



April 22, 2014

Dear Partner:

The Greenlight Capital funds (the “Partnerships”) returned (1.5)%,<sup>1</sup> net of fees and expenses, in the first quarter of 2014.

From a profit and loss perspective it was a quiet quarter. Our longs were modestly profitable, our shorts lost a bit more than we made on our longs, and macro lost a little. The net result was a small loss in a market where some indices were up a little and others were down a little.

Micron Technology (MU), our only significant winner, advanced from \$21.75 to \$23.66 and frankly there isn’t much to say about a 9% gain. Our Keurig Green Mountain (GMCR) short, which jumped from \$75.54 to \$105.59, was our only significant loser. The company announced a major strategic partnership with Coca Cola. We have lots to say about this, but we’ll defer that discussion to another time and, perhaps, another format.

There was a good amount of activity in the portfolio. We added several new long ideas including large positions in Resona Holdings (Japan: 8308) and SunEdison (SUNE), and medium-sized positions in Altice S.A. (Netherlands: ATC) and Conn’s (CONN). We also shorted a group of high-flying momentum stocks that we have dubbed *The Bubble Basket*.

We established a position in Resona, the largest Japanese regional bank, at a price of ¥547, representing 0.8x book value and 8x earnings. Resona was formed through the 2002-2003 merger and recapitalization of three local banks in the Tokyo and Osaka regions. As part of that recapitalization, the Japanese government bought a majority equity stake. Under new management, the bank cleaned up its balance sheet, began paying back the government stake, and has been profitable every year since, reaching a 13% ROE last year. In 2013, management announced a five-year plan to buy out the remaining government shareholding. Due to stronger than expected earnings, that plan is well ahead of schedule, and the company is buying back stock from the government at very attractive valuations. The accretion from the buyback does not appear to be reflected in analyst models. With the more volatile international Japanese banks trading at 9x EPS, and its peer regionals at 13x EPS, Resona is cheap on both an absolute and relative basis. Resona shares ended the quarter at ¥499.

SUNE, formerly known as MEMC, is a developer of solar power plants for businesses and utilities. The declining cost of solar energy combined with the rising cost of conventionally produced electricity should position SUNE as a winner. The company has built a large pipeline of attractive projects secured by credit-worthy buyers of electricity. Until recently, the good business was mixed in with two bad ones: manufacturing wafers for semiconductor companies,

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<sup>1</sup> Source: Greenlight Capital. Please refer to information contained in the disclosures at the end of the letter.

and assembling commodity solar modules for developers. Historically, the company's poor balance sheet forced it to sell many of its solar development projects at discounted prices to raise capital.

The company has now exited the solar module assembly business and is in the process of monetizing its semiconductor wafer business through an IPO. Later this year, we expect the company will IPO a newly-created Yieldco, which will house its most attractive solar projects rather than selling them to third parties. NRG Yield Inc. is a comparable company that trades at 12x EBITDA and has a 3% dividend yield. Were Yieldco to trade at 9x EBITDA and a 5% dividend yield it would imply a value for the solar business of ~\$34 per share. SUNE expects to run its development business close to breakeven in future periods. Adding in the value of the soon-to-be IPO'ed semiconductor business and subtracting a modest amount of corporate net debt would suggest a sum of the parts value for SUNE of ~\$35 per share. Our average entry price is \$15.55 and SUNE shares ended the quarter at \$18.84.

We established a position in ATC at an average price of €28.47. ATC owns integrated telecom assets (principally cable and some mobile) across Europe, Israel and the Caribbean. Its largest asset is a controlling stake in French cable operator Numericable. ATC's business is very stable and grows organically at a healthy clip. ATC's management owns a lot of stock and has an excellent track record in both operations and capital allocation. We see substantial upside given management's ability to improve core margins while making strategic acquisitions and disposals across ATC's portfolio. Importantly, Numericable has struck a deal to acquire SFR (France's second largest telecom operator) from Vivendi, which will create significant synergies from consolidating the French market. Presuming most of those synergies, we purchased ATC for less than 6x estimated 2016 EBITDA and a greater than 15% free cash flow yield to the equity. Beyond 2016, we expect ATC to grow EBITDA more than 10% per year for a number of years. ATC shares ended the quarter at €32.34.

CONN is a specialty retailer of appliances, furniture, mattresses and electronics with 79 locations in Texas and the Southwest. CONN finances 77% of customer purchases through its proprietary subprime credit portfolio. In February, the company announced 33% comparable store sales growth in Q4 with strong gross margins. However, it also announced increased credit losses and reduced earnings guidance from a range of \$3.80-\$4.00 to a range of \$3.40-\$3.70 for calendar 2014. Given the market's past experience with deterioration in subprime credit, the stock reaction was severe: The price fell from \$79 at the start of the year to \$32 on the news. We believe that this is a retailer with 15-20% unit growth and current double digit comparable store sales growth, and that the market overreacted to moderately bad news. We acquired shares at an average price of \$35.49 and they ended the quarter at \$38.85.

We have repeatedly noted that it is dangerous to short stocks that have disconnected from traditional valuation methods. After all, *twice a silly price is not twice as silly; it's still just silly.* This understanding limited our enthusiasm for shorting the handful of momentum stocks that dominated the headlines last year. Now there is a clear consensus that we are witnessing our second tech bubble in 15 years. What is uncertain is how much further the bubble can expand, and what might pop it.

In our view the current bubble is an echo of the previous tech bubble, but with fewer large capitalization stocks and much less public enthusiasm. Some indications that we are pretty far along include:

- The rejection of conventional valuation methods;
- Short-sellers forced to cover due to intolerable mark-to-market losses; and
- Huge first day IPO pops for companies that have done little more than use the right buzzwords and attract the right venture capital.

And once again, certain “cool kid” companies and the cheerleading analysts are pretending that compensation paid in equity isn’t an expense because it is “non-cash.” Would these companies be able to retain their highly talented workforces if they stopped doling out large amounts of equity? If you are trying to determine the creditworthiness of these ventures, it might make sense to back out non-cash expenses. But if you are an equity holder trying to value the businesses as a multiple of profits, how can you ignore the real cost of future dilution that comes from paying the employees in stock?

Given the enormous stock price volatility, we decided to short a basket of bubble stocks. A basket approach makes sense because it allows each position to be very small, thereby reducing the risk of any particular high-flier becoming too costly. The corollary to “*twice a silly price is not twice as silly*” is that when the prices reconnect to traditional valuation methods, the de-rating can be substantial. There is a huge gap between the bubble price and the point where disciplined growth investors (let alone value investors) become interested buyers. When the last internet bubble popped, Cisco (the best of the best bubble stocks) fell 89%, Amazon fell 93%, and the lower quality stocks fell even more.

In the post-bubble period, people stopped talking about valuing companies based on eyeballs (average monthly users), total addressable market (TAM), or price-to-sales. When the re-rating occurred, the profitable former high-fliers again traded based on P/E ratios, and the unprofitable ones traded as a multiple of cash on the balance sheet. Our criteria for selecting stocks for the bubble basket is that we estimate there to be at least 90% downside for each stock if and when the market reapplies traditional valuations to these stocks.<sup>2</sup> While we aren’t predicting a complete repeat of the collapse, history illustrates that there is enough potential downside in these names to justify the risk of shorting them.

Our streak of groundbreaking decisions from foreign tribunals continues. In this case, we and several other hedge funds were trying to recover losses from when Porsche cornered the market in Volkswagen shares in 2008. Criminal prosecutors have charged the former CEO and CFO of Porsche with market manipulation for publicly giving false information with respect to the failed takeover. According to the prosecutor, Porsche “denied in at least five public statements an already existing intention to increase its participation in Volkswagen AG to 75%.” Since we relied on those statements, as well as additional discussions we had with Porsche’s head of investor relations, we brought suit to recover our damages.

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<sup>2</sup> This includes counting stock compensation as an expense.

Unfortunately, the German Court dismissed our case. The court ruled that it was a valid business objective of Porsche to keep secret its goal to acquire 75% of Volkswagen at the lowest possible price, and that disclosure of its intentions would thwart that objective. As a result, the Court said “the only realistic way to limit speculation and the resulting price increase was to [publicly] deny a takeover bid.” As for the false information from the head of investor relations, the court observed that it was possible that he might not have known about the secret plan, so he might not have been lying. Apparently German companies are not required to tell the truth when they have a valid business objective not to, and when it comes to communications with investor relations in Germany, it is buyer beware.

With all the recent public attention given to market structure, we would like to discuss our trading costs. Trading costs have never been large for us because we don’t turn over our portfolio very often. When we started Greenlight in 1996, bid-offer spreads were 1/8 of a dollar per share and institutional commissions were an additional \$0.04-\$0.06 per share. With decimalization, bid-offer spreads are much tighter and commissions average about half as much. An already small cost for us has become even smaller.

Michael Lewis’s new book *Flash Boys*, like all of his books, is a fun read and is based on a true story. It brings attention to some areas of the market that can improve further, and a few areas of possible abuse. There are many legitimate and even beneficial aspects to computerized trading, including market making and statistical arbitrage, yet there are also some areas that are ripe for reform.<sup>3</sup> Most glaring is the latency arbitrage that is used to identify the presence of large institutional orders for the sole purpose of legally front-running them.

These problems fall into the classic dilemma of concentrated benefit and diffuse harm. Lots of investors lose pennies and as a result don’t care too much about market structure; the firms who have based their business around picking up those pennies care a lot about shaping the structure.<sup>4</sup> To overcome this imbalance of interests, the issue needs attention and discussion so that the many who are losing pennies can organize a response. In this regard, *Flash Boys* has provided a great service.

Although we believe that the abuses identified in *Flash Boys* don’t significantly impact us, our traders Bruce, John and Alex are incredibly aware of how market structure imperfections can add to our trading costs, and are vigilant about minimizing their impact on the Partnerships. One such countermeasure has been to support a new trading venue called IEX, which was the central focus of *Flash Boys*. We believe that the best response for any investors that are worried about fast computers taking advantage of them is to ask that their orders be routed to IEX, a company in which we hold a small stake.

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<sup>3</sup> *Flash Boys* also details some other questionable practices including high frequency traders paying for the right to execute retail order flow and for access to various dark pools.

<sup>4</sup> The aggregate of all these pennies is billions of dollars by some estimates. With everything to lose, this explains why the CEO of BATS, one of the exchanges mentioned in *Flash Boys*, went BATSh\*t on CNBC in response to the book.

The notable positions closed during the quarter were:

Closed Security	L/S	Avg. Entry Price	Avg. Exit Price	IRR	Comments
Arkema	L	€8.49	€7.04	+11%	A 2006 classic spin-off turnaround investment with a terrific management team. We weathered it through the crisis and ultimately earned a decent multi-year profit.
Delphi	L	\$20.18	\$50.28	+47%	The business outperformed fundamental expectations, the management proved to be good stewards of excess capital, and the stock re-rated as we had hoped.
DST Systems	L	\$51.52	\$84.08	+36%	The company sold non-core assets, improved operations, repurchased stock, and reached our sum of the parts valuation.
General Motors	L	\$23.87	\$35.76	+25%	GM went through a successful product refresh cycle, pared losses in Europe, and bought back stock from the government. We expected 2014 to be an earnings break out, and exited early this year when earnings guidance revealed it would not be.
Merck KGaA	L	€78.39	€112.62	+37%	A turnaround story that turned around.
NCR Corporation	L	\$14.85	\$30.56	+32%	After management exited its unprofitable businesses, addressed an underfunded pension issue, and executed well in its core ATM business, we cashed out.
Chipotle Mexican Grill	S	\$320.29	\$417.56	-33%	This short gave us gas.
Fortescue Metals Group	S	AU\$4.41	AU\$5.59	-20%	The company was able to lower its costs more than we originally envisioned.
Loblaw Companies	S	C\$32.55	C\$46.33	-26%	A competitively challenged grocery retailer created equity value through a REIT, and then diversified into better positioned drug stores.
Michael Kors Holdings	S	\$80.98	\$91.54	-114%	We expected them to miss year-end earnings in a tough retail environment. They didn't.

During the quarter, we added one new analyst to our investment team, one new baby to our growing baby arsenal, and promoted three analysts to Partner.

In March, Josh Hittman joined Greenlight in the role of Field Research Analyst to assist our investment team with supplemental proprietary research. Josh began his career as a consultant at Accenture in 1999, followed by senior positions at Washington Mutual and NetSuite. In 2006, he joined Gerson Lehrman Group and ultimately became the Head of Global Research Operations. In 2012, Josh took a position with Balyasny Asset Management, a market neutral multi-strategy hedge fund, where he helped build out a proprietary research team. Josh earned a B.S. in Finance from Southern Methodist University in 1999. In 2013, he became a Certified Fraud Examiner. We are confident that Josh will help Greenlight increase our investment winner “Hitt” rate.

Chris and Fiona Mickelson welcomed baby Owen who, despite being 2½ weeks early, was considerate enough to wait for the Greenlight audited financial statements to be completed.

Finally, at the 18<sup>th</sup> Annual Partner Dinner in January we announced the promotions of Simon Hillary, Andy Kaplan and Andrew Rechtschaffen to Partner. Simon joined Greenlight in 2009 and is based in our London office. The Partnerships have made money on his investments every year since he joined. His process is simple: Simon starts with the view that everything is “rubbish” and when he finds something a step above, it’s probably worth owning. Simon has contributed to many successful investments including Vodafone, Delta Lloyd, and most recently, the Greek Banks. Andy Kaplan joined us in 2010 and consistently develops a research edge. Andy was instrumental in our very successful short of First Solar and is involved in our long investments in Marvell and Micron. Andrew rejoined Greenlight in 2011 and we are very glad he did. This is the second time that we are promoting him to Partner (and definitely the last). Some of Andrew’s highlight investments are Cigna, Micron and Oil States International. We congratulate Simon, Andy and Andrew on their promotions to Partner!

At quarter-end, the largest disclosed long positions in the Partnerships were Alpha Bank, Apple, gold, Marvell Technology, Micron Technology and Oil States International. The Partnerships had an average exposure of 120% long and 71% short.

*“For a very long time everybody refuses and then almost without a pause almost everybody accepts.”*

— Gertrude Stein

Best Regards,

A handwritten signature in cursive script that reads "Greenlight Capital".

Greenlight Capital, Inc.

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Unless otherwise noted, performance returns reflect the dollar-weighted average total returns, net of fees and expenses, for an IPO eligible partner for Greenlight Capital, L.P., Greenlight Capital Qualified, L.P., Greenlight Capital Offshore, Ltd., Greenlight Capital Offshore Qualified, Ltd., and the dollar series returns of Greenlight Capital (Gold), L.P. and Greenlight Capital Offshore (Gold), Ltd. (collectively, the “Partnerships”). Each Partnership’s returns are net of the standard 20% incentive allocation.

Performance returns are estimated pending the year-end audit. Past performance is not indicative of future results. Actual returns may differ from the returns presented. Each partner will receive individual returns from the Partnerships’ administrator. Reference to an index does not imply that the Partnerships will achieve returns, volatility, or other results similar to the index. The total returns for the index do not reflect the deduction of any fees or expenses which would reduce returns.

All exposure information is calculated on a delta adjusted basis and excludes macro positions, which consist of credit default swaps, interest rate swaps, sovereign debt, currencies, commodities, and derivatives on any of these instruments. Weightings, exposure, attribution and performance contribution information reflects estimates of the weighted average of Greenlight Capital, L.P., Greenlight Capital Qualified, L.P., Greenlight Capital Offshore, Ltd., Greenlight Capital Offshore Qualified, Ltd., Greenlight Capital (Gold), L.P., and Greenlight Capital Offshore (Gold), Ltd. and are the result of classifications and assumptions made in the sole judgment of Greenlight. Positions reflected in this letter do not represent all the positions held, purchased, or sold, and in the aggregate, the information may represent a small percentage of activity. Internal Rate of Return (IRR) represents the return, as measured in local currency, of the position including cash-flows directly related to the position, excluding financing costs, between the initiation of the position and the closing of the position. The information presented is intended to provide insight into the noteworthy events, in the sole opinion of Greenlight, affecting the Partnerships.

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