PAPYRUS CAPITAL

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Dear Partner, January 18, 2018

The Papyrus Capital Fund returned -4.0% in the fourth quarter of 2017 net of fees and expenses, a full year 2017 return of +11.6%. Our Longs returned -2.8% and our Shorts generated -1.3% in gross attribution in the quarter. Our gross exposure was 105% while our net exposure was 65%, as we added/sized up longs and shorts, equally.

Papyrus Capital LP Performance							
Year	Q1 2017	Q2 2017	Q3 2017	Q4 2017	2016	2017	Cumulative
Net Return	**6.9%**	**5.8%**	**2.8%**	**(4.0)%**	**13.8%**	**11.6%**	**27.0%**
Long Attribution	9.3%	7.3%	4.2%	(2.8)%	17.7%	18.0%	35.7%
Short Attribution	(1.3)%	(0.2)%	(0.6)%	(1.3)%	(0.1)%	(3.4)%	(3.9)%
S&P 500	**6.0%**	**3.1%**	**4.5%**	**6.6%**	**12.0%**	**21.8%**	**36.4%**
Net Exposure	65%	66%	64%	64%	66%	65%	65%
Gross Exposure	100%	99%	101%	105%	99%	101%	100%

1. Portfolio Management in the Quarter

The VIX (volatility index) stayed fairly constant this quarter at multi-year lows given better US GDP growth along with the passing of the tax bill. Credit markets were stable, oil prices rallied, while housing was strong/as expected in Q4. Interest rates were volatile given Fed commentary and ended the quarter slightly above where they started. The labor market improved with unemployment dropping below Q3 levels and the labor participation rate increasing.

What Did We Do at Papyrus in Q4?

The volatility of the S&P 500 Media Index (S5MEDA) was significantly greater than that of the S&P 500 from September through year-end, resulting in aggravated positive/negative earnings reactions in telecom and media names. The tax plan also caused increased tax loss selling, amplifying the declines of 2017 losers in late Q4. We used the opportunity to add to longs unfairly punished (mainly LILAK and TSQ) while shorting a couple new names that hit euphoric highs. We also ramped on one new industry at the end of the quarter, aided by our new addition to the team (more information below). **Leaning into the declines in our long book positions us very well for 2018 and beyond.**

Deeper Dive into Q4 2017 Performance

In previous letters, we discussed the broader attributes of our process/portfolio including the barriers to entry, low multiple vs. the market, quality of our businesses, the benefits of our portfolio construction and the resulting high batting average (due to all of the above). Since Q4 is the first quarter since launch where we have underperformed the S&P 500 by a wide margin, we believe it's important to highlight the origin of the losses and the resulting opportunity.

While we did underperform this past quarter, we are very happy with our overall 2017 performance of +11.6% net. Recall that in our marketing meetings, I have discussed my hurdle for our Well-Managed Longs of 15-17% growth plus yield, meaning that at a steady state multiple, the FCF yield (inverse of the multiple) plus the annual medium-term FCF growth should exceed 15-17%. With some margin for error, this should result in a CAGR/IRR of 10-12%, annually, over the long-run, a goal which we hit in 2017 despite two large shocks to our LILAK and HMTV positions in 2H 2017, discussed below. A few brief stats from a recent Goldman Sachs report on some of what's driving the recent rally:

- Growth beat value by 15 percentage points
    - Just about all of the longs in the Papyrus portfolio would be classified as value, and shorts as growth
- Companies spending on growth (R&D+capex) outperformed those returning cash to shareholders by 14%
    - We prefer businesses which require limited reinvestment to grow and instead, return cash to shareholders
- High tax rate stocks (basket of 50) outperformed the S&P 500 index by 300bps
    - We actively look for longs with tax shields (through net operating losses and D&A/capex divergence)
- GS Equity Long/Short Hedge Fund Index returned 10% in 2017

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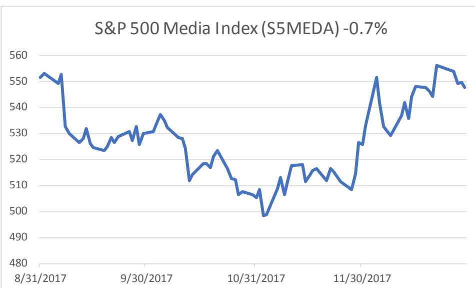
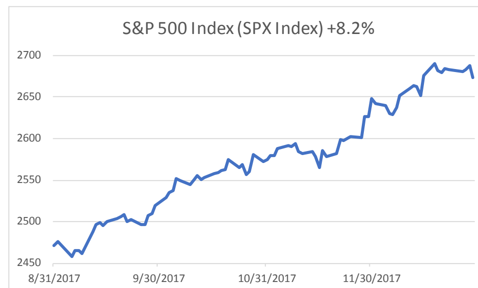
The stats above convey the recent rally as wrought with short-term speculation in a QE fueled environment where a 15-year old may become a Bitcoin multi-millionaire overnight. While we are swimming upstream against this trend, **we believe that a conservative, predictable portfolio replete with funeral homes, self-storage, broadband, good industrial businesses, cheap radio…etc will provide us with a solid long-term compounding machine through cycles, though such a cautious approach will result in short-term underperformance in a speculative rally like that of Q4 2017.**

More Specifically – Why Exactly Did Papyrus Underperform in 2H 2017?

A. Weakness in Media and Telecom

As previously discussed, the media and telecom sector offers a great opportunity due to the creative destruction (growth and decay of businesses that we can often predict) in the space. The sector also offers the least correlation to a single factor vs. healthcare (regulatory correlation), energy (oil prices), industrials (cyclicality), financials (interest rates)…etc. However, high exposure to a single sector may cause a short-term aberration to market performance when that sector undergoes a transition or rotation. This happened in media and telecom in 2017, beginning in September.





The S&P 500 Media Index (S5MEDA) dropped precipitously in September, causing investor jitteriness through Q4 and an overextrapolation of earnings I'd never seen in my 12 ½ years in the business (20% drops to slight misses and 20% increases to slight earnings beats). **While the most aggravated declines occurred in old media that missed and the most aggressive gains in new media that beat (the FANG cohort), no name with disappointing news in the sector was left unpunished. This phenomenon, combined with our exposure to the hurricane in Puerto Rico caused the greatest detraction of our peak to trough performance due to drawdowns in two large positions, LILAK and HMTV, both top 5 names.**

B. The Hurricane in Puerto Rico

As we all know, Hurricane Maria was the most powerful storm to hit Puerto Rico in 80 years, destroying buildings and knocking off power across the entire island. Since we run a concentrated portfolio which we believe allows us to outperform over the long run, such events can sometimes cause short-term volatility.

LILAK – (186bps in attribution loss from 9/1-12/31/17): LILAK owns a majority stake in Liberty Cablevision of Puerto Rico (LCPR), which operates the only HFC network on the island, providing faster speeds at better prices vs. its only major competitor, copper-based Claro (60mbps broadband at LCPR vs. 5mbps at Claro for the same price). LCPR has steadily grown revenue at mid-single-digits despite the weak macro environment given its better product and only 50% market share. When the hurricane hit and the power went out, LCPR suspended service and payment collection from its customers. Given another disappointment at LILAK (we covered the others in our 6/2017 LILAK writeup, happy to send) and a stock price well below the 2015 highs of $40 (tax-loss selling), we believe investors overly punished LILAK in a weak media/telecom tape, resulting in a drop of the stock from $27 in August to $19.89 on 12/31. We have had multiple extensive conversations with management after the hurricane and believe (1) Puerto is only about $3/share in total LILAK value and insurance proceeds will cover all of the plant damage, therefore short-term negative effects are negligible, (2) power has been restored to 60% of the island and management expects a normalization of PR earnings power by Q4 2018 and (3) Liberty management is working their magic to improve operations across LILAK's other regions.

In short, we could not have predicted the impact of the hurricane. Nor could we have predicted the dramatic reaction in the stock resulting from media/telecom jitteriness in the quarter and the tax bill's effects. We believe that had the

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hurricane not happened, LILAK would have a market value of $30/share today as the rest of our thesis has played out, resulting in 100bps of accretion to Papyrus's 2017 returns rather than 186bps of detraction (+286bps). **We also believe that our thesis is not impaired, it's only postponed. We increased our size from 6.4% at the end of Q3 to 9% at the end of Q4 as we believe the stock will rally in 2018 and beyond as Puerto Rico normalizes and the overall thesis manifests itself. We are not changing our $40 2019 price target (100%+ upside).**

HMTV – (116bps attribution loss from 9/1-12/31/17): HMTV owns Hispanic media content assets in the US, Latin America and Puerto Rico. In Puerto Rico, they own the largest and most successful broadcast network, WAPA. HMTV's predecessor (InterMedia Espanol) acquired WAPA, the number 3 Puerto Rican network in 2006 and turned it into the number 1, with a significant market share today (that of ABC, NBC and CBS in the US, combined). Despite the weak Puerto Rican macro environment, WAPA grew market share and revenue due to the phenomenal management team at HMTV. The loss of power impaired WAPA viewership, causing the stock to drop. Similar to LILAK, we have spoken to management multiple times and believe our thesis is simply postponed as (1) PR will normalize by Q4 2018, (2) HMTV's Pantaya Hispanic OTT streaming product (JV with Televisa and Lionsgate to lock Netflix out of the market) launched in 2H 2017 and has captured share beyond expectations, (3) the recent Colombia broadcasting acquisition should generate value in a turnaround and (4) their US payTV channels will continue to secularly grow as the Hispanic population grows.

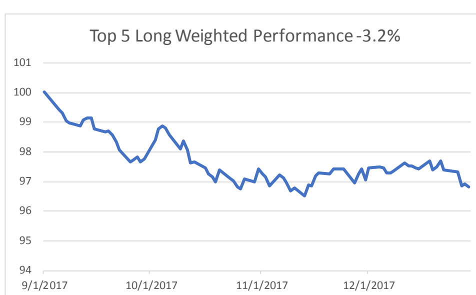
Again, we could not have predicted the hurricane's effects or the dramatic drop in the stock but we believe our thesis is not impaired, just postponed. We are not altering our $20 2019 price target (75% upside).

We Saw the Hurricane Coming, Why Not Sell?
We did see the hurricane coming and pared back our HMTV exposure from about 8% to 6% and our LILAK exposure from about 7.5% to 6.8% but did not expect the decline to be so drastic. Again, we are long-term investors and short-term volatility is often the price of long-term, great risk-adjusted returns. We also cannot make the mistake of assuming volatility and risk are the same thing.

Bottom line – the hurricane resulted in a 302bps detraction in performance in LILAK/HMTV. Moreover, given the strengths in the rest of their businesses, we believe LILAK would have very likely generated 100bps in additional attribution and HMTV would have been flat, conservatively, in which case our 11.6% 2017 return would have been 15.6%. **We only mentioning this solely because we believe this performance is not lost, just postponed and we've leaned into the decline by adding to our positions.**

C. Performance of the Top 5

With about 33-35% of our exposure in our Top 5 longs, the portfolio's overall return is highly correlated to their performance. Given the aforementioned weakness in media plus the Puerto Rican exposure in 2 of our top 5 longs, our top 5 have significantly underperformed the benchmarks in 2H 2017, as per the chart below.



Paraphrasing the words of Mark Knopfler and Dire Straits in one of my favorite songs, *we stick to our guns, take the road as it comes, it takes the shine of our shoes (or in my case, hair off my head!), but we don't play to lose!*

As such, despite a weak Q4, we have increased our exposure to our Top 5 Longs. The setup for SATS (see below), LILAK (discussed above), HMTV (discussed above) and GNCMA (discussed in our Q3 letter) are very

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good heading into 2018, while SCI should continue to slowly compound over time. We also believe we should see an early 2018 rally in some 2017 losers as tax-loss selling abates.

2. Drilling Down Into The Portfolio

Two Largest Positions

Our largest positions, Echostar (SATS) (41bps, Unrealized Gain in Q4) and Liberty Global Latin American (LILAK) (-117bps, Unrealized Loss in Q4) have not changed.

Echostar (SATS) – Echostar is an underfollowed satellite business run by a smart owner/manager (Charlie Ergen) with three core businesses trading at 10x 2019 FCF and four options worth almost 2x the value of the company, alone! UPDATE: We increased our PT on SATS to $181, 213% upside since we believe their satellite IP is very valuable for 5G wireless. We think that as the 5G standards are adopted in 2018/19, the market will realize SATS' true upside.

Liberty Global Latin America (LILAK) – LILAK offers cable services (television, broadband internet and phone) along with wireless services in Chile, Puerto Rico, Panama, the Bahamas, Jamaica, Trinidad and over a dozen other smaller islands across the Caribbean and is trading at about 9x 2019 FCF with 30%+ growth.
UPDATE: See discussion in prior section

Largest Winner This Quarter

Service Corp (SCI) (+44bps, Partly Unrealized Gain)

SCI is the largest provider of funeral services, run by a great management team with positive demographic trends, continued buybacks/accretive acquisitions, 14x 2018 free cash flow and 8% free cash flow growth which result in 15-20% compounded annual free cash flow per share growth/stock price appreciation. SCI continues to slowly grow funeral volumes, make intelligent acquisitions and buy back stock, all ensuring continued growth in intrinsic value.

New Top 5 Positions – No new Top 5 Longs in the quarter.

Realized vs. Unrealized Losses – As discussed in previous letters, distinguishing between realized/unrealized losses is important since transparency into realized losses offers an honest look into a Portfolio Manager's true process. We pride ourselves on our emotional temperament and diligence, hence a permanent impairment of capital is often a failure of that process. We had no large realized losses in the quarter.

3. Positioning For the Future

As previously discussed, we are very excited by our long and short opportunity sets despite an even frothier market. We also believe that our new hire will allow us to cover more ground to vet opportunities even faster.

4. Firm Updates

In early January, we made our first outside hire, Tim Messina, as Director of Research. I have known Tim for four years and we spoke about twice a week while he ran his hedge fund, Tekarra Capital, where his portfolio significantly overlapped with Papyrus's. As DOR, Tim will help me with sourcing and diligencing new positions and monitoring existing names while being responsible for managing current intern and future analyst workloads. Prior to Tekarra, Tim was a Senior Research Analyst at Axiom International Investors, where he led the firm's global consumer and media sector research efforts. Before he joined, Tim and I worked through a very clear delineation of his responsibilities based on his strengths and previous work experience that I'm happy to discuss one-on-one. We are very excited to have him join the team!

Should you have any questions, we are always available to speak.

Best Regards,

Nitin

Nitin K. Sacheti
Managing Member – **Papyrus Capital LP**

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