



BLACK BEAR

VALUE PARTNERS

February 5, 2018

Black Bear Value Partners LP

“A man who carries a cat by the tail learns something he can learn no other way.”

-Mark Twain

To My Partners and Friends:

Black Bear Value Fund, LP (the “Fund”) returned approximately 4.3% in the 4th quarter of 2017 ⁽¹⁾ bringing the YTD net return to 7.6%. This compares to 6.6% for the S&P 500 in the quarter, bringing its YTD return to 21.8%. The Fund has returned 9.3% as compared to 14.5% for the S&P 500 since opening to outside investors. We do not seek to mimic the returns of the S&P 500 and there will be variances in our performance. We own a concentrated portfolio that will deviate both to the up and down. In 2017 we had an average cash balance of ~26% and an average short position of ~14%.

Thank you to our partners and fellow investors in the Fund. It is an honor to manage your money alongside mine and appreciate the trust you have placed in our partnership. I send my gratitude to my friends (both old and new) and family for talking thru many topics and sharing their wisdom as it relates to investing, running a business and life. I am the beneficiary of a special network of like-minded investors who share their knowledge and expertise in a variety of fields.

Thank you to my wife and kids (for whom this fund is named) for allowing me the flexibility to pursue this dream. In order to be a successful investor one must practice patience. Of equal importance, one must also have a very patient spouse to put up with them.

As mentioned in previous letters, a substantial amount of the Fund’s capital is my own. I focus my time and energy on compounding our capital over the long-term. While I would like to grow our assets I am not prepared to spend tremendous amounts of time pitching and marketing. In time, I believe money goes where it’s treated best. At Black Bear every LP’s dollar is treated with the utmost consideration and care which should lead to good things. I am looking to build a partnership with deep and long-lasting roots.

A fundamentally-driven and concentrated investment portfolio should outperform various market indices over a long-term horizon with reduced risk of permanent capital impairment. Each investors’ return will vary depending on the timing of the investment. I would caution those reading that our portfolio is shown at a point in time and can change for a variety of reasons.

Monthly Performance Net of Fees and Expenses														
		Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Year
2017	Black Bear Value Fund	-1.3%	-0.4%	0.9%	0.2%	-0.5%	1.4%	1.9%	0.7%	0.4%	-0.9%	3.7%	1.5%	7.6%
	S&P 500	1.9%	4.0%	0.1%	1.0%	1.4%	0.6%	2.1%	0.3%	2.1%	2.3%	3.1%	1.2%	21.8%

Strategy Exposure				Top 5 Gross Long Positions & % Exposure			Top 6-10 Gross Long Positions (Alphabetical)				
	LONG	SHORT	NET								
Equities	89.5%	0.0%	89.5%	Berkshire Hathaway	BRK.A/B	14.5%	Interactive Brokers		IBKR		
Credit Related	0.0%	-19.8%	-19.8%	Alaska Airlines	ALK	10.8%	Liberty Broadband		LBRDK		
Total Investments	89.5%	-19.8%	69.7%	21st Century Fox	FOX	10.6%	Liberty SiriusXM		LSXMK		
Cash	5.8%	0.0%	5.8%	TiVo	TIVO	7.3%	MSG Networks		MSGN		
T-Bills	24.3%	0.0%	24.3%	Alphabet	GOOG	7.1%	Phillips 66		PSX		
Total Cash/T-Bills	30.1%	0.0%	30.1%								
<i>Options increase our short position by ~200 bps.</i>											
Gross Concentration Breakdown						Additional Long Positions Outside Top 10					
					Long %						
				Top 5 positions	50.2%	Apple		AAPL			
				Top 10 positions	78.7%	Autonation		AN			
						Tripadvisor		TRIP			

(1) Performance figures represent actual performance from inception.



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Brief descriptions of the top 5 long positions follow. These positions comprise ~50% of the portfolio at year-end.

Alaska Airlines (10.8 % of assets)

Black Bear has invested in a number of companies whose headline business obscures “hidden” or undervalued sticky businesses beneath the surface. ALK fits the bill. Examples of these businesses include:

- Phillips 66 – a cyclical, unpredictable refining business dominated headlines while lots of cash was being generated by chemicals, midstream and gas station assets
- AutoNation – worries about low margin cyclical business of selling cars led to investors ignoring the growing car park coupled with potential growth and sticky cash flows from parts and service

When I look at airlines I see 2 businesses: a transportation/seat-distribution business which has cyclicity and a sticky cashflowing credit-card business with limited cyclicity. Large amounts of cash are generated by the airlines selling miles to banks irrespective of airline capacity or ticket prices. There is limited disclosure by the airlines so the sell-side focuses on predicting the unpredictable. This translates into volatility and opportunity.

ALK is a cheap, well-managed airline that possesses a cost advantage versus the network carriers (American, Delta and United). ALK also benefits from significant top-line and bottom-line synergies from their recent acquisition of Virgin America. While they have historically focused on traffic in the Pacific Northwest their semi-recent acquisition of Virgin America results in more transcontinental exposure and a balanced network.

Historically airlines have been a brutal category of investment, with cut-throat competition, huge fixed costs, too much debt and too much capacity. Management teams have acted like overzealous developers who see a hole and want to build (in this case “SEE CLOUDS, BUY PLANES”). The industry appears more rational today as bankruptcies and mergers have resulted in a reduced number of airlines serving customers. I guess enough bankruptcy filings can bring religion! It appears management teams have learned from history but only their actions will prove this. In the meantime, the investment community holds their breath and gives limited credit. At a high-level I think we are buying Alaska at ~9-10x earnings and ~10-12x free-cash-flow. They should also be a beneficiary of recent tax reform which is not incorporated in the numbers.

In the last 2 quarters the stock sold off dramatically on two occasions as investors worried about their integration of Virgin America, increased industry capacity and a rising cost base. In layman’s terms they had more seats to sell and prices were going down for tickets...typically not a recipe for success and gave many a bit of a PTSD-like reaction to the memories of airline executives spending recklessly. Investing in airlines is not for the faint of heart and there are large swings in the price. A lot of analysts try to predict the next 3-6 months of capacity (seats), ticket pricing and traffic. A better approach is to think about where the business will be 3-5 years from now. When you ask questions that impact the longer-term trajectory of the business, many of the short-term headlines and worries become less relevant and as a result open up opportunities to buy the business cheaply.

An advantage we have is the benefit of time and patience. The management team has historically been best-in-class operators and while integrating a merger is not easy, things should workout in time. Recently the CEO was asked why they are not growing as fast in 2019 & 2020 and to paraphrase he said there is a time to grow and a time to be patient...this will be a time to be patient. These are the kinds of attributes we look for in the



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management teams we invest with. At current prices we're being well compensated to wait and let this team perform.

Alphabet Holdings (7.1% of assets)/Capex and Operating Expenses Discussion

I wanted to share a quick lesson on the difference between a capital expenditure and expense and why it matters to Alphabet shareholders. Hopefully this is useful for you. **WARNING** – an accounting vignette follow:

When a company builds a new plant or a distribution center they capitalize the money spent and over time recognize the expense. What does that mean? If we build a factory for \$1MM we will recognize an expense of \$100,000 a year (assuming 10 year depreciation). On a cashflow basis you pay that entire \$1MM upfront. You get the economic benefits of this new factory over its life so you recognize the expense over its life as well.

Now shift to Alphabet. Many of their new ventures are being run through their "Other Bets" and expensed NOT capitalized. So our Google Factory of Ideas (self driving car technology for one) is being dinged for the whole \$1MM upfront even though we may get a very big economic benefit over the medium to long-term. Put another way, we're taking the entire earnings hit TODAY for businesses that could pay off TOMORROW. If they were to capitalize these expenses and recognize the costs over time GOOG would look cheap, not expensive.

Alphabet is the holding company for Google (Advertising/Search) and Other Bets (Ex: Waymo, Nest, Google Fiber). Alphabet is a cash-machine with 40+% returns on capital and a fortress balance sheet (no net debt). Ex-cash and other-bets, Alphabet is trading ~6% free-cash flow yield and grows 15+%. Other Bets obscure the cash-generative abilities of the company as they currently lose money and burn cash. While pricing per click (the price Alphabet gets) has been in decline, the number of clicks (the volume) is growing as more and more people are glued to their mobile devices. Mobile is a lower price point but much higher volume. Think of this the next time you ask your friend or family member to put their phone down – they could be clicking and making you money as an Alphabet shareholder.

Berkshire Hathaway (14.5% of assets)

Describing Berkshire in a simple manner is a challenge. Allan Mecham did an admirable job describing BRK as a "meat grinder that relentlessly piles up value year over year (and decade over decade)." Berkshire is trading ~1.5x book value which underestimates its true intrinsic value. We own BRK at a 20+% discount to the combined value of their stock portfolio and their operating businesses (at a 10x multiple). Add in the benefits of investing free money (the float from insurance) and a business compounding at high single digits with wide moats and you get the aforementioned meat grinder.

TiVo (7.1% of assets)

TiVo may be one of the more misunderstood businesses in existence today. I would put this company in the low-risk/high-uncertainty camp. The company should be able to generate its entire market cap in free-cash flow over the next 3-4 years. The market seems to under value their patent cashflow, the synergies from a recent acquisition and the upside from a potential settlement with a large former customer (Comcast).

The average investor, including me at first, typically thinks this is a B2C (sells to consumers) hardware company that sells DVR's. It is now predominantly a B2B (sells to businesses) licensing and intellectual



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property company who forms the backbone of the guides, DVR's, OTT interfaces. You don't know you are using TiVo technology when you click around or use your DVR. TiVo is actually 2 companies: Rovi and TiVO who recently merged. They are going to remove \$100MM of costs as the 2 companies had overlapping expense structures. The negatives and bear case for the stock are as follows:

- 1) General negativity for all things media as people fear cord-cutting
- 2) A protracted legal battle with Comcast who was a large customer
- 3) New CEO
- 4) Lack of disclosure about patent run-offs

The new CEO, Enrique Rodriguez, is a former disciple of Jim Meyer (CEO of Sirius and also Chairman of the TiVo board). He personally bought \$1mm in stock and accepted a pay package that is almost entirely dependent on the stock compounding at 20-30+% **annually** over the next 3 years. The Board also benefits from having Glenn Welling, a thoughtful activist-investor from Engaged Capital.

There are many ways for us to win ranging from the realization that the ecosystem is shifting not disappearing, to a settlement with Comcast or to an outright sale of the company. Some additional corporate disclosure of the patents and likely medium-term cashflow would help bridge the understanding for the investment community. As they produce the cashflow and work through the issues with Comcast the uncertainty should lessen.

21st Century Fox (10.6% of assets)

It was announced in the 4th quarter that Disney would be purchasing the bulk of FOX's assets. It is hard to predict why cheap businesses become fairly priced over time. What's clear to me is if we buy businesses cheaply we can make money in a bunch of different ways. In the case of Fox, their unique content and businesses have value and were worth acquiring. While I typically don't disclose activity post-quarter, this is a unique circumstance given my decision to hold for tax-reasons. As our tax rates would go down in 2018 it did not seem prudent to sell FOX until the calendar year switched over so we could realize higher after-tax returns.

The profile of FOX as an investment has changed. As a FOX shareholder you own the remaining businesses plus an implied investment in Disney stock (assuming the deal goes through). While I love Disney and think it is a phenomenal company I'm not inclined to own it at this price. This could change but for the time being the Fund no longer has a position in FOX. We do have a number of positions across a variety of media names that suffer from the fear of cord cutting as well as other fears.

Approximate top 10 attribution for 2017:

Below are the central contributors to the Fund's 2017 performance as a percentage of the total 2017 gain.

<u>Name</u>	<u>Ticker</u>	<u>%</u>
Berkshire Hathaway	BRK	26%
Interactive Brokers	IBKR	23%
Alphabet	GOOG	19%
21st Century Fox	FOX	18%
Phillips 66	PSX	13%
Linamar	LNR.TO	12%
Autonation	AN	10%
Apple	AAPL	8%
Tivo	TIVO	-6%
Cimpress	CMPR	-5%



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Average quarterly exposure for 2017:

As you can see below we had a large cash position and a growing short position throughout 2017. Our existing exposure (as of 12/31) can be found on page 1.

Strategy Exposure - 1st Quarter				Strategy Exposure - 2nd Quarter			
	LONG	SHORT	NET		LONG	SHORT	NET
Equities	57.7%	-0.1%	57.6%	Equities	75.0%	0.0%	75.0%
Credit Related	0.0%	-2.4%	-2.4%	Credit Related	0.0%	-14.9%	-14.9%
Total Investments	57.7%	-2.5%	55.2%	Total Investments	75.0%	-14.9%	60.1%
Total Cash/T-Bills	44.7%	0.0%	44.7%	Total Cash/T-Bills	39.9%	0.0%	0.0%

Strategy Exposure - 3rd Quarter				Strategy Exposure - 4th Quarter			
	LONG	SHORT	NET		LONG	SHORT	NET
Equities	72.7%	0.0%	72.7%	Equities	85.7%	0.0%	85.7%
Credit Related	0.0%	-15.4%	-15.4%	Credit Related	0.0%	-19.6%	-19.6%
Total Investments	72.7%	-15.4%	57.3%	Total Investments	85.7%	-19.6%	66.1%
Total Cash/T-Bills	42.7%	0.0%	0.0%	Total Cash/T-Bills	33.7%	0.0%	0.0%

Process vs. Outcomes and Mistakes of Commission/Omission

I want to highlight some thoughts on Cimpress with the benefit of perspective. As a portfolio manager I am going to make mistakes and putting them down in ink for you to read will benefit my evolution and our partnership's returns.

I made some mistakes in owning Cimpress: a mistake of commission (including a name I should not have) which may have ultimately resulted in a mistake of omission (not owning when we should have). The position did not directly impact anyone but me as I exited it prior to taking in outside capital. Nonetheless I think I screwed up in buying it and although it went up substantially since I exited, it was still the right decision to sell. I am trying to avoid outcome-based analysis and focus more on evolving/bettering our investment process.

When I originally bought Cimpress I thought I understood the business. As I spoke to other investors who were involved I got more uneasy about my lack of understanding. Three things made me uneasy:

- 1) I did not feel I could adequately benchmark the management team's business plan
- 2) Leverage of the business compounded this worry
- 3) Number 1 & 2 made it hard for me to buy more when the stock was down

Typically, when encountering a name I don't understand I pass on it. Had I never owned the stock I would have just passed on the investment, but given my existing involvement I gave myself a bit more latitude which wound up costing money. I should have sold it quickly. I am glad it was a lesson that was learned solely on my dollar and not yours. If you think this was an error of omission then it most certainly cost us all a lot of money as the stock has doubled. Overtime I think the process of avoiding businesses that are too hard for me to understand (or selling if I change my mind) is good.



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Shorts

I shifted our short out of commercial real estate after thinking through the potential ramifications of the tax bill and my uncertainty of the outcome. While I am still of the belief that real estate is expensive and faces headwinds, there are specific benefits in the new tax code that could benefit the space and their ability to raise income. Additionally, given the President is a real estate guy I felt like I was fighting upstream on this and had other ideas which would similarly benefit asymmetrically without the downside worry of shorting the REIT's.

ETF's (exchange-traded funds) and passive investing are the topic du jour in the investment community. Passive investing is a good idea when not taken to extremes and indexing equities is appropriate for most people. History has shown us multiple examples of how a good idea can be taken to extremes resulting in excessive risk-taking and catastrophic outcomes (see 2007 financial crisis). Indexing illiquid junk bonds with limited legal protections is asking for trouble if the waters start to get rocky. . Note these "high yield" bonds have a current ~5-6% annual yield. When high yield prices inevitably decline and there is a need for liquidity these structures may fall apart.

The Fund continues to hold a variety of shorts in fixed-income ETF's (exchange-traded funds) spread across high-yield and international sovereign debt. We profit when bond prices fall/interest rates rise as rates and bond prices are inversely related. It seems preferable to own companies at 10-20x present cashflows that are rising 10+% a year as opposed to 10Y bonds at 40x a non-growing earning stream (simple math is when the 10Y treasury is at 2.5%, divide 100/2.5 and that's your multiple). Remember when you own a bond you do not participate in the upside of the business unless you've bought it at a meaningful discount.

If the current economic situation weakens it will likely impact the earnings abilities of the high-yield bond issuers which could lead to spread widening. It seems like a compelling bet given the low-rate environment.

Cash

We entered 2018 with ~10% net cash position (ignoring the benefit of the extra cash we have from our shorts). This was inflated a bit as we had some taxable gains that would benefit from 2018's lower tax rates. We have a larger cash position today and will provide more details in further communication.

General partnership business

Lastly, a big thank you to our partners/service providers. There is a lot that goes on behind the scenes, some of it new for an emerging manager. I count BTIG (prime broker), Opus Fund Services (fund administrator) EisnerAmper (tax/audit) and Kleinberg, Kaplan (attorney) as partners in our business and thank them for their help in 2016/2017.

Thank you for your trust and support.

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Please note that net returns presented reflect the returns of the Fund assuming an investor “since inception”, with no subsequent capital contributions or withdrawals. You should understand that these returns are not necessarily reflective of your net returns in the Fund, and you should follow-up with Black Bear if you have any questions about the returns presented herein.

An investment in the Fund is speculative and involves a high degree of risk. Black Bear is a newly formed entity with limited operating history and employs certain trading techniques, such as short selling and the use of leverage, which may increase the risk of investment loss. As a result, the Fund’s performance may be volatile, and an investor could lose all or a substantial amount of his or her investment. There can be no assurances that the Fund will have a return on invested capital similar to the returns of other accounts managed by Adam Schwartz due to differences in investment policies, economic conditions, regulatory climate, portfolio size, leverage and expenses. **Past performance is not a guarantee of, and is not necessarily indicative of, future results.** The Fund’s investment program involves substantial risk, including the loss of principal, and no assurance can be given that the Fund’s investment objectives will be achieved.

The Fund will also have substantial limitations on investors’ ability to withdraw or transfer their interests therein, and no secondary market for the Fund’s interests exists or is expected to develop. Finally, the Fund’s fees and expenses may offset trading profits. All of these risks, and other important risks, are described in detail in the Fund’s Memorandum. Prospective investors are strongly urged to review the Memorandum carefully and consult with their own financial, legal and tax advisers before investing.

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