October 12, 2017

Cable Car Capital LLC 'Late' 2017 Letter

Dear Friends,

I decided to write only three letters in 2017. The four-month period ending in December will be discussed early next year. Initially, this letter was delayed by a few weeks due to additional administrative burdens created by the firm's first investment in a private placement, detailed below, and fundraising for a special-purpose vehicle. Several exciting projects at once made for an invigorating summer that left less time than usual for introspection.

However, in truth I also dithered somewhat about publishing in public at all after the extraordinary squeeze experienced by a short position prematurely assessed in previous letters. While it is of course conceivable that the timing of a ten-fold price increase and exchange halt in the three trading days immediately following my June 1 letter was coincidental, I have had to consider the possibility that discussion of technical factors affecting even a small stub position could have motivated manipulative behavior by parties with malintent. While I am humbled to have a far larger audience than the firm's current size really warrants, regrettably it seems I may need to be more taciturn about certain topics. There's quite a bit more I would like to say about my regulatory work and short selling, but I need to give further consideration to the best approach.

In the meantime, this letter, 'longer' than usual, will focus primarily on long positions, which are actually the larger component of Cable Car's portfolio despite my more frequent discussion of short sales. Given the underwhelming performance this year, an update on the long book is long overdue.

Please note that Cable Car's letters are a labor of love meant to elicit feedback from the investor community and explain my thought process and approach to prospective clients and friends. Current clients have real-time access to performance information and communicate with me regularly.

The Cable Car Composite returned -1.3% in the five-month period from April through August 2017, bringing net returns to +0.7% in the first eight months of the year. Worldwide equity markets, as measured by the ACWI, returned +7.6% in the period and +15.0% so far this year.

Performance

CCC	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Year	ACWI
2013											+4.2	(0.3)	**+3.8**	+3.9
2014	(3.3)	+3.9	+1.9	+1.6	+3.3	(0.5)	(1.6)	(0.5)	(6.2)	+4.7	(1.6)	+5.8	**+7.2**	+4.2
2015	(3.8)	(0.9)	+17.5	+4.6	+24.9	(6.1)	(2.9)	+4.5	(1.7)	+3.5	+1.9	(4.2)	**+38.4**	(2.4)
2016	(5.5)	+5.1	+0.9	+1.6	+5.1	(1.7)	+1.2	(0.7)	+8.5	(1.3)	+1.6	(0.1)	**+14.8**	+7.9
2017	(0.7)	(1.9)	+4.7	(1.1)	(5.8)	(2.2)	+1.8	+6.5					**+0.7**	+15.0
Annualized since inception (November 8, 2013)													**+16.4**	+7.4

Attribution

At period-end, the five largest long positions were Pangaea Logistics (PANL), Insignia Systems (ISIG), Retrophin (RTRX), NetDragon Websoft (777 HK), and Dell Technologies Class V (DVMT). The largest performance impact by issuer for the representative account in the period was as follows, expressed in basis points (bps) on beginning-of-period assets:

Contributors		**Detractors**	
Position	*Performance (bps)*	*Position*	*Performance (bps)*
Long RTRX	+444	Long ISIG	(470)
Long 777 HK	+230	Long PANL	(253)
Short Company H	+133	Short WINS	(211)
Short Company D	+78	Short WRLD*	(160)
Long DVMT	+67	Short TSLA	(84)

*Denotes closed positions as of the date of this letter. Please see important disclosures on the last page of this letter. Attribution includes position-level negative rebate costs for short positions.

Net exposure for the representative account at August 31 was 75% long and 34% short.

Cable Car capitulated on its longstanding short position in World Acceptance (WRLD) during the second quarter. After WRLD received a NORA letter in 2015 indicating a supposedly imminent CFPB enforcement action, I viewed a short position as an option on the CFPB assessing significant financial penalties or restricting a significant portion of the company's activities, which my research had suggested are unlawful. I had robust debates with WRLD holders on the topic, but felt that the carrying cost was limited as long as competitive headwinds and regulatory changes were limiting growth and lenders were restricting return of capital to shareholders. Unfortunately, the CFPB did not act in a timely manner before WRLD managed to improve financial performance and relax covenants. I covered the position following the announcement of unexpectedly strong financial results and the belated disclosure of an FCPA investigation.

Unlike investors who have concluded that the CFPB is toothless under the current administration, I still believe the Bureau intends to eventually bring significant charges against WRLD. However, I got the timing wrong and now think that event is not worth waiting for with a backdrop of improving instead of deteriorating financial performance. I can only speculate about the reasons for the unusually long delay between the NORA letter and formal action. Although politics may have played a role, I believe it is more likely that the impact of a mooted CFPB settlement must have been large enough to pose an existential threat for WRLD and ensure that the parties remained far apart in discussions. WRLD has now had sufficient time to shore up its balance sheet in order to accommodate eventual regulatory penalties.

WRLD and similar situations have helped refine my approach to short selling. When considering a short position in a company I suspect of wrongdoing, I focus more closely on parsing the intended victims of management's avarice. Many public companies seem to exist for the purpose of stealing capital from shareholders, whether through questionable financing schemes, excessive insider compensation, or fraud. Short selling can be productive in these situations. However, the same character flaws in a management team are sometimes directed against customers, lenders, or other stakeholders, which though often unsustainable can inure to the short-term benefit of equity investors. I am generally unwilling to own shares of a company whose management I cannot trust in a fiduciary capacity, but that is not sufficient justification for a short position. I continue to experiment with alternative strategies to counter bad actors who support shareholders.

Private Placement

By contrast, it is a rare pleasure to have the opportunity to allocate directly to an ethical management team you know can put capital to productive use. In June, Cable Car participated in its only private placement of a publicly traded security, roughly doubling its longtime holding in Pangaea Logistics (PANL) and making it the firm's largest position. PANL is a complex equity that I believe presents an exciting risk/reward opportunity for investors willing to overcome a few biases, but before discussing the rationale for the investment, a few words on the unusual transaction for Cable Car are necessary to explain what I am trying to accomplish.

First and foremost, I only considered the placement because PANL was an existing holding, I have a longstanding relationship with the management team, and I knew the business well enough to make an opportunistic decision in a short timeframe. I have no intention of becoming a serial investor in private investments in public equity (PIPE) transactions. Although there is nothing inherently wrong with a company raising capital in a secondary offering, many PIPE deals are highly dilutive and abusive forms of financing that have been associated with stock promotion schemes. There is a whole cottage industry of PIPE financiers who provide vulture financing to marginal companies. That often requires putting money directly in the pockets of unsavory people, but when properly hedged, it is the closest thing to a 'sure thing' I have observed in the stock market. I want nothing to do with it, except as a source of short ideas. A complete discussion of the legal and ethical considerations is a subject for another letter, but just to be clear, the PANL transaction was not that kind of PIPE. PANL issued a small amount of equity at a modest discount in a Regulation D offering with substantial insider participation.

It would be difficult to overstate just how much of an administrative headache it was to participate in the offering as a manager of separate accounts. The placement was open only to accredited investors, meaning that not all Cable Car clients were eligible to participate. Shares issued in the offering are restricted during a mandatory holding period and frustratingly cannot be custodied by Interactive Brokers during that time. Participating in the transaction required enough size to justify the time commitment, an additional verification exercise for inclusion in the Composite, and coordination of paperwork and payment for about two dozen accounts. It will lead to additional performance divergence within the Composite and likely much greater mark-to-market return volatility. So why do it?

I have deliberately structured Cable Car to be as flexible as possible. Size and regulatory requirements mean I cannot participate in every conceivable transaction, but I try my best not to let the structure of the advisory firm be an impediment to investment returns. Allocating capital to a public company is core to what I do, and at the end of the day, I care about long-term returns more than the near-term performance of the Composite. Notwithstanding the price performance since the offering, I consider the PANL offering to be a rare opportunity to purchase a significant stake in a business well below its intrinsic value. I suppose it would also be difficult to overstate just how much conviction I have that the financial performance of the business will eventually support that assessment.

Pangaea Logistics

I can practically hear long-term readers scratching their heads at this point. Didn't I cite PANL more than two years ago as an example of a poorly timed initial investment? Haven't I expressed skepticism of companies that go public through reverse mergers? Haven't I read *The Shipping Man*?! Despite these truths, limited liquidity, an out-of-favor sector, and confusing valuation have once again created a contrarian

investment opportunity in PANL that I consider to have limited fundamental downside and very significant potential for price appreciation.

When I wrote about PANL in May 2015, the stock traded at about the same price per share, with the drybulk shipping industry in crisis and the Baltic Dry Index below 600, on its way to a 30-year low. The industry was heavily oversupplied, with spot day rates below operating costs, causing widespread financial distress. I argued at the time that the company's flexible chartering model and long-term contracts would enable the company to weather the downturn comfortably.

In my opinion, the intervening two years have thoroughly validated that thesis and proven the company's business model differentiation. PANL was the only US-listed drybulk operator to remain profitable in both 2015 and 2016. The company generated more than $40 million in operating cashflow during the period, which was primarily reinvested in completing a planned acquisition program, adding three additional vessels to the owned fleet to support new contracts. PANL even withstood the 2016 bankruptcy restructuring of its largest customer, Noranda Aluminum. The Noranda contract is a 10-year contract for the transport of bauxite from Jamaica to the US and a key reason for Pangaea's differentiation.

Controversial at time of initial investment was the special purpose acquisition company sponsor's contention that PANL is more akin to a logistics business than a traditional drybulk shipping operator. The Noranda business is perhaps the best demonstration of this argument. When competing in a commoditized industry like drybulk shipping, economic theory suggests that the sustainably profitable strategy is to achieve a cost advantage, generally through scale, or to identify a specialized niche like the transportation of minor bulks that is not actually commoditized.

The transportation of bauxite is one such niche, as it requires specialized handling and expertise. Absent proper safeguards, bauxite can liquefy and capsize a vessel. The International Maritime Organization has issued several warnings about transporting bauxite since a fatal accident by another carrier in 2015. Due in part to its long experience with the dangerous cargo, Pangaea was able to retain the Noranda contract in the restructuring at about a 20% discount to its previous compensation, still a significant premium to rates for other cargoes. Moreover, the new contract contained a freight escalator tied to the price of aluminum, the end product of bauxite. I'm fairly certain open-market sellers of PANL have not given the slightest consideration to the more than 20% increase in aluminum prices since the contract was assumed by Noranda's new owner.

The remainder of Pangaea's owned fleet services other specialized business, the most significant of which is the ice-class trade. Through a consolidated joint venture, Pangaea owns or operates a majority of the world's supply of ice-class 1A drybulk tonnage, enabling the company to earn a premium for operating routes that are inaccessible to ordinary vessels. In winter months, ice-class vessels trade profitably in the Baltics and Canada. In the summer, they are the only drybulk ships that can traverse the Northern Sea Route (NSR). The NSR is a route from Europe to Asia through the Arctic that can save nearly two weeks of travel time. When fuel costs are higher and/or day rates are sufficiently elevated, ice-class vessels can justify charging a substantial premium for this savings. The commodity price environment has made the NSR uneconomic since 2015. For now, the ice-class vessels are profitably employed in summer contract business in the region, and PANL has a call option on a potentially lucrative trade route in the future.

You wouldn't know it from the PANL share price, but the Baltic Dry Index now stands above 1400, with reasons for cautious optimism. Following slower order growth and high scrapping activity during the worst downturn in three decades, net growth of the worldwide fleet in 2017 is expected to be less than demand for the first time in five years and may even be slightly negative in the second half. The industry remains prone to boom-and-bust cycles and irrational behavior. The sustainability of China's commodity boom remains a concern for global demand growth, and new capacity invariably arrives a few years after any sustained increase in rates. Despite this, spot rates once again allow for narrowly profitable trade, leading to more activity and firmer vessel valuations. The conditions are present for at least a stabilization of activity, with the potential for near-term shortages which could cause sharp rate increases.

As discussed in the past, in addition to its contract activity, PANL operates a spread business that has consistently identified short-term trading opportunities. Although Pangaea is not as directly exposed to day rates as a traditional vessel owner, this chartering business benefits from increased activity regardless of the rate environment. I argued for the uncoupling of PANL shares from day rates in 2015. That never really happened until the private placement; ironically, the stock has ignored the recent recovery in rates, though trading still appears closely linked to shipping sentiment, which remains poor. That can change on a dime.

PANL remains relatively illiquid due to limited public float, which at times in the past has created attractive portfolio management opportunities and meant that Cable Car's investment has not been too disappointing overall. Companies with a history of unethical behavior like DryShips (DRYS) and Seanergy (SHIP) experienced dramatic and unexplained price increases last November, which were immediately followed by highly dilutive fundraising that I believe may have been associated with deliberate market manipulation. Less noticed was the follow-on effect on the entire shipping sector, including PANL, which I attribute to algorithmic activity. Much as I like to decry manipulative actors in the markets, who so often seem to target my short positions, I am happy to occasionally be gifted an opportunity to trim a long position due to irrational behavior.

In addition to the novel business model, unpopular sector, and illiquidity, the other reason opportunity exists in PANL shares is that the company is very challenging to value. The company fully consolidates its 33% equity ownership in the ice-class joint venture, which it controls. Debt in the JV, which is the majority of Pangaea's indebtedness, is collateralized by the ice-class vessels. The company is not subject to income taxes, and depreciation is a real economic expense. These factors make traditional comparisons of enterprise value to proxies for earnings power or cashflow, such as EBITDA, difficult to calculate and not as meaningful for comparison to other businesses.

Shipping sector specialists are more used to instead assessing net asset value, as most companies in the sector are essentially passive asset owners. Adjustments to the value of a given vessel can be made to account for favorable contracts. As accounting rules require, Pangaea's vessels are marked at cost and periodically evaluated for impairment, and the first thing most shipping analysts will notice is that several of the company's older vessels are marked above their current market values. Since the owned fleet is employed in the valuable specialized contracts described above, these book values are not impaired even when market values are lower. PANL has booked impairments only when refinancing activity has established a new cost basis.

At current vessel prices, I estimate PANL nevertheless has a liquidation value approximately equal to its current share price. That assigns no value whatsoever for the long-term contracts or the chartering business. A net asset value approach is imperfect, as it ignores going concern value for activity that is not part

of the owned fleet. As discussed before, PANL is unique in the industry in that two-thirds of its fleet is chartered in on a short-term basis. Ignoring this source of earnings is the rough equivalent of valuing a retailer that does not own its real estate at zero! However, it is a good method to assess downside protection.

In its communications with the market, the company and its sole sellside coverage analyst have gently suggested that analysts examine the historical premium PANL has been able to achieve over market rates and conservatively capitalize that premium in addition to the liquidation value of the vessels. That appropriately yields valuation estimates dramatically in excess of the current price, even after applying a liquidity discount.

My preference given these alternatives is to focus instead on the levered free cash flow available to equity holders, for which net income excluding accounting impairments provides a decent proxy. The purpose of this whole discussion is to explain my thesis qualitatively and perhaps motivate some readers to do their own diligence, but it is not an investment recommendation. For that reason, I am deliberately avoiding specific financial projections, particularly given the uncertainties of the industry. However, with its expanded fleet in the current rate environment, I expect PANL to generate cash from operations in the coming year significantly above 2016 levels, which would represent a double-digit yield on the current market cap. A substantial portion of this cashflow is dedicated to scheduled debt repayments on the owned fleet. What I like to think of as "private equity math" applies in this case: for a constant enterprise value, it would be reasonable to expect a significant increase in market value as a result of this deleveraging. Alternatively, if the company can continue to win new business, it may continue to expand the fleet and achieve scale benefits. The primary purpose of the capital raise was to support the acquisition of an additional vessel for this purpose.

I believe PANL is a prime example of the distinction between the fundamental performance of a business and the factors impacting its stock price. There is little reason to think the shares are efficiently priced today, but the uncertainty underpinning any contrarian investment is whether circumstances will allow for more efficient pricing in the future. I see two paths for that to take place. The first is a direct consequence of the private placement; liquidity in the shares may improve if the shareholder base changes after the restricted period ends. The second is the possibility that the recovery in day rates is sustained. From a risk/reward standpoint, I am excited about PANL and have sized the position aggressively because I believe the fundamental performance of the business provides downside protection even if a rebound does not materialize. The current market value represents a liquidation value at current vessel prices. Meanwhile, from both a trading and a fundamental standpoint, the upside from a recovery in the shipping industry could be dramatic.

Other Long Positions

I've already gone on long enough, so I will make only brief comments on other positions. My views are largely unchanged on the portfolio since previous comments about each.

NetDragon was the other portfolio company to raise capital recently. If I thought a US private placement was administratively difficult, participating in the company's offering in Hong Kong could have been a nightmare. Thankfully, NetDragon did not require any of Cable Car's modest resources, raising nearly $1 billion HKD last month to support the continued growth of its early-stage education business. The company's recent performance has been led by impressive sustainability in its MMORPG business. NetDragon appears to have navigated a tricky desktop-to-mobile transition by enhancing the value of its existing IP through extensions of its already popular games to another platform. The company has adopted a partnership model in mobile that has kept development and marketing costs in check and made incremental

contributions to revenue. Meanwhile, NetDragon is testing new monetization strategies in its acquired international education businesses while growing the user base of its domestic K-12 platform. Both efforts are relatively early, so I expect to have more to say about their success or failure next year. I continue to believe the education business is worth underwriting and the company as a whole trades at a reasonable valuation considering its assets, cash flow, and prospects.

During the period covered by this letter, Retrophin fluctuated sharply within a range of $16-25 per share despite few fundamental developments, providing multiple occasions for portfolio management activity.

Cable Car significantly increased its position in Insignia Systems, which is priced near liquidation value, reflecting the market's recognition that it faces a difficult and uncertain turnaround. I have great confidence in the newly assembled leadership team and the board, but the proof will be in execution of their business plan. Cable Car's significant position size both as a proportion of the company and of the Composite is reflective of the potential return if the company's strategy succeeds and what I believe is limited downside if they are unsuccessful, based on the value of the company's net assets.

I haven't said much about DVMT, which is a tracking stock trading at what I believe is too high a discount to the market value of its holdings of VMW. It is a predictably popular hedge fund hotel, but the discount has yet to close. Last year, I shared a novel theoretical approach to valuing the discount at two private events, which I'm happy to discuss upon request. Thanks to the performance of VMW, DVMT has performed well despite the discount persisting. I view DVMT as a way to own VMW, which I consider an underappreciated technology business, at a more attractive valuation. Cable Car is not short VMW. However, the DVMT position is sized conservatively due to its location within the Dell capital structure.

Finally, I have been experimenting with buy-to-lend strategies on a very limited scale. Cable Car purchased a small position in the equity of an issuer in Chapter 11 that had significant outstanding short interest and a very low dollar price. Lending the shares provided an income stream that was likely to be significantly more valuable in the downside scenario. At the time of purchase, shares were an option on equity recovery in a quick bankruptcy process, while lending income would be more significant in the context of a drawn-out restructuring without any distribution to equity. That is what ultimately materialized. During the period, the position declined sharply but recouped 40% of its cost basis through lending income, with full recovery anticipated if the court process is not concluded before 2018, as short holders have a tax incentive to maintain loans at least until then.

I am considering maintaining this less frequent cadence of letters in order to allow more time for informal blog posts again. For example, I have a lot to say about cryptocurrencies, my latest regulatory focus. For now, it is my opinion that *all* initial coin offerings are a form of stealing. At best, ICOs are unethical exchanges of value for a poorly understood token with limited rights; at worst, they are securities fraud. Please avoid them. In August, the SEC suspended the equity of First Bitcoin Capital Corp (BITCF), making it the fourth suspended security this year in which Cable Car has had an interest.

Thanks for your patience between letters. I appreciate your readership.

Jacob Ma-Weaver, CFA

Important advertising disclosures

Please be aware that because this letter is shared with non-clients, it may be considered an advertisement under Rule 206(4) of the Advisers Act. It is therefore subject to GIPS guidelines regarding advertising disclosure and SEC guidelines regarding references to past specific recommendations.

The SEC requires that references to past specific recommendations, including attribution calculations, be based on a reference account and that at least ten holdings be disclosed. Cable Car's largest account serves as the reference account. Detailed computation methodology and a list of all holdings' contribution to the account's performance are available upon request. The holdings identified in this letter do not represent all securities purchased or sold for advisory clients, and past performance is no guarantee of future results.

Please note that Cable Car maintains a selective public disclosure policy regarding positions that may be competitively sensitive, difficult to borrow, or otherwise unlikely to benefit from publicity. Clients retain full portfolio transparency, and Cable Car will generally disclose subject securities to non-clients upon request.

Cable Car Capital LLC ("Cable Car" or the "firm") is a limited liability company with principal place of business in San Francisco, CA. The Cable Car Composite reflects the performance of the firm's concentrated, hedged value investing strategy. The composite contains all fully discretionary accounts managed by the firm, and it is the firm's only composite. Cable Car claims compliance with the Global Investment Performance Standards (GIPS). To obtain a compliant performance presentation and composite description, contact Jacob Ma-Weaver at jacob@cablecarcapital.com or (415)857-1965. Verification and performance examination reports are also available upon request.

ACWI is a trademark of MSCI, Inc. "The MSCI ACWI Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed and emerging markets." ACWI total returns are presented including dividends net of withholding taxes. Composite returns are presented net of all expenses and fees, including accrued but unpaid performance fees. Returns are expressed in USD.

Cable Car implements its strategy in part through short sales and makes limited use of derivatives and leverage. Gross exposure is limited to 200% and portfolios maintain a net long bias. Additional disclosures regarding the risks associated with the firm's investment approach are contained in the firm's brochure on Form ADV. The firm's list of composite descriptions and additional information regarding valuation policies, performance calculation, and performance presentation is available upon request.

The performance of individual client accounts can vary significantly from the performance of the composite, particularly due to the inclusion of retirement accounts which cannot accommodate short sales. The timing of cash flows, type of account, base currency, fee arrangement, and the availability of investment opportunities for each account may lead to significant divergence from composite returns. In 2014, net returns of accounts funded for the full year ranged from 6-10%. The range was 22-55% in 2015 and 11-29% in 2016. For the three-year period from 2014-2016, the annualized monthly standard deviation of the composite was 20.9% versus 11.2% for the ACWI. While the composite is benchmarked against the ACWI in order to compare performance to broad market equity returns, client portfolios are not managed to any particular benchmark, and performance is likely to vary from the performance of any given index.