbuilding, or a by-product of it, is being resurrected in the Midwest. Bay Shipbuilding Company in Sturgeon Bay, Wisconsin, added 30 new employees in April after recalling all of the staff that was laid off from as far back as 2008. Ship repairs are still a primary source of business at this yard, but orders are now being placed for platform supply vessels to be used in the Gulf of Mexico for offshore oil rigs. This news came from the Green Bay Gazette.

Most U.S. flagged freighters in service? Iron ore shipping tracking like 2011? Shipyards taking new orders? We cannot wait to share more in the 3rd quarter letter.

OUR PERFORMANCE

For the first quarter ended June 30, 2012, the Otsi Keta Focus Fund was down 4.70%. Year to date the Fund is up 7.39%. Since inception, the Fund has outperformed the Russell 2000 index by 320 basis points. All of the Otsi Keta Focus Fund numbers mentioned are net of all fees and expenses. Please see the table below to review the performance of Otsi Keta Focus Fund Limited Partnership.

Fund Name	Morningstar Rating	ROR 2nd Quarter 2012	ROR YTD June 30, 2012	ROR From Inception (May 7, 2010)
Otsi Keta Focus Fund Limited Partnership*	**N/A**	**-4.7%**	**7.4%**	**22.0%**
INVESCO Van Kampen Small Cap (VSMIX)	4 star	-7.7%	9.8%	9.6%
Royce Special Equity (RYSEX)	4 star	-4.4%	6.0%	15.4%
Russell 2000 Index	N/A	-3.8%	7.8%	18.8%
Russell 2000 Value	N/A	-3.5%	7.1%	13.9%

Source: Morningstar, Otsi Keta Capital, Russell Investment (Russell data dollar weighted)
*Note all OKFF performance data is shown net of all fees and expenses

OUR SECOND ANNUAL MEETING

Our annual meeting took place on Friday, May 18 in Detroit. We had the pleasure of hosting many of our partners at the Detroit Athletic Club.

Here are the highlights:

- Review of last 12 months results. Fund up 3.2%, benchmark index down (5.6%), for 880bps of outperformance (May 2011 through April 2012)
- Brief review of all 18 holdings in the portfolio
- Detailed review of our top 5 holdings and their investment thesis
- Performance during last summer's debt crisis – 693bps of outperformance
- Our portfolio's intrinsic value and percentage undervalued – 34%
- Portfolio companies earnings growth versus change in market pricing – result earnings are out stripping price appreciation

We look forward to seeing our current partners and new partners at the third annual meeting that will be held in May 2013. It only takes a subscription for an invitation.

F. William Schwarz, III
Partner
direct: 810.247.3133
bill@otsiketacapital.com

Otsi Keta Capital, LLC
500 N. Michigan Avenue
Suite 300
Chicago, IL 60611

888.563.7349
312.473.3982

Frederick P. Rollins, Jr.
Partner
direct: 810.357.8566
fred@otsiketacapital.com