July 25, 2015

Dear Partners:

In his book *Fooling Some of the People All of the Time*, renowned investor David Einhorn recounts the sad realization that almost no one was eager to invest "with a couple of twenty-seven-year-olds with no track record." Despite this truism, Greenlight Capital was launched in May of 1996:

> "We decided that the only way to get a track record would be to get started. In one year we could have a one-year track record, and in three years a three-year record. It was not going to happen any faster than that."

While perhaps obvious in hindsight, this observation was an important inspiration in deciding to begin our own track record - irrespective of any obstacles. In May of 2014, with the trust and investment of our initial partners, we launched our first fund.

At quarter-end, we now proudly have our own track record: one year, one month . . . and counting!

The below table details the fund's performance before allocation[1] to the general partner versus the results of the S&P 500 Total Returns Index for three distinct periods: 1) the second quarter of 2015, 2) the first two quarters of 2015 combined (i.e., YTD), and 3) the one-year mark of the fund (i.e., May 1st, 2015):

	Q2 2015	Year to Date	1 Year
Fund	1.83%	14.15%	35.65%
S&P 500 Total Returns	0.28%	1.23%	14.21%

Despite this milestone, short-term performance (including our own!) is largely a meaningless pulse on current market sentiment. Case in point, June was a particularly noisy month as substantial worries about China, Greece, Puerto Rico, falling commodity prices, Donald Trump,[2] and any number of other concerns dominated the headlines and sadly dimmed Q2's short-term scorekeeping efforts. While many of these macro concerns are certainly legitimate, we expect the impact to be fairly limited on our portfolio companies - especially over the long-term.

Accordingly, it was business as usual during Q2: we divested of our positions in both Marchex (MCHX) and Dreamworks (DWA), welcomed American Airlines (AAL) to the family, and finished the quarter with cash amounting to 4.6% of the portfolio.

Marchex

As a refresher, we believed MCHX was trading at a significant discount to the combined value of its extensive domain portfolio + large cash reserves. More importantly, we believed the combined value of cash and domains was easily sufficient to mitigate our *mighty* skepticism of their unproven call analytics business.

Just two days after finishing our Q1 letter, our thesis was put to the test when the headline "*Marchex Announces the Sale of Its Domain Assets*" appeared. The short press announcement would boast a headline sale price of $34.8

[1] No management fee, performance fee of ¼ of gains in excess of 6%.

[2] Regardless of your political views, next time you hear Mr Trump's frequent diatribes regarding illegal immigrants, listen closely: that sound you hear in the background is the cash register at our portfolio company (and Spanish language broadcaster) Entravision.

million dollars, consisting of $6.7 million in domain sales sold by MCHX since January of 2015, *and* $28.1 million for the sale of "*more than 200,000 domains*" to GoDaddy.

The good news was clear: MCHX would now have a whopping 71% ($118.5 million) of its *post-announcement* enterprise value in cash. The bad news was the sale price (~$140 per domain) represented a mere fraction of the value we had so confidently ascribed to the domain portfolio. Two possible explanations for this discrepancy are: 1) we were overly optimistic, or 2) just plain wrong in our valuation.

But what if there was one other explanation? To the conspiracy theorists among us, it seemed oddly - perhaps purposefully - vague to describe a domain portfolio of 284,734 domains as "more than 200,000 domains." To be clear, the specific number of domains sold is no small detail. Here's why: at last count, the portfolio included a total of 82,728 domains classified as either two-word or "select" domains with average selling prices of $22,000 and $75,000, respectively. 284,734 - 82,728 = 202,006 certainly qualifies as "more than 200,000," but begs the obvious question: did they keep the best and sell the rest?

Further strengthening our suspicion was our discovery of an online directory of the sold portfolio. Interestingly, this directory contained the listings for approximately 202,910 domains[3] by our rough estimation.

To no avail, we called and emailed management in search of clarity / specifics. We listened to the earnings call in the hopes of hearing even the smallest detail regarding the domain sale. Instead, management eliminated the dividend (despite their gigantic and growing pile of cash), and proudly pledged their continued allegiance to the call analytics business. Several days later, MCHX disclosed an SEC order granting confidential treatment of details excluded from the announced sale of domain assets, including the actual number of domains sold.

We entered the position believing the call analytics business was likely a dud, and the true value was in their domain portfolio. Although we suspect MCHX almost certainly retained the best domains, we are confused by their secrecy, decision to hoard cash, and continued devotion to the call analytics business. Ultimately, we decided it is better to be profitable than right, and exited this position (of just 4 months) with a healthy gain of 17.6%.

Dreamworks

As an entertainment company, DWA "creates and exploits branded family entertainment," including such international favorites as the "franchise properties" *Shrek*, *Madagascar*, and *Kung Fu Panda*. Popular "franchise properties" translate into full theatres in the near-term, and a bright future of bulging cash registers propelled by sequels, toy licensing deals, and other lucrative opportunities. Unsurprisingly, many "investors" tend to focus - and trade DWA - on recent box-office success, or the lack thereof.

Heading into the new year, DWA found itself in the uneviable position of being a hit-based business without recent hits. Then, on January 22, DWA announced a restructuring plan amounting to layoffs of ~19% of their workforce, and the decision to reduce production from three films per year to just two. Worse yet, DWA would release only one feature film for all of 2015. Almost immediately, investors began worrying about the balance sheet, doubting the prospects of future films, and running for the exit.

The next day, we added DWA to the portfolio with a ~7% weighting.

With just $34 million of cash (as of YE 2014), and several recent box office disappointments, some investor anxiety was certainly warranted. At the time of our investment, we had no idea whether the next film(s) would hit or miss,

[3] 10 domains per page, 20,291 pages

but doubted all the magic had truly left the building. Hits take time (3-4 years!), resources, talent, ***and*** misses. Simply put, no one hits a homerun every time at bat. Already hard at work on the next seven animated films, it was clear DWA was far from admitting defeat.[4]

Beyond any speculation regarding the potential of future films, we thought a true liquidity crisis was especially unlikely given a balance sheet bursting at the seams with valuable assets. Among these valuable assets were real estate, films in development, and most importantly a sizeable library of enviable content including everything from DWA stalwarts such as *Shrek* and *Madagascar*, to the rights for such classics as *Casper the Friendly Ghost*, *Where's Waldo*, *The Lone Ranger*, and many others. Better yet, the library shines where it really counts: at the cash register.

By definition, DWA's library includes only films two years or older. Because the majority of expenses for feature films are for upfront costs (i.e., production, distribution, etc), the library becomes very profitable once these costs have been covered. In fact, our DWA investment was made at an enterprise value of ~$2.0 billion, or ~12x YE 2014 pre-tax library related revenue. Even after Uncle Sam takes his cut, we were paying a market multiple on library earnings, and little to nothing for DWA's real estate, portfolio of future films already in development, Chinese joint venture, and much more.

In February, DWA management took steps to strengthen the balance sheet and mitigate near-term liquidity concerns by increasing their credit facility and netting $185 million via a sale and leaseback of their Glendale campus. The next bit of good news came with the March release of *Home* - a much needed box office success.

In short order, once pervasive investor pessimism quickly turned to cautious optimism among investors. While there remains much to like with DWA, after just four months, and a gain of ~40%, we decided to catch the next showing and divested of this position entirely.

In Closing

The Fund continues to seek investments in companies where there is a disparity between our best valuation guess and current market pricing. Simply put, if we are more right than we are wrong, the performance of the Fund should be very satisfactory in both good and bad markets . . . but it almost certainly won't be as timely (or painless) as it has been so far.

Lastly, thank you for entrusting us with your investment. As an emerging Fund, we are always looking for like-minded investors, and encourage you to pass along our letters to anyone who might be interested in our approach toward capital management.

Please feel free to email me at stephen@rltcapital.com or call at (415) 894-5406 with any questions or concerns.

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[4] These seven films include both sequels and new titles intended for theatrical release through 2018, and had a book value of nearly $300 million as of YE 2014.

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