Dear Investors and Friends,

In 2012 our long/short equity fund returned 5.02%, net of fees, marking our fourth straight year of positive returns since inception. This brings our average annual return to 36.12%, and our aggregate return to 243.35% (GIPS Verified).

	Prime Opportunities *Net of Fees*	HFRX Market Neutral Index	HFRX Equity Hedge Index *(Long/short)*	S&P 500 *Including Dividends*
2009	**39.98%**	-5.09%	12.94%	34.23%
2010	**84.32%**	2.64%	8.92%	15.06%
2011	**26.72%**	-2.92%	-19.08%	2.11%
2012	**5.02%**	-4.66%	4.81%	16.00%
Average Annual Gain	**36.12%**	-2.55%	1.07%	16.30%
Overall Gain	**243.35%**	-9.84%	4.33%	82.94%

On a long-term basis, we are thrilled with the returns provided to investors. Each million dollars invested with Prime four years ago would be worth $3.4 million (net of fees), as opposed to 0.90, 1.04, or 1.8 million, had it been invested in the Market Neutral, Equity Hedge, or S&P 500 indexes respectively. We've recently opened up the fund to outside investors and have already begun to receive some positive attention in the investment community. Hedge Fund Alert, for example, did a full feature[1] on our company at the end of the year, discussing our background, investment philosophy, and positive risk-return characteristics.

While you could say that our performance speaks for itself, prudent investors might naturally be interested in learning *how* we are achieving these returns. What is our basic strategy? How do we manage risk? Is the fund's performance based on a replicable strategy? What are the investment merits of the fund?

In answering the first question regarding our investment strategy, let me give the short answer: we are value-based investors. Our results were not achieved by using tricky, short-term maneuvers or taking on substantial risk. Instead, we select the companies we think will do best over the long term and invest in those for our long portfolio, and then mirror that approach when selecting companies on the short side. (Even on the short side we only invest in actual companies, not ETFs or Indexes.) We'll look into *how* we accomplish this strategy in just a moment. As to the above questions about the merits and replicability of our efforts, we believe the answers lie in the following six key attributes of our fund:

1. **Low Net Exposure.** Because of our cautious attitude about the economy,[2] the average net exposure between our long and short portfolios has been only 7%, excluding gold, since inception. That has put us much more squarely in the market neutral camp. Traditionally, the closer you get to market neutrality, or zero net exposure, the lower the returns are. Attesting to that, if you look at the HFRX Market Neutral Index over any time period, you will see that, on average, the returns after fees and expenses are actually negative.

HFRX Market Neutral Index	
1 yr	-4.66%
2 yr	-7.44%
3 yr	-5.00%
4 yr	-10.28%
5 yr	-11.32%
10 yr	-5.98%

Investors are generally willing to forgo some investment returns in exchange for the comfort of knowing they are protected against market downturns. The noteworthy aspect of *our* fund is that we've maintained a significantly hedged portfolio while delivering substantial

returns in each of the last four years (all years in which the market has risen). The fact that we have been able to provide investors with a conscientious investment strategy *and* results that are outperforming both market neutral and long/short indexes demonstrates that our returns have truly been alpha-based—the result of picking the right investments on both the long and short side. (More on our actual investments, top of page 4.)

2. **Liquidity**. In today's environment, most investors want liquidity; the security of knowing they can get in and out of a fund at any time. Prime is one of the most liquid funds in the industry. Our weighted average market cap is over $30 billion on both our long and short positions, and since inception we have invested only in publicly traded companies, generally with a minimum market cap of $500 million. This means that 100% of our investments can be liquidated within one business day.

3. **Geography.** Because over 90% of our investments have been in US-based companies and/or large multinationals, our performance has not been based on the fortuitous growth of smaller economies and has not been exposed to the volatility inherent in such investments.

4. **Conservative Investment Principles.** We employ a “plain vanilla stock” investment approach. We have *never* purchased options on any of our long positions, and when we have done so on the short positions, they have all been limited to very deep-in-the-money LEAPS puts that were used to efficiently lower our cost basis as opposed to increasing leverage.

Our firm operates with a strong eye toward risk management. It is our observation that most investment blowups occur through the use of highly leveraged derivatives; when the investment premise is inherently risky from the outset, it doesn’t matter how many people you have watching over the shop! We plan on being around for the long haul, so we have made a point to stay away from highly leveraged investments. It would be foolish, I think, to change that approach—especially since we have been able to realize outsized returns while using a more conservative strategy.

5. **Single Strategy Fund.** We don’t employ several unrelated strategies in order to create multiple "outs" for ourselves in case some of them don't do well. We put our best ideas forward and invest our own money along with yours. You can rest assured our returns were not derived from one lucky strategy that happened to hit, among several that may or may not have been successful.

6**. Non-Correlation to the Market (S&P 500).** Since its inception, Prime has delivered gains in 12 of the 16 months the market has been down. While the market has been down an average of 3.92% during those months, Prime has been up 5.21%. As you might expect, our low net exposure should take us down close to even, but the alpha we are producing has created our positive returns during those same months. Prime has an Alpha of 3.40% compared to the S&P 500, and a Correlation of -0.17. (This means that that our past returns were not all dependent on how the market did. In today's highly volatile market, many investors do not want their portfolios tied to the market's performance, in the event of a sudden or steep downturn. Having a negative correlation gives us the ability to execute on our goal of providing outsized returns in any market environment.)

In summary, when you consider that our returns have been achieved while maintaining (1) low net exposure, (2) highly liquid securities, (3) US-based and large multinational investments, (4) straightforward stock investing without the use of highly leveraged derivatives, (5) a single strategy fund, and (6) non-correlation to the market, we hope the investment merits of our fund become clear. Statistical measures help make our case, too. Our Sortino and Sharpe ratios are a solid 1.94 and 1.12 respectively. Those numbers are especially good when you consider that, since our inception, the Sortino and Sharpe ratios for the average market neutral fund have been -0.74 and -0.59.

For all of the above reasons—along with our four consecutive years of strong positive growth—we hope you will continue to regard us as a worthy investment partner.

How Prime Compares to the Largest Long/Short Equity Funds

Now let's see how we did against the largest long/short equity funds worldwide. Even with a substantially more hedged portfolio (average net exposure of only 7% vs. about 65% for the average long/short fund), Prime outperformed the top players by a wide margin.

Our fund has the best overall performance when compared to the Hedge Fund Research, Inc. (HFRX) Top 20 long/short funds. Additionally, Prime outperformed the top five funds ranked by HFRX for the first three years of its existence. In 2012 we had returns of 5.02% net of fees, which may well qualify us as a "top five"-caliber performer yet again (although constituent data is not out yet, the HFRX Equity Hedge Fund Index number is 4.81% and the Market Neutral Index number is -4.66%, giving us a good shot at placing in the top five once again).

Overall, Prime's performance is 19% better than the number two performer (a fund that is invested only in the fast-growing economies of Brazil and Argentina).

Fund	3 Yr Ranking						Overall	
	2009		2010		2011			
	Returns	Rank	Returns	Rank	Returns	Rank	Gains	Rank
Prime Opportunities Investment Group	**40%**	**5**	**84%**	**1**	**26%**	**2**	**225%**	**1**
Tarpon All Equities Fund	126%	1	45%	2	-6%	13	206%	2
Discovery Global Opportunity Fund, Ltd.	65%	3	17%	7	4%	4	100%	3
Value Partners Classic Fund Class C	83%	2	20%	5	-17%	18	82%	4
Bay Resource Partners Offshore Fund Ltd.	60%	4	17%	8	-7%	15	74%	5
Visium Balanced Offshore Fund, Ltd.	22%	15	25%	3	2%	5	55%	6
Renaissance Institutional Equities Fund LLC	-5%	20	17%	9	38%	1	54%	7
Greenlight Capital Qualified, LP	30%	8	13%	11	2%	6	50%	8
Seligman Tech Spectrum (Master) Fund[1]	36%	6	8%	16	1%	7	48%	9
Advantage Advisers Xanthus Fund, LLC	30%	9	8%	17	0%	8	40%	10
Macquarie Asian Alpha Fund	14%	17	10%	13	9%	3	37%	11
Spinnaker Global Emerging Markets Fund Ltd.	28%	10	13%	12	-6%	14	36%	12
BlackRock UK Emerging Companies Hedge Fund Ltd.	6%	19	25%	4	0%	9	32%	13
Elm Ridge Offshore Master Fund	28%	11	1%	20	0%	10	30%	14
Spinnaker Global Opportunity Fund Ltd.	28%	12	15%	10	-12%	17	30%	15
Brummer & Partners Zenit	24%	14	5%	18	-4%	11	25%	16
M. Kingdon Offshore Ltd.	31%	7	9%	14	-18%	19	16%	17
Polar Capital Fund plc - Japan Fund (USD)	8%	18	18%	6	-9%	16	16%	18
Ivory Flagship Strategy	17%	16	2%	19	-4%	12	15%	19
Lansdowne Developed Markets Fund, Ltd. (USD)	27%	13	9%	15	-20%	20	10%	20

1. Seligman Tech Spectrum performance only reported through 11/30/2011.

Delivering Alpha Across the Board

In order to have the kinds of returns we've been having, and to have such a small net exposure, you have to be right on both sides, the short and the long, and you have to hit a *lot* of correct stock predictions. If you look across all of our investments, that is exactly what we have been doing. And the *way* we've been doing it is through steady analysis and a knack for sorting through piles of data, extracting the most vital information, and weighing that information properly against the current price. That is the core essence of true value-based investing.

Here is a summary of our top ten long and short positions and their relative performance, as of March 5, 2013.

Position Rank	Symbol	Name	Purchase Date	Months Held	Purchase Price	Price as of 03/05/2013	Prime Gain/Loss (+/-)	Stock Performance	S&P 500 Performance During Same Period
Top 10 Long Positions									
1	CMG	Chipotle Mexican Grill Inc.	Jan-09	50	$45.30	$329.24	+	+626.80%	+91.23%
2	AMZN	Amazon.com Inc.	Dec-09	39	$135.51	$275.59	+	+103.37%	+38.09%
3	CLWR	Clearwire Corp.	Jan-13	2	$2.72	$3.15	+	+15.81%	+7.79%
4	ATVI	Activision Blizzard Inc.	Dec-12	3	$10.64	$14.57	+	+36.94%	+9.79%
5	DIS	The Walt Disney company	Apr-12	11	$43.00	$56.48	+	+31.35%	+10.15%
6	GOOG	Google Inc.	Oct-11	17	$595.33	$838.68	+	+40.88%	+22.86%
7	QIHU	Qihoo 360 Technology Co.	Dec-12	3	$27.25	$34.82	+	+27.78%	+9.79%
8	1913	Prada S.P.A	Jun-12	9	HKD$50.25	HKD$81.50	+	+62.19%	+16.28%
9	DE	Deere & Company	Apr-12	11	$82.37	$90.11	+	+9.40%	+10.15%
10	DDD	3D Systems Corp.	Jan-13	2	$38.57	$34.47	-	-10.63%	+2.78%
8 out of 10 long positions outperformed the S&P 500									
Top 10 Short Positions									
1	NOK	Nokia Corp.	Apr-10	35	$15.53	$3.53	+	-77.27%	+29.46%
2	INTC	Intel Corp.	Sep-12	6	$22.71	$21.51	+	-5.28%	+6.88%
3	FB	Facebook Inc.	May-12	10	$32.09	$27.52	+	-14.24%	+16.75%
4	HPQ	Hewlett-Packard Company	May-12	10	$22.70	$20.37	+	-10.26%	+17.51%
5	BBY	Best Buy Co. Inc.	May-11	22	$31.23	$18.40	+	-41.08%	+16.61%
6	AAPL	Apple Inc.	Dec-12	3	$532.16	$431.14	+	-18.98%	+8.58%
7	JCP	J.C. Penney Company Inc.	Jun-12	9	$23.23	$14.96	+	-35.60%	+13.04%
8	NTDOY	Nintendo Co., Ltd	Feb-12	13	$19.15	$12.42	+	-35.14%	+12.93%
9	MT	Arcelor Mittal	Dec-12	3	$16.85	$14.38	+	-14.66%	+9.79%
10	SPG	Simon Property Group, Inc.	Jan-13	2	$160.51	$162.61	-	+1.31%	+2.70%
10 out of 10 short positions underperformed the S&P 500									

Although we have made, and will continue to make, mistakes, we are making substantially more correct than incorrect decisions, both on a risk-adjusted basis and relative to our peers. The in-depth research and analysis we do before we make an investment has enabled us to select stocks that have produced exceptional returns for our investors since inception. The reliability of our research and analysis shows in the fact that, although we are constantly resizing our positions based on facts on the ground, we have only exited six long positions since our inception, and only three of those were losing positions. For our biggest long, we have been in that position since the inception of our fund, and for our biggest short, we have been in that position almost three years now.

We believe it is our research approach that has enabled us to achieve the above results—results we believe will continue to accrue with the benefit of time. (As Benjamin Graham famously said, “In the short run the market is a voting machine, but in the long run it is a weighing machine.”)

The Most Sustainable Investment Approach Is One Based on Logic

It is our goal and intention to generate substantial positive results, regardless of market environment. We believe the only way to do this in a *sustainable* and *replicable* way is through sound fundamental analysis. Pure, unadulterated logic acts as the backbone of our decision-making and the seed for future returns.

What do I mean by sound fundamentals and logic? It would be difficult to capture, in a brief summation, all of the work that is done in selecting an individual investment. That is because each stock, just like each operating company the stock represents, is unique, with multiple layers of shifting variables that must be analyzed. Suffice it to say, a vast amount of research and creative idea-generation goes into identifying potential candidates for investment and then examining those candidate companies up close and in detail.

Of course, that may sound a bit vague and "generic." After all, every investment firm does research and analysis. The real question is: do we interpret the information accurately? To answer that, we thought we would share with you the logic and thought process that has gone into a few of our current investments.

CMG – Chipotle Mexican Grill, Inc.

The beauty of this particular example is that I have not had the luxury of reinterpreting my analysis in hindsight. The following piece is taken verbatim from a letter I wrote to Warren Buffet in 2008, in response to his advertised opening for an investment manager (shortly before I launched Prime). The only editing that has been done is to trim a few extraneous words and correct a few spelling/punctuation errors. Within two months of launching our fund, the stock discussed in this letter became the largest single investment in our portfolio and remains so today. It has seen an increase in price from $45.30 at the time we purchased it in January 2009, to $320.15 today.

Excerpt, Letter to Warren Buffet, 2008

My Favorite Investment

I like CMG for the reasons outlined below, but the bottom line is that **I expect it to be worth a little over $400 per share** [emphasis added] in three years based on the compounding effect of my expected earnings, store growth, and having a lower P/E ratio than where the stock is currently trading; with extraordinary results continuing into subsequent years.

I like this stock because:

1. First and foremost: The food is GREAT. …I learned about CMG by eating there, and then researching to find it's a public company. You must try the food, and the ways it's served to really understand what I am saying—otherwise this may sound just like another fast food restaurant... One of management's biggest goals is to figure out how to speed up the lines further; the lines at these restaurants are out the door… because the food is so good.

2. Besides great food, the prices are very cheap. I won't even say economical, I say cheap because on a nominal [basis] the prices are low, and on a value basis they are exceptionally [low]. …A meal there will cost about $7-8 per person after taxes, and there will be enough for some take-home unless you have a strong appetite. The portions are huge… I believe if their prices went up 15 to 20%, there would be a very marginal reduction in demand (I know that's a little hard to believe). Their food is so much better than any competitor's in terms of value that that is what I think they should do, and the company has acknowledged implementing marginal price increases— and have concurred that they have seen surprisingly low demand decrease as a result… Even without these steps, the company's earnings and margins are substantial based on almost all matrices.

3. There is great marketing accentuating [the quality of the food]. The founder and CEO is a chef, and his premise is to have great tasting quality food in a fast food environment. The slogan of the company is "Food with Integrity." Most of the food (100% of the pork, nearly 60 percent of the chicken and more than 40 percent of the beef) is naturally raised, hormone free. The goal is to get all three to 100% natural. In

Continued – Excerpt, Letter to Warren Buffet, 2008

short, you cannot compare this quality or taste to "fast food"—at all.

4. So simple. Replication of locations is easy—no chefs needed, no waiters, only 10-12 ingredients, served in a "cafeteria" style factory line. The food from one location to the next does not vary much at all because the process and ingredients are simple. I generally don't like companies that can't duplicate their performances and growth by just expanding what they do easily. I've tried different locations, and they use the same ingredients, store layouts, and consistent styles.

5. No franchises. They had a few early on that they bought out. Growth [and] quality (as well as profits) are left to the company. In this case I think that is a good thing.

6. Actual proven results—with more to build on. High earnings growth of well over 50% consistently on a year over year basis for the past four years and Chipotle has grown quarterly earnings at least 46% in each of its seven quarters as a stand-alone public company. Year over Year same store sales have been strong, consistently in the low to mid teens—while they are seeing new locations ramp up much more quickly than when they started because they are starting to reap the benefits of recognition. CMG has also consistently beat analysts' estimates (not that that is the holy grail) by a minimum of 17% in each of the seven quarters they have announced their results. …I think that is happening because the analysts haven't tried the food…

7. A *lot* of room to grow: Chipotle is in its relative infancy and has been growing stores at approximately a 25% growth rate, and currently has about 650 stores. Management has mentioned they want to open thousands of restaurants in the U.S. before going overseas. I anticipate they can maintain growth rate of 25% annualized for the next seven years, at which time there will only be approx. 3,100 stores. I believe that at that store growth rate, they will achieve over a 50% profit growth rate each year. …This concept and the serving styles offered, I believe, [have] more universal appeal and regional/cultural consistency than hamburgers—not to take anything away from a good burger.

8. Huge international opportunity. Chipotle is not really "Mexican Food" in the traditional sense. The main ingredient options are pork, two styles of beef, and chicken, either wrapped in a burrito OR served in a plate with your choices of cilantro rice, corn, bell pepper and onions, lettuce, sour cream, two styles of beans, salsa, or avocado (extra)… [M]anagement has stated that even though it is "Mexican food," stores they have opened all over the U.S… are doing about the same levels of business—not just in areas that are used to the Mexican food culture… The way I look at it, with the different combinations of burrito style or bowls that are prepared, it goes well with not only different states in U.S., but all kinds of cultures—from China, to India, to Europe, to the Middle East. Basically, a combination can be made from the options available at CMG that has great similarities to indigenous foods and dishes almost everywhere… That is an amazing opportunity in my opinion. Not to mention the natural, anti-hormone food used and the global clamor surrounding it. The first foreign CMG restaurant is planned to open in Canada early next year.

9. The P/E looks "high," but when evaluated on [the] earnings growth being experienced and expectations over the longer term (5 to 7+) years, this stock is priced cheaply. Moreover, this is where the P/E can be "tweaked." P/E measures the average of [the] last four quarters, and that is okay for a company growing at let's say 7 to 8 percent yearly, but [for] a company with this really high growth rate (74% increase last quarter year over year), it takes away a lot when you average the last four quarters, and a solid

Continued – Excerpt, Letter to Warren Buffet, 2008

argument can be made that with new stores coming on line that there is a very slim chance that you are going to see any earnings drops… [F]inally, there haven't been any extraordinary items in previous quarters—so if you look at last quarters P/E, this stock P/E on the B shares is less than 45. With a growth rate that I would expect being at more than 6 times the average company's earnings growth (when compounding is included it even looks better), this P/E looks very reasonable to me.

10. This is one of my favorites... No debt! This company is debt free and believes it can grow all its future stores and hit its growth targets from income generated. That is amazing and a big relief when investing in a company. Talk about avoiding (read: substantially reducing) potential disaster in a long-term investment.

11. Finally, other "intangibles":

- No Breakfast items yet. Breakfast is McDonald's and many other fast food restaurants' highest profit margin item and CMG doesn't even serve breakfast yet. There is certainly an opportunity here. …[T]hey are looking into… a breakfast item… which is just more upside.

- The stores are built in such a way that major upkeep… [is] minimized. There is no fabric in any of the locations. All table tops, and counters are stainless steel, the chairs and booths are solid sturdy wood that look like can take a lot of punishment. There is no paint on the walls as they are covered with textured steel-like designs that actually look good. The art is also stainless steel and wood. This place gets a LOT of traffic; I have been in there when the line has had probably over 45 people waiting—and has gone out the door. There is a lot of wear and tear with [such] high turnover—so good infrastructure is important for keeping… expenses and upgrade time low in the future years. Another example of things well planned for the future.

- B-shares [are offered at a] substantial discount (approx 10%) to A shares. Why, I don't know and neither does their investor relations department. The B-shares have ten times the voting rights of A shares except when it comes to M&A decisions, [where] both classes have equal rights. Because the B shares have more voting rights, they should objectively be worth MORE than the A shares, but are trading at a discount. The only possibility is that people don't know about the B shares (even though there are actually more B shares than A shares, B shares are traded [at] about 1/10th the daily volume). Needless to say, my entire investment is in the B shares. The A and B shares were created as part of the spin-off from McDonald's about a year ago.

- McDonald's management experience. The current founder initially sold the franchise to McDonald's and has worked under McDonald's management and has enjoyed their restaurant management expertise for several years before being spun off as a private company.

- I believe the U.S. is headed for potentially long-term (three years) slowdown, and I think this stock will do exceptionally well whether there is a major slowdown or not (as compared to the market and on an absolute basis). There are strong advantages of a protracted slowdown with CMG, like: lower rent and more prime locations to expand into, people that usually dine in higher end areas will come to CMG, and the value proposition I outlined… becoming more important—portions are huge (so they can even be shared) and costs are low, especially on a value basis. These are things people look for when the economy is not doing so well; even more so than when it is doing well.

The logical process I employed in this analysis was sound and ended up bearing fruit in reality. As stated previously, Prime first bought the stock at $45.30 in January 2009, and the B shares did fold into the A shares (in December 2009). As our analysis predicted, CMG hit $400 (on March 13th, 2012—it took four years instead of three), and has been one of the S&P 500's top performers over the time we've held the stock. Since last year, the price has come down to $320.15. But that is just one of the reasons we are still holding the stock with vigor.

It is difficult, of course, to find such amazing opportunities, wherein you have such huge upside with such limited downside—hence our enthusiasm for this investment. It is true that we may not be investing in CMG with the same zeal we once were—some of the value we foresaw in the stock has now been realized, so we have trimmed our position—but we are still quite enthusiastic about this stock. That's not because we have an emotional attachment to it, but because many of the facts used in our initial analysis still hold true. (We spend a great deal of time analyzing our current investments, and so we are fully prepared—at any time—to enter or exit a position based on its merit or lack thereof.) It's all about striking the right balance between current price and the true intrinsic value over the longer run. Based purely on the facts on the ground, CMG still has a lot of room to grow. For example, since I wrote the above piece in 2008, the following factors have emerged:

- Same Store Sales have continued to dramatically increase—over 30% in the past three years alone! And that has been accomplished with little marketing as compared to other restaurant chains. The simple reason is the tremendous value consumers are seeing. Case in point: If you weigh the food at Chipotle and compare it to McDonald's, Chipotle is actually 30% cheaper *per gram*! Analysts and many others are still failing to recognize the tremendous value CMG offers.

- Each of Chipotle's 1400+ restaurants, on average, brings in over $400K in income per year. I sometimes joke with investors that if I weren't running my fund I would start opening Chipotle restaurants. But of course, why not just keep investing in the stock, which is managed by a terrific, well-grounded team, and spend my time finding other great investment opportunities?

- CMG has no debt today, has over $800 million in cash (even after purchasing $500 million of its own stock over the past few years at an average price of $130 per share), and has the current structure to be earning over $500 million per year. The cost of new openings has come down to approximately $800K—for restaurants that are making $400K a year. So each new restaurant is essentially paid for in two years.

- Contrary to what some may think, Chipotle is not saturating the market. By comparison, McDonald's has over 30,000 restaurants and opened over 2,000 restaurants in one year alone. Subway now has even more locations than McDonald's. In fact, the top ten chains in the quick-serve/fast casual category have over 150,000 restaurants. That helps put CMG's 1400 locations into perspective.

- The strongest evidence that fears of over-saturation—or of too much competition from Del Taco and the like—have been exaggerated is that (as discussed in their Q3 2012 conference call) new stores are opening up at their highest sales volumes ever! If you add in the fact that CMG owns all of its restaurants outright, and therefore keeps all the profits from the $400K per restaurant, you see how much more profitable the company can be than a chain that only gets a small franchise fee from its individual store owners.

- And talk about international prospects. The fact that Chipotle's menu appeals to an international palate is being proven daily. It has opened up five stores in Canada, three in London, one in Paris, and one in Germany, and these shops are doing exceptionally well. There is huge room to grow internationally, and that is what CMG is prepping for. Additionally, it has opened up a Thai-themed "shop house" restaurant that uses the same basic principles of great food priced very aggressively and aimed at the mass market. This new store is doing exceptionally well (CEO Steve Ells says customers' reactions remind him of when the first Chipotles were rolled out) and adds a whole new dimension of growth prospects to CMG.

CMG is that rare stock that provides true upside potential with limited downside potential. For example, everyone has to eat three times a day. There is not going to be some new technology that comes along overnight and renders CMG obsolete. Even if a company decides to open thousands of identical restaurants, we will be able to see it from a mile away and adjust accordingly. CMG has put itself in its enviable position by keeping its profit margins per serving down and making its money on volume. Even when Taco Bell, known for the lowest-priced food, came out with its version of an imitation product (which could not match the quality, atmosphere, dining experience, or meal-customizing possibilities of CMG), it was only able to price its food about $1.50 cheaper—and that's for food that's pre-cooked and is not hormone-free, cage-free, or of nearly the same quality as Chipotle's.

CMG is just one stock, but it's one I have been particularly excited about, not only because of the tremendous potential for growth, but the limited risk described in our analysis as well. "No pain, no gain" may be a good motto for people embarking on an exercise program, but it shouldn't apply to sound fundamental investing. I like Chipotle because it's a business I can understand, and, as Buffett says about razors and Gillette, it's a product that is not going out of style. This is even truer about food than razors—especially high-quality food at low prices.

Over the past four years, I have been able to find more and more positions that hit the fundamental value threshold I'm looking for. We currently have about 45 positions in our portfolio, and are well diversified. Although we agree that it is not easy to find outstanding companies that are substantially undervalued, we believe we have demonstrated that they are out there, and when we do find them we invest accordingly. As an indication of our level of diversification, our biggest long was down 11.93% last year, and we were still up 11.39% overall, net of fees.

AAPL – Apple, Inc.

At Prime we view ourselves as non-conventional thinkers. We need to be. For a stock to be undervalued or overvalued, then almost by definition, the majority of people must be thinking about it inaccurately. We are constantly questioning "given" assumptions by unemotionally evaluating and re-evaluating the facts, on both a micro and macro level. Although we take into consideration what other analysts think, our investment decisions are based more on analysis and logic than popular opinion. Many of our investment decisions, in fact, have been made when others were taking opposing views.

As an example, the average large-cap growth manager has a 6.8% stake in Apple, and 77% of large-cap growth managers have more than 5% of their portfolios weighted in Apple. At Prime, we initiated a *short* position in Apple at the end of last year, at $532.16—not because we wanted to be contrarians, but because our own analysis told us this was the wisest course of action. As of this writing, Apple is trading at $455.72 and has fallen 14% in the three months since we shorted it.

Here is a brief summary of the thought process behind that move:

- Investors are vastly underestimating the changes that have occurred in the global competitive landscape over the past decade. China and India, not to mention many companies in the U.S. and elsewhere, are creating equal and superior phones selling at unsubsidized retail rates approaching the sub-$200 mark, versus Apple's latest unsubsidized starting price of $649. As an illustration of the difficulty of competing with that kind of threat, Google has been giving away its operating system for *free*, and in China (now the biggest market for smartphones in the world), Android has increased its market share from 0.6% in 2009 to 86.4% last year! That's largely because most of the "white label" manufacturers are making Android phones. Why? Because the software is free, the market size and growth is enormous, and these companies can be successful operating on margins that are a fraction of Apple's.

- The loss of Steve Jobs, bless his soul, is huge. Even if he was still with us it would be tough sledding for Apple, but losing the creative genius that brought Apple to the dance is a major blow. The type of vision and determination Jobs had is not easily replicable.

- We live in unprecedented times. A truly global environment has created a business dynamic never before experienced. The recent Apple iPhone 5, *at launch*, was distributed in over 120 countries! That kind of rapid global distribution enables growth rates that are almost unimaginably fast, but the subsequent fall can be almost as dramatic. Creative, groundbreaking technology is growing by leaps and bounds, making it very difficult for one company to retain dominance. We have seen that happen over and over in the technology realm. Remember BlackBerry—the "crackberry" that a few short years ago no one thought could ever be overthrown? It is now on the brink. On the other hand, Huawei, for example, has gone from an unknown in the phone industry to a top-five producer in two years.

- The iPhone makes up approximately 60% of Apple's revenue and the iPad about another 20%. I love that because it's a relatively easy company to understand. But the iPhone and iPad make up *80%* of Apple's revenue—and both are extremely vulnerable to rapid obsolescence. The Apple team (with Steve Jobs at the helm) hit lightning twice. Even *they* didn't know how popular their products were going to be. I don't believe this kind of success is replicable; not at that level, not at those numbers. (Speaking of numbers, here's something you might find as surprising as we did: the iPhone alone generates more profit than all of GE, Microsoft, Google, or Walmart.) In a world where a product can go from zero to 60 in one second—and tumble for a long time thereafter—there are both great challenges and great investment opportunities ahead.

AAPL, I believe, is currently overvalued. It has a market cap even today of $430 billion. I am not saying Apple is a bad company. On the contrary, it is an amazing company that has had an incredible run and has benefitted humanity in incalculable ways. But… is it worth $430 billion today?

What it comes down to is this: every stock in the world has a buy price, a neutral price, and a short price. That is how we look at investments. We try to be as unemotional as possible. There are price levels for every stock in our long portfolio, for example, at which we would liquidate our positions, or even short them. That is the trick: valuing each and every investment based on its merit. Yes, Apple certainly still has value, but what *is* that value? Is it worth almost four times Amazon, which has an incredible moat?

In summary, I believe AAPL is just now getting into the teeth of the competitive issues it will face in the years to come. That's the reason we decided to get into it now as a short pick. We know Apple had been a great company with tremendous growth potential and an unknowable peak, but we have seen this before and we will see it again: a top company becoming almost invincible in investors' minds. This overconfidence is reflected in the stock price, which often creates a great shorting opportunity. We decided to jump in on AAPL when we finally saw actual profits level off on a year over year basis. I am certainly not saying it will go to zero, but based on logic, it's got a long way to fall—and for a long time.

The verdict on Apple is not yet in, and I truly hesitate to talk about any of my short positions, but I think it's vital for investors to understand the type of logic process that goes into *all* of our investment decisions.

NOK - Nokia Corporation

In today's world, we believe everything is interconnected. And the more information you sift through and analyze, the more interrelations and connections you see. The tidal wave in the telecommunications industry that transformed Apple created other investment opportunities as well. A whole new playing field was created, practically overnight, and it has affected different companies in different ways. An example of this is Nokia, which is on the opposite side of CMG as our biggest short position for almost three years now.

This play starts with Apple and Android, in 2007 and 2008 respectively, introducing two brand new, groundbreaking technologies into a field that had been more-or-less dominated by Nokia for several years. My initial take on this breakthrough was that these two new software technologies were so good that other established companies in the industry were going to be in trouble. I took out a short position on Research in Motion in June 2009

at $70.18 per share. After further research, I ended up finding a company in this space that I liked even more, as a short, than RIMM, and that was Nokia. I eventually left RIMM, although it did very well for us by underperforming the market by 44.92% for the nearly two years we had it. (That kind of return on a short can be considered a "killing," but still, I wish we had held onto RIMM, *as well as* adding NOK, as RIMM's price has now dipped considerably lower.)

But onward and upward. We started shorting NOK about three years ago when it was trading at $15.53 per share. We did this for the above reasons—two transformative software systems back to back in Google's Android operating system and Apple's iOS that not only had the right technologies, but the right management and company vision to execute on them. Moreover, Android was attempting a paradigm shift, which it had perfected through its search engine business: not trying to make money on hardware *or* software, but rather giving away its software for *free*. How do you compete against a product that's free—especially if that product is as good as or better than what's out there? Android and Google's goal was to make their money via their search engine. And the world's largest technology players, from Samsung, HTC, Sony and the like, all the way down to hundreds and hundreds of fierce, top quality white-label Indian, Chinese, and other manufacturers that can operate on substantially lower margins, were primed to jump into the field.

The reason we switched from RIMM (now BBRY) to NOK, even though they did overlap for a while, brings us to the more interesting point for this discussion. We felt that RIMM (Blackberry) at least had huge market momentum, in that there were many established BlackBerry users who loved the feel and use of their handheld keyboard. And the premise, which proved to be right, was that, just as in the TV market, once the smartphone market got saturated and growth slowed, *everyone* involved would start losing money (competition and its effects are always underrated). In this case, the industry was growing, but because Android was essentially giving away its software, the barriers to entry were much lower and therefore the speed of saturation, and its potential effects, would be steeper and more dangerous than even what we saw (and are still seeing) in the television industry.

In our opinion, Nokia, at a $12.5 billion market cap, is still overpriced. The only thing Nokia had going for it was the Symbian operating system. Millions and millions of users throughout the world had grown up using Nokia phones, and were still enjoying the familiarity and the vast number of functions available to them as a result of all the accumulated time they had spent with the phones. But all that good will was lost when Nokia announced it would be leaving Symbian and forging a partnership with Microsoft. To boot, Nokia made this announcement *nearly a year before it had even created its first Microsoft phone*. A year is an eternity in the high-growth phone tech business. Consequently, many loyal users that may have wanted to stay with Symbian phones abandoned ship right away. To this day, I cannot understand the logic of announcing the dismantling of a product—especially one that is the mainstay of your company—prior to the subsequent product's readiness for release.

That was the beginning of Nokia's problems. Either way NOK was going to be in trouble, but the way it hastened its own decline increased our resolve to short this stock. Nokia compounded its difficulties when it staked its future on Microsoft. The Microsoft of today is not the Microsoft of Bill Gates. Microsoft's Windows mobile OS, in fact, launched in 2000—even before Apple or Google ever introduced a phone—and was only able to command a small portion of the market. In order for Nokia to win, now that it had dumped the system that had brought it such great success, Microsoft had to become successful in this market. If Nokia, which had the most successful operating system *ever*, and was such a dominant player for so long, could not fix its own internal issues, what made it think that Microsoft could? The truth is, I empathize with CEO Steven Elop and his predicament, and I at least give him credit for taking a shot in the dark—whether it was Symbian or Microsoft, the odds were stacked against him. But by choosing Microsoft, not only was he gambling that Microsoft's mobile platform would become successful even without Bill Gates, but that even if it did become successful, it would remain loyal to Nokia. Microsoft's goal at this time was to employ a similar strategy to Google and get as many people as possible to use the Bing search engine. Microsoft really didn't care if it was Nokia, Samsung, or anyone else promoting its software. In short, it was a long shot for Nokia to get to the summit of Mount Everest and even if it did, it was likely to discover that many other climbers were already waiting there. Case in point: Samsung and HTC ended up introducing a Windows phone even *before* Nokia did!

The final “weapon” that NOK possesses, and that its advocates would argue for, is the value of its patent portfolio. There was a time when everyone thought that the way Apple, Google, and others were going to try to knock each other out was via their patent portfolios. The problem was, and is, the bad press that results from using patents to fend off your competitors, not to mention several unfavorable judiciary verdicts throughout the world. Consumers have adamantly rejected the practice of artificially stifling competition via patents, because, by extension, this stifles the development of better and cheaper products. Even if you can get over this hurdle, it’s one thing to launch a fight based on the value of your own patents, but it’s quite another to fight a patent war by purchasing another company’s patent to use against your rival. That practice has been tried, but may no longer be viable. For example, Kodak came out with a patent portfolio, as it was going through bankruptcy, that it believed would sell for north of $2 billion. What ended up happening? Google, Apple, Microsoft, and others banded together, after the consumer and judicial backlash, and offered to purchase the patents for a fraction of that amount ($525 million). They did this not to fight each other, but to do exactly the opposite—to put these patents out of commission and lay their weapons down.

Nokia doesn’t have much value left in its patent portfolio, in my opinion, not to mention the fact that it has already licensed out the majority of its patents, so it would be hard to even use them against anyone. Not only has Nokia lost decades of value accrued in Symbian, and the more recent MeeGo operating system, but many of its hard assets, including major properties (e.g. its massive headquarters) and operating subsidiaries (e.g. Verta), have already been sold. On top of that, the secretive agreement between Nokia and Microsoft took an interesting turn recently when NOK announced that the net contribution from the partnership would turn negative for Nokia starting next year. Even good management, it seems, cannot get Nokia out of the industry-wide issues it is struggling with.

Today Nokia is hemorrhaging money and has experienced one of the most dramatic declines in the history of business. Sales in its stronghold India dropped 23% from 2011 to 2012… and that's in a rapidly expanding market. Its market share in China has shrunk from 50% to an astonishing 1%, largely because of the sudden absence of the Symbian system. To this day, Microsoft is still not getting where it hoped to get in the mobile platform game. The title of a recent Business Insider article (3/15/13) sums it up rather succinctly: “Samsung CEO: Nobody wants Microsoft’s Phones or Tablets." (Remember, this is coming from *Samsung*, one of Microsoft’s partners.) Nokia has had massive GAAP-based losses for the past two years. In 2011 it lost $1.07 billion and in 2012 had an operating loss of $2.3 billion (net loss of $3.1 billion). More troubling is the fact that its revenue numbers dropped 10% in 2012 and over 20% sequentially again from 2011 to 2012—a loss of over $8 billion in revenue.

At a recent Bloomberg conference, the following slide was shown. It seems the bigger they are, the harder they fall, especially in the tech world.

Companies you would have thought—at the time—would never go out of business do. This reflects a dangerous assumption that many investors make. They believe that once a company (much like a sports team) becomes a dominant player, it is unbeatable and destined for a long, bright future. But you have to maintain a healthy skepticism and continually check your facts and premises. This is how we have found a lot of our investment

opportunities. The tech landscape of the world has gotten substantially more competitive and unpredictable over the past fifty years. So expect this trend to increase.

AMZN – Amazon.com Inc.

Our second biggest long position, which we've held for almost three and a half years, and whose stock is up over 100% since we purchased it, is Amazon. Its current net worth is about $120 billion and it has built an enormous moat between itself and its competitors. This was even before its acquisition of Kiva Systems, a robot-driven warehouse distribution system that you have to see to believe (the human stays in one place, while the robots bring the products to *him*).

Jeff Bezos, in my opinion, may be the best CEO alive today. What he and his company have done *in just 15 years of existence as a public company* is truly remarkable. Not only is Amazon a great distribution play for retail and wholesale deliveries, but it has also become a great tech play. If you were looking for a good-upside-with-limited-downside technology investment with a company that can really execute, it would be hard to beat Amazon. You get tremendous value in its distribution core alone, then there are several auxiliary ends of the business that represent massive potential wildcards in terms of growth opportunity.

One of the only potential issues that pundits raise with this investment is Bezos' ability to actually deliver—i.e. does he have the "killer instinct," or, like some notable others, is he only trying to theoretically make the world a better place without producing profits? That question will only be answered a few years down the line, but you know where my money is. Bezos has shown himself to be highly competitive, he comes from an investment banking background, he has proven his worth in a very tough market, and his is one of the few companies that have successfully weathered the bursting of the dot-com bubble. He has demonstrated an ability to be profitable and has spoken often of investing in his company's future profit. With a slogan of "Obsess Over Customers," he understands the future of the marketplace and has the ability to focus on long-term, sustainable returns as well as operational execution.

It is tempting to think that Amazon's growth potential is close to being maxed out, but this is far, far from the case. In fact, its total *worldwide* revenue is less than 2% of the *potential* US market (based on data from the U.S. Census Bureau's Annual Retail Trade Survey). Did you know, for example, that until just last year, Best Buy actually had more yearly revenue ($49.7 billion) than Amazon ($48.1 billion)? And that included worldwide sales at Amazon, as well as all of its divisions including technology (AWS, Kindle, etc), books, clothing, etc. This year Amazon jumped to $61.1 billion vs. Best Buy's $50.7 billion. Now that Amazon is growing from a larger base, each incremental increase in revenue percentage takes out a larger and larger chunk of its competitors' operations. We have been seeing that play out in the form of more and more retailers facing difficulties as Amazon continues to grow.

If you look at the current $4.3 Trillion in U.S. retail spending and subtract major areas where Amazon has not been competing—$746 billion for motor vehicles and parts dealers, $581 billion for food and beverage stores, $222 billion for pharmacies and drug stores, $446 billion for gas stations, and $466 billion for food services and drinking places—you see that of the remaining $1.8 trillion, Amazon's $61 billion only represents around 3% (but you can cut that $61 billion in half, since half of that revenue comes from the U.S., so that brings the percentage down to around 1.5%).

And Amazon will be able eat into the $2.5 trillion market I *subtracted* above, as well. The company does a lot of business as a distributor for its third party Merchants, but much of that potential revenue can come back to them eventually. That's because they end up directly selling many of the items that do well through their third party sellers. I, for one, have purchased motor oil from Amazon. And Amazon recently started selling alcohol through third parties, and has been experimenting with an Amazon Fresh division in Seattle that delivers food same or next day, not to mention a plethora of food items that can already be purchased from Amazon—everything from breads and cereals to cheeses and live Maine lobster (yes, the lobster shows up "live and kicking," no matter where in the country you live).

This new market potential can and will continue to grow as Amazon continues to pursue greater percentages of the current $2.5 Trillion market.

There's a point that bears mentioning here. The retail sales tax issue for online vendors has been a major hurdle in many people's minds. But this is one of those areas where the tides have turned. Amazon has actually reversed its earlier position of resisting sales tax and has been lobbying for Congress to *pass* a sales tax on all online vendors. They are doing this, in part, so that they can establish more localized distribution centers around the country (they previously had to avoid a physical presence in many states, due to the tax issue), which will help them bring their delivery costs down, get into new product categories, and pursue their holy grail of obsessing over customers. As a step toward this, Amazon is partnering with the USPS in a pilot program which provides *same day* delivery service in San Francisco (for $10, you can order an item by 3:00 PM and receive it by 8:00 PM!). With the Post Office's huge losses and massive infrastructure (meaning they don't have to actually make a lot, but just recover some of the overhead they are losing), they can pull it off. The head of the USPS has said he wants to roll this service out to the rest of the country by year-end if successful—and it will be. At this point, as the leading player in the online game, collecting sales tax will actually be good for Amazon, because it will allow the company to continue to build its competitive edge—over both online and brick and mortar competitors—through improvements in delivery times, reductions in shipping costs, and creative new product and service offerings.

I look at this investment opportunity from many different angles. One of them is, "Would I rather have three and a half Amazons or one Apple?" (Apple's market cap is $420 billion vs. $120 billion for Amazon, hence the 3.5:1 ratio.) Though this might seem like an odd approach, I am constantly comparing investments on a relative basis to find the best opportunities and to make sure I am thinking objectively. When I look at Amazon, I see the massive infrastructure they've built in their warehouses, their technology headway, their proprietary systems like Kiva, the smarts and proven ability of Jeff Bezos, and the moat that all of these combined factors creates. When I look at Apple, I see everything riding on two products. Sure, there may be more game-changing products from Apple in the future, but to be *confident* in that is to underestimate the market's ability to compete, and perhaps to also over-estimate Apple's ability to create products, especially in the absence of Jobs. Even if Apple does create some amazing new product, I believe we will all see it far enough advance to be able to invest accordingly.

In the days since Steve Jobs, Amazon has actually had the better of innovation, new products, and operational efficiencies. In fact, Amazon recently took over as the most admired company in America—from guess whom? Apple. We think Amazon at some point could reign as the world's most valuable company, also a moniker that Apple once held. Amazon will have its ups and downs, no doubt, but what excites me about this company—and our other companies—is its strong management. This gives it the ability to overcome the issues I can't foresee.

As with the rest of our portfolio, I could go for pages and pages describing this opportunity. But since Amazon is a company that has so many facets and components, and since everyone is somewhat familiar with it, I think it's best, in a summary document like this, to stick to the highlights.

When it comes to choosing individual stocks for our fund, we will continue to have a few "hiccups" over the short term, but with our sound logic and value-based approach, along with our constant questioning of established assumptions, we're confident we will continue to have an edge as the future unfolds.

Some Final Thoughts About Our Investment Approach

We believe we've hit a "sweet spot" in terms of running a conservative portfolio and delivering substantial returns. Because we're providing alpha on both the long and short side of the portfolio, if there was investor preference for a long-only or an unleveraged variation of our portfolio, we would be open to accommodating that.

Still, we believe that a highly hedged, long/short strategy continues to make sense. The reasons for that belief are: (1) the market has been up each of the past four years and is at an all-time high, and thus may be primed for a fall, 2) the market, regardless of present conditions, is generally volatile in and of itself, 3) the concerns we expressed in "Sound Investing for Uncertain Times" (available on our website) are still valid, and, probably most importantly, (4) our performance has been exceptional, even with these conservative attributes in place, so why sacrifice security when you are able to achieve the best of both worlds?

In conclusion, we at Prime treat each investor's money as thoughtfully as we do our own. That's because it *is* our own; we're in the same investments you are. And so we are highly motivated to continue working hard to generate substantial returns while also employing conservative, sustainable strategies that can protect us all against future volatility. When you consider not only our numbers, but the way we have *achieved* those numbers, we hope you'll agree that Prime is a compelling investment opportunity.

Each year brings with it renewed goals and fresh commitments. We are currently accepting new allocations and look forward to speaking with you. May 2013 be a joyful and prosperous year for you and yours.

Pouya Yadegar
Founder, Chief Investment Officer March 18, 2013

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