

**Part 2A of Form ADV: Firm Brochure**

March 2023

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**This brochure provides information about the qualifications and business practices of Blue Grotto Capital, LLC. If you have any questions about the contents of this brochure, please contact Greg Deese at (404) 567-6989 or [gdeese@bluegrottocapital.com](mailto:gdeese@bluegrottocapital.com). The information in this brochure has not been approved or verified by the United States Securities and Exchange Commission or by any state securities authority.**

**Additional information about Blue Grotto Capital, LLC also is available on the SEC's website at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov).**

**Registration with the SEC or with any state securities authority does not imply a certain level of skill or training.**

## Material Changes

There have been no material changes since Blue Grotto's initial Form ADV Part 2A was filed in March 2022.

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#### **4. Advisory Business**

Blue Grotto Capital, LLC (“Blue Grotto”, “we” and “us”) was founded in June 2018 by Benjamin Gordon, the firm’s principal owner. Blue Grotto provides investment advisory services to pooled investment vehicles, certain single-investor investment vehicles, and separately managed accounts.

We seek to achieve high absolute returns on behalf of our clients through a selection of individual equity securities for both long and short positions rather than relying on options or indexes.

We look for unrecognized situations in the market to generate alpha on the long side. On the short side, we short companies with unsustainable business models where we have a line of sight to impairment. We believe a few key issues determine whether we are right or wrong on each idea. Our research process centers on these issues rather than unrelated, extraneous information. While we invest with a 3-year horizon, we believe returns are usually achieved when short-term fundamentals are on our side. We seek improving situations on the long side and deteriorating situations on shorts. We believe returns can be improved by actively managing investment behaviors. We utilize Bayesian updating to build and size positions methodically in an effort to avoid bias.

Our firm tailors our advisory services to the individual needs and specified investment mandate of our clients. Our firm strictly adheres to the investment strategy set forth in each client’s private placement memorandum or other governing documents, as applicable. We do not, however, tailor our advisory services to the individual needs or any specified investment mandates of the investors in any private commingled funds and investors may not impose restrictions on investing in certain securities or types of securities in such funds. Separately managed account clients receive tailored advisory services and are able to impose such restrictions on the management of their account.

We do not participate in any wrap fee programs.

As of December 31, 2022, we had discretion over \$787,832,405 in regulatory assets under management.

#### **5. Fees and Compensation**

Our firm, or an affiliate of our firm, receives compensation from our clients based on both a percentage of assets under management and on the performance of our clients’ accounts. We generally charge our clients an asset-based fee at an annual rate of 1.0%-1.5% of each investor’s capital account balance.

We also generally charge a performance-based profit allocation equal to 10%-20% of each investor’s annual net realized and unrealized profits, which are subject to a “loss carryforward” or “high water mark” limitation and, in the case of certain clients, is subject to an annual “hurdle rate.” This means that we only receive performance compensation when an investor’s account value for the year has recovered any losses from prior years.

The performance-based profit allocation is generally made through general partner interests that our affiliate holds in our client funds.

Our fees are not negotiable, except under certain limited circumstances. In certain circumstances, we may waive fees for certain related-party investors, such as employees.

We deduct the asset-based fee described above from each investor's capital account at the beginning of each quarter. We deduct the performance-based profit allocation mentioned above from each investor's capital account at the end of each year, or whenever an investor is making a withdrawal, but only on the withdrawn amount. An investor in one of our pooled investment vehicles may initiate complete or partial withdrawals upon at least 60 days' prior written notice, subject to any applicable early withdrawal reduction. Fees for separate accounts are negotiated with each individual client and are deducted in accordance with the terms of such agreement.

All of our clients bear various costs, fees and expenses in addition to the compensation payable to our firm or an affiliate of our firm. All investors in our clients and prospective investors should review the private placement memorandum or other governing documents for each applicable client fund, which discuss the particular expenses borne by that fund. However, below we provide a list of the organizational, investment and operating costs, fees and expenses that our clients typically incur:

- legal fees and costs (including settlement costs);
- costs of any litigation or investigation involving our clients' activities;
- accounting costs (including tax preparation and audit expenses);
- administration costs;
- liability insurance costs;
- costs associated with reporting and providing information to existing and potential investors;
- costs and expenses of holding any meetings of partners;
- expenses of the Advisory Committee and its members;
- any governmental fees imposed on our clients;
- fees, costs and expenses incurred to comply with any applicable law, rule or regulation in connection with our clients (including legal fees and expenses, the costs of regulatory filings and third party compliance consultants, and other related expenses);
- withholding and/or transfer taxes;
- proxy expenses;
- interest and commitment fees on loans and debit balances;
- borrowing charges on securities sold short;
- all costs, fees and expenses directly related to investments or prospective investments (whether or not consummated), including research and due diligence;
- the costs, fees and expenses associated with the organization and the ongoing operation of client funds and the initial and ongoing offering of the interests in such funds, including legal and accounting fees, printing costs, reporting and providing information to existing and prospective investors, travel fees and expenses related to the funds'

- offering, filing fees (including any Form D and “blue sky” filing fees) and other out-of-pocket expenses;
- custody fees and fees of professional advisors and consultants relating to investments or prospective investments;
  - brokerage commissions and other transaction costs;
  - trade processing fees, including clearing and settlement charges;
  - investment related travel expenses;
  - research fees and materials (including online news and quotation services);
  - costs of any outside appraisers, accountants, attorneys or other experts or consultants engaged in connection with specific transactions;
  - bank charges; and
  - other ordinary miscellaneous research and trade-related expenses.

For more information on brokerage transactions and costs, please see Item 12: Brokerage Practices.

We do not receive compensation for the sale of securities or any investment product.

## **6. Performance-Based Profit Allocations and Side-By-Side Management**

An affiliate of our firm receives performance-based compensation from our clients equal to 10%-20% of their net profits each year (subject to certain adjustments described in Item 5: Fees and Compensation). We do not manage any funds or accounts that do not pay performance-based compensation, but the differences in performance-based compensation creates a potential conflict of interest. We manage this conflict through trade allocation policies that generally allocate each trade pro rata among clients based on relative assets under management, with certain exceptions as specified in the policy.

## **7. Types of Clients**

Blue Grotto provides investment advisory services to certain managed accounts and to Blue Grotto Master Fund LP, Blue Grotto Capital Partners LP and Blue Grotto Capital Cayman Ltd. (collectively, the “Fund”).

The underlying investors in the Fund typically include:

- Individuals;
- Trusts and estates;
- Endowments and Foundations
- Corporations, partnerships or other business entities;
- Individual retirement accounts;
- 401(k) plans;
- Pensions; and
- Profit-sharing plans.

The underlying investors in our managed accounts typically include corporations, partnerships, endowment foundations, or other business entities.

### Investment Requirements

To invest in the Fund, we generally require a minimum investment of \$1,000,000, although at times we may waive this requirement.

To comply with Securities and Exchange Commission regulations, we require that U.S. investors in the Fund qualify as both accredited investors and qualified purchasers.

## **8. Methods of Analysis, Investment Strategies and Risk of Loss**

### **Methods of Analysis and Investment Strategies**

We seek high absolute returns through a selection of individual equity securities for both long and short positions rather than relying on options or indexes. Our approach involves the use of a Bayesian updating process for scaling into and out of positions, seeking to benefit from the cumulative conviction achieved through constant monitoring of data points and research vis a vis the valuation being assessed by the market.

Our firm believes each individual company can be broken down into a few key issues that will determine probabilistic outcomes on the stock, with these key issues and research around them the key focus. On each investment, we undertake an assessment of business position, timing, management, balance sheet, and valuation to determine how an investment compares to the available opportunities in the portfolio and outside of it. We attempt to align all of these factors in our favor and assess short-term and long-term risk reward using a mix of quality, valuation, and timing.

In managing our clients' portfolios, we take behavioral psychology and our principal's own psychology into account and have developed a number of heuristics to improve decision making. These include scaling into new positions, moving to more uniform positions to fully size positions over a 6-month timeframe, and temporarily supersizing positions when business momentum lines up very well against valuation. Incrementalism is used in most cases to drive better forecasting decisions and remove the pressure of making all or nothing decisions. Our firm attempts to balance appropriate diversification and risk mitigation strategies with sizing up highest conviction ideas, and the investments could be more concentrated at times where risk/reward is extremely favorable on a smaller number of names.

### **Risk Factors**

*Investment Judgment and Market Risk:* The profitability of a significant portion of our investment program depends to a great extent upon correctly assessing the future course of the price movements of securities and other investments. There can be no assurance that

we will be able to accurately predict these price movements and that our investment program will be successful.

*Risks of Investments Generally.* All investments risk the loss of capital. Such investments are subject to investment-specific price fluctuations as well as to macro-economic, market and industry-specific conditions, including, but not limited to, national and international economic conditions, domestic and international financial policies and performance, conditions affecting particular investments such as the financial viability, sales and product lines of corporate issuers, national and international politics and governmental events, and changes in income tax laws. No guarantee or representation is made that our clients' investment program will be successful. Our clients' investment program involves, without limitation, risks associated with limited diversification and concentration, investments in speculative assets and the use of speculative investment strategies and techniques, interest rates, volatility, tracking risks in hedged positions, systems risks and other risks inherent in our clients' activities. Certain investment techniques utilized on behalf of our clients can, in certain circumstances, magnify the impact of adverse market moves to which our clients may be subject.

*Reliance on Key Persons:* Our firm is substantially dependent on the services of Benjamin Gordon (the "Principal"). In the event of the death, disability, departure or insolvency of the Principal, our business may be adversely affected.

*Short Sales:* On our clients' behalf, we may enter into transactions, known as "short sales," in which we sell a security we do not own in anticipation of a decline in the market value of the security. Short sales on behalf of our clients that are not made "against the box" theoretically involve unlimited loss potential since the market price of securities sold short may continuously increase. We may mitigate such losses by replacing the securities sold short before the market price has increased significantly. Under adverse market conditions, we may have difficulty purchasing securities to meet our short sale delivery obligations and may have to sell portfolio securities to raise the capital necessary to meet our short sale obligations at a time when fundamental investment considerations would not favor such sales.

*Derivatives.* Derivative instruments, or "derivatives," include futures, options, swaps, structured securities and other instruments and contracts that are derived from, or the value of which is related to, one or more underlying securities, financial benchmarks, currencies or indices. Derivatives allow an investor to hedge or speculate upon the price movements of a particular security, financial benchmark currency or index at a fraction of the cost of investing in the underlying asset. The value of a derivative depends largely upon price movements in the underlying asset. Therefore, many of the risks applicable to trading the underlying asset are also applicable to derivatives of such asset. However, there are a number of other risks associated with derivatives trading. For example, because many derivatives are "leveraged," and thus provide significantly more market exposure than the money paid or deposited when the transaction is entered into, a relatively small adverse market movement can not only result in the loss of the entire investment, but may also expose our clients to the possibility of a loss exceeding the original amount invested. Derivatives may also expose investors to liquidity risk, as there may not be a liquid market

within which to close or dispose of outstanding derivatives contracts, and to counterparty risk. The counterparty risk lies with each party with whom we contract for the purpose of making derivative investments (the “Counterparty”). In the event of the Counterparty’s default, our clients will only rank as an unsecured creditor and risk the loss of all or a portion of the amounts our clients are contractually entitled to receive.

*Foreign Securities.* Investments in foreign securities involve certain factors not typically associated with investing in U.S. securities, such as risks relating to (i) currency exchange matters, including fluctuations in the rate of exchange between the U.S. dollar and the various foreign currencies in which our portfolio securities will be denominated and costs associated with conversion of investment principal and income from one currency into another; (ii) differences between the U.S. and foreign securities markets, including the absence of uniform accounting, auditing and financial reporting standards and practices and disclosure requirements, and less government supervision and regulation; (iii) political, social or economic instability; (iv) imposition of foreign income, withholding or other taxes; and (v) the extension of credit, especially in the case of sovereign debt.

*Leverage.* Subject to applicable margin and other limitations, we may borrow funds on behalf of our clients in order to make additional investments and thereby increase both the possibility of gain and risk of loss. Consequently, the effect of fluctuations in the market value of our clients’ portfolios would be amplified. Interest on borrowings will be a portfolio expense of our clients and will affect the operating results of such clients. Also, we could potentially create leverage via the use of instruments such as options and other derivative instruments.

*Interest Rates.* In connection with the significant leverage we may employ on our clients’ behalf, the level of interest rates generally, and the rates at which we can borrow for our clients, in particular, are likely to have a substantial effect on our clients’ performance. If the interest expense on borrowings – which ordinarily will fluctuate from time to time depending on market conditions – were to exceed the net return on the portfolio securities purchased with the borrowed funds, the use of leverage would result in a lower rate of return than if leverage were not used.

*Illiquid Investments:* On our clients’ behalf, we sometimes make illiquid investments. Illiquid investments are (1) investments that are not heavily traded and cannot easily be converted to cash or (2) investments that we believe our clients must hold for several years to reach their potential value. If our clients require cash and we must sell illiquid investments at an inopportune time, we might not be able to sell illiquid investments at prices that reflect our assessment of their value or the amount paid for them.

*Options.* Investing in options can provide a greater potential for profit or loss than an equivalent investment in the underlying asset. The value of an option may decline because of a change in the value of the underlying asset relative to the strike price, the passage of time, changes in the market’s perception as to the future price behavior of the underlying asset, or any combination thereof. In the case of the purchase of an option, the risk of loss of an investor’s entire investment (i.e., the premium paid plus transaction charges) reflects



the nature of an option as a wasting asset that may become worthless when the option expires. Where an option is written or granted (i.e., sold) uncovered, the seller may be liable to pay substantial additional margin, and the risk of loss is unlimited, as the seller will be obligated to deliver, or take delivery of, an asset at a predetermined price which may, upon exercise of the option, be significantly different from the market value.

*Credit Risk.* We may invest our clients' assets in bonds and other fixed income assets, including commercial paper and "higher yielding" (and, therefore, higher risk) debt securities. Such securities may be below "investment grade" and face ongoing uncertainties and exposure to adverse business, financial or economic conditions that could lead to the issuer's inability to meet timely interest and principal payments. The market values of lower rated debt securities tend to reflect individual corporate developments to a greater extent than do higher rated securities and tend to be more sensitive to economic conditions than are higher rated securities. Companies that issue such securities often are highly leveraged and may not have available to them more traditional methods of financing. A major economic recession could severely disrupt the market for such securities and may have an adverse impact on the value of such securities. In addition, it is likely that any such economic downturn could adversely affect the ability of the issuers of such securities to repay principal and pay interest thereon and increase the incidence of default for such securities.

*Investment in Distressed Securities.* The fact that certain of the companies in whose securities we may invest our clients' assets are in transition, out of favor, financially leveraged or troubled, or potentially troubled, and may be or have recently been involved in major strategic actions, restructurings, bankruptcy, reorganization or liquidation, means that their securities are likely to be particularly risky investments although they also may offer the potential for correspondingly high returns. Such companies' securities may be considered speculative, and the ability of such companies to pay their debts on schedule could be affected by adverse interest rate movements, changes in the general economic climate, economic factors affecting a particular industry or specific developments within such companies. In addition, there is no minimum credit standard that is a prerequisite to the investment in any instrument, and a significant portion of the obligations and preferred stock in which we invest our clients' assets may be less than investment grade.

*Convertible Instruments.* We may invest our clients' assets in convertible instruments. A convertible instrument is a bond, debenture, note, preferred stock, or other security that may be converted into or exchanged for a prescribed amount of common stock of the same or a different issuer within a particular period of time at a specified price or formula. Convertible debt instruments have characteristics of both fixed income and equity investments. On our clients' behalf, we may invest in convertible instruments that have varying conversion values. If a convertible instrument held on our clients' behalf is called for redemption, our client will be required to permit the issuer to redeem the instrument, or convert it into the underlying stock, and will hold the stock to the extent we determine that such equity investment is consistent with our investment objective.

*Performance Allocation.* The performance-based compensation made through the general partner interests in client funds held by our affiliates may create an incentive for us to make

investments on our clients' behalf that are riskier or more speculative than would be the case in the absence of such performance-based compensation.

*Diversification.* Since our clients' portfolios that we invest on their behalf will not necessarily be widely diversified, their investment portfolios may be subject to more rapid changes in value than would be the case if we, on behalf of our clients, were required to maintain a wide diversification among companies, securities and types of securities.

*Non-Public Information.* From time to time, our firm may come into possession of non-public information concerning specific companies. Under applicable securities laws, this may limit our flexibility to buy or sell portfolio securities issued by such companies on behalf of our clients. Our clients' investment flexibility may be constrained as a consequence of our inability to use such information for investment purposes.

*Market Conditions.* Developments in the global financial markets illustrate that the current environment is one of extraordinary and possibly unprecedented uncertainty. In light of market turmoil and the overall weakening of the financial services industry, our clients, their prime broker(s) and other financial institutions' financial condition may be adversely affected and they may become subject to legal, regulatory, reputational and other unforeseen risks that could have a material adverse effect on our clients' business and operations. Moreover, market conditions have substantially reduced the availability of credit, which may have a material adverse effect on our clients' ability to achieve their investment objective with respect to any particular investment and/or their entire portfolio, which could have a material adverse effect on the overall return objectives.

*Equity Securities.* On behalf of our clients, we will invest in equity and equity-related securities of U.S. and non-U.S. companies. Equity securities fluctuate in value in response to many factors, including the activities, results of operations and financial condition of individual companies, the business market in which individual companies compete, industry market conditions, interest rates and general economic environments. In addition, events such as domestic and international political instability, terrorism and natural disasters may be unforeseeable and contribute to market volatility in ways that may adversely affect investments made on our clients' behalf.

*High Yield, Low or Unrated Securities.* On behalf of our clients, we may invest in "high yield" bonds and preferred stock or low or unrated debt securities which are unrated or rated in the lower categories by the various credit rating agencies (or in comparable non-rated securities). Securities in the lower categories are subject to greater risk of loss of principal and interest than higher-rated securities and are generally considered to be predominantly speculative with respect to the issuer's capacity to pay interest and repay principal. They are also generally considered to be subject to greater risk than securities with higher ratings in the case of deterioration or general economic conditions. Because investors generally perceive that there are greater risks associated with the lower-rated securities, the yields and prices of such securities may tend to fluctuate more than those of higher-rated securities. The market for lower-rated securities is thinner and less active than that for higher-rated securities, which can adversely affect the prices at which these securities can be sold. In addition, adverse publicity and investor perceptions about lower

rated securities, whether or not based on fundamental analysis, may be a contributing factor in a decrease in the value and liquidity of such lower-rated securities.

*Defaulted Securities.* On behalf of our clients, we may invest in the securities of companies involved in bankruptcy proceedings, reorganizations and financial restructurings, and may have a more active participation in the affairs of the issuer than is generally assumed by an investor. This may subject our clients to litigation risks or prevent our clients from disposing of securities. In a bankruptcy or other proceeding, our clients as a creditor may be unable to enforce their rights in any collateral or may have their security interest in any collateral challenged, disallowed or subordinated to the claims of other creditors. While we, on behalf of our clients, will attempt to avoid taking the types of actions that would lead to equitable subordination or creditor liability, there can be no assurance that such claims will not be asserted or that our clients will be able to successfully defend against them.

*Investments in Undervalued Assets.* On behalf of our clients, we may invest in undervalued assets. The identification of investment opportunities in undervalued assets is a difficult task, and there is no assurance that such opportunities will be successfully recognized or acquired. While investments in undervalued assets offer the opportunity for above-average capital appreciation, these investments involve a high degree of financial risk and can result in substantial losses. Returns generated from our clients' investments may not adequately compensate them for the business and financial risks assumed. Our clients should be aware that they may lose all or part of their investments.

On behalf of our clients, we may be forced to sell, at a substantial loss, assets that are not, in fact, undervalued. In addition, on behalf of our clients, we may be required to hold such assets for a substantial period of time before realizing their anticipated value. During this period, a portion of our clients' assets would be committed to the investments purchased, possibly preventing our clients from investing in other opportunities. In addition, on behalf of our clients, we may finance such purchases with borrowed funds and thus will have to pay interest on such funds during such waiting period.

*Operational Risk.* Our clients depend on us to develop the appropriate systems and procedures to control operational risk. Operational risks arising from mistakes made in the confirmation or settlement of transactions, from transactions not being properly booked, evaluated or accounted for or other similar disruption in our clients' operations may cause them to suffer financial loss, the disruption of their business, liability to clients or third parties, regulatory intervention or reputational damage. Our clients rely on our financial, accounting and other data processing systems. The ability of our systems to accommodate an increasing volume of transactions could also constrain our ability to properly manage the portfolio.

*Volatility Risk.* Our clients' investment program may involve the purchase and sale of relatively volatile instruments such as derivatives, which are frequently valued based on implied volatilities of such derivatives compared to the historical volatility of underlying securities. Fluctuations or prolonged changes in the volatility of such instruments, therefore, can adversely affect the value of investments held by our clients. In addition,

many non-U.S. financial markets are not as developed or as efficient as those in the U.S., and as a result, price volatility may be higher for our clients' investments. Consequently, and also as a result of their investment program, our clients' performance may be volatile.

*Trade Errors.* On behalf of our clients, we may from time to time make trade errors. Trade errors are not errors in judgment, strategy, market analysis, economic outlook or the like, but rather errors in implementing specific trades which we on behalf of our clients have determined (rightly or wrongly) to make. Some examples of trade errors would be: buying 10,000 shares of an issue, rather than the 1,000 shares that was intended; or taking a long, rather than the intended short, position in a particular issue. Trade errors can result from clerical mistakes, miscommunications between our personnel and other reasons. Importantly, however, trade errors are not the function of poor strategies, valuation models, economic expectations, undue speculation, unauthorized trades or the like, but rather of the physical implementation of specific trades on which we had decided. We will determine whether to have the costs arising from trade errors borne by our clients or our firm by applying the pertinent standard of liability for our firm in its management of our clients' capital — i.e., the same standard of liability which would apply to any other action or omission by us in the course of such management. We will, accordingly, be obligated to reimburse our clients for any trade error resulting from our willful misconduct, recklessness or gross negligence, and not otherwise. We will ourselves determine in good faith whether or not a given trade error is required to be reimbursed under the general liability and exculpation standards applicable to our clients. We have a conflict of interest in determining whether a trade error should be for the account of our clients or our firm and will attempt to resolve such conflict by an objective determination of the status of such trade error under the applicable liability standard. Trade error costs can be significant — including market losses resulting from the position incorrectly acquired as well as the additional brokerage costs of closing out or reversing the error. The opportunity cost (lost profits) of not having made the trade intended to be made is not considered a trade error cost. Any gains recognized on trade errors will be for the benefit of our clients; none will be retained by our firm.

*Broker Insolvency Risk.* Transactions entered into on behalf of our clients may be executed on various U.S. and non-U.S. exchanges and may be cleared and settled through various clearing houses, custodians, depositories, broker-dealers and prime brokers throughout the world. While U.S. rules and regulations applicable to these brokers may offer significant protections to the assets of their clients if one of them were to become insolvent, our clients' assets held at such broker could be at risk. For example, while brokers are required to segregate client assets from their proprietary assets and are required to hold specified amounts of capital in reserve, client assets are normally held in pooled client accounts for the benefit of all clients and not specifically in the name of our clients. Additionally, the broker may be able to transfer client assets out of such client accounts in the ordinary course of its business. Our clients could experience losses if the clients' aggregate claims exceeded the amount of client assets such broker actually held at the time of the insolvency. In addition, while the return of client property is designed to occur on an expedited basis (usually by transfer of the accounts to a solvent broker), our clients may be unable to trade the securities that were held by the insolvent broker during this transfer period.

Our clients' assets may also be held by non-U.S. brokers. Although certain non-U.S. jurisdictions provide similar protections to client assets, there can be no assurance that our clients will not experience losses in any insolvency of such a non-U.S. broker. On behalf of our clients, we will attempt to execute, clear and settle transactions through entities that we believe to be sound, but there can be no assurance that a failure by any such entity will not lead to a loss to our clients. In addition, the Securities and Exchange Commission, other regulators, self-regulatory organizations and exchanges in the United States and other countries are authorized to take extraordinary actions in the event of market emergencies. Such actions could lead to a loss for our clients as a result of delay in settling transactions or other circumstances.

*Trading and Investing Vehicles.* On behalf of our clients, we may effect certain investments through limited partnerships, limited liability companies, corporations or other vehicles sponsored or managed by our firm or third parties. Such investments may be effected through the purchase of debt, warrants or other investments of issuers, the equity of which is owned by our firm. A creditor having a claim that relates to a particular investment held by any such vehicle may be able to satisfy such claim against all assets of such vehicle, without regard to the participation rights of our clients and other investors of such vehicle in the assets of such vehicle.

*Systems Risks.* Our clients depend on us to develop and implement appropriate systems for our clients' activities. Our clients rely extensively on our portfolio management and risk systems to evaluate certain securities based on real-time trading information, to monitor their portfolios and net capital and to generate risk management and other reports that are critical to oversight of our clients' activities. In addition, certain of our and our clients' operations interface with or depend on systems operated by third parties, including market counterparties and other service providers, and our clients or we may not be in a position to verify the risks or reliability of such third-party systems. These programs or systems may be subject to certain defects, failures or interruptions, including, but not limited to, those caused by worms, viruses and power failures. Any such defect or failure could have a material adverse effect on our clients. For example, such failures could cause settlement of trades to fail, lead to inaccurate accounting, recording or processing of trades and cause inaccurate reports, which may affect our ability to monitor our clients' investment portfolios and their risks. Studies have shown that a lack of adequate systems is often a significant contributing factor to failures of funds like those we manage on behalf of our clients.

*Regulation.* Regulation of securities markets has undergone substantial change in recent years, and is expected to continue to change. There can be no assurance that we will be able, for financial reasons or otherwise, to comply with future laws and regulations.

*Relevant Laws.* Amendments to relevant laws could alter an expected outcome or introduce greater uncertainty regarding the likely outcome of an investment situation. In addition, market disruptions and the dramatic increase in the capital allocated to alternative investment strategies during recent years have led to increased governmental as well as self-regulatory scrutiny of the "hedge fund" industry in general, and certain legislation proposing greater regulation of the industry periodically is considered by the U.S. Congress.

and the Securities Exchange Commission, as well as the governing bodies of non-U.S. jurisdictions. It is impossible to predict what, if any, changes in the regulations applicable to our clients, our firm, the markets in which our clients and we trade and invest or the counterparties with which our clients and we do business may be instituted in the future.

*Recent Developments in the Financial Services Industry.* Recent developments in the U.S. financial markets illustrate that the current environment is one of extraordinary and possibly unprecedented uncertainty for the financial services industry. In July of 2010, the Dodd-Frank Financial Reform Act was passed which imposes many new requirements and restrictions on the financial services industry that may likely affect the business, operations and performance of hedge funds, such as increased reporting requirements, limitations on certain trading activity and regulatory oversight by different agencies, such as the newly created Financial Stability Oversight Counsel. The implications of the passage of the Dodd-Frank Financial Reform Act for the hedge fund industry as a whole still remain somewhat unclear. The hedge fund industry may continue to be adversely affected by the recent developments in the financial markets in the U.S. and abroad, and any future legal, regulatory or governmental action and developments in such financial markets and the broader U.S. economy could have an adverse effect on our clients' business, operations and performance.

*Cybersecurity Risk.* With the increased use of technologies such as the internet and the dependence on computer systems to perform business and operational functions, portfolios (such as those we manage on behalf of our clients) and their service providers may be prone to operational and information security risks resulting from cyber-attacks and/or technological malfunctions. In general, cyber-attacks are deliberate, but unintentional events may have similar effects. Cyber-attacks include, among others, stealing or corrupting data maintained online or digitally, preventing legitimate users from accessing information or services on a website, releasing confidential information without authorization, and causing operational disruption. Successful cyber-attacks against, or security breakdowns of, our clients, our firm or a custodian, or other affiliated or third-party service provider may adversely affect our clients and/or our firm. For instance, cyber-attacks may interfere with the processing of transactions, affect our clients' ability to calculate their net asset value, cause the release of private investor information or confidential information, impede trading, cause reputational damage, and subject our clients to regulatory fines, penalties or financial losses, reimbursement or other compensation costs, and additional compliance costs. Cyber-attacks may render records our clients' assets and transactions, ownership of interests, and other data integral to the functioning of our clients inaccessible or inaccurate or incomplete. Our clients may also incur substantial costs for cybersecurity risk management in order to prevent cyber incidents in the future. Our clients could be negatively impacted as a result. While we have established business continuity plans and systems designed to minimize the risk of cyber-attacks through the use of technology, processes and controls, there are inherent limitations in such plans and systems, including the possibility that certain risks have not been identified given the evolving nature of this threat. Our clients rely on third-party service providers for many of their day-to-day operations and will be subject to the risk that the protections and protocols implemented by those service providers will be ineffective to protect them from cyber-attack. Similar types of cybersecurity risks also are present for issuers of securities

in which we, on behalf of our clients, invest, which could result in material adverse consequences for such issuers, and may cause our clients' investment in such securities to lose value.

*Force Majeure.* Social, political, economic and other conditions and events (such as natural disasters, epidemics and pandemics, terrorism, conflicts and social unrest) will occur that have significant impacts on issuers, industries, governments and other systems, including the financial markets. As global systems, economies and financial markets are increasingly interconnected, events that once had only local impact are now more likely to have regional or even global effects. Events that occur in one country, region or financial market will, more frequently, adversely impact issuers in other countries, regions or markets. These impacts can be exacerbated by failures of governments and societies to adequately respond to an emerging event or threat. Clients will be negatively impacted if the value of their portfolio holdings decreases as a result of such events, if these events adversely impact the operations and effectiveness of the adviser or key service providers or if these events disrupt systems and processes necessary or beneficial to the management of accounts.

For example, in late 2019 and early 2020, a novel coronavirus (SARS-CoV-2) and related respiratory disease (COVID-19) emerged in China and spread rapidly across the world, including to the United States. This outbreak has led and for an unknown period of time will continue to lead to disruptions in local, regional, national and global markets and economies affected thereby. With respect to the U.S., this outbreak has resulted in, and until fully resolved is likely to continue to result in, the following among other things: (i) government imposition of various forms of "stay at home" orders and the closing of "non-essential" businesses resulting in significant disruption to the businesses of many companies including both supply chains and demand, and in lay-offs of employees, which effects are hoped to be temporary but may be permanent for some of these businesses; (ii) increased indebtedness by businesses; (iii) increased requests by borrowers for amendments and waivers of their credit agreements to avoid default, increased defaults by such borrowers and/or increased difficulty in obtaining refinancing at the maturity dates of their loans; and (iv) rapidly evolving proposals and/or actions by state and federal governments to address problems being experienced by the markets and by businesses and the economy in general which may or may not adequately address these problems. This outbreak is having, and any future outbreaks could have, an adverse impact on the economy in general, which could have a material adverse impact on, among other things, the ability of certain companies to continue operations profitably. As of the date of this Brochure, it is impossible to determine the scope of this outbreak, or any future outbreaks, how long any such outbreak, market disruption or uncertainties may last, the effect any governmental actions may have or the full potential impact on Blue Grotto and its clients and investments.

In addition, in response to the spread of COVID-19, many businesses, have encouraged or mandated that their personnel work from home in an effort to help slow the spread of the coronavirus pandemic. Notwithstanding such precautionary measures, Blue Grotto may still experience a significant increase in illness of their respective personnel. To the

extent personnel, as a result of working remotely, rely more heavily on external sources for information and technology systems for their business-related communications and information sharing, that business will likely be more vulnerable to cybersecurity incidents and cyberattacks and could have more difficulty resuming normal operations in the event it is the target of such incident or attack.

*Special Purpose Acquisition Companies.* A special purpose acquisition company (a “SPAC”) is a publicly traded company formed for the purpose of raising capital through an initial public offering to fund the acquisition, through a merger, capital stock exchange, asset acquisition or other similar business combination, of one or more undervalued operating businesses. Following the acquisition of a target company, a SPAC typically would exercise control over the management of such target company in an effort to increase the value of such target company. Capital raised through the initial public offering of securities of a SPAC is typically placed into a trust until the target company is acquired or a predetermined period of time elapses. Investors in a SPAC would receive a return on their investment in the event that a target company is acquired and such target company’s value increased. In the event that a SPAC is unable to locate and acquire target companies by the deadline, the SPAC would be forced to liquidate its assets, which may result in losses due to the expenses and liabilities of the SPAC. Investors in a SPAC are subject to the risk that, among other things, (i) such SPAC may not be able to locate or acquire target companies by the deadline, (ii) assets in the trust may be subject to third-party claims against such SPAC, which may reduce the per share liquidation price received by the investors in the SPAC, (iii) such SPAC may be exempt from the rules promulgated by the SEC to protect investors in “blank check” companies, such as Rule 419 promulgated under the Securities Act, so that investors in such SPAC may not be afforded the benefits or protections of those rules, (iv) such SPAC may only be able to complete one business combination, which may cause it to be solely dependent on a single business, (v) the value of any target company may decrease following its acquisition by such SPAC, (vi) the value of the funds invested and held in the trust decline, (vii) the inability to redeem due to the failure to hold the securities in the SPAC on the record date or the failure to vote against the acquisition and (viii) if the SPAC is unable to consummate a business combination, public stockholders will be forced to wait until the deadline before liquidating distributions are made. In addition, most SPACs are illiquid and have a concentrated shareholder base that tends to be comprised of hedge funds (at least at inception). The Investment Adviser may cause clients to invest in a SPAC that, at the time of investment, has not selected or approached any prospective target businesses with respect to a business combination. In such circumstances, there may be limited basis for the Investment Adviser to evaluate the possible merits or risks of such SPAC’s investment in any particular target business. To the extent that a SPAC completes a business combination, it may be affected by numerous risks inherent in the business operations of the acquired company or companies. For these and additional reasons, investments in SPACs are speculative and involve a high degree of risk.

## **9. Disciplinary Information**

Neither our firm, nor any of our directors, officers or principals has anything to disclose in response to this item.



## **10. Other Financial Industry Activities and Affiliations**

### Registered Representative of a Broker-Dealer

Neither our firm nor any of our directors, officers or principals is registered, or has an application pending to register, as a broker-dealer, futures commission merchant, commodity pool operator, a commodity trading advisor, or is an associated person of any of the above.

### Blue Grotto Capital GP LLC

Blue Grotto Capital GP LLC, our affiliate, serves as the general partner to our private fund clients. Blue Grotto Capital SLP LLC is a special limited partner of the GP and was created to receive the performance allocation described in Item 5. Benjamin Gordon controls each of Blue Grotto Capital GP LLC, Blue Grotto SLP LLC, and Blue Grotto Capital, LLC.

We address this potential conflict of interest by fully disclosing the relationship among Blue Grotto Capital GP LLC, Blue Grotto SLP LLC, Blue Grotto Capital, LLC, Blue Grotto Capital Partners LP, Blue Grotto Capital Cayman Ltd. and Blue Grotto Master Fund LP in our clients' offering documents. Although Benjamin Gordon's control of our clients' general partner and investment manager gives him heightened control and discretion over our clients, he manages any potential conflicts of interest by strictly adhering to the investment strategy and business philosophy discussed in each of our clients' private placement memoranda or other governing documents. In addition, Blue Grotto Capital GP LLC, as our clients' general partner, negotiated the investment management arrangement with Blue Grotto Capital, LLC. While this may be a conflict of interest, the material terms of the investment management arrangement are fully disclosed to all investors in the funds prior to their investment.

We do not recommend or select other investment advisers for our clients.

## **11. Code of Ethics, Participation or Interest in Client Transactions and Personal Trading**

We have adopted a Code of Ethics in accordance with the Securities and Exchange Commission requirements. Our Code of Ethics works to ensure that our employees' securities transactions are consistent with our firm's fiduciary duty to our clients. Our employees are required to conduct their activities in such a manner as to avoid actual or

potential conflicts of interest or any abuse of an individual's position of trust and responsibility.

The Code of Ethics includes, among other things, provisions relating to personal securities transactions, insider trading prohibitions, the acceptance of significant gifts, reporting of certain gifts and business entertainment items, political contributions, charitable contributions and conflicts of interest.

As part of our fiduciary duty, we seek to identify and to mitigate or avoid both conflicts of interest and the appearance of any conflicts of interests. If we believe that we may have an actual conflict of interest with a client, we require a full and fair disclosure to that client of any material facts regarding such conflict (in addition to any other necessary and appropriate actions to manage and mitigate such conflict).

From time-to-time service providers provide us with gifts and entertainment. While this may create a conflict of interest, we use the best execution factors when selecting brokers, and we do not take the gifts or entertainment into account when scoring the various brokerage options.

It is our firm's policy not to engage in principal or cross trades. Therefore, we may not engage in a principal or cross trade without the prior authorization of the Chief Compliance Officer.

In brief, we prohibit personal trading which misuses confidential or material non-public information or otherwise involves a conflict of interest or the appearance of one and require (a) pre-clearance before purchasing an IPO, a limited offering, interest in a private fund, interest in a private company or a private placement, (b) periodic reporting of employees' personal securities transactions and holdings, and (c) annual reporting of all brokerage accounts and holdings.

Employees of our firm do not recommend to our clients, nor do they buy or sell for our clients' accounts, securities in which they have a material financial interest. Additionally, employees of our firm do not recommend securities to our clients, nor do they buy or sell securities for our clients' accounts, at or about the same time that they or a related person buys or sells the same securities for their own account.

Clients may request a copy of the Code of Ethics by contacting us at the address or telephone number listed on the first page of this document.

## **12. Brokerage Practices**

We have complete investment and brokerage discretion over our clients' accounts. The factors we consider in selecting and approving brokers-dealers that may be used to execute trades for our clients' accounts include but are not limited to:

- reputation;
- financial strength and stability;

- quality of execution;
- overall costs of a trade;
- error correction capabilities;
- availability and costs of securities to borrow in relation to short sales;
- block trading and block positioning capabilities;
- willingness to execute difficult transactions;
- willingness and ability to commit capital;
- access to underwritten offerings and secondary markets;
- market intelligence regarding trading activity;
- back office and processing capabilities; or
- the value of research and brokerage and research products and services provided by such brokers.

Although we generally seek competitive commission rates, we will not necessarily pay the lowest commission. Transactions may involve specialized services on the part of a broker-dealer, which may justify higher commissions than would be the case for more routine services.

We Utilize Soft Dollar Benefits. We will from time to time pay higher prices to buy securities from, or accept lower prices for the sale of securities to, brokerage firms that provide us with investment and research information. This investment and research information is often referred to as “soft dollar” benefits. The research services that broker-dealers might provide include written information and analyses concerning specific securities, companies or sectors; market, financial and economic studies and forecasts; statistics and pricing or appraisal services; discussions with research personnel; and invitations to attend conferences or meetings with management or industry consultants. Research furnished by brokers may include, but is not limited to, both internally generated items (such as research reports prepared by employees of the broker), as well as items acquired by the broker from third parties (such as quotation equipment). Although we will generally use the research and services in making investment decisions for our clients whose commission dollars provided for the research and services, we may also use such research or services for other clients whose commission dollars did not provide for the research and services. Therefore, clients may not, in any particular instance, be the direct or indirect beneficiaries of the research and services provided. As a result, clients who generate sizeable commissions subsidize research and services provided to clients whose accounts generate minimal brokerage commissions since the commission dollars generated by transactions for such clients are not sufficient to pay for research and services that may be received by such clients from other brokers.

We Intend Any Use of Soft Dollar Benefits to Fall Within the Safe Harbor. The Securities and Exchange Commission created a safe harbor that protects investment advisors from liability for a possible breach of fiduciary duty to their clients when advisors engage in soft dollar arrangements for certain services at other than the lowest transaction costs. The safe harbor protects advisers so long as the products and services received constitute lawful and

appropriate assistance and the amount indirectly paid for those products or services is reasonable. We intend that our soft dollar arrangements will fall within this safe harbor.

The Use of Soft Dollars Can Create a Conflict of Interest. Although our policies require us to always obtain the best execution for our clients by taking into account all applicable factors, using client transactions to obtain research and other benefits creates incentives that result in conflicts of interest between advisers and their clients. When we use client markups or markdowns to obtain research products and services, our firm receives a benefit because we do not have to produce or pay for the research products and services. The availability of these benefits may influence us to select one broker-dealer rather than another to perform services for our clients, based on our interest in receiving the products and services instead of on our clients' interest in receiving the best execution prices. Obtaining these benefits may cause our clients to pay higher fees than those charged by other broker-dealers.

The use of soft dollars to obtain research services creates a conflict of interest between our firm and our clients because our clients pay for products and services that are not exclusively for their benefit and that may be primarily or exclusively for the benefit of our firm. To the extent that we are able to acquire these products and services without expending our own resources, our use of soft dollar benefits could increase our profitability. We note, however, that our clients generally would pay for our research costs if we were to pay for the research directly.

Our firm uses Cowen Inc. as our outsourced broker and trading desk. When we direct Cowen to make trades, we provide them with a budget and a list of accepted brokers that may be used to make such trades. On our behalf, Cowen may make trades directly themselves. Cowen varies its use of the brokers per our instructions and follows its obligation to obtain best execution for our clients. We also avail ourselves of capital introduction services provided by our prime brokers. However, we neither take such services into consideration when selecting our prime broker, nor do we rely on such services to find investors in our products.

We Do Not Consider Client Referrals in Selecting or Recommending Broker-Dealers.

Our Clients Do Not Direct Brokerage. We do not permit our clients to direct us to execute transactions through a specified broker-dealer.

Trade Aggregation and Allocation. On behalf of our clients, we may execute transactions on an aggregated basis among certain of our clients. The following procedures will apply to all aggregated transactions:

- **Disclosure.** Our firm's procedures for the aggregation of orders shall be disclosed in our clients' governing documents.

- **Obtain Best Execution.** We will not aggregate orders unless aggregation is consistent with its duty to obtain best execution and the terms of the investment guidelines and restrictions of each client for which trades are being aggregated.
- **Fair Treatment.** No client will be favored over any other client. Generally, each client that participates in an aggregated order will participate at the average price for all of the transactions in that security on a given business day, with transaction costs shared pro rata based on each applicable client's participation in the transaction.
- **Determination of Allocation.** Before entering an aggregated order, the CCO or an appropriate person or party will determine how the order will be allocated among those clients ("Allocation Policy"). If the aggregated order is filled in its entirety, it will be allocated among the applicable clients in accordance with the Allocation Policy (generally pro rata to the extent there are no client-imposed restrictions).
- **Partial Fills.** On occasion, we will not be able to purchase, or sell, all of the securities ordered as part of an aggregated order in a single day. If the order is partially filled, it will generally be allocated pro rata in proportion to the size of orders placed for each applicable client to the extent practicable based on the Allocation Policy.
- **Deviations from Allocation Policy.** Notwithstanding the foregoing, an aggregated order may be allocated on a basis different from that specified in the Allocation Policy if all relevant clients receive fair and equitable treatment. Reasons for allocating on a basis different from that specified in the Allocation Policy include but are not limited to: a client's investment guidelines and restrictions, available cash, liquidity requirements, tax or legal reasons and to avoid odd-lots or in cases when a pro rata allocation would result in a *de minimis* allocation to one or more clients.
- **Safeguarding Client Assets.** Each client's assets will be deposited with one or more custodians and the client's assets will not be held collectively any longer than is necessary to settle the purchase or sale in question.
- **No Additional Compensation.** Our firm will receive no additional compensation of any kind as a result of an aggregated order.

### 13. Review of Accounts

We will generally monitor our clients' aggregate portfolio holdings on a regular basis. The Principal or a qualified representative will periodically review our clients' accounts as necessary to respond to significant changes in economic or market conditions.

Our clients' administrator provides our clients and their investors, as applicable, with monthly written statements. We also furnish our clients' investors with annual written audited financial statements and tax information to assist investors in completing their tax returns.

### 14. Client Referrals and Other Compensation

Our firm does not, nor do any principals or employees of our firm, receive any economic benefit from non-clients for providing advisory services to our clients.

Our firm does not, nor do any principals or employees of our firm, compensate anyone other than a supervised person for client referrals.

## **15. Custody**

While it is our firm's practice not to accept or maintain physical possession of our clients' assets, we are deemed to have custody of its assets under Rule 206(4)-2 of the Investment Advisers Act of 1940, as amended, because we have the authority to access our clients' funds and deduct fees and expenses from their accounts.

In order to comply with Rule 206(4)-2, we utilize the services of qualified custodians (as defined under Rule 206(4)-2) to hold all of our clients' assets. We also ensure that the qualified custodians maintain these funds in an account that contains only our clients' funds and securities, in the name of our clients. As required by Rule 206(4)-2, we also (1) engage an independent public accountant registered with, and subject to, regular inspection by the Public Company Accounting Oversight Board to audit our clients at the end of each fiscal year and (2) distribute the results of the audit in audited financial statements that are prepared in accordance with generally accepted accounting principles to all investors in our clients within 120 days after the end of the fiscal year.

## **16. Investment Discretion**

### Scope of Authority

Our firm accepts discretionary authority to manage our clients' securities accounts. Essentially, this means that we have the authority to determine, without obtaining specific client consent, which securities to buy or sell and the amount of securities to buy or sell. Despite this broad authority, we are committed to adhering to the investment strategy and program set forth in each of our clients' private placement memoranda or other governing documents.

### Procedures for Assuming Authority

Before accepting their subscriptions for interests, we provide all investors in our clients with a private placement memorandum and/or governing documents that set forth, in detail, our investment strategy and program and the terms of investment for investors. By completing our subscription documents to acquire an interest in our private fund clients, investors give us complete authority to manage their investments in accordance with the private placement memorandum and/or governing documents they each received.

### Side Letters

We have entered into "side letter" agreements with certain investors to accommodate an investor's particular legal, tax or regulatory requirements or to otherwise have the effect of establishing rights under, or altering or supplementing the terms of the private placement

memorandum and/or governing documents (including those relating to management fees, the performance allocation, transparency, and withdrawals) with respect to such investor, without obtaining the consent of any other investor (other than an investor who is materially and adversely affected by such waiver or modification).

## **17. Voting Client Securities**

Our firm has authority to vote our clients' securities. Our policy is to vote proxies solely in the best interests of our clients. Generally, we believe that a company's management is best suited to make decisions that are essential to the ongoing operation of the company. Therefore, we generally vote proxies in line with a company's management. However, under certain circumstances, when we believe that management's proposal is not designed to maximize value for our clients, we will vote against management.

Clients, and investors in our clients, cannot direct our portfolio managers' proxy votes.

If there are any potential or actual conflicts of interest in connection with voting a client proxy, the CCO must present any purported conflict to the managing partner, external compliance consultants or to our compliance attorney for consultation on the matter and conduct a conflict analysis accordingly. The CCO must document the matter thoroughly and preserve the documentation in accordance with our record retention policies.

Clients may request a copy of the records detailing how their securities were voted and/or a copy of our proxy voting policies by contacting us at the address or telephone number listed on the first page of this document.

## **18. Financial Information**

We do not require nor do we solicit prepayment of more than \$500 in fees per client, six months or more in advance.

We are not aware of any financial condition that is likely to impair our ability to meet our contractual commitments to our clients.

Our firm has never been the subject of a bankruptcy petition.