February 27, 2019

Dear Partners:

Amid fears of continued Fed tightening, elevated trade tensions, slowing global economies, and persistent political/government uncertainty . . . Q4's shift in market sentiment was as swift as it was broad. In their indiscriminate race for the exits, investors left few stones unturned. By year-end, US stocks experienced their steepest annual declines since 2008, and few other asset classes offered much reason for celebration.

With few places to hide, ***none*** of the Fund's positions proved immune from Q4's market sell-off, and two of our larger positions suffered especially severe declines. Given this combustible combination, the Fund limped across 2018's finish line with a serious case of whiplash, and losses of (20.51%) for the year:

	1H 2018	Q3 2018	Q4 2018	FY 2018	Since Inception (5/1/14)
Fund	2.70%	9.98%	(29.62%)	(20.51%)	49.44%
S&P 500 TR	2.65%	7.71%	(13.52%)	(4.38%)	46.57%

With the Fund's long-term mandate in mind, we spent much of the fourth quarter reassessing the merits underlying each position, researching new opportunities, and repositioning accordingly:

- Where losses exceeded our optimism/patience, we gulped hard and booked the loss,
- Where gains exceeded our optimism, we trimmed or closed positions, and
- Where optimism persisted despite mounting losses, we did our best to catch whatever knives merited catching.

During the second-half, the Fund:

- exited our positions in American Airlines, General Electric, and Sprouts Farmers Market,
- initiated positions in Credible Labs, Facebook, and Southwest Airlines,
- trimmed our position in Under Armour, and
- increased our existing exposures in Apple, Entravision, Quotient, and Verisign.

In the long-term, there are only two times when prices matter: when we buy, and when we sell. With that in mind, the risk that today's prices *might* decline tomorrow is not the sort of risk that should keep long-term investors (such as the Fund) awake at night. That said, when it comes to short-term scorekeeping, the only thing worse than broad declines across a broad portfolio are quotational implosions to large positions. Unfortunately, two of the Fund's larger positions provided a costly case in point during the fourth quarter:

Between the start of Q4 and Christmas Eve, Apple's shares fell by ~35% - evaporating more than ~$400 _billion_ in market value.	Shares of Spanish broadcaster Entravision fell by more than ~50% within just 28 trading days during Q4.

Whether the above declines constituted calamity or opportunity, depends - *as they say* - on your perspective:

- For those aiming to outperform *all of the time,* the case for calamity was as clear as it was costly: we could have sold Apple and/or EVC at the beginning of the fourth quarter, and would have been (much) richer for doing so. Duh!
- For those aiming to outperform *over time*, the sheer magnitude of the price declines meant two of our highest conviction ideas were suddenly among the most severely discounted. As opportunities go, these declines were tantamount to stumbling upon something we know, understand, and like . . . in the clearance aisle!

Absent a viable means of *trading* in hindsight, we seized the opportunity to trade short-term pain for long-term gain, and increased our investment in both positions. Without further ado, let's revisit the reasons why we were happily buying while others were frantically selling.

Apple

As many of you are likely aware, Apple spent much of 2018 flirting with - then exceeding - a market value of $1 trillion dollars. Just three months after a torrent of headlines celebrated this artificial milestone, Apple's narrative quickly reversed course:

> *"Apple! A year ago analysts were tripping over themselves to raise their price targets. This year, they're tripping over themselves to lower their price targets. A year ago, the stock was flying to the moon. This year the stock has taken a serious tumble back to earth . . . Apple has been getting hammed on numerous reports that it's cutting back orders for iPhones based on supply chain chatter . . . As a steady stream of reports about Apple cutting iPhone orders leaked out, the conversation shifted to 'what's wrong with Apple?' . . .*
>
> *We believe there are three fundamental reasons for the shifting perceptions of Apple:*
>
> 1. *The stock fell 40% from its high. Companies can talk all they want about not caring about stock prices, but the truth is, it's bad for a brand to have a stock crater. It suggests something is wrong with the company.*
> 2. *Apple's growth rate has tanked. . . . For years Apple had high double digit growth . . . The population available to buy an iPhone is thought to be limited now, thus sending Apple's growth rate tumbling.*

3. *Apple no longer has a marketing and product genius running the company. Steve Jobs was known for his ability to create a 'reality distortion field' around Apple and its products. Tim Cook is not.*

. . . So, yes, Apple's growth has slowed and its stock has tumbled. But those are just facts."

To the extent the above excerpt[1] succinctly captures the "facts" underlying Q4's rapid shift in market sentiment, it also helpfully explains the current sense of déjà vu experienced by long-time observers of Apple. After all, the above quotes all came from an article published in March of 2013 . . . Cheap trick for sure, but nonetheless illustrative of the similar sky-is-falling hysteria that beset Apple in the final months of 2018.

Then, as now, bears bemoaned Apple's reliance on the iPhone franchise - convinced slower growth and lower margins were the inevitable result of looming saturation in the smartphone market, inevitable difficulties of international expansion (especially China), and/or the ever-present threat of fierce competition. Despite (some) merit to many of these concerns, Apple nonetheless has continued to make the most of their strong position:

	2013	**2018**
Net Sales:	$170,910	$265,595
Operating Income:	$48,999	$70,898
Net Income:	$37,037	$59,531
EPS (diluted):	$5.68	$11.91

Alas, after years of predicting Apple's best days would soon be a thing of the past, bearish investors eagerly seized on Apple's decision to stop disclosing iPhone unit sales as the canary in the coal mine they had long been (incorrectly!) forecasting. Adding fuel to the fire, persistent concerns about Apple's second biggest source of growth - China - were further amplified by escalating trade tensions and/or fears of a potential slowdown to the Chinese economy.

With a Bloomberg columnist declaring "the optimistic narrative about Apple's iPhone business is falling apart in front of our eyes,"[2] Wall Street's herd was quick to make sure they too were appropriately pessimistic. From optimism to pessimism, Apple's swinging pendulum quickly erased more than ~$400 billion in market value:

[1] Business Insider: Only Thing That Has Really Changed At Apple Is That There's No More Reality Distortion Field
[2] 1.2.2019 Bloomberg: Apple's iPhone Warning Comes Years Too Late

As is the case with all abrupt price movements, context is key. At its apex of ~17.5x FY 2018 earnings,[3] Apple was neither cheap nor anywhere near the nosebleed multiples more commonly found in the land of euphoria. With more than ~$400 billion erased from its market value, Apple's undemanding year-end valuation (~12x 2019 earnings estimates) offered clear evidence the market had shifted from hoping for the best to - once again - fearing the worst.

Just two days into the new year, Apple lowered their guidance for Q1 2019 and confirmed slowing sales in both their iPhone and China segments. When the earnings were finally released (at the end of January), the ~15% year-over-year slowdown in iPhone sales looked downright mild compared to the ~27% year-over-year collapse in Apple's China segment. Amid such bad news, a bit of context is merited:

- iPhones: Even though slowing iPhone sales "disappointed" expectations, Apple ***still*** sold nearly $52 billion worth of iPhones in the last quarter. Among the viable headwinds cited for the iPhone's results: a slowing Chinese economy, longer upgrade cycles, reduced carrier subsidies, and an already pricey product made even pricier by a stronger dollar in several international

[3] Calculation based on FY 2018 EPS (diluted) of $11.91 and an adjusted top tick of $208.95 ($233.47 - $24.52 in net cash & marketable securities per share).

markets. Unmentioned by most, but no doubt a critical headwind, is where the current iPhone models exist in the overall product release cycle for iPhones.[4]

- China: Although it is hard to put a good spin on a ~27% year-over-year decrease, it is equally hard to know how much of this decrease should be attributed to China's slowing economy vs Chinese consumer interest (or lack thereof) towards current iPhone models. Moreover, even *if* lower upgrade activity is driven by widespread disinterest in current iPhone models among Chinese consumers . . . other aspects of Apple's Chinese business suggest consumers are nonetheless remaining firmly within Apple's universe. From the earnings call transcript:

  > Although the iPhone, Mac, and iPad all experienced decreases in China, China "*generated record December quarter Services revenue*" . . . "*fueled by an amazing ecosystem with over 2.5 million registered iOS developers*" . . . and booked "*very strong results from our Wearables business there, with revenues up over 50%"* . . . "*More than two-thirds of all customers in China who bought a Mac or an iPad during the December quarter were purchasing that product for the first time*."

  As smell tests go, it is hard to reconcile the ongoing strength in peripheral products with all the hyperventilating that Chinese consumers may be champing at the bit to abandon Apple for "cheaper competitors."

Negative headlines aside, it wasn't all bad news blues. In fact, the ~19% year-over-year increase in sales across the rest of Apple's product portfolio reaffirms the iPhone's effectiveness as Apple's chief-salesman:

Net Sales By Product Category	**Q1 2018**	**Q1 2019**	**Δ (%)**
iPhone	$61,104	$51,982	-14.93%
Mac	$6,824	$7,416	8.68%
iPad	$5,755	$6,729	16.92%
Wearables, Home, & Accessories	$5,481	$7,308	33.33%
Services	9,129	10,875	19.13%
Total Net Sales	**$88,293**	**$84,310**	-4.51%

Without a doubt, Apple will hardly be immune from the revolving cast of boogeymen breathlessly touted by skeptics. Indeed, boogeymen such as smartphone saturation, widening upgrade cycles, competing products, fluctuating macroeconomic conditions, etc. are as problematic as they are inevitable. While we harbor no illusions that Apple will prove immune from such challenges, we believe the market's stubborn

[4] Generally speaking, Apple releases iPhones in a two-year product cycle wherein the phone released in the second year often contains only slight improvements/tweaks to the prior year's model. Accordingly, this year's iPhone models are basically only slight improvements of last year's (blockbuster) iPhone X.

fixation on all-things iPhone obscures the bigger picture. As we see things, Apple's future is less about trying to sell ever-more iPhones, and more - *much more* - about using the iPhone to capture ever-increasing wallet share of users' computing dollars.

In fact, signs that Apple's wallet share is expanding can be found throughout their last earnings conference call:

- "*We had our best quarter ever for Mac revenue . . . our active installed base of Macs reached a new all-time high and half of all the customers purchasing Macs in the December quarter were new to Mac*."
- "*iPad revenue was up 17%, its highest growth rate in almost six years . . . our installed base of iPads reached a new all-time high, and among customers purchasing iPad during the quarter half were new to iPad*."
- "*We also had our best quarter ever for Wearables, Home, & Accessories with 33% growth in total, and almost 50% growth from Wearables, thanks to strong sales of both Apple Watch and AirPods . . . both of which were supply constrained as we exited the quarter*."
- Although growth in Services revenue was slightly less than some analysts had hoped, there was still plenty to like: "*The level of engagement of our customers in our ecosystem continues to grow. The number of transacting accounts on our digital stores reached a new all-time high during the quarter with the number of paid accounts growing by strong double digits over last year. And we now have over 360 million paid subscriptions across our Services portfolio, an increase of 120 million versus a year ago . . . we now expect the number of paid subscriptions to surpass 0.5 billion during 2020*."

Apple's iPhone customers will eventually upgrade and will eventually buy new computing technology. And when they do, the overwhelming majority will remain religiously loyal to Apple. Simply put, although the vast majority of the iPhone's large installed base certainly doesn't upgrade as frequently as we (or Apple) would prefer . . . if you can't have frequency, you especially want loyalty. In this sense, our view remains unchanged: as the iPhone's large installed base of ~900 million satisfied customers continues to expand Apple's wallet share, we remain confident our wallet will continue to reap the benefits.

Entravision

Irrespective of the *many* headwinds affecting the broader broadcasting industry, Entravision (EVC) is stronger now - by just about any measure - than in years past. Nonetheless, Spanish broadcaster EVC spent much of 2018 - and especially Q4 - changing hands well below even the most conservative estimate of asset values.

While we have discussed EVC in previous letters, a bit of a refresher is likely helpful. In addition to EVC's 49 radio stations and ho-hum collection of digital marketing assets, EVC's primary source of asset value derives from its portfolio of 55 TV stations. As a timely illustration of the latent value within these

TV assets, EVC received ~$264 million in exchange for the spectrum usage rights of just 4 stations in the FCC's recent spectrum auction (as last chronicled in our YE 2017 letter).

These days, EVC retains full spectrum ownership on the remaining 51 stations within its TV portfolio, but nonetheless was changing hands at an enterprise value of just ~$320 million in Q4. Even if the radio and digital assets prove as worthless as some suspect, EVC's 51 TV stations (with spectrum usage rights intact) were changing hands at just ~$6.3 million ($320 million / 51 stations) each during Q4. This substantial gap between price and value provides the sort of wide margin of safety necessary to mitigate everything else we dislike about the company.

Among our main dislikes, the following factors necessitate (and perhaps even justify) EVC's substantial margin of safety:

- **Digital Segment**: Most investors (us included) simply do not believe a sprinkling of digital pixie dust will deliver meaningful (read: *profitable*) growth. A dash of digital investment here and there seemed tolerable enough, but absolutely *nothing* is scarier than Walter Ulloa's (EVC's CEO) stubborn flirtation with further digital investment! With underwhelming results to date, it is hard to find much excitement for continued digital expansion that is expensive, unprofitable, and actively adding risks to the overall thesis. Foremost among such risks:

    - Risk that management's thesis that the "latino market is too puny for the giants to compete," is as wobbly as it is naive,
    - Risk that the digital segment is unavoidably exposed to the whims and changing search methodologies of dominant search portals,
    - Risk that current management lacks the expertise needed to realistically compete in the uber-competitive field of digital advertising (no offense, but a former Facebook "global compensation manager" simply does not a techie make),
    - Risk that management is operating well outside any obvious circle of competence, and/or
    - Risk that management is nonetheless intent on making further investments.

  As evidenced by the persistent gap between underlying asset value and current enterprise value, leery investors are applying an *ever-expanding* discount to account for the perceived risks stemming from the digital expansion. Although we are no fan of EVC's CEO (more on him below), his position as the company's largest shareholder thankfully means no one feels the sting of EVC's anemic stock price more than him. This reality sets up three possible scenarios:

    - Worst Case Scenario: Continued digital investment is as value destructive as many investors fear. This value destruction erodes our wide margin of safety and makes Mr. Ulloa - and us - poorer.
    - Tolerable Scenario: Mr. Ulloa doesn't like being poor and/or doesn't want to be the guy who squanders his life's work on flirtations with digital technologies he doesn't fully understand. In this case, he hopefully takes a more measured approach - walking before

he runs. After all, delivering profits from current digital assets would send a powerful message to us naysayers that the road might be less perilous than many fear.
    - Wishful Thinking: Perhaps all of us nayers will eventually be proven wrong about the prospects of the digital segment. Stranger things have happened . . . If so, that will be good news for both Mr. Ulloa *and* the Fund.

- **Walter Ulloa**: Mr. Ulloa's voting control empowers him - above all others - to act both proactively and opportunistically.[5] That is the good news. The bad news is Mr. Ulloa doesn't exactly have a compelling track record of savvy/opportunistic moves. Not to throw mud or anything, but Mr. Ulloa is surely a classic candidate for what Dan Loeb once dubbed "Chief Value Destroyer." With that in mind, when it comes to Mr. Ulloa and his management team, our view remains unchanged: "expect the worst and you won't be disappointed."

  The underwhelming leadership of Chief Value Destroyers rarely comes cheap, and Mr. Ulloa is no exception. Per the proxy, Mr. Ulloa took home total compensation of ~$4.2 million (~1.6% of Q4's market value) for his "achievements" in 2017. Just three months later, shareholders learned the one thing Mr. Ulloa failed to achieve in 2017: the timely preparation/filing of the 10-k. And when the financials were finally filed, shareholders learned that the Headway acquisition (i.e, the digital segment) had resulted in:

  > *"a significant increase in the volume of complex accounting matters and the number of control activities necessary to properly present consolidated results. We did not have sufficient account resources and personnel . . . Accordingly, management has concluded that this control weakness constitutes a material weakness. Management has further concluded that, in light of the material weakness described above, we did not maintain effective internal control over financial reporting as of December 31, 2017 . . ."*

  Said differently, the digital segment had indeed resulted in elevated risk. Within a month, this "whoopsie" wiped off more than ~23% from EVC's market value. Ruh-roh!

  Even more audacious than Mr. Ulloa's robust compensation (especially so in light of these reporting deficiencies), is the fact that he still enjoys a $24,000 annual automotive "allowance?!" That this compensation bonanza was received amid control weaknesses - and necessary belt tightening within the radio segment - is bad form at best, egregious self-dealing at worst. While we genuinely do ***not*** mean to be hostile, that sort of self-serving hubris doesn't merit the effort diplomacy requires.

  Moreover, Mr. Ulloa's position as an officer dictates a fiduciary duty to all EVC shareholders. Despite this fiduciary duty, his actions (e.g., bloated compensation, dividend preference, etc)

[5] Mr. Ulloa is both the largest shareholder and the controlling shareholder due to the 10 votes per share afforded by his ownership of EVC's super voting B shares.

> often seem particularly - almost unmistakably - skewed in his favor. In a letter sent in December of 2018, we informed Mr. Ulloa (and his docile board) such self-dealing was certainly not going unnoticed . . .

Although we fully recognize EVC's thesis isn't without a wart or two, we continue to believe it is priced as though it is missing a limb or two. Along those lines, we believe EVC's margin of safety is sufficiently wide to mitigate many (perhaps even all) of the risks to our investment over the long-term. That said, we remain vigilant for any indication that EVC's Chief Value Destroyer may be destroying more asset value than we expected, and/or can prudently stomach.

In Closing

With long-term outperformance as our founding goal, the Fund continues to employ an ownership mindset to assemble a portfolio of businesses we understand, want to own, ***and*** believe can be purchased for a fair price. The desired result is a portfolio of 8-15 investments - concentrated according to conviction, underlying value, and return potential.

As we have often sermonized in the past, this straightforward approach works *over-time* precisely because it doesn't work *all of the time.* While we certainly did not foresee the severity of Q4's price declines, and absolutely did not enjoy the impact to our short-term scorekeeping . . . we remain confident the Fund's performance should be very satisfactory over the long-term.

May 1st will mark the five year anniversary of the Fund. To each of you who have supported us along the way, a sincere thanks for all of the trust and encouragement. As always, please feel free to email or call with any questions or concerns.

"Here's something to think about: How come you never see a headline like 'Psychic Wins Lottery'?"
Jay Leno

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