PAPYRUS CAPITAL

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Dear Partner, November 6, 2017

The Papyrus Capital Fund returned 2.8% in the third quarter of 2017 net of fees and expenses, a YTD return of 16.3%. Our Longs returned +4.2% and our Shorts generated (0.6)% in gross attribution in the quarter. Our gross exposure increased slightly while our net exposure decreased slightly as we sized up/added a few shorts.

Papyrus Capital LP Performance

Year	Q1 2016	Q2 2016	Q3 2016	Q4 2016	Q1 2017	Q2 2017	Q3 2017	2016	2017 YTD	Cumulative
Net Return	**0.5%**	**2.2%**	**4.9%**	**5.6%**	**6.9%**	**5.8%**	**2.8%**	**13.8%**	**16.3%**	**32.3%**
Long Attribution	1.4%	2.8%	8.7%	4.8%	9.3%	7.3%	4.2%	17.7%	20.8%	38.5%
Short Attribution	0.1%	0.3%	(2.8)%	2.1%	(1.3)%	(0.2)%	(0.6)%	(0.1)%	(2.1)%	(2.6)%
S&P 500	**1.4%**	**2.5%**	**3.9%**	**3.8%**	**6.0%**	**3.1%**	**4.5%**	**12.0%**	**14.2%**	**27.9%**
Net Exposure	71%	67%	64%	61%	65%	66%	64%	66%	65%	66%
Gross Exposure	97%	102%	99%	96%	100%	99%	101%	99%	100%	99%

1. PORTFOLIO MANAGEMENT IN THE QUARTER

The VIX (volatility index) stayed fairly constant this quarter at multi-year lows given slightly better US and global GDP growth along with excitement around the Trump tax plan. Credit markets were strong due to the aforementioned growth, along with a recovery in oil prices, housing was as expected in July/August with some hurricane volatility likely in the September data. Interest rates were volatile given the North Korea situation and hawkish commentary from the Fed, though they ended the quarter at the same level as the end of Q2. The labor market improved in the quarter with unemployment dropping below Q2 levels and the labor participation rate increasing.

What Did We Do at Papyrus in Q3?

Similar to last quarter, we sized up a couple of our longs ahead of catalysts, added positions in new industries in which we've ramped our knowledge (mainly radio as discussed last quarter) and we sold a couple longs where the thesis changed or approached our price target. We increased our short book from 16% to 20% as we ramped on one new industry and added opportunistically to shorts that rallied. As previously discussed, frothy markets such as this limit our opportunity set but we believe that even then, fear/greed in the market will always cause isolated dispersions, allowing the nimble bottoms-up investor to identify mispricings.

How Do We Generate Alpha as Value Investors in a Market Dominated by the FANG Stocks?

In previous letters, we've dived into many of the reasons for the lofty market multiple including speculation in high revenue growth tech and a move towards passive investing, both of which have contributed to the rise in price and valuation of the FANG stocks, Facebook, Amazon, Netflix and Google. While much of this is a function of the current interest rate environment, it's also due to the increasing usage/functionality of interconnected technology disintermediating traditional services. I emphasize interconnected because that's exactly what the FANG ecosystems have done – pushed us towards connecting and consolidating our way of life through their technology platforms.

For example, while Amazon began as an online book seller, it now accounts for half of US e-commerce sales. Aiming to be "Earth's most customer-centric company", they started generating positive net income in only 2015, mainly because 75% of it comes from its AWS, cloud-computing business. Its consumer facing retail business barely generates a profit. However, the company has continued to disrupt so many industries, most recently groceries (through Whole Foods) and now the home speaker market with its Echo which accounts for 76% of the US smart home speaker sales. In its recent earnings release, despite earning just $0.52 in quarterly EPS, the stock rallied 12%, crossing the $1,000 mark!

Similarly, Netflix's stock slightly rallied in the quarter after they reported higher subscriber additions even though they expect to spend $7-8bln in 2018 on content (almost 100% of sales!), and will generate negative free cash flow of $2-2.5bln! Founder/CEO Reed Hastings believes "negative free cash flow will be an indicator of enormous success" since it allows them to provide increasingly popular content at extremely low prices, accelerating subscriber growth.

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Given the low interest rate environment and their capital-light business models, FANG stocks rise as their management undertakes projects that disintermediate and increase their share of customers' minds, regardless of the return on invested capital required to disrupt.

Further adding to the mispricings, investors are rotating into the FANGs from the 'old media' networks, advertising agencies, television broadcasting/content/distribution and radio stocks despite their free cash flows due to fear of longer-term disintermediation by the FANGs' growth at all costs strategy.

As we've discussed ad infinitum (or nauseum), we believe that the intrinsic value of a business is the sum of its cash flows over the life of the business and we invest when we believe a company's stock price trades at a discount to its intrinsic value. However, if FANG generates no free cash flow, how can we estimate their intrinsic value? And if FANG disintermediates free cash flow generative music, books, newspapers, retail, grocery, automobile, datacenters…etc, how can we estimate the life of a business (and thus, its intrinsic value)?

While the rise of the FANG ecosystem has made value investing significantly harder, we believe that the two ways to overcome such odds and generate alpha for our investors is through (1) staying small in order to identify off-the-radar opportunities to play the trends that benefit cheaper businesses alongside the FANGs and (2) investing in great owner/managers with the foresight to steer their businesses through obsolescence risk.

Information Growth – the Secular Trend Generated by the FANGs

Smartphones and the connected ecosystem have made data abundant while allowing the FANGs to very easily capture and map that data. As cars, watches, speakers and household appliances connect to the internet, machine learning will extract more data from such devices to more closely predict our actions to customize product advertising and offer consumers more value-added services. Google can see exactly what we search for, Facebook can tell what we value on our newsfeeds, Amazon knows exactly what we purchase and Netflix develops more curated original content at higher resolutions. **Collecting and mapping all this data while disseminating more valuable consumer services requires faster and broader pipes.**

How Do We Play This Trend at a Discount to Intrinsic Value?

Despite a recent sell-off related to video subscriber losses as consumers cut the cord, we believe that **cable offers one of the best opportunities to buy the pipe through which FANG sells its services**. Further, we believe that the Charter Communications (CHTR) great management team, rural footprint (less competition) and M&A optionality offer the greatest opportunity in cable. However, at 18x free cash flow (or cash EPS), CHTR is too expensive for us to play directly which is why Papyrus's size (now and in the future since we never plan on getting too large), allows us to buy CHTR at a significant discount through a derivative business, General Communications (GNCMA).

As previously discussed in a few of our letters, we started buying GNCMA in early 2016 as a standalone Alaskan quad-play cable and wireless business trading at a high-single-digit FCF multiple. Also, as previously discussed, GNCMA was acquired by Liberty Ventures (LVNTA), a John Malone holding company that owns a pass-through interest in CHTR. Given the multiple holding company discounts, equity shrink at LVNTA and CHTR, along with potential future M&A at both companies, we believe owning GNCMA offers us the opportunity to buy CHTR at a 50% discount to fair value, i.e. 100% upside! This allows us to play the FANG growth trend as value investors with a wide margin of safety and a better risk adjusted return.

The Pieces:

GNCMA –Until the LVNTA/GNCMA merger closes, a $40 GNCMA share converts into 0.63 $55 LVNTA share (along with a preferred instrument).

LVNTA – In addition to GNCMA (once the deal closes), LVNTA also owns 42.7m shares of Liberty Broadband (LBRDK) and 5.4m shares of CHTR.

LBRDK – LBRDK owns 54.1m shares of CHTR.

CHTR – 3rd largest cable company with 25m subscribers in 41 states

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M&A Optionality – Convergence of Wireless & Cable
VZ's main business is wireless. However, competition in wireless in the US is fierce due to a price aggressive T-Mobile. As previously discussed in our Forbes interview (https://www.forbes.com/sites/lukeschiefelbein/2017/07/12/why-billionaire-john-malone-just-bought-16m-of-his-own-business/#2c2729ba5c94), we believe the transition from triple play cable (home phone, broadband and television) to quad-play (+wireless phone) significantly increases the profitability of a customer and thus cable will merge with wireless over time. We believe that Malone sees this value and wants to participate in the long-term upside of a combined CHTR/VZ. **While VZ is the most likely candidate, CHTR could merge with TMUS, DISH or Sprint (rumored this morning, 11/6/17).**

VZ/CHTR Rumored for a Year+. Why Not Yet?
We believe Malone wants over $500/share for CHTR but this is too dilutive for VZ. Unlike Malone and other good owner/managers, the management at VZ is solely focused on stability of free cash flows and maintenance of the dividend. They are politicians, paid to keep the business in steady-state. They are not owner/managers, paid to take the right risks to compound shareholder value like Malone & Company. As such, when we run the accretion/dilution math of VZ/CHTR at $500/CHTR share today, VZ's dividend coverage jumps from 62% pre-deal to 78% post-deal. VZ will not take this risk and therefore will not meet Malone's ask.

However, the power of free cash flow growth + buybacks allows Malone to keep shrinking his share count at CHTR by maintaining his leverage ratio and buying back 10%+ of CHTR shares outstanding each year. This capital structure engineering plus free cash flow growth through the core business means that CHTR's FCF/share will grow from $11.50 in 2017 to $30 by 2019/2020! When we run the VZ accretion/dilution math on 2019 financials, at $500/CHTR share, VZ's dividend coverage stays constant at its current 62%. This means VZ will very easily be able to pay $500 for CHTR next year.

Why Did Malone Buy GNCMA through LVNTA? And Why is this Better than Owning CHTR Directly?
As discussed in our last letter, GNCMA is the only true quad-play cable operator in America. GNCMA/VZ have a roaming agreement in Alaska where VZ pays GNCMA a fee for wireless customers in Alaska to roam on the GNCMA network. The disparate footprint but overlapping service (cable and wireless) means GNCMA is a natural fit for VZ/CHTR. Since we believe Malone wants to fully participate in the upside of a combined VZ/CHTR (or any other wireless player**), we believe that he fit GNCMA into LVNTA so that VZ buys LVNTA along with LBRDK in a CHTR merger rather than paying Malone cash for LVNTA. This allows Malone to participate in pro-forma VZ/CHTR through all his indirect holdings, tax-efficiently.**

We also believe the GNCMA/LVNTA merger allows Malone to begin buying back stock at LVNTA since, before GNCMA, LVNTA never generated any free cash flow (it was solely a holding company). The double buyback at CHTR and LVNTA really helps generate significant upside.

We estimate that with LVNTA's expected cost improvements at GNCMA, keeping its leverage ratio constant, the new LVNTA will be able to shrink its share count through buybacks from 107m when the deal closes to 90m by 2019/2020.

By fixing our CHTR price target at our $500/share acquisition price, we believe GNCMA is worth $78/share, offering us 100% upside even though $500/CHTR share is only 50% upside from CHTR's current $340. Buying GNCMA as a pass through to CHTR offers us an additional 50% upside in an entity that we believe will participate in the same M&A outcome!

Now, as previously discussed, the world is moving towards a quad-play converged solution and the cable pipe offers the most cost-effective way to play the growth in data through the FANG ecosystems. This is why we believe Malone prefers to own stock in the combined VZ/CHTR (or Sprint/TMUS/DISH) entity, post-merger.

While it's almost impossible to predict all the synergies in a VZ/CHTR deal (or any other cable/wireless merger), we know that VZ and the other wireless carriers (S, T, TMUS) need the cable pipe to offload data in a 5G world, will be able to reduce marketing costs per service offering and will achieve programming cost synergies.

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If we assume savings of $8/subscriber per month in content costs plus a 25% reduction in pro-forma marketing costs, PF VZ/CHTR can achieve almost $2/VZ share in synergies. Even before the countless backhaul, truck-roll, employee synergies, VZ/CHTR could generate $7 in 2020 FCF/share for a very large, extremely stable, liquid business with a sizeable dividend. We would argue that this combined business deserves one of the lowest discount rates in the world, especially if Malone & Company run it.

Cord-Cutting Risk – while cable stocks have sold off recently on cord cutting, when we look at the actual gross margin generated from a video customer (given the cost of programming) along with the capex costs (set top boxes), the incremental free cash flow lost from a video subscriber loss is minimal and the FCF/share impairment of losing 10% of video subscribers is barely 2%.

Again, while a VZ/CHTR deal is the most likely outcome, even a CHTR/TMUS, CHTR/Sprint or CHTR/DISH deal offers similar synergies and upside.

In summary, the changing business obsolescence landscape makes value investing much harder as the growing businesses that will be around in 10-15 years do not operate for profitability while disintermediating companies that do. While it's tough to find opportunity, we believe that staying small and nimble at Papyrus while investing in great management allows us to buck the negative trends facing many other value investors.

2. Drilling Down Into The Portfolio

Two Largest Positions

Our largest positions, Echostar (SATS) (-40bps, Unrealized Loss in Q3) and Liberty Global Latin American (LILAK) (+83bps, Unrealized Gain in Q3) have not changed.

Echostar (SATS) – Echostar is an underfollowed satellite business run by a smart owner/manager (Charlie Ergen) with five core businesses trading at 12x 2018 cash PE and three options worth the entire value of the company, alone! UPDATE: While SATS missed its Q2 subscriber estimates, causing a drop in the stock, we believe the issues were 1x since they serviced existing customers interested in upgrading to their new Jupiter 2 satellite vs. new customers. We believe they will beat Q3 consensus subscriber estimates and increased our position size, accordingly.

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: The stock is trading about 15% below where John Malone made his recent insider purchases due to the hurricane in Puerto Rico. However, the company announced that insurance will pay for most of the facilities damage and they should be almost fully online by December. While we likely won't see revenue in Puerto Rico at pre-hurricane levels until mid-2018, the island accounts for only $3/share in total value on a $22 stock.

Largest Winner This Quarter

CommerceHub (CHUBA) (+77bps, Partly Unrealized Gain)

Another derivate to owning FANG, CHUBA offers a SAAS (subscription as a service) platform for omni-channel/drop shipping related retail. i.e. Walmart links the software to its own website and product manufacturers who sell on Walmart.com also link to CHUBA. When a customer on Walmart.com buys the product, CHUBA locates the product at the warehouse closest to the customer, notifies FedEx/UPS (also on the platform) to ship it and handles all payment processing and payment distribution to Walmart and the product manufacturer. This scales shipping time/cost (since it allows the manufacturer to place products in many more warehouses) which helps smaller retailers compete against Amazon's wide logistics network. CHUBA's customers include Walmart, JCPenny, QVC, Best Buy, Toys R Us, Sears, Walgreens, Dell, Panasonic, among many others. The more retailers and product manufacturers on the CHUBA platform, the greater the network effect.

While CHUBA's valuation at 20x 2020 EPS is well above our other longs, we believe they can sustain high teens EPS growth for a very long time. CHUBA is sized at the low end of our Well-Managed Long bucket given its high valuation.

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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, the stock market rally has benefited mainly the FANGs and other large-cap growth stocks (up an annualized 12.1% over the last 3 years vs. small-cap value up 6.7% annualized). While we cannot predict market moves, we will continue to express stock market exposure through businesses with predictable cash flows and quality management teams cognizant of capital allocation. We will also maintain our short exposure to protect against a market drawdown. We will continue to search for value with downside protection and in the event of a drawdown, we will be ready with our 20%+ cash position to buy better businesses, even cheaper.

4. Firm Updates

No new firm updates though we are focusing on raising additional capital to invest in our infrastructure.

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

Best Regards,

Nitin

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