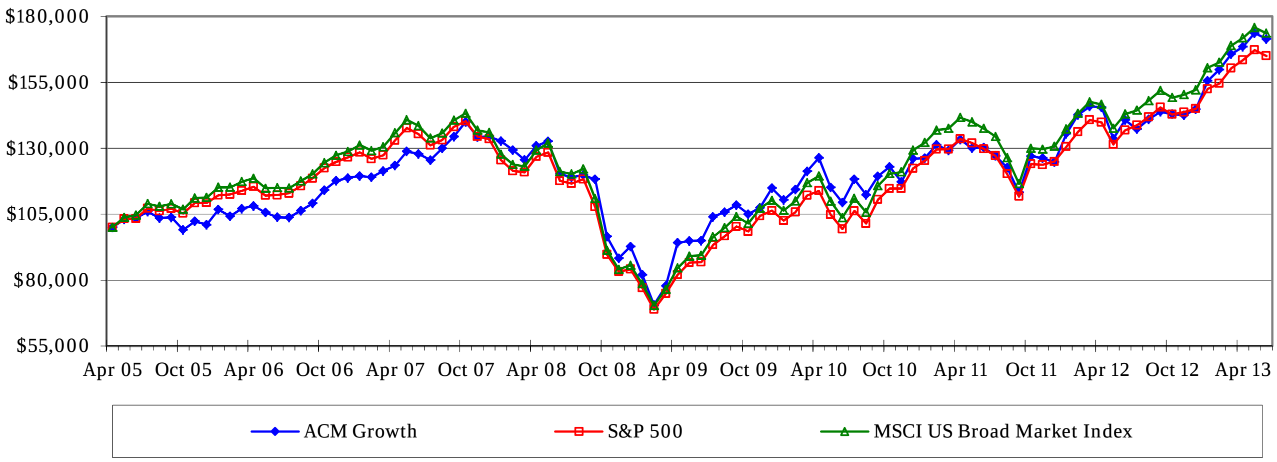
ATHENA CAPITAL MANAGEMENT

Cumulative Growth Performance

Performance as of 6/30/13	Year to date	3 years	5 years	7 years	Since inception (4/30/05)
ACM Growth	18.38%	56.71%	42.59%	65.13%	71.42%
S&P 500	13.82%	66.20%	40.32%	47.01%	65.02%
MSCI US Broad Market Index	14.09%	67.43%	43.25%	50.96%	73.60%

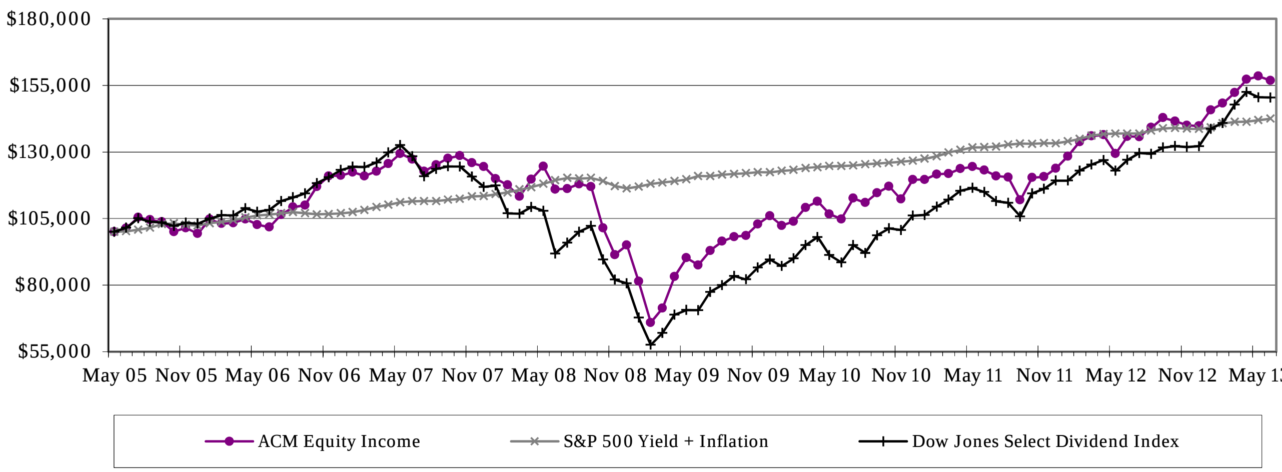
Comparison of the change in value of $100,000 investment in ACM growth
versus S&P 500 and MSCI US Broad Market Index



Cumulative Equity Income Performance

Performance as of 6/30/13	Year to date	3 years	5 years	7 years	Since inception (5/31/05)
ACM Equity Income	12.23%	49.69%	35.26%	54.13%	56.83%
S&P 500 yield + inflation	2.78%	14.25%	19.33%	33.79%	42.49%
Dow Jones Select Dividend Index	13.85%	70.04%	63.82%	39.01%	50.44%

Comparison of the change in value of $100,000 investment in ACM equity income versus
S&P 500 yield plus inflation and Dow Jones Select Dividend Index



Past performance is no guarantee of future results. As in all equity investing, there is a risk for potential loss. Performance results were calculated after deduction of all management and trading fees. Portfolios were valued daily, trade date accounting was used, accrual accounting was used for dividends. Time-weighted rates of return that adjust for significant cash flows were used. Returns from cash were included. For ACM growth accounts, the S&P 500 was used as benchmark because it was deemed the most readily available and widely known growth composite. It should be noted that ACM growth accounts were more concentrated, sometimes had higher cash investments, included international investments, and were invested in companies with different market capitalizations and characteristics than the S&P 500. Although these differences existed, the accounts shown were invested for growth and not set to achieve any particular market capitalization or exposure. ACM equity income accounts used S&P 500 yield plus inflation because this combination of the most readily available equity yield and growth with inflation was deemed the most relevant benchmark for equity income accounts. These accounts are designed to provide an equity yield for income plus growth to maintain purchasing power over the impact of inflation. Both out- and under-performance of accounts shown were due both to individual security selection and to concentration of investments. Neither market nor economic conditions contributed significantly to account performance relative to benchmarks. ACM growth and equity income portfolios include all portfolios under management during all periods of management and include portfolio performance as of the first day of management. The accounts depicted used no leverage or derivatives. The S&P 500 and S&P 500 yield plus inflation returns shown do not reflect commissions, trading expenses, or management fees, which would have reduced both benchmarks' results.

ATHENA CAPITAL MANAGEMENT

July 16, 2013

The stock market provided nice returns during April and May only to retreat in June at the first hint the Federal Reserve might raise interest rates. The S&P 500 returned 2.9% for the quarter and 13.8% year-to-date. Our portfolios soundly beat both growth and equity income benchmarks over the same periods.

In this letter, I will review our investing results, discuss my view on markets and the economy, and review one of our investing successes: Comcast.

Performance this quarter

Growth portfolios out-performed the S&P 500 over all periods except the 3-year this quarter. I cannot point to any general theme (like personal computers last quarter) that provided our out-performance. Instead, it was just a steady stream of better earnings and growth from our holdings. This trend should continue with occasional fits and starts over the rest of the year.

Growth's out-performers this quarter were **Microsoft** and **Ryanair**.

Microsoft is the world's largest software company with five major divisions (Windows, Business, Servers & Tools, Online, and Entertainment). Investors seemed to awaken this quarter to the fact that Microsoft's Business and Servers & Tools divisions are generating large and growing profits even as questions abound about its other three divisions (which may not be as bad off as many believe). I think investors are still under-estimating Microsoft, and that such a realization could mean even more upside for us.

Ryanair is Europe's leading discount airline. In addition to posting better than expected sales and profits amidst a dreadful European economy, Ryanair also made an order for 175 brand-new Boeing 737's. This order will allow Ryanair to grow its passengers at an estimated 7% per year over the next six years. In addition, Ryanair may benefit from lower fuel costs as oil supply increases from booming petroleum extraction and demand decreases as China slows. With or without lower oil prices, Ryanair looks like a winner.

POSCO and **Dell** were growth's under-performers this quarter.

POSCO is a Korean steel producer, the third largest in the world. Its price declined this quarter as steel producers are stuck between high priced inputs (mostly iron ore and coal) and low priced steel (mostly due to over-supply from China). This situation is unlikely to resolve itself quickly, but because POSCO is a low-cost producer, it isn't in danger of going out of business, and will benefit when costs and prices adjust to match market fundamentals over time.

Dell under-performed this quarter as rumors swirled about its plan to go private. This saga pits founder Michael Dell and private equity firm Silver Lake Partners against buyout specialist Carl Icahn and value mutual fund Southeastern Asset Management. The shareholder vote takes place July 18th, and only then will we know what happens next. I think Michael Dell is trying to steal the company at a low price and I will most likely vote against the deal.

Equity income portfolios out-performed our long-term benchmark over all periods reported. Our equity holdings continue to provide growth as our bond holdings generate dependable yield. As interest rates rose in June, our bond holdings suffered a pull-back, but that was expected and why we hold only small bond positions. Over time, our stock/bond mix should provide adequate yield and growth above inflation.

Equity income saw out-performance from **Microsoft** and **Mercury General**. Please see my comments above on Microsoft.

Mercury General is an auto insurance company with major operations in California and a smaller presence in 12 others states. Mercury benefited this quarter from some of its best-ever metrics outside of California. Growing an insurance business in new places takes time, and Mercury has mostly struggled in the new states it has entered. But things are looking up and that trend may continue.

Pfizer and **Phillip Morris International** were equity income's under-performers this quarter.

Pfizer, the world's largest pharmaceuticals firm, declined this quarter on disappointing sales growth and the separation of its animal health division, Zoetis. Investors may be sour about a lack of new drugs and the selling of a growing division, but they may also be missing the benefits of intelligent capital allocation that management has demonstrated. The company pays a healthy 3.5% dividend (try finding that in a safe bond) and has an impressive pipeline of drugs, so there are good reasons to be patient.

Philip Morris International (PMI) sells leading cigarette brands everywhere outside the United States. Its price declined this quarter over concerns about foreign currency declines and regulatory hurdles in many countries. PMI has become adept at handling such issues, and a business with strong brands and probably the best pricing power in the world should have little problem weathering these latest concerns.

Market and economic outlook

The S&P 500 gained 2.9% this quarter. This better than average growth again decreased my six year return expectations. Better returns can be found with hard work and diligence, which I'm supplying.

Projected annualized returns over the next 6 years	
S&P 500 (growth benchmark)	-3.4% to 8.4%
S&P-500-yield-plus-inflation (equity income benchmark)	3.6% to 6.6%

How do I arrive at these numbers? See my 2Q2005 article.

The world economy seems to be muddling along. Growth in the U.S. is resilient at around 2%, but much slower than the 3% to which we've become accustomed. China's growth is slowing from 8% to 7%. That may sound like a nice "problem" to have, but such slowdowns can cause unpleasant disruptions. Europe continues to shrink slowly as it refuses to deal realistically with its structurally unbalanced labor markets. Japan is growing again, but only by depreciating its currency, which is NOT a lasting solution to its high debt and aging population. The likely outcome for global growth: 2.5% to 3.5%.

I don't mean to suggest that muddling is a bad investing climate. Far from it, such periods can be quite good for businesses with sustainable economic advantages, because slow growth, low interest rates, and political gridlock allow for steadily growing profits and a good environment to stay ahead of competitors. The economic apple-cart can always—and unpredictably—be tipped over by crises, but so was it ever.

With that, I'm eagerly seeking out businesses with meaningful advantages. Some companies can seemingly grow profits at will over time because they have an economic franchise, enduring low costs, or a structurally protected niche or locale. If we can buy such businesses when they are slightly out of favor, and hence at a reasonable price, we can lock in *years* of above average growth. We own many such businesses already (like Comcast described below), and many others are on my radar. More importantly, I'm steadfastly researching new candidates that fit the bill.

Comcastic!

Comcast has been our best investment over the last eight years. The reason: we purchased a large position, paid a low price to fundamentals (when other investors were scared), held it for a long time, and the underlying business grew at over 10% per annum.

I first became interested in Comcast between 2002 and 2005 when I saw other smart investors buying its stock. Although I looked hard at the company for a couple of years, I just couldn't figure out the underlying value or why others admired the business. To illustrate, Comcast only became consistently profitable in 2004, and even then was selling at an unattractive price.

After several years of analysis, though, I began to understand. The company showed hefty expenses to build-out broadband internet and phone capabilities (versus legacy video distribution), but the revenues and profits from broadband and phone had not yet built to scale. It seemed like Comcast would generate a lot of incremental sales from those two new services, and the costs of deploying them would decline significantly after the initial build-out was complete. When that happened, profits would likely take off.

We started buying Comcast at around $20 a share in late 2005. Its price promptly went up 50% over the next year along with rapidly growing sales, though profits had barely moved. At that point, Comcast's price was ahead of its fundamentals.

Then the housing market tanked (impacting cable TV sales growth), followed by the stock market and the economy in 2008-2009. As Comcast's price declined, we bought some more below $25, then even more below $20. We weren't very aggressive in these purchases, though, because Comcast hadn't become ridiculously cheap, yet. While its price was descending, however, earnings took off: climbing from $0.70 per share in the first quarter of 2008 to $1.94 two years later—a 177% increase. **My thesis about earnings had been correct, and the market was not yet recognizing it**. That's when we backed up the truck to buy a lot more: 50% of our Comcast position was bought in the 4th quarter of 2009 at an average $15.09 per share.

It was also in late 2009 that Comcast agreed to buy 51% of NBCUniversal from General Electric. At first, I wasn't happy about the deal. 75% of acquisitions reduce shareholder value, so the odds are always against them. In this case, I didn't see how the distribution of video content—a business where low costs and efficiency matter most—could work well with content creation—where creativity and big budgets are usually the rule. What I didn't count on was the brilliant execution of Stephen Burke, the Comcast executive put in charge of NBCUniversal. **More than a quarter of the 10% per year earnings growth**

since 1st quarter 2010 has come from NBCUniversal. Thank you, Mr. Burke.
Today, Comcast consists of two main businesses, each with several segments:

COMCAST	
Comcast Cable 67% of sales, 82% of profits	**NBCUniversal** 33% of sales, 18% of profits
Video 33%	Cable Channels 10%
Broadband 16%	Broadcast 9%
Phone 6%	Film production 6%
Business 5%	Parks 2%
Advertising 6%	

Comcast's business is mostly cable, but only 1/3 of the company is the video business everyone thinks of as cable TV. And, surprising to most, ***all*** five cable segments are *growing* (despite the worries about cord cutting), with video growing the slowest at 3% and the business segment growing the fastest at over 25%. The cable business is changing, but it is not in decline or going away soon.

1/3 of Comcast is NBCUniversal. This includes: cable channels (USA, Bravo, Golf channel, E!, etc.), NBC and Telemundo broadcast TV, Universal Pictures film production, and Universal amusement parks. The under-appreciated value behind NBCUniversal is that broadcast TV and Universal film are *grossly* under-performing peers, but that is starting to change. **If NBCUniversal simply catches up to peer performance levels over the next five years, that would be an extra 3% a year in growth for Comcast**. That's a very nice tailwind in a slow-growth economy.

The business as a whole looks capable of growing 6-7% per share a year. Of course, there are threats from Google Fiber, Disney, other cable channels, Verizon and AT&T broadband, Satellite TV, etc., but Comcast is well positioned with cost effective distribution and solid management. At $42 per share, it's not as cheap as it was at $15 per share, but a company likely to grow a percent or two faster than the economy could be a very nice investment.

UNTIL NEXT QUARTER

If you have any questions, comments or feedback for me, please feel free to contact me any time. I always enjoy hearing from you.

Respectfully,
Mike

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