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PETER LUPOFF

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{ INTERVIEW BY KHAI NGUYEN }

Peter M. Lupoff is an owner-member and founded Tiburon Capital Management, an event-driven investment advisor, in 2009. Peter formerly was a Managing Director at Millennium Management, the New York based Multi-Strategy hedge fund where he managed an allocation of the Millennium Partners flagship fund employing identical event-driven strategies. Previously he was Managing Director and Senior Portfolio Manager of the Robeco WPG Distressed/Special Situations Fund.

During the course of Peter's more than twenty-year investment career, he can be credited with initiating some of the meaningful advances that have taken place in the distressed and high yield markets. In the late 1980s, Peter envisioned that a liquid secondary market in bank loans would provide institutional investors with an alternative debt instrument to conventional bonds. As such, he became one of the first traders of bank loans, which revolutionized liquidity and existing trading conventions. In the mid-1990s, he conceived of "bankruptcy and default-triggered puts" for suppliers to troubled companies, thereby expanding their use of derivatives and creating another new investable product for institutional funds and trade creditors.

Mr. Lupoff's experience in deep value equity and distressed investing strategies began in 1990 where he began working with Marty Whitman of Third Avenue Funds. Peter's bottom-up approach is largely informed by this experience. His acumen and theses regarding risk and trading to defend NAV are informed by his experiences with Izzy Englander and Millennium Management. Funds Mr. Lupoff have managed or co-managed have achieved awards such as GAIM's Top Performing Emerging Distressed Manager, MARHedge's Event-Driven Manager and an Institutional Investor nomination as Hedge Fund House of the Year.

Mr. Lupoff is a regularly featured discussant on academic papers related to, and consultant to, The Federal Reserve Bank regarding market shocks and liquidity. Mr. Lupoff provides expert testimony on matters related to hedge funds, trading and his specific strategies.

Khai Nguyen: *Peter, welcome and thank you for joining us.*

Peter Lupoff: Thank you very much.

KN: You started Tiburon Capital Management in 2009. Why did you decide to launch your own hedge fund and how did you plan to differentiate it from other hedge funds, especially Third Avenue and Millennium where you were started?

PL: Well, Third Avenue and Millennium were terrific places to get started. I liked talking about Marty Whitman and Izzy Englander, each as important personalities that helped make me who I am and we, at Tiburon, who we are today. I learned deep value from Marty from '90 to '98. He's an academic at heart. Still teaches at Yale and really is one of the ranking thinkers in deep value and, you know, it was a classic thing that Marty would walk into the trading room and say, "The world will figure out that we're right." Often I would mutter to my friends: "If only it happens in our lifetime." Which is kind of how I got to the place where I started to focus on events, and event-driven. I took the deep value sensibility I learned at Third Avenue, applied probability weighting of plausible catalysts and our own methodology BRACE began to unfold.

Later on in my career, as a portfolio manager at Millennium, I learned some very different things from Izzy. These are very smart, capable, and difficult personalities (Whitman, Englander) that I got along well with and think of as mentors. From Izzy I recall a day in '08, the world is going to hell for a change, and we were short regional and community banks in the top five foreclosure markets in the US where originally their equities traded in excess of 250 percent of book value and where more than 70% of their assets were real estate related. Raw land, HELOCs, home mortgages, and commercial real estate. That was an unbelievable hit list of banks that failed. But then Paulson made shorting illegal. Our shorts started to rip in our face and I got a call from Izzy, which at the time was very commonplace. He actually listened to the theory about why we

> So what I take away from Marty is: we're right the markets are wrong, the world will figure that out. And from Izzy: the market is right, protect yourselves and defend NAV

should stay in the trade and was very gracious all things considered. That's not grace he necessarily exhibited to a lot of people in that time and place. As I punctuated my thesis with, “This is why we're right,” he paused for a second and said, "Peter, you might be right but we're not in the business of being right, we’re in the money management business. Those are two different things."

So what I take away from Marty is: we're right the markets are wrong, the world will figure that out. And from Izzy: the market is right, protect yourselves and defend NAV. I think this dual mantra puts us in an excellent place to manage money on our own in these sideways trading markets. After the great recession I've written a lot on the topic of multiple equilibrium and sideways trading markets. I think we're in these kinds of volatile, choppy sideways trading markets for many years. I think the right ethos for operation in these markets is a combination of the two. To have the conviction level and confidence about valuation and plausibility of catalysts and at the same time defend NAV through hedges and trades and sizing.

I left Millennium to start Tiburon in ‘09 in part because after better than twenty years in the business, at some point, you have a strong sense for methodology and you have a great connectivity with clients. You either lavish attention and are expressive around points of view with clients that are comforted by that or you’re not. At larger firms, the house will make decisions to protect itself or because the direction it wants to go in may differ from your own unique perspectives on markets. It is a younger or newer person in the business' foible to say that the house or my firm is wrong and I was right. But if you reach that place where you're mature enough and your gut tells you that you have the weaponry sufficient to do this on your own—it’s quite liberating.

KN: *Who are the ideal investors in Tiburon?*

PL: An ideal investor is one that recognizes that despite the talk of trying to defend NAV, moderate volatility, particularly downside deviation, events occur when they do. And that means in huge up markets we may be flat. It probably also suggests the possibility that in down markets we'll be flat because what we're trying to do is deliver alpha from events as they occur and those events occur when they occur and not always do they occur uniformly and ratably over a twelve month continuum of observances.

Secondly, an ideal investor is one that recognizes the distinctiveness of our BRACE methodology, which I think covers a lot of sins that can occur because of human bias and helps us make the best risk adjusted decision we can. Last year, we were up maybe 1 to 1.5% going into June and the S&P 500 rallied hard that first half of the year. Inevitably, we got questions from existing clients and prospects about our performance and it was pretty easy to point out that the trades we had on the books just simply didn't have catalysts. I make the argument a lot about reversion to the mean. It cuts both ways. That in any six month observance like January through June of last year, where we might be up one and change, is a fraction of the observable time a manager like us has in this business. If you believe in the methodology and when we drill down into each of the particulars of the trades that were in the portfolio, if the plausibility of the catalysts were apparent, and the pricing was attractive, a fair amount of them were going to unlock value. It just so happens that in the second half of last year we made better than 14%, a time when the S&P did not do so well. That's a perfect example of the kind of client that's ideal for us: one that recognizes that any one month to even six month observance period is not meaningful so long as we continue to adhere to our proprietary BRACE methodology and that we're flexible around the mandate and doing all the things within the scope of our skillsets.

KN: *Speaking of methodology, can you explain your BRACE methodology?*

PL: Sure, BRACE is a five prong methodology. Each of the letters stand for a prong that must be reviewed and considered before a trade idea gets in the portfolio. You know, it's a cute acronym and it isn't the case that we're clever marketing people where we sat down one day and said well BRACE is a great name let's build a methodology around a cute expression. Let me take you through the five elements, BRACE:

“B” for the deep value Bottom-Up. The bottom-up approach we employ and informed by my eight years with Marty Whitman, well I'd argue we do that at least as well as anyone. For that reason, the team is trained and comes from comparable backgrounds where deep value matters. That is, determining what's cheap on an intrinsic basis. What companies are cheap within their industries relative to peers and within the company's own balance sheet? What's cheap and what’s rich on an intrinsic basis. As our mandate allows us to be long or short, we're not biased directionally. We're looking for the best way to express a point of view, not just in any one security either, we can be across the cap structure.

The “R” part of BRACE is the Revaluation Catalyst. That is, that plausible, hard event that will revalue, re-rate that security that we're long or short and move it to fair price in a step function change. I use the word plausible because unlike say, merger arb, merger arb people and others might self-identify as event driven. But broadly event driven, the richest landscape are events that are unannounced or are simply plausible and we glean them best utilizing this methodology we dub BRACE. So the plausibility of that catalyst is all that matters. The sizing of trades is a function of our conviction level around this catalyst. So if you employ the “B”, bottom-up approach properly and you have “R”, a revaluation catalyst that is plausible and predictable with some level of probability, you'd done then, de facto, a lot to wring out the downside in a trade because it's either bought right or short right on a price basis, providing a margin of safety, and there's a plausible catalyst that will unlock value. So the “B” and the “R” of BRACE basically are belt and suspenders in delivering low downside deviation.

The “A” part of BRACE is the Actor's Assessment. This is highly qualitative in a business where there are very many capable quantitative thinkers. You find that there are many managers and analysts in this business that can't seem to figure out how humans behave. We discuss often how human beings behave, both in our office and in the investing landscape as they can weigh on trades and provide us clues to probability weighting. So the actor's assessment is game theoretical. It is behavioral and this is not something that everybody is good at. And while we all do it, I've not really seen anyone else codify it as part of a process. We, by methodology, consider who are all the financially interested parties that can weigh on the thesis of a plausible revaluation catalyst. It's more than just your Cap IQ or Bloomberg based model that might drive the top five holders of equity or the top five bond holders if you go that deep, or even if you use the forensics to figure out who are the holders of loans. It goes beyond that. It's our holders of instruments; holders of different instruments throughout the cap structure. There are holders of bank debt that actually benefit more from a default because of CDS positions. For example, it's understanding if you're looking at a retailer who the chief vendors are. Are the vendors shipping normal terms? It's understanding if a company has non-core assets. Are there other companies that have said in their public reporting that they're potential acquirers of such assets? Have private equity shown interest? Do competitors or strategics have an existing public equity stake in the company already? How is management compensated? Are they compensated in ways that suggest that their financial interests are aligned with our view of this plausible revaluation catalyst? Who are the litigants and the major causes of action that are described in the 10-K, usually buried in footnotes. The actor's assessment, the "A" part of BRACE, gives us a lot of the qualitative meat. So this is not an easy mathematical formula but the qualitative derived probable outcomes that we will fashion around the probability weighting of catalysts. In short, how are human beings likely to behave given their financial interests?

The "C" part of BRACE is for full Capital Structure review. We can't know what the equity is worth without understanding where the company is in meeting its loan covenants or where the bonds are trading; what the underlying covenants are in all those bonds. So we do an entire capital structure review. It's a "shield and a sword" I like to say. It's a shield in that we will not be in the wrong part of the cap structure on a risk adjusted basis for failure to review loan covenants or the indentures of bonds. It's a sword in that we periodically will find interesting, inter capital structure trades where we might be long a bond with heightened rights and remedies relative to a bond that has light or reduced rights and remedies.

The "E" part of BRACE is External and having been trained as a deep value investor from my eight years with Marty Whitman, I was completely taken by the interconnectivity of markets that we began to see in '07 when, you know, if China sneezed we caught cold in the US, or in '08 when I literally would spend twenty out of twenty four hours a day awake watching markets open and close because it's what was called for at the time. So the "E" part of BRACE is external. It doesn't really matter that our model tells us that a company is cheap at five times cash flow if we're going to get to buy that company at four or three and a half times because of something technically happening. Whether it is the risk of Euro contagion, which is not an expression that's been said much since 2011 but was front and center in 2011. Whether it's slowdown in China. Whether it's the ECB cutting short term interest rates two weeks ago, creating the prospect of currency translation for those kinds of multinational companies in this coming quarterly period. The "E" part of BRACE also requires that we drill down to more specifics such as if the company that we're looking at has a particular commodity exposure or we think one commodity company is going to buy another. The risk we don't want to take is, say, where an underlying ounce of silver might trade. Then maybe that's a risk that we might take out. Are there risks that we face that are calendar risks? Are there key covenant dates for loan agreements? Are there key court dates that we need to be aware of or conference dates when a company is presenting? This sounds like a lot but we can distill all those things into our team outlook calendar which drives a reminder to us. One last thought on the "E". Perhaps this is due to my Millennium DNA, but I don't ever want to hear that a security is down 10 to 15 percent at market and we're trying to scramble to understand the reason why. And the reason why is a critical court date that we were unaware of. We will not get caught by those things if we have an element in our methodology BRACE, which requires us to be aware of externalities that can weigh on a particular trade.

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BRACE, a five prong methodology. We teach it. We train it. We debate it internally. It's like a stew or a wine that gets better with time—it gets better as we practice it together.

KN: *What is a current top holding and how does it fit into BRACE?*

PL: I'd rather talk about themes than top holdings. Let's start with themes and from that I can talk about a couple names and examples I think are important. So let's take something that's topical. I will say this is in the portfolio and it was something that I was just recently asked to talk about on a business program so it's sort of front of mind but let's take some industry consolidation we foresee happening that's thematic in and around telecoms and wireless in particular.

There's speculation that T-Mobile is for sale. Well, it's not speculation. From a bottom-up basis is T-Mobile cheap or has T-Mobile been cheap? You could look at T-Mobile on a discounted cash flow basis or you could look at it on a multiple of EBITDA and we like T-Mobile which is probably $28 a share or cheaper as we speak. It seems cheap on an intrinsic basis. Maybe eight times, maybe seven and a half times 2015 EBITDA. That's probably reasonable as I'm doing that off the top of my head. What is the revaluation catalyst here? Clearly T-Mobile is for sale. Actors such as Sprint had made its foray. The FCC says they want four strong telecoms in the US and you know, Wheeler as head of the FCC, has made that clear and apparent. Sprint has backed down but it doesn't mean that they go away. We can talk about that again in a minute but they were the first to raise the specter of the combination. Iliad, which is a French company, has talked about putting up a bid of $33 a share for some amount less than all the T-Mobile shares that are outstanding.

And there's some speculation as to whether they can raise that money or not. We think the company is probably worth somewhere between $35 and $37 in a buyout scenario and think that it's plausible that Sprint could come back post-election day and post the spectrum auction that's happening in November. We think Iliad could come to the table any day now with something new, that's plausible as well.

Let's go through “A” a bit further, which is very, very rich. The actor's assessment. You have, as mentioned, Sprint already saying they want to buy T-Mobile and is at odds with the FCC over this. There could be change of personal at the FCC at any point in time but the FCC's current stance is they want four strong telecoms and that would require T-Mobile perhaps to be outstanding. But it doesn't obviate the ability of somebody other than Sprint or other than the big four coming in, so who could that be? Could be that Iliad comes in. When you look at Iliad, it is sort of in the midst of consolidation in France and the French regulators are seeking to facilitate that. The three French telecoms that are potentially consolidating in some respects are Iliad, Bouygues, and Orange. And there's some talk that Iliad putting a bid on the table to buy T-Mobile is a ruse to get Bouygues to the table again, saying your best and last shot is to merge with us. Though the work we've done suggests that Iliad really is seeking partners. The potential partners that Iliad could team up with aside from a myriad number of private equity are strategic. They could also bid outright and without Iliad. Could be Dish, Charter, Cox, or

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American Movil. Between Charlie Ergen and Carlos Slim you have some very monied movers in the space that might find it interesting to buy T-Mobile for any number reasons. I could go on ad nauseum here for why this might make sense. There's one last important actor here which is Deutsche Telekom, which owns the majority stake of T-Mobile. It's been publicly expressed by Deutsche Telekom on their last quarterly call. Their great exasperation about the FCC's misguided view that there must be four strong US telecoms. They clearly wanted the Sprint deal to go down. There's speculation in Europe that Deutsche Telekom needs the monetization of their T-Mobile interest in order to do the more extensive cap-ex and build out that they want to do in their local markets in Europe. Iliad is talking to Deutsche Telekom directly and Deutsche Telekom may be jawboning saying that half the board is on the fence now about price. I think this is really all about price.

If you look at “C”, capital structure review, there is nothing in the T-Mobile cap structure that is an impediment to this equity valuation and there's nothing in our view in the T-Mobile cap structure that is a more attractive way to play this than through equity.

Finally, the externalities, the “E” part of BRACE. I'll go back to it again because we touched on it when we talked about “A”, the actor's assessment. There's the French regulatory environment that might really have Iliad, Bouygues and Orange more interested in each other than Iliad really is in T-Mobile, we'll see. There's the consistency of the FCC regulatory personnel and the FCC's take on four strong US telecoms. There's a wireless spectrum auction occurring in November and there is one last element to all this, which is the competitive climate that comes from Sprint and T-Mobile not immediately combining which may lead to price war. If there is a price war then valuations could get dampened. Just quickly, when you look at T-Mobile through the lens of our BRACE methodology, on its face it seems cheap on an intrinsic basis. There's a plausible revaluation catalyst in the potential buyout of T-Mobile. Deutsche Telekom is a very compelling actor in the process being a majority holder. There are a myriad number of potential acquirers that might make attractive strategic fits. All for very different reasons and any of them, other than Sprint, qualifies as creating a stronger fourth participant in the US wireless telecom market. The downside being that between here and there, there's a price war that starts to deteriorate margins. So there's T-Mobile. I think the upside downside suggests that it's attractive at current levels and I think that there's a better chance than not of a strategic combination. My guess is that we'll hear of that sometime between the wireless auction and the end of the first quarter of next year.

KN: *Have the current events in the Middle East and the West's response influenced your investment decisions? If so, how? If not, why not?*

PL: The impact of current events in the Middle East relate to hedges at best. I mean no political statement when I say that any politics associated with current events has no place in a portfolio unless it is mandated by the client. In the pursuit of the highest risk adjusted returns for clients what we care about and look for are the ways we can be hurt or benefit from geopolitics and how such concerns or opportunities should be reflected in a reshaping of the portfolio. The US is largely immune now to the vagaries of oil prices should any events in the Middle East impact oil pricing. We deem this unlikely. At the moment oil is in free fall and Saudi Arabia isn't helping it any. If, out of Middle East conflict, there is any terrorist activity in a developed market major city, there can be new market disruption and volatility as a function of this “new” geopolitical concern. Frankly, that worry is a default worry now, front page news or not, and should be addressed.

KN: *You've talked in-depth about human biases in investing. In your most recent white paper, you wrote: Given a manager's plausibly effective process, it is culture and the wringing out of human biases that allows a manager to demonstrate the differentiation of their methodology. What do you do as an investor to identify biases and how do you avoid them?*

PL: It starts with culture. We are a team of just six in New York which means we can avoid the dysfunctionality that comes from silos at larger firms. For example, there was an interesting trade we identified a year and a half ago through work that one of our people, Charlie, did on Activision. The majority of shares were held by a European media company, Vivendi. Through that work we identified Vivendi as interesting. Why was Vivendi interesting? Well, there's been a change of management. Vincent Bolloré became CEO. He's a large shareholder and he is shareholder friendly and talking about what we dub "social contract" behaviors—behaviors that would return value back to shareholders. So we put on two trades. We bought Activision and we bought Vivendi because we believed that Vivendi was going through a transformation. The revaluation catalyst at Vivendi was transformation with non-core assets being shed and shareholder friendly behaviors ensuing. The flip side of that was that Activision was going to be able to buy out the majority of its own stock and retire it at an attractive price. It was the only likely buyer which would be highly accretive for Activision shareholders. What's important about this is a theme then. When we screen for this theme, European holders of non-core US assets, we identified that Vodafone was a majority owner of Verizon shares. We had a parallel trade where it appeared that Vodafone was going through some likely shareholder friendly behaviors and the shedding of non-core assets. Similarly, in the US, Verizon was going to be the beneficiary of an ability to retire a significant amount of stock held by an overseas majority holder. So we have four companies, two environments, Europe and the US, varied researched industries or specialties. At a much larger firm there are any number of ways in which those trades wouldn't have happened. That quick connecting of the dots occurred at Tiburon because you have six people in the room that are all paid off of the performance of the fund and where we don't bring to that room every day the bias that "I need to have this trade on in my book in order to be important or to be compensated." You need to have people recognize that they don't own their positions—they're stewards of them for the benefit of the team and our investors. For that reason we can connect the dots quicker. In some firms you could have several different analysts or teams working on the deal because it involves a media and a gaming company trade in Vivendi and Activision. In our firm it's just one person. And that's one guy that stands up and says, "I think I see a theme here." We get there a lot quicker.

The BRACE methodology rings out biases as well because if you are dispassionate, if you are the stewards of portfolio positions, they don't take on a life of their own. They are not your friends. They're not animate objects. They're not even anthropomorphized. They are line items in a book that create gains and losses. There's a constant drum beat of the new. Our models tell us very forensically what is cheap or rich on an intrinsic basis and then we debate the richness of the actor's assessment and the plausibility of those catalysts routinely. We consistently underwrite and re-underwrite that portfolio utilizing our methodology. In that way, if you check your egos at the door, you lose a lot of the bias that somehow anyone is a de Medici that somehow just knows that "this is gonna make money." For many firms, from afar, they and their brand look like a smooth moving ship but internally there's great dysfunction in the house.

KN: You're a big advocate of the concept of "eat your own cooking", that is, investment teams that have stakes in the fund they manage, skin in the game so to speak. Why do you feel it so important?

"If I have to go home and explain to my wife why I can't pay for my son's education is a much more powerful motivator to getting this right than coming in and clocking and collecting a check every day. Which you effectively do when you don't have skin in the game.

PL: First of all, it's highly disarming when you have those down months as I described. The observances that don't match with markets. It's got to be comforting to the client for them to know that your money is in alongside with them and in fact, here at Tiburon, locked up longer than the traditional terms that we give clients. Two, when you're looking around the room you're not creating an environment where you have anyone that feels they are swinging for the fence with other people's money. An analyst or portfolio manager might have the internal conversation that goes like this: "If I'm right on a position I'm going to participate in performance fees and if I'm wrong, well I made my salary. My downside is limited." If I have to go home and explain to my wife why I can't pay for my son's education is a much more powerful motivator to getting this right than coming in and clocking and collecting a check every day, which you effectively do when you don't have skin in the game. I think it's a really important and powerful motivator.

I also like to talk about drinking our own Kool-Aid. There's just so much Kool-Aid you want to serve up. The methodology matters and BRACE matters but you serve too much Kool-Aid and you can get into the "not invented here syndrome". You know, any idea that emanates outside of the house sucks. Well that's not true. But, if you have your own money in, it kind of becomes part of that Kool-Aid service. I also have an obligation and my guys are obliged to roll not less than 25% of performance back in the fund every year and lock it up for two years. It is a way of making sure that we are genuinely excited about the decisions we are making in the portfolio. That doesn't mean that you can't still have the bias that you believe your ideas are best or better and you could be wrong to the detriment of all of us, but it helps mitigate this I think.

KN: *You've outperformed your peers and the benchmark (HFRI Event-Driven Index) over the past year. What contributed to your outperformance?*

PL: Our BRACE Methodology, as mentioned previously, includes both "B" the bottom-up approach, allowing us to discern rich versus cheap and "R" the revaluation catalyst. That hard event that's plausible. These two elements of our methodology give us the belt and suspenders to produce low downside as securities are bought or short "right" and have asymmetric upside upon the occurrence of the contemplated event. Sensitivity to the risks that can hurt portfolio performance, whether intrinsic to the trade, or macro/technical, can be distinguishing as well. For example, alpha is generated when plausible catalysts in the portfolio

We're often in trades that wind up being future trades put on by larger firms, but before they get crowded.

unfold. If market risks are wrung out at the portfolio level, risks not contemplated at the trade level such as commodity prices, then some of the ways you can be "right" and still not make money, are limited.

KN: *Outside of performance, how do you measure success for your firm, your team, and yourself?*

PL: I think we all know when we've done our best work and when we have not. If you have the right people with you they are harder on themselves than anyone. In fact, whether we outperform or not in any one month say, one observance, is not relevant at all. I hate losing money—ever—that is probably due to my Izzy Englander (Millennium) coding. What does matter is that decisions are being made that are apolitical and absent, as best as we can manage, of human biases. If we are doing those things we are making an effort and being open-minded to the range of possibility outcomes, and ultimately all is right with the world. A refined methodology, utilized by a cohesive and confident, carefully selected team, is going to outperform for the long term. Ours is BRACE. If we do, we will create a lasting legacy for Tiburon. I am confident in this outcome.

KN: *I think this quote best summarizes Tiburon Capital Management: "Where the next big idea comes from should not be important. The risk-adjusted return of our investor's portfolio is." Would you agree and is there anything else you would add to it?*

PL: Yeah, that is, risk-adjusted return doesn't necessarily mean downside protection. We're out there looking for new themes but they need to present asymmetric upside and once we think we found asymmetric upside it's properly sized in a portfolio. A portfolio that is managed for what is a reasonable return characteristic in what is and has been a very low risk-free rate environment. It is in some ways very mathematically and logically divined. We get back to that too when we talk about the human bias. A lot of what we try to wring out is that notion of some messianic view. You know, "I had a dream last night that Pepsi was gonna separate the snack foods from beverages. Let's double the trade." I've worked in environments where I've heard people talk like that. Hunches matter only when they're observable and then it turns out that they're not really so much hunches. That's the "A" part of BRACE perhaps. We're probability weighting the events based on highly qualitative things. So there already is a qualitative aspect to what we do. Everything else we're trying to be as quantitative about it as we can. We're not looking for the needles in the haystack. We're not buying biotechs for the optionality of the home run ball. There has to be something to that and that's not to say that we can't have significant asymmetry in return characteristics of the fund. If we had a huge 60, 70% year, massive 10, 20, 30% months, you'd have to raise some questions about sizing. Everybody likes those returns when you have them but I would be extremely concerned about what that means in terms of how one drills down to size positions. At Tiburon, we'll consider the co-dependent risks that run through the portfolio. There's a lot of opportunities we will uncover that get us to a place where we'll say that in this low return environment we can target mid-teens, low risk-adjusted returns and likely deliver on that. We care very much about the big ideas but they come typically from in the reeds and work like the story I told of identifying the overseas share buybacks through work on Activision. You get there one building block at a time. One trade begets an industry overview. An industry overview gives you a sense for the dynamism of regulatory, legal, capital markets or other thematic veins.

KN: *And with that, I want to open it up and ask you questions submitted by the Harvest investment community.*

From risk management to idea generation to doing the due diligence on your ideas, which aspect of the investment process do you find most difficult?

They all differ and often times draw on various Tiburon personnel. I spend a lot of time on themes and particularly like to get out in front of their inevitable discovery by other investors. Some of our people (Charlie Trisiripisal, Harini Chundu, Levon Kololyan) are comparatively advantaged to process such themes and are looking for the best company's securities to express these themes. Brian Swain, my co-PM, among many things, is comparatively advantaged to shape the hedges around risk we might identify and manage exposures accordingly. So what I am saying is that Tiburon has the luxury of being able to draw upon many talented people with diverse strengths in order to construct a terrific portfolio.

One aspect not mentioned is that the market can make you look like an idiot every day. We are in a much harder investment environment post the Great Recession than I've seen in my better than twenty years of investing. I often talk of this, and agree with Mohamed El-Erian's take that we are in a period of "multiple equilibria", what I would anticipate to cause many years of sideways trading markets. The difficulty of this work in this environment washes out many people not suited to it. I think we are advantaged here based on our unusual lineage. My eight years being a student of—a partner of my mentor, Marty Whitman of Third Avenue Funds, gave me the unusual training hands-on with a ranking academician on Value Investing who was a great investor. From Marty, I learned about gleaning cheap from rich. He would say about some investments that would go against us, "The world will figure out that we are correct. Absent a change in assumptions a large price move down means we should own more." My three years with Izzy Englander, also a major influence, was about how to manage risk. How to not lose money which is different than how to make money, in my mind. In markets post the Great Recession the combination of these philosophies has been integral to winning.

KN: *How important is discussing your ideas with other investors as a part of your research process?*

PL: We don't shy away from that. If you look at the last white paper I wrote on wringing out human biases, I mentioned it and alluded to it a little bit earlier, the "not invented here syndrome" versus the "proudly found elsewhere syndrome". Because other people are involved in trades doesn't mean we care more and because we might hear about it elsewhere, whether it's sell side or friends and colleagues at other firms, or preferably professionals that are in uncorrelated walks of lives that we might collaborate with, doesn't mean we don't care. If you have a strong team that is confident in its own capabilities and you have a refined methodology, which we do in BRACE, then you can have the confidence to read outside research, talk to management, and talk to other investors out there and draw your own conclusions. There is a fine balance. We have after twenty five years in this business extremely good connections in many places and are often, let me choose my words carefully, comparing notes with people about the things that we're working on. Cautious to the point where we make sure our own situations are well established before we discuss them. But oftentimes in forums such as conferences or dinners or visits we might have with friends and we might compare notes.

If you're in this business a long time you tend to get to know many people and such people can come from unusual walks of life as well. For example, two years ago we had a theme that started in the spinoff of Motorola handset and security businesses. From that, working with somebody that worked at a wireless company that had become a consultant in wireless telephony, and came to a view about the race to zero in handset costs and the advertising costs that these companies were spending. That led to so many other trades. Broadly, we had a concise industry-based theme. This led to the value of intellectual property which we expressed through long Nortel bonds and through long a company called Interdigital. The race to build out 4G led to a Sprint long/short in the cap structure because they were going to either need to finance the buyout of ClearWire or 4G. The short on Blackberry, on RIM because the world was bifurcating into Android or Apple architecture. My point being that it is important to touch the outside including sell side. We're not reliant on it, but we don't shy away from it. It rarely finds its way into our models as reasons to do anything but if you think about it, sell side and other firms are as much actors and should be considered in the BRACE actor's assessment.

KN: *Event driven investing has become a new buzzword around consultants and institutions as they look at recent trailing performance numbers. How will your firm maintain its approach and independence even as significant assets are rolling into the space and certain "events" are becoming crowded trades?*

PL: Well, the beauty of our approach is that it is very well thought-through. Before we even get to the uniqueness of BRACE, there is a differentiation in the Tiburon mandate. Not all event-driven managers are the same. Our mandate has agnosticism long or short; not all are. Agnosticism among the myriad of securities so bank debt, bonds, equities, options and derivatives thereon. And agnosticism around the fully rich landscape of plausible catalysts. Whether it's a sum of the part trades, spinoffs, asset sales, divestitures, M&A, lawsuits, that could be won or lost, product launches or failures, scandal, fraud, stub trades, when-issued to regular way, all sorts of arbs. The broadness of that mandate and the flexibility of BRACE as a focal point to channel those ideas through gives us a significant leg up. We're often in trades that wind up being future trades put on by larger firms, but before they get crowded. We connect the dots quicker because of the lack of dysfunctionality in the room. The BRACE methodology allows us to identify the best risk-adjusted trade in a cap structure that might not be the most obvious. Maybe playing a merger arb trade through a long change of control bond or short a bond in a cap structure where we think there'll be significant leverage laid on is a better trade that via equity–as might be typical for many merger arb funds. When Dell got bought the best trade was not in Dell shares, it was short Dell bonds. This flexibility in mandate, along with a refined and proprietary methodology, gives us a significant leg up relative to others as assets find their way in to the discipline.

> “Two lessons. One, check your ego at the door. No one needs to know how smart you are and two, listen and don’t talk unless it’s essential to attain knowledge”.

KN: *For the aspiring managers on Harvest, can you talk about other memorable experiences or lessons learned prior to working with Marty Whitman at Third Avenue?*

PL: I came to Marty from trading bank loans on a bank syndications desk. When 1990 came and the witch-hunt of Drexel, I knew where all the bank debt was, which was compelling to Marty. Anyway, this was a pioneering time in the product of bank debt. It was a telephone business with all trades offered and accepted telephonically. I got a call from five people on a box; not the best audible quality. It was perhaps my then biggest counter-party. A newly launched and one of the first Prime Plus Funds. After pleasantries, they’d said they just completed a portfolio meeting and needed to buy a decent size piece of the Pullman Term Loan. I took the order and the price limit. This was huge as Pullman rarely traded in a market where I might have been 50% of the volume in those days and the price limit was generous. There was one holder of Pullman Term Loan that was a more panicky seller than the others. I bought their piece cheaply. Pleased with the promptness and execution of the trade, I called back the Prime Plus-ers to confirm it out. I said “I sell $XX million of Pullman Term Loan to you at YY.YY%”. The PM put me on hold and got the rest of the team on the call. He asked me to repeat myself. I said, “As per your order, I sell $XX million of Pullman Term Loan to you at YY.YY%.” I heard laughter. On the same speaker phone over a box method, one of them said, "We asked for Pullman." “Yes”, I repeated, “that is what I am selling you.” Laughing again, “Spell it.” they said. “P-U-L-L-M-A-N”, I repeated. Laughing, they said, “No, we said go buy Coleman—C-O-L-E-M-A-N.”

Well, not only wasn’t it funny at the moment to be long $XX million of this POS, but there was no way I was going to hold them to it. The best thing to do was to mitigate and try to get out. I did the best I could calling around to the one or two legitimate loan traders of the day, first offering the Pullman Term Loan at my cost and asking for a counter. There was none. One of them who I was particularly close with at the time, I asked as a friend, if he was aware of anyone who cared for Pullman at any price. I was long the loan and was going to have to deal with it but if I could enlist him, the two of us could be quite formidable with my balance sheet exposure. In the interim, perhaps only an hour passed by or so. In the world then, this small but ridiculously profitable market was fairly cut throat. Every loan syndications secondary desk had ever more game personnel trying to get a loan trading business started. Those that did but had no real flow, connectivity, wiles, or creativity didn’t trade much, but did all the leg work to determine who were buyers and sellers of various

They all talked. In my calls to the one or two legitimate traders to gauge their interest they must have themselves called a few others and they themselves may have called others and so on.

Anyway, in my urgency to limit this exposure and potential loss, I started to call the trading desk wannabes to see who might plausibly take on the exposure. I reached one who had an enormous chip on her shoulder about her place in the business. Nonetheless, she needed to let you know that she knew everything that was going on and was truly involved. I called her and said one word, “Pullman.” “I know, I know, XYZ Bank is a seller, ABC Prime Plus Fund is a buyer, what’s your offer?” She lifted me without any question. I got off the phone and at this point my desk was fully aware of this issue. They were dumbfounded by the outcome—I had in one hour’s time bought size of a crap loan and passed it to another without a loss for the benefit of a purported buyer not interested in this loan at all. “Two lessons," I said. “One, check your ego at the door. No one needs to know how smart you are and two, listen and don’t talk unless it’s essential to attain knowledge”.

KN: *What was your most memorable investment and why?*

PL: There have been many over the years but one that I love to talk about, and the team makes fun of me for this, is Landry’s Restaurants—a position I had at Millennium. I joke it was one of two times that I could watch a weather pattern on one screen and securities prices on another, knowing there was correlation. Landry’s is an amalgam of restaurant brands. The company was public at the time. Tilman Fertitta, the founder, owned and controlled something in the order of 40% of the shares or so and was talking about taking out the balance and going private. This was 2008 and deals like this were failing left and right. Fertitta did a great job at securing Wells Fargo and Jefferies in an underwriting to acquire the company at $23 a share or so. We were long a short dated bond. I believe that it matured or could be put to Landry’s at 101 in March of 2009 and the shares in and around $14 a share or so. Wells and Jefferies had airtight obligations to fund absent a Material Adverse Change (“MAC” clause). Hurricane Ike was making its way up the Gulf of Mexico. It was poised to hit perhaps near Galveston, Texas. I was watching a constant 99.5 bond price on one screen and a hurricane gathering strength, bearing down on Galveston on another. This was the headquarters of Landry’s and the location of 25% of company revenues along the beachfront of Galveston. Bonds were 99.5 bid and the shares were trading at $21. My inclination was to get out of each as there was little upside in seeing the aftermath of Ike. I called some of my friends at other larger firms with meaningful holdings in the bond. “We are well covered through par” was the common refrain. I bolted the bonds at 99.5 and sold our position in the shares and put on a short at $21 a share or so.

Hurricane Ike devastated Galveston. The beachfront was under ten feet of water. Tilman Fertitta, who had a “hell and high-water” (pun intended) obligation to finance the buyout from Wells and Jefferies, stated to the press, “This is not the company I thought that I was buying.” Bonds traded down to 74 and shares traded down to $14. But Landry’s also had business interruption insurance. The company would be able to completely rebuild and the insurance also covered, as I recall, up to one year run rate EBITDA. The business interruption insurance I would argue, and Fertitta could argue, would cover any technical claim of a MAC based upon EBITDA. If you consider an “A”, actor’s assessment, why would Tilman Fertitta say this in the public domain? In an era where Huntsman was attempting to compel closing the Hexion deal, with language in his documents not as air tight, why would Fertitta lend credence to a MAC? Unless he had a community of interest with Wells and Jefferies. What if the conversation with them went like this: “Wells, Jefferies, you have no ability to get out of financing this buyout, but wouldn’t we all want to do it at a lower price?” This is what I suspected. This seemed most probable. We covered the short equity position at $14 and bought long. We bought the bonds back at 74. As I recall, shortly thereafter, the deal was struck at $18 a share and the bonds came out at 101.

KN: *What would you consider the largest impediment and obstacle in this career field?*

PL: Dysfunctionally run organizations and capricious portfolio decisions—largely a function of egotism and human biases.

KN: *Has it helped you or hurt you looking like Christopher Walken?*

PL: [Laughs] It's come up from time to time. I can't dance like he does and he probably can still get a table at a restaurant quicker than I can.

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