April 20, 2015

Dear Partners:

The Fund finished the first quarter of 2015 with returns of 12.09% before allocation[1] to the general partner. By comparison, the S&P 500 (our benchmark) finished the quarter with returns of just 0.95%.

As of the quarter end, the Fund's portfolio consisted of 7 positions with Apple (AAPL) and Verisign (VRSN) still remaining our largest holdings to date. Because we prefer to know everything possible about the investments we make, and because good ideas are rare, the Fund maintains a concentrated portfolio by design. However, we began taking steps in the new year towards our (arbitrary) goal of 8-10 investments weighted according to investment potential and overall confidence in each investment thesis. In practice, this resulted in a bit of movement in the quarter resulting in a slight reduction to our large AAPL position, an increase to our VRSN holdings, and the addition of Marchex (MCHX), Dreamworks (DWA), and Civeo (CVEO) to our portfolio.

That said, quarterly performance was mainly a team effort with continued significant contributions from our two largest holdings AAPL (up 12.7%) and VRSN (up 17.5%). Even so, the MVP of the quarter was likely DWA, which was added early in the quarter and returned 13.6% for the Fund by quarter end. Of course, not everything was up in the quarter with MCHX, Zynga and Entravision finishing flat / slightly negative, and continued pain (hopefully short-term) by our return to the altar with CVEO.

One constant across all three new additions this quarter was the theme of quality assets overshadowed by *current* earnings disappointments / fears. Wall Street's singular focus on earnings is often taken to an extreme as near-term earnings disappointments / concerns are met with significant (and rapid) declines in market values. Sometimes, such short-termism becomes so severe that a company's tangible assets are either forgotten or sold at a discount due to the rapid stampede for the exit and current nervousness. Needless to say, such situations can be especially fertile ground for long-term investors eager to buy quality assets at discounted prices. Accordingly, we would be hard pressed to offer a better example of current fears and severely discounted assets than the case of MCHX:

Marchex

At first glance, MCHX is a small-cap tech company with $0 in debt, more than 50% of market value in cash, substantial management ownership, and two business segments.[2] This optimism soon turns into skepticism as you notice a history of losses, overly generous stock compensation, and the ample uncertainty surrounding their much hyped "technology platform" and "mobile advertising" leadership.

While we agree there are reasons for concern surrounding the future prospects of MCHX's call-driven segment, we simply don't think it matters. In fact, we believe the second business segment (Archeo) is the true gem of this company; and by itself, eliminates most (if not all) long-term risk of capital loss in this investment. For this reason alone, we have happily plucked MCHX from the clearance rack.

Smile and Dial

Before diving into Archeo, lets start with with the segment that seems to get the most spotlight by management and investors: the "call-driven" business segment. In an effort to leave no buzzword behind, management trumpets that:

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[1] No management fee and a performance fee of ¼ of gains in excess of 6%

[2] Despite profitability at both segments, MCHX has reported net losses in 3 out of the last 5 years primarily due to stock-based compensation, impairment charges, and taxes.

"our technology platform delivers performance-based, pay-for-call advertising across numerous mobile and online publishers to connect millions of high-intent consumers with businesses over the phone."

If that leaves you scratching your head, worry not, for we brought our shovels to translate: MCHX provides mobile-focused advertising and analytics on call-based advertisements / transactions. In other words, MCHX aims to tell advertisers where a call originated (website, or some other advertisement), what keywords were most relevant, and what happened when the consumer was on the call (how long were they on hold, did the caller convert, etc).

The business case to untold riches goes something like this: telephone calls are important drivers of sales,[3] mobile search and calls from search are growing rapidly, performance-based measurement will increasingly be applied to call-based marketing, understanding calls and call-relevant performance metrics is complex, and MCHX has the (unique) solution(s) to meet this "growing" need.

Indeed, the recent increase in mobile usage has resulted in impressive revenue growth for this segment, growing from just $47 million in YE 2010 to $168 million at YE 2014. Better yet, mobile's growth arrived just as the prospects in the other business segment, Archeo, were beginning to deteriorate. Accordingly, call-driven revenues have rocketed from just 48% of total revenues at YE 2010 to a whopping 92% as of YE 2014.

Unfortunately, soaring revenue tends to be less impressive when very little of it makes its way to the bottom line. Despite significant top-line growth, the call-driven segment continues to stutter out dismal profit margins in the range of 4-6% over the last three years: $168 million in YE 2104 call-driven revenue resulted in a paltry $11 million in actual profits (and that is a 2% improvement over the last two years!).

Perhaps even scarier than MCHX's tiny margins is their extreme reliance on a small handful of customers: in 2014, just 5 customers accounted for 62% of total revenues. The 2nd largest customer, Allstate, accounted for a full 24% of 2014's revenue and parted ways in Q3 2014. With the existing contracts of their largest customer, Yellowpages.com, set to expire in June of 2015, this could continue to be a tough year for the call-driven segment.

All things considered, MCHX's call-driven technology could be the future, and this future could be very profitable . . . but, it could also be a total bust / prolonged slog with dismal profits. Clearly there is some smoke in the air, and most investors (ever fearful of a fire) long ago abandoned ship.

In the off chance that smoke becomes fire, remain calm: there are two ships in this sea, and great safety can be found in the slow and steady ship named Archeo.

Archeo

Whereas the call-driven segment is a bet on growth in an uncertain future, MCHX's second segment (Archeo) is more analogous to a bet on the enduring asset values for a portfolio of real estate. Of course, there is a twist: this giant portfolio contains *digital* real estate in the form of ~280,000 domain names. While the notion of digital real estate may seem a bit strange to the senior citizens among you, we believe the value is both very real and terribly misunderstood.

To understand why this opportunity exists, it helps to briefly explore how assets are valued. In particular, there are really only two valuation approaches: intrinsic and relative valuations. Intrinsic valuations start with the premise that all assets are worth the sum of the cash flows generated by such asset. Thus, assets with high and predictable cash

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[3] particularly so in high-value categories, such as professional services, financial services, automotive and travel where transaction values are large, complex, or require additional information prior to completion

flows are valued higher than assets with low and unpredictable cash flows. In the more common (and less quantitative) approach of relative valuation, assets are valued simply based on comparable prices of similar assets. Using the relative valuation approach, a house is worth $1 million dollars simply based on sale prices of comparable houses.

Applying either of these frameworks to Archeo's portfolio of domains is - at best - only partially helpful. Here's why:

- Intrinsic valuation requires an understanding of an asset's cash flows. In the case of domains, there are two main sources of cash:
    - Advertising - While there was a time when Archeo's domains did produce significant (and reliable!) advertising revenue, those days appear to be solidly in the past. In terms of intrinsic valuation, this results in declining cash flows and lower valuations.
    - Domain Sales - Despite declining ad-revenue, domains still retain significant resale value. Domain sales (accounting for a small percentage of the total portfolio) were $6.3 million in 2012, $6.2 million in 2013, and $7.3 million in 2014. Yet, these sales are of little help in determining an intrinsic value simply because of uncertainty regarding the final price or actual timing of future domain sales.
- Relative valuation requires comparable data points, which - once again - proves only partially helpful:
    - A quick look at comparable data helps to determine insights such as .coms are generally worth more than .nets, shorter domains are generally more valuable than longer domains, two-word domains are usually better than five-word domains, and domains in the English language are normally more expensive than domains in any number of lesser-known languages.
    - Unfortunately, comparable data offers little insight into the very specifics which often make all the difference in domain sales. For example, comparable data will be of little help in determining whether joesburger.com is worth more or less than jimsburger.com. Moreover, even if comparable data helps you to determine that socks101.org is likely worth less than a gem such as insurance.com, you will still be left in the dark on the only two questions that matter: when will it sell, and for how much?

With only partial answers from traditional valuation approaches, a more practical approach may be to focus on the one thing we do know for sure: the price we paid! With a market cap of ~$180 million dollars, $0 in debt, and ~$80 million in cash, our investment in MCHX was made at an enterprise value of ~$100 million dollars. Ignoring everything else, we can simply divide the $100 million we paid by the number of domains we received, to arrive at the only question that matters:

On average, is Archeo's portfolio of domains worth more than ~$360 per domain?

In short, we think the answer is a resounding yes. Consider the following:

- Marchex paid ~$164 million to acquire the bulk of the domain portfolio (~200,000 domains) in 2004, and has grown the portfolio (despite some domain sales) to today's level of just over 280,000 domains.
- Archeo's most popular selling domains are 12 characters long, contain two words, and have an average selling price of $22,000 per domain. There are 65,283 two-word domains in the portfolio.
- 17,445 of the domains are categorized as "select" domains which Archeo describes as "typically 1-word 'category killers' or domains that contain popular search terms." These domains range in price from $20,000 to $5 million dollars each, with the overall average sales price for these "select" domains clocking in at $75,000.

Of course, we have no illusions (although one can dream!) that the above average selling prices can realistically be applied to *every* domain in the portfolio or even some large percentage thereof. Instead, we expect management will steadily work to monetize this portfolio at levels significantly in excess of the market's current expectations. Either

way, our investment in MCHX was made well below our most pessimistic estimate for the domain portfolio irrespective of any future potential for the call-driven segment and the inevitable bumps in the road ahead.

In Closing

May 1st will mark the one year anniversary of the Fund, and absent a substantial market downturn, we expect to finish the year strong. However, our goal has always been outperformance of the S&P 500 over the long term; that is, a period spanning several years and ideally through both up and down markets. Thus, much work remains.

Along the way we will continue to report performance on a quarterly basis mostly because everyone else does, not because an up or down quarter is indicative of any true value or strength of the underlying portfolio. 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 always be as timely (or painless) as it has been in the past year. Because long-term gain almost always entails some short-term pain, it is all but certain we will experience turbulence at some point in the future.

As always, thank you for entrusting us with your investment and please rest assured that we remain hard at work to make you both rich and proud in the many years to follow.

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

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