Steel Partners LP (SPLP)

INVESTMENT REVIEW
DECEMBER, 2016

MASSIF CAPITAL, LLC | New York, NY

Why Buy SPLP?

- Invest with a superior capital allocator whose company currently trades at a 12% discount to the value of the publically traded equity held by the company.
- 6% ownership stake in AJRD, a niche aerospace defense contractor trading at a 38% discount to intrinsic value.
- Free option on WebBank, a niche lending bank that originates loans for Lending Club and Prosper Marketplace

Investment Overview: At the heart of any good investment is the capital allocation skill of management. From Henry Singleton at Teledyne to Warren Buffett at Berkshire Hathaway, the capital allocation skill of management has been the surest evidence of an investments compounding potential. With that in mind, we direct our focus to an idea with management that has a proven track record of capital allocation skill, is underfollowed, slightly complicated and trades at a discount to the publicly traded equity it owns.

Subsidiary	Current Mkt Price	Estimated Per Share Value	SPLP Stake	Shares Outstanding	Current Value of SPLP Position (Mil)	Intrinsic Value Estimate (Mil)
HNH	$26.8	$21.4	70%	12.2	$229.95	$183.62
SXCL	$14.9	$17.8^	64%	10.9	$103.31	$123.83
AJRD	$18.5	$27.2	7%	70.0	$84.18	$123.76
MLNK	$1.5	$1.4	32%	55.3	$26.63	$24.37
WFH LLC					$188.35	$188.35
WebBank					$59.52	$78.00*
Other Investments					$9.41	$9.40
Debt					($75.14)	($75.14)
Cash					$7.17	$7.17
Current SPLP MktCap		$385.76			$633.37	$663.35
Per Share Value		$14.75			$24.22	$25.37
Margin of Safety					64.19%	71.96%

*$78 Million is the low end of our valuation range, WebBank is privately held and niche, valuation is difficult and we have come to a resonable valuaton of as much as $250 million, which results in a per share value of $32 a share for SPLP, 116% margin of safety.

^$17.8 is the price at which SPLP will be buying the 36% of shares outstanding that they do not own. Transaction was announced on 12/7/2016. A DCF at 12% discount with FCF going for the next five years of 50% of 2015 plus TBV yields a per share value of $24.16.

Steel Partners Holdings L.P. (SPLP) is the successor of the successful Steel Partners hedge fund run by Warren Lichtenstein. At this time SPLP is a diversified holding company that operates and owns businesses in a variety of industries through several majority-owned subsidiaries. The primary holdings of SPLP include a 70% ownership stack in industrial manufacturer Handy& Harman, a 64% ownership interest in Steel Excel[i], which runs several small oil field services businesses, a 6.5% ownership position in Aerojet Rocketdyne a leading manufacturer of propulsion systems and a 90% ownership stake in WebBank, a bank focused on niche lending. At the current time, the publicly traded holdings of this conglomerate are worth roughly 12% more than SPLP's current market capitalization, without considering the value of several privately held subsidiaries, such as WebBank.[ii]

Based on a sum-of-parts analysis we believe that SPLP is worth between $25 and $30, depending principally on if WebBank is valued at the low or high-end of our valuation range. At $25 a share the company is trading at discount to intrinsic value of 61%, at the high-end it is trading at a discount of 102%.

Investing with a Proven Track Record: Following 17 years of average annual performance of 28%, Steel Partners L.P and Steel Partners L.P II (the primary hedge funds) experienced an abysmal 2008, suffering a 39% decline that caused a number of large investor redemptions. In response management executed a public listing to facilitate management's continued pursuit of their investment strategy and allow for, what they believed to be, a more orderly redemption process.[iii]

Over the course of 18 years at the helm of various Steel Partners hedge funds Lichtenstein produced an average annual return of 24% gross of fees, this includes 2008. In addition to this excellent track record, Lichtenstein appears a philosophical sound investor with intelligent approach to unlocking value.[iv] The following is a selection of excerpts from his Annual Letters to Shareholders over the last 6 Years:

- *We invest on the basis of value, not popularity. We invest in good companies with simple business models at prices that have built-in margins of safety.* (2015 Letter)
- *We adhere to our "blocking and tackling" style of investing in easy-to-understand businesses and situations that have built-in margins of safety. We view ourselves as business analysts, not market analysts, and we believe that with prior proper planning we will prevent poor performance. Our strategy is to remain focused on basic investment principles (which we employ to preserve and build our capital) and keep things simple. We intend to continue to focus on fundamentals, such as undervalued assets, free cash flow, and return on capital, and use common sense when making business decisions.* (2014 Letter)
- *While many management teams focus on short term performance, we focus on buying and operating companies in order to unlock and increase their value over the long term, for the benefit of all shareholders and stakeholders. As such, we are not concerned by short-term market fluctuations and volatility. As I have said many times before, and will continue to reiterate going forward, SPH invests on the basis of value, not on popularity.* (2012 Letter)

It took several years to emerge from OTC trading and get listed on the NYSE (2012), and several more to reorganize the business[v] as a well structure holding company. Following the reorganization, which mostly ended 2015 Lichtenstein started making accretive bolt-on acquisitions, principally within the Diversified Industrial subsidiaries. We believe these investments foreshadow the type of future acquisitions investors can expect from Lichtenstein.[vi] Net revenue generated by the diversified industrial segment in 2015 increased by $162 million or 27.1% from 2014 and in the nine months ended September 30th, 2016 net sales from diversified industrial is up 29% versus the same period in 2015. The 2016 growth reflects roughly $170 million in incremental sales associated with acquisitions of three entities over the last two years.[vii] In total, since the beginning of 2015 SPLP has spent $566 million on acquisitions within the diversified industrial segment which have generated a total of $326 million in additional incremental sales. Integration of new segments is still on going, and they are not without issue, as there has been some erosion of the pre-tax income margin over the course of the last three years (down 2%) but cost saving measures are still being executed.

Most acquisitions within the diversified industrial segment were added to Handy & Harmen (HNH). At the current time, HNH has a market value of $324 million, of which SPLP owns 70% and has several board seats, including the Chairmanship. HNH focuses on the manufacture of joining materials, tubing, building materials, various types of carbon fiber performance materials and, as a result of recent acquisitions electronic power products. Earnings per share at HNH have grown from $1.09 per share in 2012 to $1.43 per share last year excluding extraordinary items. The business currently trades at 1.7x book value and 5.05x FCF.

The Free Option: WebBank, a hidden gem on the balance sheet, generated a dividend for the parent of $9.5 million last year (and paid $18 million in cash dividends to the parent from 2012 to 2014) but is on the balance sheet at book value, roughly $60 million. The subsidiary has returned to the parent cash dividends equal to 46% of the book value of the subsidiary in four years and has generated cash dividends on net income year to date of 22.78%.[viii] Given the fact that stakes in publicly traded companies can be acquired at a discount to SPLP's current market capitalization, we view WebBank as a free option.

WebBank is a Utah-based Industrial Bank, which focuses on revolving private label lending, bank card financing programs (branded credit cards) and alternative lending (loan origination for companies like Lending Club). WebBank is not a traditional bank and does not seek to hold loans on its book; it primarily originates loans for client companies that pay them a fee for the service. The business is capital lite and allows for WebBank to earn a yield on capital employed in the lending operations of as much as 30%, as they did in 2015.[ix]

Putting a value on WebBank is difficult, but a simple dividend discount model suggests a value far more than the current $60 million book value assigned the company by management for FY2015. If we conservatively assume that last year's dividend to the parent of $9.5 million was an aberration (despite the fact that performance has improved in 2016 and that the dividend going forward is closer to the 2015-2010 average of $6.875 million and discount at 10%, the value is still roughly $9 million, or $0.34 a share, more than reported book value.

This very conservative valuation is still a positive situation, but we believe it fails to reflect the likely reality. There is no question that there should be a private market discount to the business value, that there is also regulatory risk and the business is driven by niche lending services, but if it traded at the dividend yield closer to the global banking sector (2.79% - dividend yield on 2,376 publicly traded banks globally) WebBank is worth $339 million.

This is perhaps an overly simplistic approach to valuation. If instead, WebBank traded at a P/E comparable to other alternative financial services companies[x] that focus on consumer lending of various kinds, WebBank would be worth $293 million, less a 10% private company discount and the business is worth $263 million. The shortcoming of this valuation is that while the comparables all have similar lending profiles, in terms of who they are lending to and for what reasons, the comparables had an average earnings yield of 7.4% in 2015. WebBank had an earnings yield of 51%. Would Steel Partners be able to sell WebBank for $339 to $293 million to a private buyer, maybe, could they get well in excess of the $60 million the bank is on the books for, absolutely.

As previously noted, WebBanks primary business is not without risks, the alternative/market-lending industry continues to attract regulatory scrutiny.[xi] Regulators may make changes that impact the capital lite nature of issuing bank partnership's and/or the ability of alternative lenders to easily sell loans to institutional or retail investors.[xii] The future of the business will rise and fall with the alternative lending industry. [xiii]

Large Stake in Underappreciated Defense Contractor: One of the more significant holdings of SPLP is its 6% stack in Aerojet Rocketdyne, a manufacturer of propulsion systems for the defense and aerospace industries. The business has a stable and simple business model, with a foreseeable revenue stream focused principally on long-term contracts with defense contractors. Rocketdyne appears cheap as it trades at a steep multiples discount to peers, has an opaque FCF and has hidden assets on the balance sheet. Furthermore, management has historically communicated poorly with shareholders, which appears to have resulted in confusion in regard to the government contracting process, the nature of pension and environmental liabilities on the balance sheet[xiv] and the value add of existing cost cutting programs implemented following the acquisition of United Technologies rocket engine business in 2013. All of which have hampered the ability of the market to accurately value the business.[xv]
In the period since the 2013 acquisition of United Technologies rocket engine business AJRD has realized cost savings related to the integration of approximately $100 million. Management believes the company still has several phases of cost cutting to go that will produce an estimated $145 million annually in savings beginning in 2018-2019. Further cost savings measures consist of operating improvements[xvi], closing several plants and collapsing six business segments into two (which is forecasted to produce $8M annually savings starting in 2017). If cost cutting measures produce $145 million a year in savings, gross margins in 2018 and 2019 will likely improve to around 20% from a usual range of between 12% and 15% over the course of the last decade.

Given the current enterprise value of $1.8 billion and NTM EBITDA in line with 2016, AJRD currently trades at a TEV/NTM EBITDA of 7.2x, peers such as Raytheon and Lockheed Martin trade at multiples close to 11x. Should AJRD rerate to a multiple more in line with its peers its per-share value would be closer to $33 a share or 65% more than it currently trades.

The company also owns roughly 11,300 acres of mostly development ready land 15 miles east of Sacramento. At the current time, the land is on the balance sheet for $60 million. Current comps and discussions with local commercial real estate brokerages suggest a valuation of more like $120 to $175 million depending on a number of factors, including how quickly Aerojet seeks to monetize the land assets. At the low end of the valuation the land is worth $1.7 per share, bringing the company value to $34.70, less approximately $7 a share in LT debt and the company is currently trading at a 38% discount, which does not consider the 12% discount investors receive by acquiring shares through SPLP as opposed to through the open market.

Investment Risks

Management Cannot Replicate Historical Results: Management may have produced strong returns as a hedge fund, but past returns have not been matched since going public. One school of thought on this is that management has been focused on sorting out a combination of post-IPO legal issues and sorting out the corporate structure, another is that Lichtenstein just can't produce the same returns via the public structure as he could in the hedge fund structure.

Dilution: Management is entitled to a distribution of corporate units worth 15% of the increase of book value of SPLP in any given year (this is akin to a hedge fund carried interest arrangement). The dilution potential of this compensation, which is always made in units, not cash, is significant. Furthermore, it is not outside the scope of possibility that management would prefer to amass as a large an ownership stake as possible and eventually take the business private. If this does come to pass it is likely that the tender will have to be in excess of Managements reported valuation as of FY2015, which was $21 a share. IN short, while maybe not the ideal situation, not a bad one for buyers at the current price.

Catalysts: There are no immediate catalysts to the realization of value, as such investors risk an opportunity loss while waiting for growth in share price that never comes. Management is buying back shares, and continues to simplify the business, both are likely to produce price appreciation.

Liquidity: SPLP has limited liquidity and building a position in the stock does take time for all but the smallest of funds.

Disclaimer: Opinions expressed herein by the author are not an investment recommendation and are not meant to be relied upon in investment decisions. The author's opinions expressed herein address only select aspects of potential investment in securities of the companies mentioned and cannot be a substitute for comprehensive investment analysis. Any analysis presented herein is limited in scope, based on an incomplete set of information, and has limitations to its accuracy. The author recommends that potential and existing investors conduct thorough investment research of their own, including detailed review of the companies' SEC filings, public statements and competitors. Consulting a qualified investment adviser may be prudent. The information upon which this material is based was obtained from sources believed to be reliable, but has not been independently verified. Therefore, the author cannot guarantee its accuracy. Any opinions or estimates constitute the author's best judgment as of the date of publication, and are subject to change without notice. The author explicitly disclaims any liability that may arise from the use of this material.

Full Legal Disclaimer

As of the publication date of this report, Massif Capital, LLC and its affiliates (collectively "Massif Capital") has a long position in the stock of SPLP. Massif Capital stands to realize gains in the event the price of the stock increases. Following publication of the report, the Massif Capital may transact in the securities of any company covered or discussed herein. All content in this report represent the opinions of Massif Capital. Massif Capital has obtained all information herein from sources they believe to be accurate and reliable. However, such information is presented “as is,” without warranty of any kind – whether express or implied. Massif Capital makes no representation, express or implied, as to the accuracy, timeliness, or completeness of any such information or with regard to the results obtained from its use. All expressions of opinion are subject to change without notice, and Massif Capital does not undertake to update or supplement this report or any information contained herein. This report is not an investment recommendation and is only a discussion of Massif Capital’s opinions.

This document is for informational purposes only and it is not intended as an official confirmation of any transaction. All market prices, data and other information are not warranted as to completeness or accuracy and are subject to change without notice. The information included in this document is based upon selected public market data and reflects prevailing conditions and Massif Capital’s views as of this date, all of which are accordingly subject to change. Massif Capital’s opinions and estimates constitute a best efforts judgment and should be regarded as indicative, preliminary and for illustrative purposes only.

Any investment involves substantial risks, including, but not limited to, pricing volatility, inadequate liquidity, and the potential complete loss of principal. This report’s estimated fundamental value only represents a best effort estimate of the potential fundamental valuation of a specific security, and is not expressed as, or implied as, assessments of the quality of a security, a summary of past performance, or an actionable investment strategy for an investor.

This document does not in any way constitute an offer or solicitation of an offer to buy or sell any investment, security, or commodity discussed herein or of any of the affiliates of the Massif Capital. Also, this document does not in any way constitute an offer or solicitation of an offer to buy or sell any security in any jurisdiction in which such an offer would be unlawful under the securities laws of such jurisdiction. To the best of Massif Capital’s abilities and beliefs, all information contained herein is accurate and reliable.

Massif Capital reserve the rights for their affiliates, officers, and employees to hold cash or derivative positions in any company discussed in this document at any time. As of the original publication date of this document, investors should assume that Massif Capital has a position in one or more of the companies discussed and has positions in financial derivatives that reference the security and stand to potentially realize gains in the event that the market valuation of the company’s common equity is lower or higher than prior to the original publication date depending on if we are short or long as noted above in this disclosure and on the cover page of this report. Massif Capital, officers, and individuals shall have no obligation to inform any investor or viewer of this report about their historical, current, and future trading activities. In addition, Massif Capital may benefit from any change in the valuation of any other companies, securities, or commodities discussed in this document. Analysts who prepared this report are compensated based upon (among other factors) the overall profitability of Massif Capital’s operations. The compensation structure for Massif Capital analysts is generally a derivative of their effectiveness in generating and communicating new investment ideas and the performance of recommended strategies for the Massif Capital. This could represent a potential conflict of interest in the statements and opinions of Massif Capital documents.

The information contained in this document may include, or incorporate by reference, forward-looking statements, which would include any statements that are not statements of historical fact. Any or all the Massif Capital’s forward-looking assumptions, expectations, projections, intentions or beliefs about future events may turn out to be wrong. These forward-looking statements can be affected by inaccurate assumptions or by known or unknown risks, uncertainties and other factors, most of which are beyond Massif Capital’s control. Investors should conduct independent due diligence, with assistance from professional financial, legal and tax experts, on all securities, companies, and commodities discussed in this document and develop a stand-alone judgment of the relevant markets prior to making any investment decision.

[i] On 12/7/2016 signed a definitive agreement to acquire the remaining outstanding shares of SXCL at $17.8 a share. See: http://seekingalpha.com/news/3229252-steel-partners-acquire-rest-steel-excel

[ii] Based on 70% interest in HNH, 64% interest in SXCL, 6.5% interest in AJRD and 31% interest in MLNK, as of 12/6/2016 these positions had a market value of $441.5 million vs. SPLP MktCap of $393.6 million.

[iii] The plan was not without its critics but was executed despite 48% of LP investors who voiced disagreement. See the following for further details: http://www.wsj.com/articles/SB124018380851833125 & https://www.ft.com/content/1af3a1d2-dd9d-11dd-930e-000077b07658

[iv] SPLP core principals and strategies:

- Investing on the Basis of Value, Not Popularity"
- Invest in good companies with simple business models at prices that have a built-in margin of safety;
- Create a continuous improvement culture and implement operational excellence programs;
- Control costs and use leverage prudently, or not at all;
- Avoid complex businesses or investments that cannot be easily explained or understood;
- Reward people who deliver results; and
- Ensure the right core principles and culture.

[v] Since 2012 SPLP has reorganized the company and consolidated subsidiaries, going from a fairly complex corporate structure with 14 subsidiaries and principal holdings to a more sensible 5 subsidiaries. The process of simplification is and will probably always be ongoing (as evidenced by the offer to acquire outstanding shares of SXCL on 12/7/2016) and as it seems a goal of interest to Lichtenstein: "During the past year, we continued our program to simplify our business structure by reducing the number of entities, organizations, and companies we own and manage. "(2015 Annual Letter). See: 2012 Shareholder Letter & 2015 Shareholder Letter

[vi] Diversified Industrial includes Handy & Harmen (manufacturer of engineered niche industrial products) and

[vii] SLI, JPS and API subsidiaries

[viii] WebBank financials are freely available through the FDIC website, the bank's FDIC certificate number is 34404.

[ix] Up from 25.9% in 2014.

[x] Comparables list: LOAN, TCAP, ENVA, RM, WRLD, QCCO

[xi] See extensive risk discussion in 2015 10-K

[xii] See: https://www.bloomberg.com/news/articles/2015-04-16/webbank-where-peer-to-peer-loans-are-born and http://www.wsj.com/articles/behind-the-boom-in-online-lending-a-tiny-utah-bank-1450046828

[xiii] In November of 2016, Cross River Bank, a NJ based competitor of WebBank, received a $28 million investment from three Silicon Valley VCs (Battery Ventures, Andreessen Horowitz and Rabbit Capital). It is unclear how much of the business $28 million purchased but post investment financial statements will be available via the FDIC website in coming months and should allow for a comparative valuation of WebBank.

[xiv] Please See Excellent Write up of AJRD by Eric DeLamarter. AJRD's FCF is obscured by non-cash pension charges and environmental expenses and the 85% of R&D expenses that are customer-funded. Furthermore, although the Company's pension is underfunded by an estimated $581M, creating a significant balance sheet liability, the US Government bears 82% of the Company's pension obligation. Similarly, environmental reserves on the balance sheet appear large, but 75% of the liabilities are reimbursable by the prime contractors (people like Raytheon) and not payable by AJRD. These accounting footnotes have a significant impact on AJRD's annual cash pension contribution which appears to be around $70 million but is, in fact, less than $10 million. Factors such as these combine to make the real earnings power of the business hard to get at.

[xv] The company appears to be heading towards improved corporate communication as they have hired a new CFO who led investor relations at United Technologies, hopefully this leads to increased intuitional awareness and appreciation of the business

[xvi] For Example: In June AJRD and Raytheon announced a deal with the DoD whereby 3 missile programs (including the Tomahawk Missile and Patriot Missile programs) were extended and given permission to reduce overhead, resulting in savings of as much as $25 million a year.