

To: Culibrk Partnership Partners
 From: Stefan Culibrk
 Date: October 9, 2017

Dear Partners,

The Partnership recorded a gain of 6.7% during 1.7.2017. – 30.9.2017.

	Return	S&P 500 ¹
Quarter	6.7%	4.5%
Current year	30.9%	14.2%
Since inception (Jan 2015)	96.6%	29.7%

Most of you will not be surprised to hear that our stretch of compounding at 28% annually will eventually stop. Investment gravity affects returns. In the long run, return on capital of a business tends to approach its cost of capital. This stands true for fund managers. Large, once successful funds are cursed to operate in increasingly competitive areas. Their returns are tied to the returns of the index (for long-only funds).

While I have no insight into when investment gravity will kick in (I think we are very far from being burdened by our size), another force is affecting our returns. Our 35% cash holding (as of Q3 2017) weighs on returns in the short term. High cash holding doesn't bother me and it shouldn't bother you either. Part of the explanation for it is my limited experience. Expansion of one's circle of competence takes time.

What other causes contribute to such a high cash holding? Attractively priced opportunities are rare in times of optimism. Few questions help to determine if we are operating in optimistic times. If we are not, my youth will take all the blame for our underinvestment.

Is capital freely flowing? Yes. Are yields compressed in comparison to historical levels? Yes. Are investors optimistic or pessimistic? Optimistic. Are investors reaching for yield by investing in riskier instruments? Are get-rich-quick schemes capturing public imagination? Indeed. Investors across asset classes have started to forget that the market is not an accommodating machine.

It is difficult to know for how long the opportunities will remain scarce. One or two attractive situations can significantly change our allocation. Cash holding is not and will never be a market timing instrument.

¹ Note: S&P 500 measured by SPX

Inotek Pharmaceuticals - A lesson in investing in unknown and unknowable

On July 7th 2017 Inotek Pharmaceuticals announced its glaucoma trial failed, sending shares down 45% on the day and down 83% for the year. The company, at the time without anything promising in the pipeline, announced that it will seek strategic alternatives. Strategic alternatives typically mean a sale, a reverse merger, acquisition of a new pipeline or a liquidation. At the time Inotek had net current asset value per share of \$1.9 (close to liquidation value), as well as valuable net operating losses (NOLs). We bought a small position at 95c/share.

The worst case was a dodgy reverse merger done to secure board and management seats. Such is typically done by investing in or buying an asset that is difficult to value or overpriced. Upside was clear, based on deep discount to net current asset value. Backtesting for similar situations (with help from a more tech-savvy friend) revealed that buying a busted pharma company at such a wide discount to its net current asset value has proven to be a very profitable strategy over time. This backtesting gave me a very rough idea of a base rate.

On September 12th 2017, Inotek announced an agreement to commence a reverse merger with Rocket Pharmaceuticals, a gene therapy startup. It would exchange its cash, NOLs and public listing for a 19% stake in Rocket. Attributing c. \$50m, Inotek would own 19% of a startup valued at \$263m. CEO of Rocket stated that similar publicly listed companies trade for \$300m to \$500m. Not a bad feat for a two-year old enterprise. Did Inotek invest its cash at a discount?

I don't know. Preferring a bird in hand (a sale or a liquidation), I congratulated the management for protecting their interests (incentives won again) and sold our shares after the announcement at an average of 94c/share, locking in a 3bps loss for the portfolio.

Key takeaway was that Zeckhauser probably wouldn't sell. After reporting that worst case scenario has materialized, price dropped only briefly to 90c, before closing the day at \$1.22/share. On Friday it has closed trading at \$2.62/share.

I followed my investment process and it resulted in an attractive risk-adjusted outcome. I don't pretend to be as smart as Zeckhauser at this stage and am happy with the outcome. I will leave operating in the unknown and unknowable to folks smarter than me. However, without sacrificing core tenets of my investing process, I will pay more attention to investor positioning in the future.

New position – Discovery Communications

We have acquired shares of Discovery at \$22.7 following the announcement of its merger with Scripps Networks. The announcement sent shares from \$26 to \$19 in a matter of days.

What is not to love about Discovery? It is a levered cable network (Net debt/EBITDA 4.8x post-closing) with declining subscribers (-3% year on year across networks) and 60% EBITDA margins in its core US market that is attacked by well-capitalized low cost disruptors (Facebook, Netflix, Amazon, Apple, Google all appear to be focused on video). It appears that the cooperative industry structure that allowed for such margins is crumbling.

Cable networks have a long history of raising prices above inflation. Consolidation of cable operators and networks launching streaming services could halt or reverse decades of price escalators. Advertising is under threat from more measurable, higher ROI alternatives such as Google and Facebook. A cyclical downturn in advertising could pressure big ad spenders to focus on ROIs and measurable results. Google and Facebook will be ready to take market share from cable networks. If cord cutting keeps coming from a younger demographic, an essential one for the advertisers, cable networks cost per thousand impressions (CPM) will suffer as well.

Discovery's international business has challenges. Its margins in Europe will never match those of the US because Europe has different languages, interests and regional peculiarities. It is hard to sell or market content successfully across the area.

The bear case sounds convincing. Why buy for 5% of the portfolio?

Discovery is a cable network that produces and shows non-fiction, niche, low cost, fully-owned content that travels well globally due to its universal appeal. In the current television ecosystem, Discovery is enormously cash generative.

Its free cash flow is set to rise over time as international assets reach a critical point of scale that brings profitability. Scaling globally will be easier with the acquisition of Scripps. Discovery will either add Scripps networks to their package or enhance the appeal of Discovery's existing channels by adding Scripps content.

Mr. Market has focused on the negative feedback loop that it seems coming with a decline in the number of customers. Behind the decline in customers is somewhat the structure of the OTT services which have so far rarely included Discovery (SlingTV, Hulu, etc.) because of their ownership structure. Discovery recently announced a non-sports entertainment streaming service in cooperation with AMC Networks, A+E and Viacom. This service (named "Philo") will improve subscriber count. Entertainment bundle will be priced at \$20 and will offer profitable economics to cable networks.

Slower or fully averted decline in the number of subscribers, coupled with rising profits internationally, will keep Discovery's free cash flow growing. Cash flow will be deployed to repay debt in the first two years.

I agree with Charter CEO Tom Rutledge that the main reason for cord cutting is unaffordability. As Disney's ESPN starts their stand-alone streaming service in 2018, it will start seeing pressure from operators to reduce their price or risk being kicked out. A discussion along these lines has already started with the most aggressive operator, Altice (it has been successfully resolved). A bundle without ESPN could offer great value to many subscribers. Discovery's channels TLC, Discovery, Animal Planet, Travel Channel, HGTV, OWN, Cooking Channel, Food Network, Velocity and Science will be keep being an important part of the "fat basic". Discovery content accounts for a significantly higher share of television viewership than their share of distribution revenues. In a post-ESPN world, this might change and be a source of further distribution price increases.

At a double digit free cash flow yield, we don't need much improvement at Discovery to earn attractive returns over the next three years.

Exited positions

Boston Omaha

We acquired shares of Boston Omaha in June 2017 for \$13.5 and sold them three months later for \$18. Without a significant change in its underlying business, there was little rationale to stay invested after a 33% gain as upside got reduced and downside increased, given that significant part of the net asset value is cash. I will be following how the duo of operators at Boston Omaha is executing and will reassess investing when the opportunity is presented at a more favorable risk/reward.

OPAP

We acquired a small amount of shares of OPAP in June 2015 at €7.4/share in anticipation of further stress in Greek assets that would allow us an opportunity to significantly increase the size of the investment. The expected stress didn't materialize. Meanwhile, I lowered my estimate of fair value because of higher than expected government interference into OPAP's business. We have sold OPAP for €10/share in the past quarter. Over the past two years, we have collected €1.84/share in dividends, for a total return of 60%.

CIT Group

We invested in CIT Group at \$36/share in September 2016. Upon selling its aircraft leasing unit, CIT was significantly overcapitalized. Return of capital through a tender offer was core part of the thesis that materialized in the past months. I sold the final portion of our investment in CIT Group at \$48.5/share.

Liberty Braves

We acquired shares of Liberty Braves in April 2016 at \$16.3/share (adjusted for the rights we sold). We bought as soon as we could after the creation of the tracking stock. Upon receiving higher investor awareness, completion of the new stadium and its surrounding real estate facilities, Liberty Braves were trading closer to fair value at \$25.6/share. We sold our stake. Liberty Braves are still in good hands and could be worth more in the long-term due to pending media rights increases that are starting in a couple of years. However, as the gap between price and fair value narrowed, I grew less comfortable being invested in a business valued to a large extent on billionaire vanity (rather than discounted cash flows).

Sizing changes

We increased our stakes in PICO Holdings, Liberty Ventures and Zedge as the gap between my estimate of fair value and market price widened.

We reduced our stakes in Idorsia and Sports Direct due to price appreciation.

Culibrk Partnership
Largest Gains and Loses
For the Three Months ended September 30th 2017
(% contribution to the portfolio)

Largest Gains

Sports Direct (+2.53%)
Liberty Ventures (+1.42%)
Fiat Chrysler (+1.41%)
Boston Omaha (+0.67%)
LiLAC (+0.5%)

Largest Losses

Discovery Comm. (-1.1%)
PICO Holdings (-0.53%)
Zedge (-0.19%)
CIT Group (-0.04%)
Inotek Pharma (-0.03%)

Sports Direct

Reasons for a 72% stock price drop from the peak in 2014 to the trough in 2016 were numerous: PR nightmares, poor corporate governance, loss of market share to athleisure dominated by JD Sports and a loss of faith in international expansion and premium lifestyle.

I thought that the core UK-based sports retailer is a strong, durable, low-cost business run by an owner operator that can generate £200m+ in steady state earnings. We bought Sports Direct at 326p/share during Q2/Q3 2016, which I thought is an attractive price.

Since Q3 2016, little has fundamentally changed to the positive. Removal of regulatory overhang, a change in business model (to the negative in my eyes), decent buyback below 300p/share and a sale of Dunlop, all contributed to the share price recovery in Q3 2017.

I sold a third of our position at 415p/share. I think that a real estate-intensive, leveraged, "Selfridges of sports" business model is less attractive than the old no-frills model. Dealings with an unsophisticated related party on real estate acquisition are not helping. I think fair value is currently 450-500p/share.

After a 45% increase in Q3 and a partial sale, Sports Direct is now a 4% position.

Liberty Ventures

Exceptional execution at Charter, as well as speculations regarding M&A with multiple suitors involved, helped push Liberty Ventures shares higher.

I expect aggressive share repurchases as soon as Liberty Ventures becomes asset-backed (to be named GCI Liberty upon completion of the transaction with GCI by year end). What makes Liberty Ventures attractive? Repurchases at a

large discount to its net asset value (24% at the moment), eventual combination with Charter that will permanently close the discount and growth of Charter itself.

I added at \$51 to make Liberty Ventures a 11% position.

Fiat Chrysler

We bought Fiat Chrysler in February 2016 at \$6.43/share and sold it in thirds at \$8.2, \$11.1 and kept a third to follow execution of Marchionne's plan. M&A talks heated up, with multiple suitors interested for a part or the whole of the Fiat Chrysler business. At \$18/share, I am still a happy holder as Marchionne executes on the plan. After a 68% price rise in Q3, Fiat Chrysler is a 2.6% position.