October 20, 2015

Dear Limited Partners,

The fund endured its first "down" quarter in over two years, but is up just over 4% for the year through September 30 after all fees and expenses. This compares favorably to the S&P 500 that is down more than 5% over the same period. When considering our fund's performance year to date, I would like to highlight two items of note. First, with the fund's six percent hurdle rate, as of September 30 investors have not accrued any performance fees in 2015. Second, as the largest investor in the fund, my family took the same losses in the quarter as you did; we are in this together. This will not be the last down quarter. We will have more down quarters and years and sustained periods of under-performance in the future. However, as long-term investors, we view the volatility as a creator of opportunities which we try to seize. Nothing happened this quarter to make me believe that markets are efficient. I continue to believe that our small size and broad investing universe provide ample opportunity to generate substantial returns over the long term, even with down quarters and years along the way.

I want to take a moment to put the performance in context. Unfortunately, investors who joined the partnership this quarter are "down" on their initial investment through September 30th. You will pay no fees until wee exceed our 6% annualized hurdle rate. Unfortunately, investing is rarely just a straight line up. The year to date out-performance of 9% (+4% vs -5%), if sustained, would be heroic because of the power of compounding small differences over long periods. $1 that earns -5% per year over 30 years shrinks to $.21 while a dollar growing at 4% a year grows to over $3.24. This is a 15X difference. To be clear, the vast majority of funds don't generate any out-performance, and I am not promising 9%, but what appears to be a ho-hum absolute performance number is very meaningful on a relative basis. With a long bias we will typically go down with the market, but a little bit of out-performance over an extended period of time will have a huge impact on the where we end up in the long run.

A TALE OF TWO COMPANIES

Charles Dickens wrote the famous opening sentence to the *A Tale of Two Cities*,

> "It was the best of times, it was the worst of times, it was the age of wisdom, it was the age of foolishness, it was the epoch of belief, it was the epoch of incredulity, it was the season of Light, it was the season of Darkness, it was the spring of hope, it was the winter of despair."

I don't think the situation that I am about to describe quite lives up to Dickens' description, but as a long/short fund, we are trying to own (be long) high-quality companies and sell (short) low-quality companies. It sounds easy in theory. Even my three-year-old daughter gets the idea of keeping the good and giving away the bad. She would like to be long lollipops and short veggies. However, in practice when it comes to investing, lollipops are hard to find and when you try to feed the veggies to the dog you can have your hand bitten. Below I am going to describe a company that we were long and a company that we were short at a moment in time – August 31. These

letters rarely discuss shorts in detail or by name, but I think this discussion is illustrative of the differences in quality of the companies we are long versus those that we are short, and how those differences may not be reflected in price over a short time period. Here we go.

We will start with the "short." This will be interactive. What would you pay to purchase 100% of the following company? I mean the most? The most – like you had a billion dollars sitting in the closet? The company has two employees and declining revenues; last quarter the revenues were $44,000 (no zeroes missing) down from $81,000 a year ago. The company has not been aggressively investing in R&D. In the first six months of 2014, the company spent a grand total of $38,928 on research and development. The company's marketing budget for the first half of 2015 was $9,047 or just over $1,500 a month or $400 a week (again no zeroes missing). The company operates within the technology industry with much better-funded competitors including Citrix and Logmein, not to mention Microsoft. Do you have a maximum number you would pay for this operation? I assume the amount of cash they have may factor into your valuation. The answer is less than $5M. Some people will ask, "do they have valuable patents?" The answer is no. Ok – what would you pay? Most people conclude cash + $10 or $20 million would be pretty generous for a company with almost no revenue that is losing money and has little chance of making money real money in the foreseeable future.

Our "worst of times" company being described above is Code Rebel (CDRB). At the end of August, the shares were priced over $14, providing a market capitalization (the amount required to buy the whole company) just shy of $200M. Anyone want to argue markets are efficient? The fact is even if Code Rebel did have a good product, and all indications are they do not, they don't have a sales and marketing infrastructure, and they don't have a support infrastructure. Companies are comprised of people working together. Success is reliant on the pieces coming together. There needs to be an offering, the offering needs to reach the market so that it can be sold, and the offering needs to be supported going forward. As best I can tell, Code Rebel has none of the attributes required to build a long-term business. However, they do have a stock hype machine. Press releases are their specialty. They have a video with a "futurist" who speaks of how the Code Rebel solution solves problems that vexed him while at Apple. He leaves out the part that he left Apple in the 1980s. The one press release they did not put out recently is for their earnings. Their earnings had no conference call and no press release – just a quiet Friday night filing with the SEC. I think it is very likely that almost everybody who owns Code Rebel stock has not bothered to open a single SEC filing like a 10Q that showed actual sales numbers or details on the business. We will return to Code Rebel in a minute.

Admittedly, our "best of times" company is not as great as Code Rebel is terrible, but the company has become our largest position, and we actively purchased shares during the quarter. The company is Fortress Investment Group, which we have been involved with for several years. Fortress Investment Group is a global investment management firm, specializing in alternative

investments such as private equity funds and hedge funds, but with a significant fixed income business. Fortress' management is very well aligned with common shareholders. More than 50% of the company is owned by insiders, and their compensation is tied to the performance of the funds that they manage. Strong performance leads to growing AUM, and thus management fee and performance fee growth.

The funds Fortress manages are divided into several lines of business: private equity funds, hedge funds, credit hedge funds, permanent capital vehicles and fixed income (Logan Circle). The asset management business has very attractive economics. The business scales well as assets can often be added with very little extra expense. In the case of Fortress, they earn money in two ways: management fees and performance fees. Fortunately, the management fees for Fortress represent a very stable stream of recurring revenue. The fee varies by fund and asset class, but is generally between 1% and 1.5% of the AUM (lower for fixed income). In my opinion, investors who have been selling shares of Fortress are very focused on short-term loss of performance fee revenue from their hedge fund business, and have lost sight of the quality of the underlying business and the management fees that it generates. Fortress has a very healthy asset management business that is raising record amounts of capital. Of particular note are the permanent capital vehicles. These are publicly traded and Fortress has been growing them through public offerings: NRZ, NCT, SNR, NEWM, ECT, FTAI. This is an exciting long-term growth opportunity for the firm as these vehicles typically earn 1.5% management fees as well as25% incentive fees subject to a hurdle of 10% or less. So far this year, they have raised $2.4B, bringing the total managed to $7B. The "permanent capital" moniker is a bit misleading as Fortress can be replaced as the manager with enough shareholder votes – and there have been activist rumblings in different vehicles – but at a high level, this is an incredibly attractive business. It has the same fee structure as private equity with a much longer expected fund life.

Fortress is not without its challenges. The company rarely fires on all cylinders, and there is always a problem child or two. This year, the Hedge Fund division performance has been terrible. There are no performance fees anywhere in sight and there will undoubtedly be redemptions. As a point of reference, last year the performance fees on the hedge funds were $16M vs. management fees of $137M. It seems clear that this $16M in hedge fund performance fees were not driving Fortress earnings when one considers that on a firm wide basis investment management and performance fee-related revenue was $1.1B in 2014.

This quarter was the first time that we were buying aggressively in years and it was entirely valuation driven. The opportunity became more asymmetric as the price declined closer to the cash and investments. As of August 31, the shares were off more than 30% YTD. The share price has bounced around, but at the end of August, they were trading for $5.80 a share. Over the course of August, shares were available in the $4s and low $5s. As of their quarter end June 30, the company had $2.87 per share in cash and investments and another $1+ per share in embedded

incentive fees. There has been modest deterioration in the value of the cash and investments, but there is on the order of $3.50 in cash and investments per share, or more than 60% of the value of the company.

Our downside is limited here in the long run. In effect the core asset management business is selling for just over $2 per share. With less than 500 million shares outstanding, we are paying just north of $1 billion (net of cash, investments, and embedded incentive fees) for a diversified asset manager with more than $72 billion in assets under management and another $10 billion in capital that can be called from current investors. The company had distributable earnings of 42 cents a share for the first six months – annualized this would be 84 cents – for a stub that is trading at just north of $2. There is a base dividend of 32 cents supported by management fees alone, which implies a 5.5% dividend yield. This has historically increased based on performance fees and realizations. Last 12-month dividends are 62 cents, or over an 11% yield. There are dozens of valuation metrics one could use with the number of moving parts that Fortress has, but one approach is to take the base dividend and apply a 15 multiple to it. This results in a value of approximately $4.80. Then add cash, investments and embedded gains of ~$3.80, and the value climbs to $8.60. Next add the value of performance fees on $38 billion AUM (ex-Logan Circle), of which $16B was incentive eligible at the end of last quarter. Just using a mid-single digit multiple on that would get you to a total value of approximately$11, or almost a double from today's levels.

However, the point here is not that Fortress shares could easily double from here. Rather, the point is that this is a wonderful, sticky business with aligned management, recurring revenues, and scalability, and it is selling for not much more than cash, investments, and embedded incentives despite the fact that the business has real value. This is the type of business we want to own. Yet over the short term (the last six months), we have lost money on Fortress Investment Group. We have used the price decline to increase the size of our position. Over the long term we should be rewarded.

Let's return to our worst of times company, Code Rebel. Code Rebel is a poster child for why individual short positions are less than 2% positions. It started as less than a 1% position. I have little doubt that over a two-year period, shares of Code Rebel will be worth less than $3 per share – and probably a lot less. Through August 31 we got our head handed to us by owning shares of Code Rebel. The shares were up over 100% in August when the market was selling off. This gets into the challenges of shorting – clearly the company was not being valued on any sort of fundamentals. This is unlikely to be a problem over the long term - eventually the lack of sales, product, and team will catch up. To use fancy Stanford Business School language, this is a "terd." However, when we sell a company short, we need to borrow the shares. This is typically not an issue, but In the case of Code Rebel, the cost to borrow the shares has become expensive – at points hitting an annualized rate of more than 90% -thus timing is important. If it takes three years for

the shares to go to zero, we can be right on the eventual price and still lose a lot of money because of the borrow fees. The other reason why we size short positions to be small is that when we are short, we are borrowing the shares. The lender can take the shares back. When the borrow rates are high, it is not unheard of for short sellers to be "bought in." This means the shares are no longer available to be borrowed and we have to buy shares that day, regardless of price. When the cost of the borrow and the risk of being bought in are factored into our "worst of times" Code Rebel short, it goes from being a no-brainer to something we sized very small and approached gingerly. Shares have declined precipitously since the end of August – but it is still a tiny position in the fund.

Over longer periods of time I believe we will make money in both our "best of time" and "worst of time" positions, but two or three months is not a long enough period to measure our success. Unlike an ETF which holds companies indiscriminate of quality, we own/short these companies for very specific reasons.

TOP 5 HOLDINGS

Company	Ticker	Description/Thesis
Fortress Investment Group	FIG	The share price is more volatile than the underlying business. There is downside protection with more than $3 per share in cash and investments and a strong alignment of management interests with common shareholders because management owns more than 50% of the common shares. There is also significant upside from performance fees on the $70B+ in assets under management. The company's move towards raising "permanent" capital through publicly listed vehicles is a very positive development as it eliminates the need to return fee generating capital at the end of a funds life. Fortress listed an infrastructure fund in the quarter raising over $350M.
Interactive Brokers	IBKR	Interactive Brokers is the low cost provider with industry leading margins, room for price increases, growing customer base, and attractive industry dynamics with large banks such as JP Morgan and Goldman Sachs exiting the primer brokerage business for small funds. Accounts continue to grow at 1-2% per month and there is a very substantial "white label" opportunity for the firm. The CEO has built the company from nothing and management owns over 80% of the firm.
American International Group Equity and TARP Warrants	AIG	A leading insurance firm trading at 70% of a growing book value. If the company is able to continue to grow book value and the discount to book value diminishes with the passage of time this has the potential for a multi-bagger return without heroic execution required. The net result is an overcapitalized company with the ability to further reduce debt, pay dividends, and repurchase shares significantly below book value. The warrants are long dated expiring in 2021 and "in the money" representing an attractive risk/reward as the company grows book value and receives improved valuation metrics creeping back to book value.
Halogen Software	HGN (TSE)	A Canadian based software as a service firm with over 2,000 customers and strong customer retention dynamics. A strong balance sheet, high life time value of a customer, insiders owning over 40% of the company and a long runway for growth with more than a dozen potential acquirers for this sub $200M company.
Fiat Chrysler	FCA (BIT)	An auto manufacturer undergoing a turnaround and an expansion led by a world class CEO with strong capital allocation skills. The company has a robust product lineup including model refreshes and line extensions. There is an upcoming spinoff of Ferrari and a longer term opportunity to reduce borrowing costs as Chrysler debt is repaid which "ring fences" Chrysler cash.

Careful readers will notice that RIB software and ChipMOS do not appear in the top five. In the case of RIB, we have not sold any shares, but it dropped out because of share price declines, and we did not add shares as additional assets have come in to the fund. We have added shares of ChipMOS as the price declined but not at a rate significant enough to keep it in the top five.

Over the course of the quarter, we sold approximately half of our position in Straight Path Communications. This is the second time that we have sold shares in the company. Straight Path has been a wonderful investment, and the shares were sold at approximately eight times their purchase price just three years ago. If we hadn't sold any shares, Straight Path would be our largest position. In fact, if new money had not come into the fund and we had not previously sold shares, Straight Path would be more than 25% of the fund at its peak. It is currently a sub-4% position. Straight Path has three assets: cash, a patent portfolio, and a nationwide footprint of wireless spectrum. These assets currently generate virtually no cash, thus it is impossible to argue that current cash flows support Straight Path's $500M+ market capitalization. Straight Path is a lottery ticket type investment because it has a far greater chance of going to zero than a typical investment. It effectively all comes down to the viability of the wireless spectrum. If the spectrum can be used in 5G or future cell phone applications, it has a value multiples of where is the stock trades today. The exact value will be determined by prices the Verizon's of the world are willing to pay as well as how the spectrum is being used. There are primary use cases which are more valuable and secondary use cases which are less critical. Even if the technology becomes viable, the government may open up even better spectrum thereby diminishing the value of the Straight Path spectrum. If the spectrum remains unused, the shares are worth a fraction of today (legal settlements + cash). Given the number of scenarios where the shares sell off more than 75% and the difficulty I have in assessing the technical viability, we are thankful for the multiples we have made on the original investment and have reduced the size of the investment accordingly.

SHORT SIDE

Our short positions remain a very small portion of our portfolio. Over the course of the quarter, we added a short position in the previously discussed Code Rebel. We remain short a telecom services company that is in the process of losing a contract that constitutes a majority of revenue. We profitably covered our short position in our oil and gas "fracker". The individual company short positions remain very small, with no single short position being larger than 2% of the overall portfolio.

ROYCE'S QUIET ROOM

It is funny how rewards and punishments change over time. When we want to punish my 11- and 13-year-old daughters, taking away their cell phones and laptops are the near nuclear option. In that context, it is odd that one of the developments that excited me the most last quarter is my new "quiet room."

Over the course of the summer, Chuck Royce, a small cap investing pioneer, has become an investor in the fund through his personal family investment vehicle. Chuck has been investing for more than 40 years, and through his Royce Funds, is one of the largest investors in the small cap

universe, managing more than $20 billion. Chuck has literally seen it all. He also has a track record of meaningful outperformance that spans decades, which is exactly what I am trying to build. In the course of Chuck's diligence on the fund, he offered me office space in his family office complex in Greenwich. As a value guy, it was impossible to argue with his price – free - but the benefits have extended way beyond a desk and a key. Chuck has become an advisor and a useful person to discuss ideas with. I am really enjoying being in his orbit. The office space he has given me has a small room off to the side that only has a chair in it. For me, it is wonderful. There are no screens of any kind in the room. The room is dead quiet. I can read and read and read without distraction. The truth is, I have trouble staying in the room for too long, but I am getting better at it. When investing over the short term, it is possible to have strong performance and weak process – some call it luck. Over the longer term, I don't see a way to have sustained out-performance without a superior process. I think our process just got stronger with the inclusion of Chuck Royce as an advisor and sounding board and the addition of an improved environment that includes a quiet room. Hopefully over time performance will follow. I never thought I would be this excited by a quiet room.

FIDELITY AND EVOLUTION

Over the course of the quarter, we were able to set up everything on the backend for an investment in our fund to occur through Fidelity. It still requires being an accredited investor and additional paperwork (shocker), but it can be done. We owe a thank you to my father-in-law who served as the guinea pig. As the fund approaches its fifth birthday, I am considering some changes to the fund such as raising the minimum investment and formalizing the waiving of the management fee. I don't expect the changes to negatively impact existing investors but I may reach out in November or December to discuss.

OUTLOOK

Our friend Mr. Market is acting a bit funny. There was the return of volatility in August and a 10% correction, both of which I think are ultimately healthy. I am finding individual stocks having large day-to-day movements unrelated to discernible fundamentals. This creates opportunity and noise. Fortunately, the U.S. jobs picture is healthy, interest rates remain low, and lower oil prices are putting money in consumers' pockets, which all sets up well for autos and housing which continue to have pent-up demand. Like many, I have guesses as to when the Fed will act and how they will act and how it will impact both the operational aspects of the companies we own as well as their prices. At the end of the day, our investment decisions are not hinging on quarter point moves by the Federal Reserve: they are very company-specific. That is why more than 90% of this letter is dedicated to specific companies and why the opportunities exist. As I ended the last letter…. the angst in the world creates volatility, multiple compression, and buying opportunities for investors focused on companies that are not impacted in any direct way by the crisis of the

month. I remain optimistic. The fund remains by far my largest personal holding, so I am eating my own cooking every single day. Thank you for the opportunity to manage your assets alongside mine and my family's.

Sincerely,

Scott Miller

VIDEOCON D2H (VDTH - $10.65)

Fortunes are often created by going against conventional wisdom. For example, "airlines are not good investments" is a maxim that makes sense to me, given the high fixed costs and volatility of fuel. However, Southwest Airlines was the best-performing stock over a multi-decade period for those willing to do the work to understand the industry, culture, and operations of the company. Unfortunately, I was not one of those people. Similarly, I am currently missing out on some wonderful opportunities in China with companies with real products and real accounting in the world's largest market. In the case of China, trying to separate the real opportunities from the frauds while sitting in the United States feels too hard. Undoubtedly, this laziness or skepticism is creating opportunities for others.

While not quite as tainted as Chinese companies listed in the U.S. via reverse merger, when I hear the term SPAC (Special Purpose Acquisition Corp), my initial reaction is queasiness. I equate SPACs with reverse mergers, which is not quite accurate, but they are related. I cannot think of a single SPAC/reverse merger homerun that I regret missing out on, and if there is a Southwest Airlines equivalent to the SPACs/reverse mergers universe, I am not aware of it. I am, however, aware of dozens of Chinese fraud reverse mergers where the U.S. investor was the dupe. So you say "SPAC," I say "no, thank you." However, when a talented investor like Jake Rosser from Coho Capital devotes three pages in his investor letter to an Indian-domiciled, U.S.-listed SPAC, my curiosity is piqued. Jake only shares his thoughts twice a year – so I read his letters carefully. Jake and company management make a similar case to the one I am going to outline below for a SPAC named Silver Eagle Acquisition Corp that purchased and listed a minority interest in Indian company Videocon d2h (VDTH)

Two very successful U.S. media executives with both cable and international experience were able to raise $300M to find and buy a business. Their SPAC vehicle was called Silver Eagle Acquisition Corp. Shares were sold at $10 per share, and in the event they did not find a business in the prescribed time, the original investors would get their $10 per share back minus some operating and fundraising expenses. Even in frothy markets, raising $300M typically requires a track record of success. For Silver Eagle, the two principals, Henry Sloan and Jeff Sagansky, fit the bill. They have accomplished the following (from the prospectus):

> Mr. Sloan was chairman and chief executive officer of Metro-Goldwyn-Mayer Studios Inc., or MGM. During his tenure, Mr. Sloan revived key MGM movie franchises, including James Bond, Rocky and The Pink Panther, restarted and rebuilt MGM's theatrical and television distribution and marketing units and launched numerous MGM television channels in the United States and internationally. Prior to MGM, Mr. Sloan founded and operated SBS Broadcasting. Beginning with a personal investment of approximately $5M Mr. Sloan transformed SBS, through a series of acquisitions and organic growth, into a leading pan-European broadcaster, with, as of 2005, 16 television

stations, 21 premium pay channels and 11 radio networks, reaching 100 million people. Mr. Sloan oversaw the initial public offering of SBS in 1993 and its eventual sale to private investors in 2005 for $2.5 billion with an equity value of $1.4 billion. Prior to founding SBS, Mr. Sloan served as co-chairman of New World Entertainment. Mr. Sloan led a group that originally purchased New World in 1983 for $2M. Mr. Sloan extended the company's business into television production, ultimately growing New World into one of the largest producers of U.S. primetime television. New World was sold in 1989 for $260M.

Jeff Sagansky brings over 30 years of senior-level media and entertainment industry management experience. Mr. Sagansky currently serves as co-founder and chairman of Hemisphere Capital Management LLC, a private motion picture and television finance company, deploying more than $300 million in debt and equity across four investment funds. Mr. Sagansky was formerly chief executive officer and then vice chairman of Paxson Communications Corporation, from 1998 to 2003, where he launched the PAX TV program network in 1998. Under his leadership, PAX TV became a highly rated family-friendly television network with distribution growing from 60% of U.S. television households to almost 90% in only four years. In addition, Mr. Sagansky drove substantial improvement in the network's financial performance with compounded annual revenue growth of 24% and compounded annual gross income growth of 30% from 1998 to 2002. Prior to joining Pax, Mr. Sagansky was co-president of Sony Pictures Entertainment, or SPE, from 1996 to 1998. While at SPE, he spearheaded SPE's acquisition, in partnership with Liberty Media Corporation and other investors, of Telemundo. Telemundo was sold to the National Broadcasting Company, Inc., for over six times its original investment less than three years later.

What did these talented executives buy with their $300M? After a long search, they settled on a minority stake in an Indian satellite TV company called Videocan d2h. Being a pure play Indian company in itself is interesting due to the political reforms occurring in India and its status as a growing economy with an emerging middle class. Additionally, gaining exposure to India as a U.S.-domiciled investor is no easy feat (http://horizonkinetics.com/docs/Under%20the%20Hood%20What%E2%80%99s%20in%20Your%20Index%20%20Emerging%20Market_FINAL_Sep2015.pdf). There are several very interesting attributes of the Indian satellite TV market that lie at the core of the Videocon d2h opportunity.

Growth: There are 275 million homes in India, 175 million of which have televisions. Of those homes with television, 153 million pay for television either through satellite (55M), digital cable (25mn), or analog cable (73mn), meaning there is a long history of consumers paying for television. Over the next several years, there are expected to be two growth drivers for satellite television. The first is that under a government-mandated digitization drive analog cable boxes will be replaced. The second is continued growth in population and penetration of television into the 100M homes that currently do not have television,

meaning that in aggregate there are approximately 100 million homes up for grabs over the next several years. Videocon d2h is the fastest growing provider in this market, rising from 9% to 20% market share over the last four years.

Consolidation: There are currently six satellite TV providers in India, with Dish TV and Videocon being the top two players. There is no other major market in the world with six providers. The natural state in almost all major markets is two providers. There are obvious economies of scale and savings that will result if the industry consolidates. Consolidation would reduce the risk of aggressive price competition and likely lead to expanded margins as fixed costs are spread across a larger base.

Pricing Opportunity: Unlike the United States where the average cable bill is approaching $100 and consumers are evaluating less expensive options (unbundling), the average Indian cable bill is less than $4 per month for 300 channels. Even in India, this is less than a cup of Starbucks or a trip to the movies. Relative to other emerging markets, Indian satellite TV is an excellent value for the consumer. In China the average cable/satellite bill is $4.50, in Vietnam it is $4.70, and in the Philippines it is $9. Inexpensive satellite TV bills are largely driven by historical competition from inexpensive analog cable. The satellite industry has been increasing prices 5-7% per year. In fact, just last week the company announced a 6% price increase.

Mix Shift: Videocon d2h will see improved revenue per user and profitability as users shift to more expensive digital and 4k offerings. Currently 30% of new subscribers (10% of overall) are taking digital packages, which are 2.5 times more expensive than the standard definition package. Over time, this mix shift, combined with the price increases, will drive operating leverage.

Competition Remains Rational: To date, despite there being six satellite TV providers, the competition has not been as fierce as I would expect. All of the competitors are in similar price bands and compete primarily on number of channels and service. Videocon d2h has benefitted greatly in this environment, growing share from 8% to20%. If/when a competitor decides to compete aggressively on price, there will be a combination of margin pressures and share loss – both of which are negative. The sooner there is consolidation, the better from my perspective.

Effectively, we are riding several major trends. One is that as consumers have more income, they will continue to buy and watch TV (growth), prices will rise over time to be in parity with similar markets (pricing), India will not remain the only satellite TV market with six providers (consolidation), and as people have bigger televisions and more money, they will want better quality (mix shift).

Part of any investment decision is getting comfortable with the "yes, buts…" Initial diligence reveals it is an interesting idea. Almost every investment will have some "buts" which are effectively risks. In the case of an Indian satellite TV company, there are certainly many to address including:

Cord Cutting/Unbundling: Any media investor or reader of the *Wall Street Journal* is familiar with the idea of cord cutting - getting rid of the expensive monthly cable bill and substituting it with Netflix, You Tube, Amazon Prime, Hulu and whatever free. There are three primary differences between the United States and India that mitigate this risk in the intermediate term. The first is that residential broadband penetration is very low in India. Currently only 1.5 million homes, or less than 1% of homes, have broadband penetration capable of handling streaming frees. The second contextual difference between India and the U.S. is prices. In the United States where cable bills approach $100 a month, a $7.99 Netflix bill on top of a broadband bill is very attractive. In India because of the low cable pricing – under $4 a month for 300 channels – unbundling is less attractive. Finally, Netflix is only in the process of launching in India – so the unbundling alternatives are more limited than in the United States.

Triple Play: If unbundling is not an immediate threat, what about the "Triple Play" that is popular in the US with phone, TV, and broadband? One of the most surprising features of the Indian media landscape is the fragmentation of Local Cable Operators (LCOs). The LCO is the company that owns the last mile and the customer relationship, and does the billing. Instead of having one company like Time Warner cover New York City arranging programming, servicing the boxes, and billing customers, in India the value chain is broken up. LCOs provide the customer service and billing. The LCO will get the content from MSO (multi system operators). The LCOs will frequently switch from MSO to MSO depending on who gives it the best deal. In India, the LCOs are really, *really* local; there are more than 50,000 local cable operators. There is a public MSO (Siti) that has a press release outlining their 1,000+ LCO relationships in the city of Dehli alone (http://www.televisionpost.com/cable/siti-cable-inks-most-number-of-interconnect-deals-with-lcos-in-phases-i-and-ii/). When the city of Dehli is chopped into more than 1,000 pieces with the LCOs able to change their relationships, putting the infrastructure in place to support a triple play is no small feat.

Non-Exclusive Content: In the U.S., market share gains by satellite providers were driven by exclusive content. In particular, Direct TV had the NFL package allowing subscribers to watch every game. In India, an NFL-type deal for cricket or other major sports is not a threat. Under current law, there cannot be exclusive content, effectively greatly reducing the risk.

Poor Governance: Emerging market companies are known for poor governance, which can take many forms, including enriching the founders at the shareholder's expense. Given the related party transactions and overlapping ownership between Videocon (consumer electronics) and Videocon d2h (satellite), American investors (us) could be on the short end of related party transactions. However, both Sagansky and Sloan have board seats, and the majority of the board are independent directors, which partially mitigates the risk.

It is always helpful to understand the roots of a business success, why the business is successful, and if the success will continue over time. While we often think of being the first mover as being a huge advantage, often it is not. Videocon d2h is actually the sixth mover, or last entrant into the Indian satellite TV market. Ironically this has proven to be an advantage because they have the latest technology. As a result, Videocon d2h currently has the most channels and most HD channels of any provider at each of the industry price points. This advantage will dissipate over time.

Another advantage that Videocon d2h has is a broad national footprint. Videocon d2h was initially financed by the Dhoot family, owners of the Videocon group in India, which sells more appliances than Samsung. As a result, Videocon d2h has more than 200,000 points of distribution. This is important in a market where the satellite product is "prepaid," which often has consumers going to locations to "top off" their cards.

In addition to currently having the best product offering and very broad distribution, unlike their U.S. cable/satellite counterparts, Videocon d2h has an excellent brand and reputation for service. According to the company, 97% of purchasers of satellite equipment who want same day installation receive same day installation. The company's ability to service customers will likely endure. Customer satisfaction levels can be seen with churn rates below 1% per month over the last three years (and it is actually declining).

The final point of differentiation for Videocon d2h is that they manufacture their own equipment. This relates back to their consumer electronics heritage. The company claims this allows for rapid innovation. I am skeptical, but it is worth noting.

India in many ways resembles the U.S. satellite industry decades ago. There is a lot of low-hanging fruit. There are basic opportunities that management is beginning to take advantage of as scale grows. In particular, much like John Malone did with TCI, Videocon d2h is beginning to launch channels that they can sell advertising on. They are also starting to charge channels for better placements in their line-up, often in the form of advertising space. Further, they are starting to put advertising on the channel guide. This ad space is virtually 100% margin revenue, and these techniques are all proven money-makers from mature satellite markets.

As a final exercise, let's walk Videocon d2h through the selection criteria framework outlined in our Q2 2015 letter: specifically insider ownership, reasonable valuation/asymmetric risk reward, variant perception, scalable, growing market, recurring revenue, and strong customer value proposition.

Insider Ownership: The company scores very highly on this, as the founding family has retained 60% of the equity. In addition, the U.S. executives who created the SPAC own 5% of the outstanding shares with additional options. Further, both parties will receive additional shares if the share price remains above $15 for a period of 30 days.

Reasonable Valuation: On a relative basis, Videocon d2h shares trade at an approximately 15% discount to its slower-growing peer, Dish TV India. On an absolute basis, the company trades at approximately 10X EBITDA, but EBITDA is growing very quickly because of the operating leverage in the business from growth, pricing, and ancillary opportunities such as advertising. Looking out a couple of years, the company would be trading on the order of 5X EBITDA. If the company comes even close to executing on their plan, there should be significant price appreciation.

Variant Perception: As a U.S.-based investor looking at an Indian company, it is unlikely that I have any company-specific insights. If there is anything, it is the patience to look closely at a post-SPAC company with all of their operations in India. In addition, SPACs tend to have an unusual dynamic where the initial shareholders buy the SPAC when it is not tied to an operating business. In fact, many SPACs have the same set of hedge funds as initial investors who view the SPAC as a cash-like holding (limited downside) with the potential for 20%+ upside if the right deal is found. These initial shareholders are often most interested in getting their $10 back at a minimum and there is typically enormous shareholder turnover as the early-SPAC investors leave upon deal announcement, and the ultimate investors in the operating business replace them as shareholders. We are buying this for the long-term appreciation of the underlying business – not for any SPAC arbitrage reasons.

Scalable: The company has all of the infrastructure in place to monetize the growth opportunities ahead. With the majority of programming costs fixed, incremental subscribers are very high margin.

Growing Market: With the conversion of analog cable households (75M) and natural migration of households to television (25M), the satellite TV market has several years of double-digit growth ahead of it.

Recurring Revenue: With churn rates below 1% per month, the company has strong and predictable recurring revenue.

Strong Customer Value Proposition: Even for emerging markets, Indian satellite consumers have an excellent deal with bills averaging less than $4 per month for 300 channels. Given the low churn, customers seem to agree.

Videocon d2h has an off-putting SPAC pedigree and does not currently have a natural shareholder base. However, the Indian-based company has several secular tailwinds and an un-demanding valuation, which could provide an attractive return over the next three to five years as the company executes, TV penetration increases, and digitalization progresses. Clearly we did not "bottom tick" this investment as shares have declined more than 10% since our initial purchases. We have modestly dollar cost-averaged into the position and lowered our cost basis. Is the share price decline rationale? For all of the reasons that looking at overall fund performance over short periods is meaningless, the same holds for individual companies. It is noise. What I can say, though, is that over the last three months, the shares of the primary competitor Dish India have declined 1% vs 30% for Videocon d2h. These are comparable companies except Videocon d2h is cheaper and growing more quickly. Over the three-month period, Videocon d2h raised prices and earnings guidance, which are both positive events. I suspect that part of the divergence in prices and valuation is driven by shareholder dynamics, as there is no obvious fundamental driven explanation that I am aware of. Over time our success in Videocon d2h will be driven by consumer adoption and competitive dynamics. The simplified thesis here is that more Indian people will watch more TV over the next several years. They will want more channels of higher quality resolution. These will be provided by fewer and fewer players who will raise prices and realize expanding margins. We own one of the players along with some very savvy media industry veterans.

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