January 19, 2016

Dear Partners:

Howard Marks often compares the behavior of financial markets to that of a pendulum; always in motion, passing through the middle (i.e., normal) only briefly en route to one extreme or the other. In his pendulum analogy, the extremes are greed vs fear, optimism vs pessimism, and overvalued vs undervalued.

It is safe to assume the pendulum is in motion - and likely not for the better - when the morning news starts allocating airtime to market coverage in lieu of the Trump campaign and / or viral videos. Case in point, on the morning of August 24th, there stood Jim Cramer in the Today show studio. In the short segment that followed, a subdued Cramer discussed the "tremendous decline coming from China," and predicted "it is going to be a bad day, it's probably going to be a bad week."

In fact, it was a bad *second half*:

- US stocks closed out 2015 with their worst annual performance since 2008.
- The S&P 500 - after three years of double-digit gains - finished 2015 (0.7)%, or 1.38% with dividends.
- Hedge funds - on average - lost more than 3% for the year.[1] Among the carnage were several renowned (and truly skilled) investors, whose portfolios fared even worse.

The below table details the Fund's performance before allocation[2] to the general partner versus the returns of the S&P 500 Total Returns (our benchmark) for the 3rd quarter, full year, and since inception in May of 2014:

	Q3 2015	Full Year 2015	Since Inception
Fund	(7.82)%	6.99%	26.79%
S&P 500 Total Returns	(6.44)%	1.38%	12.39%

The fund finished 2015 *ahead* of our index by 5.61%. Since inception in May of 2014, the Fund has now outperformed our benchmark by a spread of 14.40%. That's the good news. The bad news is very little worked in our favor during the second half, resulting in a 6.27% decline from Q2:

- Our largest holding, Apple (AAPL), lost 16% during the second-half, finishing the year down 4.6%.
- All but two positions of the portfolio declined by year-end.
- Of our two gainers (Verisign and American Airlines), Verisign (VRSN) carried nearly all the weight - gaining 53% over the year (and 41.5% during the second half).
- Declines in *existing* investments only accounted for roughly half of our second-half woes. Unfortunately, the other half came from investments added to the portfolio during the second-half.

Despite increased market turbulence throughout the second-half, we remained (nearly) fully invested, increased our positions in both AAPL and Civeo (CVEO), and added a position in Quotient Technologies (QUOT). Given the cost of these decisions to our performance, it is fair to ask: what were we thinking? To answer that, let's start with our largest position:

[1] 1/1/2016 WSJ: Wasted Opportunity: Hedge Funds Falter

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

Apple

By most accounts, AAPL had a fantastic 2015: Net sales grew by 28% to $233.7 billion, diluted earnings per share grew by nearly 43% to $9.22 per share. In the meantime, total shares *decreased* by 5.4%, while cash (and equivalents) grew 32.4% to $205.7 billion. Although AAPL's fiscal year ended in September (and thus excludes holiday sales), they still managed to sell 231 million iPhones (an increase of 37% from 2014) and do so at higher prices (average selling prices *rose* 11%) than the year before.

February's headlines declared AAPL as the first company to hold a market value of $700 billion - a dubious milestone for our style of investing. Yet, it is enterprise value - not market value - that matters especially when talking about a company with a cash register stuffed to the tune of $150 billion in net cash (i.e., cash-debt).[3] At peak valuations AAPL traded at 14.5x 2015 earnings, but an enterprise value of just 11.7x those same earnings - all during a time when the S&P 500 was sporting a P/E ratio of nearly 19x earnings on average, and AAPL was pocketing 92% (not a typo!) of total income from the world's eight top smartphone makers![4]

By the second-half, the good news became old news as Mr. Market concluded the good times can't last. To the bears: AAPL is overly reliant on iPhone sales. Not everyone in the world is going to purchase an iPhone, and especially not at the margins AAPL currently enjoys. iPad sales continue their decline, indicating either iPads do not share the same update cycle as the iPhone, or worse, further confirmation of AAPL's over-reliance on the iPhone. Then there's China, a key source of growth for the company now at risk due to China's current economic woes.

Of course, there is *some* truth to each of these concerns. That said, it is worth trying to quantify the two main concerns (iPhones and China) as a rough sanity check. In 2015, the iPhone accounted for $155 billion (~66% of total) of sales, while China accounted for ~$59 billion (~25% of total) in sales. AAPL declined 16% during the second-half, wiping out nearly $150 billion in market value, or the equivalent of ~3x 2015's total sales to China, or just $5 billion short of total revenue earned from *all* iPhones sales in 2015. Another way to frame the second-half's decline would be to see how things *might* look given considerable declines in iPhone or Chinese related revenues. To do so, we need look no further than 2013's results when iPhone sales were ~41% lower, and Chinese sales were ~54% lower. While certainly not a comprehensive doomsday scenario, in 2013 AAPL still managed to earn more than $37 billion, which would be ~16.8x 2015's peak enterprise value.

Obviously, there are many differences between 2015 and 2013 (a year when iPod's contributed $4.4 billion in sales) that prevent this calculation from being a perfect comparison. Yet, the relevant question is not *if* the bearish concerns are a reality, but rather if those concerns are *as bad* as the market seems to believe. We think not. Instead, we continue to see AAPL as a top-tier company, priced for pessimism amid abundant reasons for optimism. Key among these reasons, is AAPL's growing ecosystem: continued innovation + industry leading customer satisfaction continues to strengthen AAPL's ecosystem irrespective of near-term concerns. Perhaps the best evidence of this expanding ecosystem can be found in growing sales *beyond* the iPhone, as iPhone *users* become AAPL *consumers*: sales were up 6% for Macs, 10% for Services (i.e., iTunes Store, App Store, etc), and 20% for Other Products (i.e., Apple TV, Apple Watch, Beats, etc).

Civeo

Simply put, CVEO has been the costliest position in the short history of the Fund. As a quick refresher, CVEO is in the business of providing accommodations and lodging services in remote and resource-rich areas of the world. In

[3] Even at milestone market valuations of $700+ billion, and even if (or when) the tax man takes his share, AAPL's $150 billion is hardly a rounding error.

[4] 7.12.2015 WSJ: Apple's Share of Smartphone Industry's Profits Soars to 92%

September of 2014, management announced their decision to redomicile to Canada - a decision in opposition to the proposed REIT conversion advocated by both the broader market and several prominent investors. The next day, the stock fell nearly 50%. Shortly thereafter, we initiated our first position (and have been in and out of CVEO since).

To us, management's decision to redomicile seemed logical, *even* at the expense of the higher multiple paid by income-starved, REIT-loving investors. Even then, declining commodity prices and early rumblings of a slowing Chinese economy were already evident, but the deterioration in both would only accelerate further as the year progressed. From a high of ~$107 per barrel in June of 2014, the price of oil began its freefall during the second-half of 2014.[5] By January of 2015, the price of oil had fallen more than 50%.

At the risk of stating the obvious, falling commodity prices is not good news for a company in the business of providing accommodations to oil and other commodity providers. Further complicating things was the $750 million in debt CVEO received as a parting gift during their spin-off from Oil States International. In short order, investors were left to worry:

- Would CVEO redomicile without issue?
- How would falling commodity prices and large fixed costs affect CVEO's ability to maintain the business, service debt obligations, and stay within covenant restrictions?
- And the big daddy of all question: Just how low might commodities go?!

With sizeable losses, and the above concerns in mind, we exited our CVEO position in the final trading days of 2014. Even so, we couldn't shake the feeling that CVEO had become a baby with the bathwater-type situation. Yes, CVEO was in business with commodity providers. Yes, many of these commodity providers had seen better days. Yes, lower commodity prices would likely result in a reduction (maybe even a *severe* reduction) in new projects and industry capital expenditures. Yes, we had (and still have) no idea how low commodity prices might go. Yes, all of the above is bad news for CVEO.

In February of 2015 - after falling an additional ~53% from our 2014 exit price - we again added CVEO to the portfolio. And here's why: while it was apparent to us the pendulum was in motion, and things could get much worse before they got better, it was equally clear that embedded in all investing is some element of cyclicality. Accordingly, the key question is not how low will prices go, but how long can CVEO hold on before the cycle turns? If given lemons, would they make lemonade?

We believe they are certainly trying: management halted the dividend, successfully completed the redomicile, amended the credit facility, paid down debt, and renegotiated looser financial covenants (providing some much needed extra breathing room). Additionally, management wrote down assets by $120 million (a.k.a. swallowing the big pills first), announced / signed new business, added to their own personal stockholdings, and rapidly cut expenses. Even so, commodity prices continued their decline throughout 2015.[6] By Q3, CVEO's revenues and "adjusted EBITDA"[7] for the first nine months of 2015 had fallen by ~42%, and ~55%, respectively. Unsurprisingly,

---

[5] Oil pricing is dependent on several factors including its grade and location. "Oil's price" generally refers to the spot price of a barrel on some benchmark. In the US, that benchmark is usually West Texas Intermediate (WTI). This detail is noteworthy because most of CVEO's oil customers are Canadian, and thus their oil prices are quoted on the Western Canadian Select benchmark (WCS) . . . which trades at a <u>discount</u> (sometimes a significant discount) to WTI's prices due to lower quality and transportation costs. Low WTI = Lower WCS

[6] By December of 2015, WCS was trading at the lowest price ($23.46) since December of 2008, and the WTI-WCS differential was $13.65.

[7] Adjusted primarily to *add back* the expenses associated with the Canadian migration and $120 million impairment - both of which *should be* true one-time expenses.

CVEO's stock price finished 2015 ~65% lower.

At this point, CVEO has been a humbling reminder that even things that already look cheap, can still get (much!) cheaper when fear, sentiment, and uncertainty are leading the charge. It is clear we underestimated how badly things could deteriorate, and how quickly the carnage would become the new norm. Even so, CVEO is now selling at a discount to our best guess for pessimistic liquidation scenarios[8] - a valuation we expect will look especially silly should they successfully hold the fort until the pendulum finally shifts course once again.

Quotient Technologies

We initiated a position in Coupons.com (now renamed to Quotient Technologies) in August of 2015. At first glance, QUOT is not the type of company we would normally find attractive. For starters, there is this disclosure in the risk section of the 10-K: "we have incurred net losses *since inception*." A history of losses is perhaps most alarming given the company's inception date of 1998 and the large stock-based compensation expenses along the way. For example, 2014's net loss of $23.4 million looks small only when you see the $35.5 million in stock-based compensation the company paid out. Just nine months into 2015, the stock-based compensation gravy train had already reached $25.5 million on net losses of $23.2 million.

Nonetheless, if you hold your nose past the (long) history of net losses and (large) dilution, you will find a technology company in the unsexy business of coupons, lead by the original founder (and ~9% shareholder), with 8+ years of runway (~$190 million in cash and $0 debt) at current burn rates, and little (if any) notable competition. You also will almost certainly find that very few investors use or even know much about coupons . . . which is both the problem and opportunity.

For starters, according to Inmnar's 2015 "Promotion Industry Analysis:"

- A whopping 319 billion coupons[9] were distributed in 2014 - an amount equivalent to ~1,000 coupons for every man, woman, and child in the United States!
- Of all those coupons distributed, just 2.8 billion were actually redeemed.
- While 2014 saw a decline in both distribution and redemption rates of ~3%, more coupons were distributed in 2014 than 2008 (so much for the death of coupons . . .).
- Yet, nearly 90% of all coupons distributed in 2014 were of the old-fashioned printed form, distributed with the Sunday newspaper (i.e., not mobile, digital, social, or any other tech buzzword)

Inmar's research clearly indicates coupons remain a pervasive (albeit antiquated) means of both marketing and price discrimination. Further, Inmar's shopper behavior research found that 66% of shoppers surveyed want coupons loaded to their store loyalty card for items they normally buy, while 65% want stores to email them with coupons for products they normally buy. And here is the kicker, the "clearly expressed want is for relevancy, immediacy of acquisition, and ease of redemption:"

- **Relevancy**
    - Through their technology (and integration with ~2,000 brands and ~64,000 stores), each month QUOT provides ~17 million unique visitors with digital coupons, personalized for each shopper according to purchasing data and behavior.
    - In terms of relevancy, the people shown these campaigns are shoppers who make 25% more trips, and spend 12% more on each trip and 40% more overall, than the average shopper.

---

[8] While it is always possible our *pessimistic* scenario is too *optimistic*, we assume CVEO pays 100% of all liabilities, while receiving 25% on all current assets (except cash - set at 100% recovery), and 40% on all Property, Plant, and Equipment (with recovery on accommodation assets the key driving factor).

[9] 119.2 billion were food related, 199.9 billion were non-food

- **Immediacy of Acquisition**
    - QUOT delivers digital coupons directly to shoppers through mobile apps, the Coupons.com site (a top 100 web property), as well as an online network of ~30,000 publishers including a variety of blogs, lifestyle sites, and several retailers.
- **Ease of Redemption**
    - For years, digital coupons always had to be printed before redemption (a.k.a. digital in name only). However, through Retailer iQ (introduced in 2014) coupons can be digitally transferred (no printing needed) to the shopper loyalty cards of participating retailers. After shopping, customers receive digital receipts and new recommended offers they can easily apply to their next shopping trip.

Of course, QUOT's solutions aren't just good for consumers, they also are compelling for both brands and retailers:
- With data comes insights, allowing QUOT to offer reporting and analysis that help retailers understand shoppers better, provide more relevant / personal offers and ads, and ensure continued shopper loyalty.
- Retailer iQ, provides tools that allow retailers to influence consumers' behavior in a relevant and targeted manner <u>**when**</u> they are planning their shopping trips. As QUOT explains, "when" is a big deal: "most targeting data tells you what people *were* interested in or bought in the *past*. What makes us different is all the unique data that reveals what people *intend to buy next*. Whether they are searching for product categories, clicking on coupons or adding something to a shopping list app, we capture all that data about *future buying intentions*, and we apply it to target your ads more effectively . . . Our mobile shopping lists . . . help shoppers create lists as they prepare to go to the store. That means we know in real time what products are on their shopping lists, the definition of *purchase intent."*

Given that advertising dollars are most efficiently spent on those consumers with the intent of actually purchasing, all treasure maps in marketing begin with the magic words "purchase intent." Thus, QUOT truly is chasing a big and profitable opportunity - and, from our seats, is doing so without any notably competition. Further, as of Q3 2015, retailers representing ~$350 billion in sales (~50% of the US market) <u>were</u> <u>already</u> <u>under</u> <u>contract</u> for QUOT's Retailer iQ program. Despite the significance of this commitment, slow is the prevailing speed when it comes to change at the cash register - and particularly so when it comes to the retail industry. Thus, delays and lowered expectations sent the stock down ~28% from our cost by year-end, as impatient investors headed for the exits.

That said, slow change isn't always bad news: if retailers are as slow to remove QUOT's products from their all-important point-of-sale platforms as they have been to add them . . . QUOT is well-positioned to benefit. Although we harvested our losses at year-end, don't be surprised if QUOT returns to the portfolio.

"Today is the most difficult day to invest."
T. Rowe Price

As a new fund without an extensive track record, the focus of our previous letters has been to detail *our* investment thesis / rationale for specific companies within *your* portfolio. By design, we have largely avoided espousing on some overarching strategy or theoretical approach to investing . . . if for no other reason than our approach is - in full disclosure - both unoriginal and better articulated by those from whom we have generously borrowed. However, amid continued headlines of a Chinese slowdown, falling commodity prices, and a rocky early opening to 2016, we thought it may be apt to conclude with the "plan" for the Partnership. Let's start with the goal:

The Goal

In the purest form, the goal of this Fund is *outperformance against our benchmark over the long-term*. While making more money than others (and doing so over the long term) is hardly original, there are three points worthy of emphasis:

- **Benchmark**: We benchmark our results against the S&P 500 **Total Return** Index - an index that includes the market returns of the S&P 500 Index *plus* the resulting dividends. By itself, the S&P 500 Index omits the (real) returns resulting from dividends.
- **Outperformance**: The desire for outperformance - and the ensuing greed, envy, and pride - is an important driving factor of markets and their cyclicality. More importantly, outperformance is a *necessary* result for the continued viability of the Partnership - if we can't beat our benchmark, your capital would (logically) be better allocated to passive investment in the benchmark itself.
- **Long-Term**: The reach for outperformance inevitably becomes most problematic at market extremes: when everyone is acting crazily, the only options are to act crazier, or not act at all (i.e., risk underperforming). Unsurprisingly, an unchecked reach for outperformance - especially in the short-term - often results in smart people doing dumb things just to keep up. The solution to this perilous path is to measure over the long-term: you can't do dumb things in the short-term if you also hope to outperform in the long-term. We aim to achieve solid gains in good years, while losing less than others in bad years (even if it means sitting out a mania or two). In the short-term, our ability to beat our benchmark on any given day, week, month, or specific quarter is influenced by any number of factors out of our control and unrelated to the underlying investments in your portfolio.

The Process

More important than stating the goal, is achieving it. To do so, we offer neither magic sauce, nor whiz-bang formulas stored in black boxes. We don't make market forecasts nor pay much attention to those who do. We don't read charts, or even trade with any frequency. Instead, we adopt Ben Graham's advice that the market is there to *serve* us, not *guide* us, and we believe the market *best* serves those who invest in companies not stock prices. Such an ownership mindset (as others have called it) is logically segmented into the following three steps:

- **Thinking Like An Owner:** Savvy owners focus their efforts on understanding the questions of "what" and "why," rather than "when" and "do others agree?" To do so, we utilize publicly available information, broad reading, considerable elbow grease, and old-fashioned common sense to learn and understand a business. We do not try to understand every company or every industry (some are simply above our pay grade). We spend little effort trying to predict / forecast next quarter's earnings or tomorrow's stock **price**. Instead, our aim is to develop a more holistic understanding of the business, specifically:
    a. What does the business do and why does it matter (both today and into the future)?
    b. What drives the numbers?
    c. What will protect the earning power / relevance of this company in the future?
    d. What do the numbers reveal about the company, its competitive position, and the management leading the charge.

    In essence, our process for buying a percentage of a business should be much the same as that employed by a savvy owner looking to acquire the corner bar. Such an owner would spend the bulk of their efforts trying to understand how the business has performed historically, why people frequent said bar, and why (or why not) they may continue to do so in the future. Our theoretical owner would seek to understand the neighborhood and nearby competition, potential opportunities for growth, and any political and / or social realities that may derail / alter their expectations for the business and its potential.

- **Investing Like An Owner:** Charlie Munger said it best, when he declared: "All intelligent investing is value investing - acquiring more than you are paying for." Thus, smart buyers try to buy assets today that will be worth *more* at some future date. Smart sellers (even when distressed) sell today when they think an asset will be worth *less* at some future date. Either way, valuation is *always* the crucial element for all smart buying / selling.

That said, valuation is more of an art than a science. Despite the merits of various valuation techniques, they all *require* the combination of the quantitative (the numbers) with the qualitative (the narrative). In practice this means, two perfectly smart people starting out with the same numbers can end up with vastly different valuations based on the differing narratives they apply. Thus, valuation is less about coming up with a specific "price target," and more about *thinking through* and *understanding* the drivers of value. To the extent thinking like an owner entails knowing what you are buying and understanding why an asset is compelling, investing like an owner leverages this homework as the foundation for determining the narrative and thinking through its various implications.

That said, we generally avoid (but especially so in terms of overall valuation) the financial press's favorite topic of near-term "beats" or "misses" in any one quarter - if for no other reason than we (like true owners) expect to own a business for a period spanning *many* quarters.

- **Acting Like An Owner:** In many ways the discipline to act like an owner is the hardest step simply because it is so psychological. It's normal to look at an investment and feel validation as the price climbs, or self doubt as the price declines. It is natural to hear expert opinions or popular consensus and wonder if they know something you don't, or if it is just easier to assume they do and act accordingly. Groupthink, self-doubt, and the need for validation are at the very core of human psychology . . . and bad investment results.

  All great investing necessitates the combination of conviction, humility, and discipline. Conviction is the hard-earned result of the painstaking / slow work required to understand what you are buying and what it is worth. Humility is the recognition that it is never possible to know everything, and few things unfold *exactly* as planned (so plan accordingly). Together, all the conviction and humility in the world are of little help without the discipline to seek perspective among noise, prioritize value over price, and invest based on what you know to be true irrespective of popularity. That is how you act like an owner.

We recognize such an approach may sound overly simplistic, or just old fashioned compared to the more speculative, high-tech, or formulaic approaches adopted by others. We also fully admit that our investment approach is both unoriginal and often better articulated by names far bolder than ours. Nonetheless, we believe an ownership mindset is most compelling precisely because it is so rare.

In Closing

The Fund continues to seek investments in companies we understand and at prices we believe are below our best guess of intrinsic value. 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 investment approach.

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

Past performance is not necessarily indicative of future results. The performance data presented represents that of Pomeroy Capital Partners, LP (the "Fund"). Performance results represent fund-level returns, and are not an estimate of any specific investor's actual performance, which may be materially different from such performance depending on numerous factors. All performance results are estimates and should not be regarded as final until audited financial statements are issued.

Performance results have been compared to the S&P 500 Total Returns Index (the "Index") for informational purposes only. While this Index is widely used as a proxy for overall market performance, we offer no guarantee that the Index will always reflect an appropriate benchmark for the Fund whose holdings, performance and volatility may differ significantly from the securities that comprise the Index.

Specific companies or securities discussed in this presentation are meant to demonstrate the investment style and types of industries and instruments in which we invest, and are not selected based on past performance. The analyses and conclusions contained herein include certain statements, assumptions, estimates and projections that reflect various assumptions concerning anticipated results that are inherently subject to significant economic, competitive, and other uncertainties and contingencies, and have been included solely for illustrative purposes. No representations, express or implied, are respect to any other materials herein. The Fund may currently, or in the future, buy, sell, cover or otherwise change the form of an investment in the companies discussed for any reason, and without any obligations of notice.

All investments, including those in the Fund, involve risk including the loss of principal. All information is provided for informational purposes only and should not be deemed as a recommendation to buy or sell securities. RLT Capital LLC ("RLT Capital" or "RLT") is an investment manager engaged in providing discretionary investment advisory services to its proprietary private investment funds (each a "Fund" collectively, the "Funds"). This transmission is confidential and may not be redistributed without the express written consent of RLT Capital, and does not constitute an offer to sell, or the solicitation of an offer to purchase any security or investment product. Any such offer or solicitation may only be made by means of delivery of an approved confidential offering memorandum.