June 1, 2017

Cable Car Capital LLC Q1 2017 Letter

Dear Friends,

The Cable Car Composite returned +2.0% in the first quarter of 2017, but as of this writing has declined by a few percent in the year to-date. Worldwide equity markets, as measured by the ACWI, returned +6.9% in the quarter. Although the eclectic mix of securities in the portfolio exhibits very little correlation to the broader market (R^2 of daily log returns with the ACWI is ~0.06 since inception), a period of underperformance with a backdrop of strong index returns is nonetheless disappointing.

That may well be the subject of next quarter's installment, once it is clearer what represents a temporary mark-to-market impairment and where there are lessons to be learned. For now, there are a number of idiosyncratic updates to report.

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										**+2.0**	+6.9
Annualized since inception (November 8, 2013)													**+19.0**	+6.0

Attribution

At quarter-end, the five largest long positions were Insignia Systems (ISIG), Pangaea Logistics (PANL), Retrophin (RTRX), NetDragon Websoft (777 HK), and Dell Technologies Class V (DVMT). The largest performance impact by issuer for the representative account in Q1 was as follows, expressed in basis points (bps) on beginning-of-period assets:

Contributors		**Detractors**	
Position	*Performance (bps)*	*Position*	*Performance (bps)*
Short FNBC (Company G)*	+262	Long ISIG	(204)
Long DVAX*	+160	Short WINS	(73)
Long NRS GR	+104	Short TSLA	(71)
Short WRLD	+87	Long SDOI	(64)
Long 777 HK	+87	Short Company D	(56)

*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 March 31 was 63% long and 28% short.

You wins some (reprise)

You wouldn't know it from the attribution table, but Wins Finance (WINS), mentioned briefly as my then-worst ever short sale in last quarter's letter, consumed much of my attention during the past few months. It was a stressful experience, so I will allow myself a short victory lap and reflection. For those unfamiliar with WINS, a March Bloomberg article provides a better explanation than I could write.

WINS last traded at $20 per share, after closing as high as $452 per share in February. Though that outcome is cause for relief, if not celebration, shorting WINS ultimately proved to be a significant distraction. Faced with a choice between crystalizing an obviously incorrect price or staying the course with very high carrying costs, I am pleased to report that I had sized the position responsibly and made the correct risk management decision under pressure, maintaining Cable Car's position continuously through the volatility. Equally importantly, I am proud of the depth of my research, irrespective of the financial outcome. The price increase led me to redouble my efforts, and the resulting work was highly differentiated. Through primary source materials, extensive analysis, and a full-court press of behind-the-scenes engagement with regulators, journalists, and others, I discovered—and will take a measure of credit for helping to stop—what I believe was a deliberate and sophisticated market manipulation scheme. Some of my WINS findings, which I cannot yet discuss, provided the necessary conviction to withstand the extraordinary price movement.

Interactive Brokers provided mixed service, maintaining a difficult locate but substantially increasing collateral requirements at the height of the market dislocation, severely constraining portfolio management flexibility. The custodian also would not allow opening transactions for new accounts or increased exposure on the news that WINS was set to be removed from the Russell 2000 index in June, an event attributable in part to my own outreach. It was frustrating not to be able to fully monetize that work, but as is usual with a high-profile short position, I am satisfied to have protected capital, engaged in productive advocacy, and developed valuable relationships. The custodial challenges also provided useful operational knowledge that may be helpful if I manage a larger pool of capital in the future.

The attribution includes approximately $66 per share in stock loan costs during the first quarter alone, more than five times the book value of WINS and a great illustration of how usurious the stock loan marketplace can be. For hard-to-borrow securities, short sellers typically pay a floating interest (technically a "fee" or "negative rebate") rate on collateral tied to the market price of the stock. The cost to borrow WINS rose as the price increased, both due to the increased collateral required and additional demand from short sellers. A loan expected to cost less than $1 per share per month last fall cost more than $30 per share per month at the peak!

This dynamic is a fact of life for short sellers and one of many basically unfair impediments to profitable short selling. However, it also serves to illustrate that there can be value in obviousness. With the benefit of hindsight, WINS was a far better short in April, with the situation widely known, than it was before. Even at rates in excess of 100% APR, a stock that is highly likely to fall significantly in a well-defined timeframe can still be a good short-sale candidate. (To be clear, I think stock loan costs are higher than they should be, but that is a subject for another letter). Companies with impending events are often expensive to borrow, but a short seller may be reasonably confident of paying elevated rates for only a brief period of time.

In the current environment, I am short obviousness. Why quibble over the right multiple on businesses with cash and real operations when there are empty shells with meaningful market capitalization? There are still several of the former in the short book, of course, but I have recently observed more examples of successful OTC pump-and-dump schemes, bankrupt companies driven up to meaningful valuations by day traders, and cannabis-related shell companies with no operations remaining high. These entities are often expensive, but available to borrow, and frequently the analysis lies in trying to determine when holders of low-basis stock will sell. Often the expiration of required holding periods for private placements, or the upcoming effectiveness of a registration statement, can justify paying a few months of elevated borrow cost. Occasionally regulators even step in, though not always before Cable Car has moved on due to the high carrying costs; Cable Car had current or previous short positions in three issuers suspended by the SEC this year.

With relatively small position sizes due to the elevated risk associated with many hard-to-borrow names, I continue to experiment with different trading strategies and refine my understanding of likely catalysts through experience. Clients should expect greater turnover in hard-to-borrow short positions.

Sky-high

I do not normally like to discuss the most expensive active short positions, but just to provide one extreme and entertaining example, consider the case of Airborne Wireless (ABWN), a recent, pre-revenue reverse merger trading OTC that currently sports a market cap of about $200 million. ABWN spends a lot of money on marketing, but it has not raised sufficient capital to execute the business plan described in its regulatory filings. As of this writing, Interactive Brokers indicates that at least $110,000 worth of additional ABWN stock is available for borrow at an eye-watering annual fee rate of 177%. That may nevertheless be worthwhile.

I first heard about ABWN when it was the subject of a paid promotional campaign earlier this year, which included the boiler room services of an investor relations firm that cold-called registered investment advisers, including Cable Car, about the company. ABWN purports to be developing an in-flight broadband network using a 19-year-old technology it acquired for stock. A complete discussion of the individuals involved in the promotion and the efficacy of the technology is unnecessary.

A more important consideration might be that the required holding period elapsed last week for 1.5 million shares and warrants issued at one-third of the current share price. Additional upcoming vesting and holding period schedules over the next few months should be considered in the context of the high borrow cost. I believe it is likely that these ABWN shares will be distributed to credulous members of the public in the coming months, with predictable impact on the share price and potential improvement in borrow cost. The main question in my mind in these sorts of situations is whether or not the company or its shareholders will choose to engage in illegal activity in order to obtain even higher prices for their shares.

Float

A key contributing factor to the WINS situation was a tightly controlled supply of shares freely available for trade in the marketplace, i.e. a very limited public "free float." Since market prices are set by the incremental buyer and seller, a company with only a limited supply of shares available for trade may experience greater price fluctuations due to small marginal changes in demand. This natural leverage can be exploited by unscrupulous actors to set a misleading price for the entire entity, known colloquially as "cornering the market." In edge cases, limited float can also impede short selling activity and provide a highly distorted indication of the true valuation of a company as a whole. If for whatever reason the valuation is not corrected through corporate actions (e.g. share issuance) or insider selling (which would increase the float), distorted prices can and do persist indefinitely. This can be both a blessing and a curse for short sellers. It is a dynamic characterizing many stocks in Cable Car evaluates for the short portfolio, including ABWN.

The market clearing price for an entire company may be higher or lower than the price of the marginal transaction. This concept is, in a sense, at the core of every stock market transaction. It is therefore worth pondering for a moment the insanity of using the most recent market price as an indication of overall corporate valuation for anything but the largest and most widely held companies. Once you start thinking about float as a potential contributor to mispricing, it is hard not to see it distorting prices in one form or another in many situations: Stub IPOs are a phenomenon whereby closely held companies offer only 5-10% of their shares to the market, potentially improving the reference price for later secondary sales. San Francisco rental prices make headlines, but the impact of rising demand is exacerbated by the fact that only about 28% of the rental supply is not rent-controlled. Limited float is the basic premise behind most pump-and-dump schemes and cryptocurrencies: create a something out of nothing, control most of it, and then encourage others to place value on very small pieces of it.

When limited float intersects with price-insensitive capital flows, the results can be dramatic. Adding a company with too little float to an index creates problems. When fund managers experience inflows or outflows, it can affect the marginal price of their large holdings. These are not novel observations, but if WINS taught me nothing else it was the degree to which supply constraints can become dominating considerations.

As evidence that I do try very hard to learn from experience, note that I have thus far resisted the extreme temptation to short iFresh (IFMK), a comically overvalued grocery business brought public by the very same sponsors and management team as WINS. How many shares do you suppose are actually available for trade in the public market? I am long 1 share in a personal account, which was purchased in order to obtain the right to inspect the company's shareholder register. Suffice it to say that the results of that inspection leave me on the sidelines for the time being.

Market commentators sometimes point to a lack of speculative excess as justification for a continuing bull market. Perhaps they are just looking in the wrong places. Qualitatively, I see far more activity from retail investors online today than I did a year or two ago. If I had a nickel for every time I hear the phrase "low float runner" used to describe a stock being deliberately manipulated by a group of day traders…well, I actually do usually end up paying a lot more than a nickel in borrow costs when encountering that kind of behavior. It seems more common and more blatant than in recent memory.

One such company was First NBC (FNBC), the short identified as Company G in previous letters. FNBC was a fundamental short, but it experienced unusual trading activity after the bank failed. I believed the problems at FNBC were worse than most people thought, but had nevertheless expected some equity value to remain. I was just as astonished as everyone else when the FDIC seized the bank of April 28 and announced that taxpayer losses of nearly $1 billion were expected. The stock closed at $0.09 per share the following Tuesday. But I was perhaps even more astonished when a group of daytraders ran the stock up nearly 10x by Thursday, providing another bite at the apple for short sellers.

One of the reasons FNBC was a compelling short, even though the magnitude of the losses surprised me, is that the bank had lent an unusually high amount of money to related parties, some of whom were not properly disclosed. Notably, a small publicly traded bank called Florida Parishes (FPBF) had several undisclosed related-party relationships with FNBC. While it does not appear to be similarly at risk, I do think it remarkable that the FPBF share price has not reacted negatively to news of First NBC's failure.

Cable Car filed its first schedule 13D during the quarter, disclosing a greater-than-five percent stake in Insignia Systems (ISIG). I have been deliberately quiet in public about the investment ever since two louder shareholders became involved a few years ago, and I have no immediate plans to change that. It is currently Cable Car's largest position.

Cable Car also began raising money for a special-purpose litigation finance vehicle, which is whimsically named after the kakapo, an endangered New Zealand parrot that survives only because of human intervention. I do not intend to discuss Kakapo Capital's activities in these letters. More information is available to accredited investors upon request.

Thank you for your continued support.

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.